

FITCH RATES MESQUITE ISD, TEXAS \$29.85MM GOS 'AAA' PSF /'AA' UNDERLYING

Fitch Ratings-Austin-08 August 2006: Fitch Ratings assigns 'AAA' rating to \$29.85 million of Mesquite Independent School District, Texas (the district) unlimited tax school building bonds, series 2006, based on a guarantee provided by the Texas Permanent School Fund (PSF), whose insurer financial strength is rated 'AAA' by Fitch. Additionally, Fitch assigns an underlying 'AA' rating on the series 2006 bonds and affirms the 'AA' rating on the district's \$429.2 million in outstanding unlimited tax bonds. The Rating Outlook is Stable.

The bonds are scheduled to sell via negotiation to a syndicate led by Bear, Stearns & Co. Inc. on August 10. The bonds are payable from the proceeds of an unlimited ad valorem tax levied against all taxable property within the district. Bond proceeds will be used to fund facility improvements and site acquisitions.

The 'AA' underlying rating reflects the district's strong financial management, sizeable reserves, and the healthy, moderately diversified residential and commercial economic base of the cities of Mesquite (the city) and Balch Springs, TX, located 15 minutes east of Dallas. Also considered in the rating is the district's increasing debt burden with additional capital needs, although significantly assisted by state funding for debt service. Challenges lying ahead are managing additional capital needs with moderating tax base growth and, as for all Texas school districts, incorporation of the new state funding formula in the upcoming fiscal year.

The district's taxable assessed valuation (TAV) grew by a compound average annual rate of nearly 8% during fiscal years 1998-2004. Due to the lagging effect of the recession, TAV grew by less than 1% in fiscal 2005, but subsequently recovered some momentum with moderate increases of 4.5% in fiscals 2006 and 2007. Given the breadth and diversity of the regional economy, Fitch Ratings anticipates that district TAV growth likely will continue to resume a growth pattern more consistent with historical gains. The top ten taxpayers account for less than 7% of a diversified tax roll, with residential property accounting for roughly 65% of the district's TAV and commercial property approximately 28%.

Consistently improving the district's financial position, management has achieved positive operating results in each of the last three fiscal years. The fiscal 2005 unreserved, undesignated general fund balance of more than \$40 million represents nearly 20% of expenditures and transfers out, in compliance with the district's goal of two months' spending. Liquidity is substantial with fiscal 2005 general fund cash and investments totaling nearly \$30 million. Although a modest drawdown was budgeted for fiscal 2006, preliminary figures point to a \$1 million-\$2 million operating surplus. The fiscal 2007 budget is expected to be balanced with a legislatively mandated reduction in the operations and maintenance (O&M) tax rate and offsetting increase of state funding.

The Texas Legislature recently passed property tax relief measures for school districts. The legislation provides for mandatory reductions in the local operations tax rates of 11% for fiscal 2007 and a cumulative reduction of 33% by fiscal 2008. To offset the revenue loss, the state will increase its share of funding to local school districts, including Mesquite ISD, so that the measures will be revenue-neutral.

The current offering is the fourth and final installment of the district's \$150 million authorization, approved by 81% of voters in March 2003 for new facilities, capital outlays, and technology. As promised to voters, the total tax rate will not exceed \$0.35 per \$100 of TAV. The district benefits from substantial state support for debt service, which is currently about 51% of annual requirements. Including state aid, direct debt per capita is \$1,456 or 3.9% of TAV, compared with \$2,782 per capita or 7.41% of TAV if the district was not a recipient of state assistance. Debt amortization is average with 50% retired in ten years. The district plans to seek another \$150 million authorization in May 2007 for additional capital improvement needs.

The district encompasses approximately 60 square miles in eastern Dallas County. Enrollment, currently at around 35,800 students, has grown steadily over the last decade and is projected to increase at a rate of roughly 2% annually for the next several years. A maturing middle-class suburb, the city and Balch Springs benefit economically from the three interstate highways that traverse the district. The city's economic base includes retail, telecommunications, manufacturing, warehousing, and distribution enterprises. Development activity is strongest in the southern portion of the district, where residential building remains active. Local wealth indicators, as measured by median household buying income and per capita personal income, comfortably exceed both state and national averages. The city's unemployment rate is on par with state and slightly higher than the national level.

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