
Fitch: TX Perm School Fund Cap Has Minimal School District Credit Impact

Fitch Ratings-Austin/New York-31 January 2023: Fitch Ratings expects minimal negative effects on the credit profiles of school districts that issue debt without the benefit of the Texas Permanent School Fund's (PSF, or the program) 'AAA' guarantee as a result of the program's currently limited capacity.

School districts must have an investment-grade rating in order to qualify for the PSF guarantee. School districts with a weaker demographic profile, which are often lower rated, will receive priority under the program, and available capacity will be allocated based on need. Those districts forced to issue without the guarantee will face increased borrowing costs, but these costs should be easily absorbed by wealthy, higher-rated districts. Although the prioritization of lower credit quality school districts could weaken the program's aggregate pool quality over time if the program's guarantee cap is not raised, Fitch's cash flow modelling demonstrates that the program has ample cushion to mitigate this risk.

The program's leverage capacity is restricted by both state statute and IRS rules. The IRS limit (currently the constraining limit) is capped at 5.0x the fiscal-year 2009 book value of the fund, or $117.3 billion. The amount of guaranteed bonds was approximately $109 billion at the end of October 2022.

PSF management is working with state and federal regulators to expand the capacity limit, but timing of a resolution is uncertain. Until then, guarantee capacity will be based on bonds maturing or bond issuance amounts that are lower than the authorized amount. As of 4Q22, approximately $4.3 billion of bonds were scheduled to mature in 2023, or about 4% of the total.

Wealthier school districts' strong and growing tax bases support their ability to absorb higher borrowing costs and repay debt. Tax base growth has been driven by population inflows and home price appreciation. Home prices in Texas have softened slightly in the past few months, but generally remain near peak levels observed over the past three years.

In addition to potentially higher borrower costs, building materials and labor cost inflation may also cause some school districts to pause capital projects and postpone debt issuance. Non-residential construction materials and labor costs have trended up since the beginning of the pandemic, and issuers may wait until building supply availability improves and costs decrease. Other districts may not be able to wait on much-needed improvement and repairs due to strong enrollment growth and the need for additional classroom space.

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