FITCH RATES WASHINGTON COUNTY SCHOOL DISTRICT, UT GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-San Francisco-19 November 2014: Fitch Ratings assigns an 'AAA' rating to the following Washington County School District, Utah (the district) general obligation (GO) bonds:

--$47.5 million GO school building and refunding bonds (Utah School Bond Guaranty Program), series 2014.

The 'AAA' rating is based on the state's full faith and credit guarantee provided as credit enhancement to the district's GO bonds under the Utah School Bond Default Avoidance Program, which is rated 'AAA' with a Stable Outlook by Fitch.

Fitch also assigns an underlying rating of 'AA' to the bonds, reflecting the district's credit quality without consideration of the guarantee provided by the Utah School Bond Default Avoidance Program.

In addition, Fitch affirms the underlying rating on the district's $192.7 million in outstanding GO school building bonds at 'AA'. The Rating Outlook associated with the underlying rating is Stable.

The series 2014 bonds will sell competitively on Dec. 3, 2014. Proceeds will be used to build new schools, and to refund $19.1 million of outstanding GO building bonds, series 2005 principal to achieve net present value level savings over the life of the debt.

SECURITY

The bonds are payable by an unlimited property tax to be levied, without limitation as to rate or amount, on all taxable properties within the district.

KEY RATING DRIVERS

GENERAL FUND STRUCTURAL BALANCE PROJECTED: After raising its tax levy, the district is projecting structural balance in its general fund from fiscal 2015 onwards which should result in gradual strengthening of its unrestricted general fund balance.

SOUND FINANCIAL POSITION: Despite three years of general fund draw downs, the district maintains strong liquidity and good financial flexibility on both the revenue and expenditure sides.

ECONOMY CONTINUING TO STRENGTHEN: The local economy is geographically isolated, remains somewhat dependent on economically volatile industries, and was very hard hit by the recent recession. Economic conditions are improving, however, as the employment base expands, the unemployment rate drops significantly, and the population continues to grow.

TAX BASE REBOUNDING: The district's tax base is well diversified but was severely affected by the housing-led recession, dropping a cumulative 29% between fiscal years 2009-2013. It is now rebounding due to both new development and existing properties' rising values.

SOUND DEBT PROFILE: The district's debt levels are low, principal amortization is extremely rapid, carrying costs are moderate, and further bond issuances will not greatly alter the current debt profile.

RATING SENSITIVITIES

SOUND FINANCIAL FLEXIBILITY: The rating is sensitive to fundamental changes in financial management and performance. However, the Stable Outlook reflects Fitch's expectation that the district will be able to achieve and maintain structural balance going forward using improved revenues to offset ongoing remuneration cost pressures.

CREDIT PROFILE

The district is coterminous with Washington County, an area of more than 2,400 square miles. The district operates 41 schools and several alternative programs which serve a population of approximately 142,000 in southwestern Utah, approximately 315 miles southwest of Salt Lake City and 125 miles northeast of Las Vegas. About half of the county population is located in the city of St. George (sales tax revenue bonds rated 'AA', Stable Outlook by Fitch) which serves as the county's economic and retail hub. A significant portion of the population consists of retirees and young families.

While the district is geographically isolated, it is also well situated along a major transportation route, the I-15 freeway, making it an attractive location for warehouse and distribution facilities. These facilities comprise a key, but volatile, segment of the local economy. Other significant components of the local economy, tourism and retail, are also vulnerable to economic volatility.

The district experienced extremely rapid growth until the housing-led recession severely pressured the local economy. The outsized local construction industry was particularly hard-hit. Wealth indicators are largely below average, though this partially reflects larger family sizes and the substantial retiree population.

LOWER BUT SOUND UNRESTRICTED GENERAL FUND BALANCE

After a moderate deficit in fiscal 2012, the district recorded a general fund drawdown of $4.3 million in fiscal 2013. The operating deficit was largely attributable to remuneration cost increases (including a one-time staff bonus) and $2 million in revenue underperformance due to lower than expected student enrollment (overly aggressive projections were caused by inadvertent double-counting). Fiscal 2013 ended with a still sound unrestricted general fund balance of $15.2 million or 9.1% of spending.

The district projects that the general fund will end fiscal 2014 with a $2 million net operating deficit, in line with Fitch's previous expectation. This was caused largely by deferral of unspent state aid revenues only partially offset by programmatic under-expenditures. Consequently, fiscal 2014 is projected to end with a more constrained unrestricted general fund balance of $13.2 million or 7.7% of spending.

The school board approved a significant 5% property tax levy increase for fiscal 2015 which, along with growing student enrollment, state revenue increases, and ongoing cost controls, have resulted in structural balance. The district is expecting to maintain or grow its unrestricted general fund balance as it returns to the practice of annually adjusting its tax rates by inflation. This would allow the district to rebuild slowly its unrestricted general fund balance to 9%-11% of spending during fiscal years 2016-2018 as revenues continue to improve, taking into account offsetting remuneration pressure.

STILL SOUND FINANCIAL OPERATIONS

The district retains a number of options with regard to future revenue and expenditure flexibility, despite the pressures on its general fund. In addition to good general fund liquidity, the district could borrow from its $2.6 million student activity fund and transfer up to $12.3 million from its capital projects fund, if necessary. It could raise up to $35 million more per year, subject to the advisory truth-

in-taxation public hearing process, under its voted, board, and capital local tax levies. The district could also reduce its capital outlay levy and commensurately increase its operations and maintenance levy to direct more tax revenues to the general fund.

A material degree of expenditure flexibility exists in terms of class sizes, number of teaching days, and how future remuneration cost increases are handled through permanent salary schedule increases versus one-time bonuses.

The district is currently implementing a new financial management system and recently instituted a new chief accountant position. Fitch views these developments favorably as they will facilitate financial planning and oversight going forward.

ECONOMY CONTINUING TO STRENGTHEN; TAX BASE REBOUNDING

The county has seen a strong employment recovery with 35 consecutive months of year-over-year gains. Employment levels have increased by 16% over this period, reflective of both job growth and the substantial decline that preceded it. Employment volatility is especially apparent in the county's unemployment rate, which rose from 2.8% in 2007 to 10.4% in 2010, before falling to 3.5% as of September 2014. The county's current unemployment rate compares favorably to the national rate of 5.7% and is only slightly below the 3.3% rate for the state.

The local housing market has experienced similar volatility and was severely affected by the housing-led recession. House prices dropped steeply from their peaks, contributing to a peak-to-trough decline in assessed value (AV) of 29% between fiscal years 2009 and 2013. AV rebounded by 7.3% in fiscal 2014, and the district is projecting 4% annual growth going forward, reflecting both new development and existing properties' rising values. The district has seen the value of construction permits rising to 2.8% of market valuation in fiscal 2013, up from only 0.9% in fiscal 2009.

Due to a high proportion of retirees and large families, per capita income levels are well below national averages and moderately below state levels. However, household incomes are just moderately below state and national levels.

Population continues to grow as a result of both the local birth rate and in-migration. As a consequence, the district is projecting steady ongoing student enrollment growth despite a number of local charter schools.

SOUND DEBT PROFILE

The district's debt profile is good. Overall debt levels are low at $1,904 per capita (taking into account recently updated overlapping debt amounts) and 1.9% of TAV. Direct debt amortization is extremely rapid, with 92% of principal maturing within 10 years. Voters recently approved a $185 million GO bond authorization of which the $30 million new money portion of the series 2014 bonds is the first issuance. Further new debt issuances will be staggered through fiscal years 2016-2020, not adding greatly to the overall debt burden as old debt rolls off. The new bonds will primarily fund new school construction designed to absorb the projected student enrollment growth.

In fiscal 2013, cumulative carrying costs for debt service, annually required pension contributions, and OPEB prefunding costs were a moderate 18.6% of total governmental spending. After five years of increases, pension contributions to the state-run retirement system will remain elevated but stable going forward, while the district's residual liability for its closed OPEB system was fully paid down in 2014.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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