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Mesquite Independent School District, Texas

Credit Profile

US$29.85 mil Unlimited Tax School Building Bonds, Series 2006 dated 07/15/2006, due 08/15/2031	AAA / AA (ICR)
Sale date: 14-AUG-2006	
AFFIRMED	
Outstanding GO Bonds, Various Series	AAA / AA (ICR)
Outstanding Variable Rate Unlimited Tax Bonds, Series 2003A	AAA / A-1+ / AA (ICR)
OUTLOOK:	STABLE

Rationale

The 'AAA' enhanced rating on Mesquite Independent School District, Texas' unlimited-tax school building bonds series 2006 is based on the strength of the Texas Permanent School Fund guarantee.

The 'AA' issuer credit rating (ICR) on the bonds reflects the district's:

- Access to the Dallas Metroplex and growing, diverse local employment base;
- Continually growing, solid, and diverse property tax base;
- Above-average income levels; and
- Strong financial position due to historically sound financial performance that has led to consecutive surpluses.

An offsetting factor is reflected in ongoing capital pressure resulting from steady enrollment growth and renovation needs, which have led to additional bond issuances that should keep debt levels elevated.

The bonds are secured by unlimited ad valorem taxes.

Mesquite Independent School District (population 165,526) is on the eastern border of Dallas, providing convenient access to the deep and diverse employment opportunities within the Dallas Metroplex. The leading employers located in the district include the district itself (about 4,000 employees), Town East Mall (3,000), and United Parcel Service (2,932).

Mesquite serves as eastern Dallas' retail center, as it contains a large retail district composed of the Town East Mall and adjacent retail developments. The city's 2005 unemployment rate was 5.3%, which was in line with state and national levels. Mesquite's household effective buying income was above average at 121% of the national level, although per capita income levels were average at 99% of the national average.

The district serves the city of Mesquite ('AA' GO rating) and a portion of Balch Springs. Reflecting the strong residential new-home development in the district, student enrollment growth averaged 2% annually during the past five years (2001-2006), increasing to a level of 35,800 for fiscal 2006. Enrollment is projected to grow at about the same pace in the future, with more than 6,000 new home sites expected to be built in the city over the next 15 years, mostly on the southeast side of the city. Commercial and industrial development is also expected to continue. Both Mesquite and Balch Springs are about 70% built out.

Mesquite Independent School District's financial performance has been strong despite growth-related operating and capital pressures; in addition, teacher salaries have been increasing in order to improve turnover and recruitment. Three consecutive years of positive financial operations, including $2.7 million and $4.1 million operating surpluses in fiscals 2004 and 2005, respectively, have increased the ending general fund balance to $41.7 million, or a high 20% of expenditures. Management budgeted to improve reserve levels for fiscals 2004 and 2005 to provide and additional operating cushion due to uncertainty surrounding state legislative changes. For fiscal 2006, management expects a $2 million-$3 million surplus, which would increase the year-end fund balance to about $44 million. Steady student enrollment growth has led to a modest wealth per student. The district, therefore, is a beneficiary of Texas' school finance system. State aid accounted for 55% of fiscal 2005 revenues, down slightly from 58% in fiscal 2001.

Mesquite Independent School District's financial management practices are considered strong under Standard & Poor's FMA methodology, indicating these practices are strong, well embedded, and likely sustainable.

State debt service support programs provide for about 50% of the debt service on the district's bonds. This support lowers the district's overall net debt burden to a moderate 5.1% of market value and $1,921 per capita. The district's debt service carrying charge is high, with total debt service accounting for 18% of 2005 operating expenses. Amortization is average, with 49% of debt retired in 10 years. This issuance is the district's last installment of its $150 million 2003 authorization. The district will likely seek another bond election in May 2007, sized similar to its most recent authorization, to renovate some older schools and build some additional elementary schools. The district has a strong track record of successful bond elections. The district has had five successful elections over the past 15 years, with the electorate approving over $550 million in bonds that carried an average voter approval rate of 82%.

Outlook

The stable outlook on the enhanced rating reflects the strength and liquidity of the Texas Permanent School Fund. The stable outlook on the ICR reflects Standard & Poor's expectation of continued strong financial performance and good fiscal planning by the district. Upward rating potential is limited due to ongoing capital pressures related to steady enrollment growth and renovation needs, leading to additional bond issuances that should keep debt levels elevated. In addition, stateimposed constraints inhibiting the district's ability to fully benefit from its deep and diverse economic base preclude a higher rating.

Economy: AV Up 36% In Five Years

The district's assessed value (AV) stood at $6.2 billion for fiscal 2006 following significant 36% growth during the past five years. Taxpayer concentration is low: the 10 leading taxpayers account for just 6.3% of AV. Single-family residential properties account for 59% of total AV, and commercial properties account for 28%. New homes in the district are affordable, ranging from $110,000-$150,000, which results in a below-average per capita market value of $37,534.

FMA: 'Strong'

Mesquite Independent School District's financial management practices are considered strong under Standard & Poor's Financial Management Assessment (FMA) methodology, indicating these practices are strong, well embedded, and likely sustainable. Management has historically maintained a conservative budget based on its analysis of the local economic environment, state funding projections, and local property tax base data, as well as an independent consultant to assist with the potential fiscal impact of legislative changes. Management provides monthly reports on the state of the budget at school board meetings, and the board can make amendments to the budget at any meeting. The district also engages in long-term financial forecasting for both revenues and expenditure and capital planning, which is an integral part of its comprehensive strategic plan. The potential effect changes in the state funding formula and increases in personnel costs will have on the district are updated annually and projected for a multiyear period. The assessment of capital needs not only looks at the cost of the facility improvements but also at their effect on the district's operating funds. Management monitors district investments and provides reports to the board quarterly, which follow the state's conservative investment guidelines. In addition, the district has a general fund reserve policy of maintaining at least 16% operating expenditures, which is has exceeded for more that 10 years and derived around cash flow needs. While the district does not have a formal debt-management policy, officials institute practices that manage the issuance of debt to minimize the tax rate impact and maximize savings in the case of refunding bonds. Debt maturities are designed to match the life of the asset being financed. The district has issued variable-rate debt and has entered into a swap with periodic swap performance update give to the board. The district does have a formal swap management policy to govern existing and future use of derivatives.

DDP: '1.5'

The district has been assigned a Standard & Poor's Debt Derivative Profile (DDP) overall score of '1.5' on a scale of '1' to '4', with '1' representing the lowest risk and '5' the highest. The overall score of '1.5' reflects Standard & Poor's view that the district's swap portfolio reflects a very low credit risk at this time, due to the following factors:

- A highly rated swap counterparty;
- A low degree of involuntary termination under the swap due to a sizable ratings trigger spread;
- Good economic viability of the swap; and
- Good management practices, including a formal swap management plan.

Mesquite Independent School District's current notional amount outstanding under its one swap is $29.9 million. The district's net variable-rate debt exposure, after giving effect to the floating-to-fixed rate swap, is relatively low at 6.5%. The district's counterparty in the swap is JP Morgan Chase Bank (AA-/Stable). Under the swap, the district is paying 4.46% and receiving floating interest based on the Bond Market Association index from JP Morgan. Because of the low termination risk, Standard & Poor's is not factoring the value-at-risk under this swap as a contingent liability.