S&P Global Ratings

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Summary:
Kyle, Texas; General Obligation

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Credit Profile		
US$28.33 mil comb tax & rev certs of oblig ser 2020 dtd 06/01/2020 due 08/15/2050		
Long Term Rating	AA-/Stable	New
Kyle GO		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Kyle, Texas' anticipated $28.3 million 2020 series combination tax and revenue certificates of obligation (COBs). At the same time, S&P Global Ratings affirmed its 'AA-' rating on the city's existing general obligation (GO) debt. The outlook is stable.

The city's bonds and certificates are payable from revenue from a direct and continuing ad valorem tax levied, within the limits prescribed by law, on all taxable property within the city. The certificates carry an additional limited pledge of the surplus revenue of the city's waterworks and sewer system in an amount not to exceed $1,000. Given the de minimis pledge, we rate the certificates based on the city's ad valorem pledge.

Texas statutes limit the ad valorem tax rate for home rule cities to $2.50 per $100 of taxable assessed valuation (AV) for all city purposes. Administratively, the state attorney general will permit the allocation of $1.50 of the tax rate for ad valorem tax debt service. In fiscal 2020, the city levies well under the maximum at 54.2 cents per $100 of AV. We rate the bonds and certificates on par with our view of the city's general creditworthiness, as the tax base supporting the obligations is coterminous with the city, and we see no unusual risks regarding the fungibility of resources or the city's willingness to support the debt.

We understand the proceeds will fund wastewater treatment plan improvements to increase capacity. After the issuance of the COBs, the city will have about $105 million of GO debt outstanding.

Credit overview

The city has benefited from its access to the diverse and expanding Austin-Round Rock MSA metropolitan statistical area (MSA). Due to the combination of a growing tax base and prudent budget management, the city has grown its reserves to a very strong level of about 72.7% for fiscal 2019, which we think positions the city well to navigate the COVID-19-prompted recession. S&P Global Economics believes that the COVID-19 pandemic has caused the national economy to fall into a recession. (See "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020.) The scope of COVID-19-induced economic impact at the local level will vary, and stability of the rating will depend on the city's ability to adapt its budget to a rapidly changing economic environment. Recent implementation of austerity measures that freeze all nonessential spending should aid in its ability to do so. Given these factors, we expect the city's credit profile will remain stable over the near term.

The rating also reflects our view of the city's:

- Adequate economy, with projected per capita effective buying income at 84.0% and market value per capita of $75,984, though that is advantageously gaining from access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 73% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.7x total governmental fund expenditures and 6.7x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 25.7% of expenditures and net direct debt that is 180.4% of total governmental fund revenue, as well as high overall net debt at greater than 10% of market value; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic, and specifically, how stay-at-home orders and an extended economic slowdown may weaken the city's revenues. Absent the implications of COVID-19, we consider the city's social risks to be in line with those of the sector. We view its environmental and governance risks as being in line with those of the sector.

Stable Outlook

Downside scenario

We could lower the rating if Kyle were to experience substantial economic deterioration, or if structural imbalance were to develop, resulting in available fund balance falling below the policy requirement.

Upside scenario

Although unlikely in the current recessionary environment, we could raise the rating if the city's economic profile, including growth in per capita market value, and income levels continue to improve to a level more commensurate with those of its higher-rated peers. In addition, we would like to see the city continue to successfully manage its growth-related capital program without compromising its financial position or further weakening its current debt profile.

Credit Opinion

Adequate economy

We consider Kyle's economy adequate. The city, with an estimated population of 43,189, is located in Hays County in the Austin-Round Rock, Texas, MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 84.0% of the national level and per capita market value of $75,984. The city's market value grew by 8.8% over the past year to $3.3 billion in 2020. The county unemployment rate was 2.8% in 2019.

Kyle's location, roughly 15 miles south of Austin and eight miles north of San Marcos, and relative affordability compared to the rest of the greater Austin-Round Rock MSA have resulted in healthy commercial and residential development. In aggregate, AV has grown by just over $1 billion between 2016 and 2020, or 69%. Moreover, major roadway improvements along the I-35 corridor that resulted in better traffic flow, coupled with a growing population, continue to support strong growth in the city's commercial and retail sales tax revenues. The city's property tax base is diverse, with the top 10 taxpayers accounting for slightly more than 8% of the total tax base. Management reports that commercial and residential construction activity has not slowed since the onset of COVID-19 and that March and April monthly permits doubled compared to a year ago. About 16 residential subdivisions are under construction, with 200-300 homes opening in phases within each. Commercial development includes medical offices, a bank building, and an Amazon fulfillment center. Amazon is expected to become a leading taxpayer, possible in the top 10-15. Phase 1 was scheduled to be completed in spring 2021, opening with 150 employees. Phase 2 would possibly be completed in fall 2021. However, depending on the depth and duration of the recession, especially if there are multiple outbreaks, growth and demand for new housing could be stifled and rise in property tax delinquencies could rise and pressure the revenues.

Although a lagging indicator of rapidly changing events, the March county preliminary unemployment rate rose slightly to 3.6% from 2.7% in February, with the small contraction in the size of the labor force (120,130) in addition to a decline in the overall number of employed. We expect the unemployment rate to continue to rise based on growth in claims for unemployment insurance in the state, as reported in the Department of Labor's weekly report. Through the last recession, the county annual unemployment rate reached a high of 7%.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or regularly monitor all of them.

Key practices include management's:

- Use of three to five years of historical trends and a revenue forecasting model during the budget process;
- Quarterly budget updates of year-to-date performance provided to elected officials;
- Five-year rolling capital improvement plan with identified funding sources;
- Formal investment management policy that mirrors Texas Public Funds Investment Act, with quarterly updates of performance and holdings to city council;
- Formal debt management policy with basic provisions; and
- Formal policy, as outlined in the city charter, of maintaining 25% expenditures in the general fund, which it is currently exceeding.

The city lacks a long-term financial plan.

Adequate budgetary performance

Kyle's budgetary performance is adequate, in our opinion. The city had deficit operating results in the general fund (after transfers) of 18% of expenditures, but a surplus result across all governmental funds (before transfers) of 29.7% in fiscal 2019. We adjusted for routine transfers into the general fund from the proprietary funds, one-time capital projects, and general fund and total governmental fund expenditures through bond proceeds.

Revenues for the fiscal year ending Sept. 30, 2020, have not yet been negatively affected by the recession. Major general fund revenues are composed of property taxes (30%), sales and use taxes (31%), charges for services (15%) and franchise taxes (8%). The property tax collection rate was 97% as of the end of February. According to officials, preliminary AV, as reported by the assessment district, is 12% higher than the prior year, but does not include potential appeals, the process for which has not yet been completed. As a result, management expects actual value, certified in July, will be between 10% and 12%. For sales tax revenues, March retail transactions were 1.5% below the city's projections; however, year-to-date retail transactions are up 2% above projections. Sales tax revenues for transactions occurring in April are not yet available and are expected to be reported in June. With shelter-in-place restrictions lifting, including retail and restaurant reopenings, officials reported that vehicle and pedestrian activity has increased noticeably. The city expects to end fiscal 2020 balanced. As of midyear (March 31), the city reported revenues were ahead of budget and expenditures were slightly under at 45% of budget. In late March, the city froze new noncritical expenditures and put on hold any capital projects not yet started, which officials report will provide $10 million to $15 million of savings on a $26.3 million adopted budget for fiscal 2020. Due to the timing of when AVs are certified, any impact of the recession on property values would not take effect until fiscal 2022. Over the next 12 months, prolonged business closures and reduced activity due to COVID-19 could deepen unemployment, leading to an increase in property tax delinquencies and reduced sale tax revenues. However, officials informed us they intend to maintain the fiscal austerity measures that are currently in place until they are certain they can maintain a balanced budget.

For fiscal 2019, negative general fund results were the product of a use of reserves in excess of the city's reserve policy minimum requirement and surplus revenue transferred to the capital projects and wastewater funds for capital projects.

Very strong budgetary flexibility

Kyle's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 73% of operating expenditures, or $15.5 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The city has historically maintained very strong budgetary flexibility, with reserves in excess of 30% of operations. It does not plan to draw on reserves. We believe Kyle will likely maintain very strong budgetary flexibility due to its formal fund balance policy of maintaining available reserves in excess of 25% of operational expenditures, as well as its plans to maintain current budget austerity measures in place.

Very strong liquidity

In our opinion, Kyle's liquidity is very strong, with total government available cash at 1.7x total governmental fund expenditures and 6.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

At fiscal year-end Sept. 30, 2019, the city had $54.4 million of unrestricted cash and investments. As of that date, investments were primarily in local government investment pools, which comply with state statutes and which we do not consider aggressive. The city has demonstrated strong access to capital markets, with several GO-supported debt issues over the past 20 years. We do not expect a deterioration in the city's very strong liquidity profile.

Very weak debt and contingent liability profile

In our view, Kyle's debt and contingent liability profile is very weak. Total governmental fund debt service is 25.7% of total governmental fund expenditures, and net direct debt is 180.4% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 10.5% of market value.

We understand the city's capital plans are large and include the need for increased capacity and consolidation of multiple sites for the police department. The city might request voter approval of a $25 million-$30 million GO bond issuance during the November 2020 election. However, plans have not yet been formalized.

Portions of the city's GO bond debt service are supported by wastewater system revenues, as follows:

- Series 2009, 4.86% of debt service is allocated to the wastewater system;
- Series 2014, 18.38%;
- Series 2015, 3.41%; and
- Series 2020 (this proposed issuance): 100%.

Pensions and other postemployment benefits (OPEBs):

- Pension and OPEB costs are not a source of credit pressure, given that they represent just 4.2% of the city's budget.
- Recent volatility in the markets and the amortization and payroll growth assumptions will likely lead to increased costs in the future. However, we believe the city has sufficient budgetary flexibility and liquidity to address these costs.
- The OPEB liability is well funded with a minor liability.

The city participates in the following plans as of Dec. 31, 2018:

- Texas Municipal Retirement System (TMRS): 80.8% funded with a net pension liability of $4.76 million, and
- OPEB plan: 87.8% funded with net liability of about $195,566.

Kyle's combined required pension and actual OPEB contributions totaled 5.1% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

The city provides pension benefits for all of its full-time employees through the TMRS, a multiple employer, defined-benefit pension plan. Actuarially determined contributions fell slightly short of our minimum funding progress (MFP) metric. The MFP metric assesses whether the most recent employer and employee contributions cover total service cost, plus unfunded interest cost, plus one-thirtieth of the principal. When MFP is achieved it indicates that an issuer has a strong funding discipline that aims to ensure timely progress on reducing its plans' liabilities. Actuarial assumptions include a discount rate of 6.75% and a 26-year closed amortization period. The plan's assumed discount rate is not aggressive, in our opinion, although we consider the closed amortization period of 26 years extended, leaving greater potential for costs to grow based on actual performance. Lastly, contributions are likely to increase given the level percent of payroll funding method, as opposed to level-dollar contributions, which would result in consistent payments.

OPEB include a health care benefit and a supplemental death benefit. The supplemental death benefit is a lump-sum payment. The health care benefit assumes an elevated 7.25% discount rate.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 26, 2020)		
Kyle GO (ASSURED GTY)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Kyle GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.