

Tax Supported New Issue

San Antonio Independent School District, Texas

Ratings

New Issue

Unlimited Tax Refunding Bonds, Series 2006* AAA

Outstanding Debt

Unlimited Tax Bon	ds AA-
Lease Revenue Bon	ıds A+
Dating Outlook	Negative

*The rating is based on a guaranty provided by The Texas Permanent School Fund, whose insurer financial strength is rated 'AAA' by Fitch Ratings. The bonds' underlying rating, reflecting the credit quality before consideration of the guaranty, is 'AA-'.

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New Issue Details

\$47,609,950 Unlimited Tax Refunding Bonds, Series 2006, are scheduled to sell on Nov. 27 via negotiation to a syndicate led by Coastal Securities.

Security: Payment for the bonds is provided by an ad valorem tax levied, without legal limitation as to rate or amount, against all taxable property within the district.

Purpose: Bond proceeds will be used to refund a portion of the district's outstanding debt and pay issuance costs.

■ Outlook

The 'AA-' rating reflects the district's broad tax base, which benefits from the area's strong economy, substantial state support for operations and debt service, and adequate financial reserves. The rating also takes into consideration the district's below-average principal amortization rate and declining enrollment. The combination of growing taxable assessed valuation (TAV) and declining enrollment has pressured operations. The Negative Rating Outlook reflects the district's weakened financial performance incurred during fiscal 2005 and additional deficits anticipated for fiscal 2006 and budgeted in fiscal 2007. Significant reduction in state aid from enrollment losses since fiscal 2003 caught up with the district in fiscal 2005, when state aid for operations declined by about 6.5%, while expenditures remained level. Additional fund balance reduction is expected for the current fiscal year, and failure to implement significant cost reductions in light of a declining revenue stream may apply downward pressure on the rating. Achieving budget balance and maintaining solid reserve levels consistent with a high-grade rating remains key to future credit quality.

Rating Considerations

The district covers about 80 square miles and encompasses downtown San Antonio in Bexar County with a tax base of about \$9.5 billion. Prominent industries in the local economy are domestic and international trade, convention and tourism, military and government finance, health care, medical and employment, telecommunications. The district's overall population in 2006 was estimated at 316,000; its historically stable average daily attendance (ADA) declined significantly in fiscal years 1999 and 2000 and. although at a slower pace, has continued to drop. Despite district efforts to boost enrollment with the expansion of early childhood programs, the implementation of alternative educational venues such as internal charter schools, and increased downtown residential development, the competition from surrounding area school districts pressures the district operations, most significantly in terms of teacher salaries and an aging infrastructure in need of renovations and costly to maintain.

After deteriorating significantly in fiscal 1999, the district's financial position improved in fiscal 2000 under a new administration that implemented an increase in its operating and maintenance (O&M) tax rate and conservative projection for its ADA. The district maintained a positive trend in its financial performance through fiscal 2004 at which time the general fund unreserved fund balance totaled a solid \$63.8 million, or 16.2% of expenditures and transfers out. In fiscal 2005, however, the district posted a large deficit of \$13.8 million

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primarily as a result of a reduction in state aid, ending the year with an unreserved fund balance of \$51 million or 12.8% of expenditures and transfers out. Further decline is expected as unaudited results for fiscal 2006 point to a \$3.6 million deficit. Further, the fiscal 2007 budget was adopted with an anticipated deficit of \$10 million further thinning the unreserved general fund balance to an estimated 10% of expenditures and transfers out. The fiscal 2007 budget was adopted with substantial pay increases beyond the state mandated level in response to pressure from the teacher union and salary competition among area school districts, further weighing on the future of the district's finances. District administration is in the of reviewing alternatives, consideration of school consolidations, in an effort to tighten expenditures. However, a formal plan to stabilize its financial operations beyond marginal expenditure controls (such as freezing vacancies) has not been developed at this time.

The Texas Legislature recently passed property tax relief measures that were subsequently signed by the governor. The legislation provides mandatory reductions in the local O&M property tax rate of 11% for fiscal 2007 and a cumulative 33% for fiscal 2008, based on the fiscal 2006 O&M tax rate. To offset the loss of local revenue, the state will increase its share of funding to local school districts, including the district, so that the measures are expected to be revenue neutral. In accord with this legislation, the district dropped its maximum \$1.50 O&M rate, maintained for the past seven fiscal years, to \$1.33 for fiscal 2007 and approved the \$0.04 per \$100 TAV levy for operations allowed under House Bill 1.

The district has issued all of its 1997 and 2001 authorizations for \$483 million and \$126 million, respectively. Its large capital programs were designed to renovate or replace many of its aging facilities and add early childhood facilities (ECF's), gymnasiums, and other amenities to nearly all campuses. In May 2005, district voters rejected a bond package that was proposed to fund additional renovations of aging facilities. Although the district does not currently have any authorized but unissued debt, the district may elect to seek additional voter authorization to address its aging infrastructure. With adjustments for state support for debt service, equal to about 61% of the current offering and outstanding debt, the district's direct debt burden totals a low \$721 per capita and moderate 2.4% of TAV. Overall debt levels are moderate on a per capita basis at \$1,634 but above average as a percentage of TAV at about 5.4%. Principal payout is well below average at 36% in 10 years, designed to allow the district to avoid any debt service tax rate impact for both bond programs.

■ Strengths

- Broad tax base.
- Substantial state aid for debt service on bondfinanced capital projects.
- Strong area economic indicators.

■ Risks

- Declining reserves and state support as a result of declining enrollment.
- · Slow principal amortization.

Debt

After nearly 30 years without an approved general obligation bond election, the district embarked on a major overhaul of its aging campuses that was enabled by a \$483 million bond authorization approved by voters in 1997. Affecting 92 campuses, the facilities improvements included safety, health, fire, and security improvements; asbestos abatement; new classrooms; and new or renovated facilities for libraries, science labs, music, speech, and physical education. Subsequently, voters approved a \$127 million bond program in 2001, mostly for new ECFs, high school music facilities, renovation or replacement of eight school campuses, and land acquisition. proceeds, Substantial interest earnings from amounting to nearly \$100 million, enabled the district to expand both bond programs to address additional capital needs.

The completion of 30 new ECFs and the renovation of five existing ECFs enabled the district to increase its enrollment in its prekindergarten program to about

Debt Statistics	
This Issue	47,610
Outstanding Debt	
Unlimited Tax Bonds*	458,079
Lease Revenue Bonds	5,440
Less State Support	(283,341)
Direct Debt	227,788
Overlapping Debt	288,576
Total Overall Debt	516,364
Debt Ratios	
Direct Debt Per Capita (\$)**	721
As % of Taxable Assessed Valuation†	2.4
Overall Debt Per Capita (\$)**	1,634
As % Taxable Assessed Valuation†	5.4
*Less refunded bonds. **Population: 316,000 (2 †Taxable assessed valuation: \$9,504,751,000 (2	

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4,200 three- and four-year-olds in fiscal 2005. As a result, there has been a three-year trend of growing ADA at the first grade level, as families decide to continue with the district's schools upon their children reaching the elementary grades. The district's first grade ADA increased by about 900 students since expansion of the ECFs started in fiscal 2000. However, total ADA declined mostly due to a decline in middle school and high school grade level students.

The district's refunding offering is estimated to result in net present value savings of about 3% of refunded bonds. There is no restructuring of outstanding debt. The district's direct debt burden is moderate, at \$721 per capita and 2.4% of TAV after adjusting to reflect state support equal to about 54% of debt service. The overall debt burden is above average as a percentage of TAV at 5.4% but moderate on a per capita basis at \$1,634. The district does not currently have authorization to issue new money bonds. In May 2005, district's voters rejected a \$399 million bond proposal for additional capital improvements and facility renovations. District administration is reviewing facility needs to determine the size and timing for future bond programs.

The principal payout rate is slow, at 36% in 10 years, as the series 1997 and 2001 bonds were issued with 30-year maturities to minimize the tax rate impact. Voters were promised the debt service tax rate would increase to \$0.385 per \$100 TAV for the \$483 million bond program approved in 1997, but it has remained well below this rate at \$0.22 per \$100 TAV and will drop one cent more in fiscal 2007. The 2001 authorization also was issued with no anticipated tax

impact, even with flat TAV growth assumptions. In addition, a \$29.4 million fund balance has accumulated in the debt service fund, which may be used for managing the tax rate for future bond programs.

■ Finances

district rebounded from a significant deterioration of reserves in fiscal 1999 that had resulted from a combination of decline in ADA, funding of a large 10% employee pay raise, and a cut in effective O&M tax rate. Under a new administration, the district's financial position improved substantially in fiscal 2000 due to an increase in its O&M tax rate and conservative projections for its ADA. In addition, the administration and school board leadership adopted a formal policy to maintain fund balance reserves within 10% of the Texas Education Agency's recommended optimal fund balance, equal to one month's expenditures. Expenditure monitoring and controls also have been strengthened with the implementation of an automated purchase authorization system.

For fiscal 2000, a \$12.0 million operating surplus increased the undesignated general fund balance to 4.0% of expenditures and transfers out. In fact, the district posted positive general fund operating surpluses in four of the five years including fiscal 2000 through fiscal 2004, increasing its unreserved fund balance to \$63.8 million, or 16.2%, by the end of fiscal 2004.

Audited results for fiscal 2005 were much different than previously anticipated. Despite significant efforts to boost ADA, the district continued to

General Fund Summary

(\$000, Audited Fiscal Years Ended Aug. 31)

	2001	2002	2003	2004	2005
Revenues	372,155	372,306	383,004	394,056	382,217
Expenditures	348,770	363,378	391,614	391,421	394,708
Net Change	23,385	8,928	(8,610)	2,635	(12,491)
Transfers In		30	3,309		_
Other Sources	-	51	790	241	
	(2,226)	(1,210)	(1,235)	(1,241)	(1,268)
Transfers Out Net Income	21,159	7,799	(5,746)	1,635	(13,759)
Total Fund Balance	67,804	75,682	69,934	71,572	57,812
As % of Expenditures and Transfers Out	19.3	20.8	17.8	18.2	14.6
Unreserved Fund Balance	60,487	68,367	62,306	63,795	50,860
As % of Expenditures and Transfers Out	17.2	18.8	15.9	16.2	12.8
Undesignated Fund Balance	28,180	29,637	32,435	31,283	32,496
As % of Expenditures and Transfers Out	8.0	8.1	-8.3	8.0	8.2

Property Value and Student Enrollment Trends

(\$000, Fiscal Year Ending Aug. 31)

	Taxable Assessed Valuation	Change (%)	Student Enrollment	Change (%)
1999	6,081,585		53,739	
2000	6,386,120	5.0	53,635	(0.2)
2001	6,938,276	8.6	53,545	(0.2)
2002	7,267,286	4.7	53,948	0.8
2003	7,570,318	4.2	53,475	(0.9)
2004	7,968,622	5.3	53,371	(0.2)
2005	8,231,705	3.3	53,053	(0.6)
2006	8,608,879	4.6	52,877	(0.3)
2007	9,504,751	10.4	51,839*	(2.0)
*Estimate.				

experience a decline in enrollment resulting in lower than anticipated state revenue. Primary-grade level ADA has increased, although the district is still experiencing decline in the middle school to high school age students. Moreover, the state adjusted prior-year overpayments in fiscal 2005 to adjust for previous-year declines, resulting in state aid decline of 6.5% from fiscal 2004. The district recorded a \$12.5 million operating deficit and a net deficit of nearly \$13.8 million after payment of the lease revenue bonds in fiscal 2005.

Although unaudited results for fiscal 2006 were also negative, the net deficit was significantly lower at \$3.5 million. For fiscal 2007, the budget includes large pay raises for teachers and paraprofessional staff that were approved as a result of collective bargaining pressure from the teachers union. As adopted, the budget will dip into the fund balance reducing reserves by another \$10 million, reducing the general fund unreserved fund balance to an estimated \$37.3 million, or 10% of spending. The budget is based on a more conservative ADA estimate of 51,839.

District administration is exploring cost-cutting alternatives to achieve structural balance and has already imposed a hiring freeze leaving open positions vacant. One significant alternative being considered includes school consolidation, but its fiscal impact is still being analyzed. A formal plan to stabilize its financial operations beyond marginal expenditure controls is being developed. Achieving budget balance and maintaining solid reserve levels consistent with a high-grade rating remains key to future credit quality.

■ Economy

With an estimated population of 316,000, the school district is the fourteenth largest in terms of enrollment in the state and remains among the 50 largest nationally. It includes the downtown area of the city of San Antonio. Student enrollment, historically stable at 54,000–55,000, declined 3.2% (1,779 students) in fiscal 1999 due to demographic dynamics largely beyond the district's control. Despite downtown redevelopment efforts, new early childhood programs, and new internal charter schools, the district's ADA continues to decline but at a slower pace and currently reports ADA at 52,877.

Health care and bioscience, hospitality, and government, including the military, are the leading sectors of the local economy. The health care and bioscience industry is the largest segment, with an estimated \$14.3 billion economic impact in 2005, providing about 19% of all jobs in the San Antonio area and employing more than 108,000, with an annual payroll of nearly \$4.2 billion. The major components of this sector include the 900-acre South Texas Medical Center, with 10 major hospitals, and the University of Texas Health Science Center at San Antonio; military health care, consisting of three major military hospitals; and biomedical research and development, including the Texas Research Park.

The hospitality industry, consisting of conventions and tourism, is a significant component of the city's economy, with an estimated economic impact of \$7.2 billion and employing more than 86,000. During 2002, San Antonio attracted nearly 20 million visitors, which resulted in direct spending of \$4.8 billion in the city. To capture larger conventions, the convention center has undergone a significant expansion and renovation. The project is complete, giving the center 400,000 square feet of contiguous space. Also, plans are being developed for the establishment of a convention center headquarters hotel.

Another principal component of the local economy is the military, whose presence is represented by Lackland Air Force Bases (AFB), Randolph AFB, and Fort Sam Houston U.S. Army Base. The property of a fourth installation, Brooks AFB, was transferred to the city as part of the Brooks City-Base Project, which is designed to lessen the operating costs of facility maintenance for the Air Force.

The Air Logistics Center at Kelly AFB was closed in July 2001, which led to the establishment of the Greater

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Kelly Development Authority (GKDA). The goal of the GKDA is to create 21,000 jobs by 2006 at Port San Antonio (formerly KellyUSA), the new business and industrial park, including the 12,000 lost as a result of realignment. To date, the GKDA has successfully leased eight million square feet of space through the execution of 74 leases and attracted numerous companies, Lockheed-Martin, Chromalloy, including Boeing, Standard Aero, General Dynamics, General Electric, and Pratt & Whitney. An additional 2.4 million square feet of space has been leased back to the Air Force for its continued needs. These efforts have retained 7,400 military personnel and created more than 5,200 new commercial jobs at Port San Antonio. The next phases of development at Port San Antonio will focus on establishing an international cargo port, rail accessibility for inland port distribution, and expanding aviation maintenance, repair, and overhaul operations. A recent development affecting Fort Sam Houston is the announced relocation of the U.S. Army South from Puerto Rico, bringing approximately 500 new jobs with an annual economic impact of \$200 million.

From employment and unemployment standpoints, San Antonio and the surrounding area have been faring well. The latest unemployment figures available, for September 2006, point to an unemployment rate of 4.4% for the city and metropolitan statistical area. The corresponding rates for the state and nation are 4.7% and 4.6%, respectively. The civilian labor force in the city grew modestly at about 1.7% annually over the past three years, while employment growth averaged about 2.1% annually for the same time frame.

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