S&P Global
Ratings

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Summary:
Kyle, Texas; General Obligation

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Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings revised its outlook to stable from positive and affirmed its 'AA-' long-term rating and underlying rating (SPUR) on Kyle, Texas' existing general obligation (GO) debt.

The revised outlook reflects our view of the city's very weak debt profile and increasing debt burden that has continued to outpace the growth in economic indicators. In addition, we anticipate that ongoing growth-related capital needs will likely contribute to budgetary challenges, or require the issuance of additional debt over the next few years, which will likely keep debt ratios elevated.

A limited-ad valorem tax levy on all taxable property within the city secures the bonds. Given the city's ad valorem tax levy of roughly 57 cents per $100 of assessed value (AV), we believe there is significant tax flexibility well below the maximum allowable tax rate of $2.50 per $100 of AV. The city's outstanding debt constitutes a direct obligation of the city, payable from the levy and collection of a direct and continuing ad valorem tax, within the limits prescribed by law, on taxable property within the city. In accordance with our published criteria, titled "Issue Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" (published on Jan. 22, 2018, on RatingsDirect), we do not make a rating distinction on Kyle's limited-tax bonds because they are on par with our view of the city's general creditworthiness, as reflected in the rating on the unlimited-tax GO bonds.

The rating reflects our view of the city's:

- Adequate economy, with 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;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2016, and continued strong growth in revenue performance;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 54% of operating expenditures;
- Very strong liquidity, with total government available cash at 74% of total governmental fund expenditures and 2.5x

governmental debt service, and access to external liquidity that we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 29% of expenditures and net direct debt that is 278% of total governmental fund revenue; and
- Strong institutional framework score.

Adequate economy

We consider Kyle's economy adequate. The city, with an estimated population of nearly 40,000, is located in Hays County in the Austin-Round Rock MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 89% of the national level and per capita market value of about $66,000. Overall, the city's market value grew by nearly 20% over the past year to $2.3 billion in 2017, and is estimated to increase by another 13% to $2.6 billion in 2018. The county unemployment rate was 3% in September 2017, in line with the state and national averages.

Kyle' 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 nearly $1 billion since fiscal 2013, or roughly 75%. 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 expects residential and commercial retail development to continue for the medium term and to support similar growth trends in taxable value.

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 monitor all of them on a regular basis.

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 which 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.

Strong budgetary performance

Kyle's budgetary performance is strong in our opinion. The city had a surplus operating result in the general fund of 3.6% of expenditures, and slight surplus results across all governmental funds of 1.9% in fiscal 2016. 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.

The city's strong budgetary performance is supported by management's conservative budgetary practices, which often result in actual operations exceeding budgeted expectations. For fiscal 2016, actual operations were nearly $2 million better than budgeted because of outperforming sales and property tax revenues, as well as achieved savings. The results in fiscal 2016 reflects a significant increase in capital outlay in the general fund, with an adjustment for one-time capital spending. For fiscal 2017, the city had budgeted for balanced operations in the general fund, but year-to-date actual operations indicate it will finish with a $2.6 million surplus at fiscal year-end. We anticipate the current and subsequent fiscal years' operations sustaining strong budgetary performance, and being supported by growth in revenues and conservative spending practices. In the long-term, we understand that the city has significant growth-related capital needs, and management notes that the capital-spending plan will be contingent on the availability of cash funding and future revenue growth. We believe there will likely be steady strengthening in revenue performance, but we will continue to examine the effects of growth-related capital expenses on overall financial performance.

Very strong budgetary flexibility

Kyle's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 54% of operating expenditures, or $10.5 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. For fiscal 2017 (unaudited), management reports available reserves of approximately $13 million, or 63% of operating expenditures; it does not plan to draw on reserves significantly over the next two fiscal years. 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.

Very strong liquidity

In our opinion, Kyle's liquidity is very strong, with total government available cash at 74% of total governmental fund expenditures and 2.5x governmental debt service in fiscal 2016. In our view, the city has strong access to external liquidity if necessary. We expect liquidity to remain very strong over the next few fiscal years due in part to unaudited results for fiscal 2017, which reflect an improved liquidity position. The city has demonstrated strong access to capital markets with several GO-supported debt issues over the past 20 years. Currently, investments comply with state statutes and we do not consider them aggressive. At fiscal year-end 2016, investments were in safe local government investment pools, U.S. agency securities, and certificates of deposit.

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 29% of total governmental fund expenditures, and net direct debt is 263% of total governmental fund revenue. We expect that ongoing growth-related capital needs will likely require the issuance of additional debt over the next few years, which will likely keep debt ratios elevated. We understand the city plans to issue approximately $10 million to $12 million in additional debt for its wastewater treatment plant expansion project within the next two years. We believe future tax base growth will continue supporting additional debt needs.

Kyle's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4% of total governmental fund expenditures in fiscal 2016. The city made its full annual required pension contribution in 2016. The city provides pension benefits for all of its full-time employees through Texas Municipal Retirement System

(TMRS), a multiemployer, defined-benefit pension plan. The city has historically paid its annual pension cost in full. On Dec. 31, 2015, the date of the most recent actuarial valuation, the plan maintained a funded level of 76%. We do not anticipate a significant increase in these costs in the near future, and believe Kyle will continue to make 100% of its annual contribution. The city's OPEB for retirees are paid on a pay-as-you-go basis. Based on the most recent actuarial valuation on Oct. 1, 2015, its OPEB had a funded ratio of 50% and an unfunded actuarial accrued liability of nearly $550,000. (For additional details on GASB Nos. 67 and 68, see the report, titled "Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria," published Sept. 2, 2015 on RatingsDirect.)

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that it will likely not change the rating during the two-year outlook period. We believe Kyle will likely maintain its very strong budgetary flexibility and liquidity, which its formal reserve policy supports. We also believe the city's economy will likely continue to experience ongoing tax base growth and economic expansions due to its proximity to the Austin-Round Rock MSA.

Upside scenario

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 its higher-rated peers. In addition, we would like to see the city continuing to successfully manage its growth-related capital program without compromising its financial position or further weakening its current debt profile.

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.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

S&P Global Ratings

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February 1, 2018

City of Kyle
100 West Center Street
Kyle, TX 78640
Attention: Mr. Perwez Moheet, Director of Finance

Re: ***Kyle, Texas, General Obligation Bonds***

Dear Mr. Moheet:

S&P Global Ratings hereby affirms its rating of "AA-" for the underlying rating (SPUR) on the above-listed obligations and changed the outlook to stable from positive. A copy of the rationale supporting the rating and outlook is enclosed.

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