

RatingsDirect®

Summary:

Schertz, Texas; General Obligation

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Credit Profile

US\$7.925 mil comb tax & ltd pledge rev certs of oblig ser 2019 dtd 08/01/2019 due 02/01/2039		
<i>Long Term Rating</i>	AA+/Stable	New
Schertz comb tax and ltd pledge rev certs of oblig		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Schertz comb tax and ltd pledge rev certs of oblig (Taxable)		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Schertz, Texas' series 2019 combination tax and limited-pledge revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's previously issued general obligation (GO) bonds and certificates of obligation. The outlook is stable.

The 'AA+' long-term rating reflects ongoing economic growth in the city, attributed to outward expansion from nearby San Antonio. While local wealth and income indicators are somewhat weaker than those of its national peers, Schertz benefits economically from access to employment throughout the broad and diverse San Antonio metropolitan statistical area (MSA), where projections for employment growth exceed 10% over the next five years. In addition, the city is well positioned along major transportation corridors, which is expected to spur interest and economic development from prospective employers in the distribution, warehousing, and logistics sectors. While rapid economic growth has also resulted in a growing population base and increased service demands, Schertz's comprehensive financial management framework has allowed the city to maintain its very strong financial profile. Capital needs associated with outstanding infrastructure needs will keep the debt burden relatively elevated; however, we understand that the city uses impact fees as an additional source of funding for capital, which could reduce the need for a significant amount of future debt.

Schertz's GO bonds and certificates of obligation constitute direct obligations of the city, payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within its borders. The maximum allowable ad valorem tax rate in Texas is \$2.50 per \$100 of assessed value (AV) for all purposes, with the portion dedicated to debt service limited to \$1.50. The city's total tax rate is well below the maximum, at 51.46 cents, 16.49 cents of which is dedicated to debt service. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Jan. 22, 2018), we view the limited-tax GO debt pledge on par with the issuer credit rating, which is based on the city's general creditworthiness. The ad valorem taxes are not levied on a narrower or distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service.

The certificates of obligation have a limited pledge of net revenues from the city's combined utility system--not to

exceed \$1,000. Given the limited revenue pledge, we rate the certificates based on the city's ad valorem pledge.

Officials will use proceeds to fund street improvements, utility system projects, and the purchase of a replacement fire engine.

The rating reflects our opinion of the city's:

- Strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 51% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 9.7x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 19.7% of expenditures and net direct debt that is 172.3% of total governmental fund revenue; and
- Strong institutional framework score.

Strong economy

We consider Schertz's economy strong. The city, with an estimated population of 40,931, is located in Bexar, Comal, and Guadalupe counties in the San Antonio-New Braunfels MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 107.8% of the national level and per capita market value of \$99,083. Overall, the city's market value grew by 6.3% over the past year to \$4.1 billion in 2019. The weight-averaged unemployment rate of the counties was 3.1% in 2018.

Schertz is approximately 22 miles northeast of San Antonio, between Interstates 10 and 35. The city's location along major transportation corridors provides residents convenient access to various employment centers throughout the San Antonio MSA, in addition to attracting key industries such as distribution and warehousing to further increase the local employment base. Schertz's leading employers include the Schertz/Cibolo/Universal City Independent School District (1,837 employees), Amazon Inc. (900), Sysco Central Texas (807), The Brandt Companies (476), and FedEx Ground (462).

Economic growth in Schertz is stable, reflected in construction and development activity across sectors including residential, retail, and industrial. The current development pipeline includes several residential subdivisions, commercial and office space construction, and a hotel. As a result of ongoing development, tax base growth has been healthy, averaging 8% per year over the past five years. In aggregate, the tax base has increased by \$1 billion, or 33%, since 2014. We consider the local tax base diverse, with the 10 leading taxpayers accounting for only 14% of overall AV in fiscal 2018. Given the robust development pipeline and a trend of regional employment growth and expansion, we expect our view of the city's local economy to remain strong.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Management analyzes five years of historical trends and consults with outside sources when developing the revenue and expenditure assumptions used in the annual budget process. Budget amendments can be made as needed, while city council receives budget-to-actual updates quarterly. Management uses a long-term financial plan, updated annually, which projects revenues and expenditures for five years. Formal capital improvement plans (CIP) are also maintained for roads and general capital needs, and are updated annually; while a new general CIP is generated every five years corresponding with the city's bond election cycle, the roadway plan spans 10 years, and provides comprehensive outlines of the city's street- and thoroughfare-related projects. The city's formal debt management and investment policies comply with state statutes, and the council reviews quarterly investment reports on holdings. Furthermore, the formal reserve policy requires a minimum of 25% of operating expenditures plus an additional 1% to be used to mitigate economic fluctuations.

Strong budgetary performance

Schertz's budgetary performance is strong, in our opinion. The city had operating surpluses of 10.0% of expenditures in the general fund and of 17.1% across all governmental funds in fiscal 2018. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2018 results in the near term.

Schertz's strong budgetary performance is reflected in the maintenance of positive operating results over the past five audited fiscal years. Over that time period, the general fund operating surplus has averaged a nominal amount of approximately \$2 million. In general, economic growth has spurred increases in the city's primary revenue streams, including property taxes, sales taxes, and permits and development fees, which have offset growth in the underlying expenditure budget. Schertz's ability to maintain structural balance and positive performance has allowed the city to build its reserve position to a level commensurate with growth in the overall budget.

The city's primary sources of governmental fund revenue include local tax revenues: property taxes (42%), sales (31%), and franchise (6%). These revenues are largely driven by changes in the economy, and as a result of economic expansion, total tax revenues have increased 25% over the past five years.

For fiscal 2018, audited general results reflect a \$2.66 million increase in fund balance. According to management, positive results were largely spurred by strong revenue performance, with actual revenues finishing \$2.2 million over budget. In particular, sales tax collections were 17% over budget, and the city reported record permitting fees that were almost \$1 million over the original budget estimates. To supplement strong revenue performance, Schertz also realized expenditure savings from personnel vacancies and project cost rollovers. Final expenditures were almost 7% under budget.

The fiscal 2019 budget was approved with a reserve appropriation in an effort to draw reserve levels closer to established policy thresholds. However, despite the expected reserve appropriation of \$2.2 million, current trends indicate that net results will remain, at least, balanced. Positive budgetary factors include continued strong sales tax growth and expenditure savings from personnel vacancies. Given recent performance, positive revenue trends, and the city's very strong framework of budget development and monitoring, we expect budgetary performance to remain

strong over the near term.

Very strong budgetary flexibility

Schertz's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 51% of operating expenditures, or \$13.4 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.

Schertz has historically maintained very strong reserve levels, exceeding 40% of operating expenditures in each of the past three fiscal years, and providing substantial flexibility over its formal policy of 26%. And while management indicates that fund balance may be used to cash finance future capital projects in an attempt to bring reserves close to the formal policy level, no plans exist to materially draw below the 26% policy level. Therefore, we expect budgetary flexibility to remain very strong in the near term.

Very strong liquidity

In our opinion, Schertz's liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 9.7x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

Schertz's strong access to external liquidity is demonstrated by its access to the market over the past two decades, which includes numerous GO-backed bond issuances. It has historically maintained what we consider very strong cash balances, and given budgetary performance trends, we do not believe its cash position will materially weaken in the near term. All of the city's investments comply with both Texas statutes and its own formal policy, and at the end of fiscal 2018 were held in certificates of deposit, U.S. agency securities, and local government investment pools--none of which we consider aggressive.

The city has seven series of debt that have been privately placed, with principal outstanding of \$14.4 million (17% of total direct debt). However, the obligations do not contain any provisions, such as acceleration or non-standard events of default that we view as a potential liquidity risk.

Very weak debt and contingent liability profile

In our view, Schertz's debt and contingent liability profile is very weak. Total governmental fund debt service is 19.7% of total governmental fund expenditures, and net direct debt is 172.3% of total governmental fund revenue.

Schertz does not have any swaps or variable-rate debt. The city's direct debt burden includes \$83.8 million of tax-backed debt, including GO bonds, tax notes, and certificates of obligation. Our ratios have been adjusted to reflect the portion of tax-backed debt supported by the city's water and sewer fund. Following the issuance of the series 2019 certificates, the city plans to issue an additional \$15.9 million of tax-backed debt for road and utility system improvements in the next 24 months. Of that amount, \$6.5 million is expected to be self-supported by the water and sewer fund. In light of these future debt plans, we believe that the city's debt profile will remain stable at very weak levels in the near term. It will amortize about 63% of net direct debt over the next 10 years.

Schertz's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.3% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

Schertz participates in the Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system. The city is required to contribute at an actuarially determined rate, and it has historically paid 100% of the annual required costs. The city's net pension liability measured \$14.6 million as of the Dec. 31, 2017 measurement date, down from \$17 million the previous year. The plan maintained a funded level of 78%, using its fiduciary net position as a percent of the total pension liability. While we do not anticipate short-term, fixed-cost pressure resulting from the city's TMRS obligations, the amortization period is long (29 years as of Dec. 31, 2017), in our view, and the level percentage of payroll amortization method (assuming 3.5% annual payroll growth) creates negative amortization where the net pension liability is expected to grow each year until contributions grow large enough to reduce the unfunded liability in the future. Therefore, we recognize the potential for the city's pension-related costs to increase in the longer term.

The city also offers a supplemental death benefit through TMRS. The plan is funded on a pay-as-you-go basis. Benefit contributions are actuarially determined and the city has fully funded these costs in recent years. As of the Dec. 31, 2017 measurement date, the total OPEB liability was \$622,941. In addition to the TMRS OPEB, the city also offers continuing health care benefits to retirees until they achieve Medicare eligibility. While Schertz does not explicitly contribute to retiree health premiums, the OPEB liability reflects the cumulative cost of the implicit subsidy of these benefits. The total OPEB liability for retiree health care was \$2 million as of the Dec. 31, 2017 measurement date.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our view of the city's growing economy within the broad and diverse San Antonio-New Braunfels MSA, as well as its very strong budgetary flexibility and liquidity. It also reflects our expectation that the city's debt profile will remain elevated, corresponding with anticipated growth and planned future debt issuances. Consequently, we do not expect to change the rating within the two-year outlook period.

Upside scenario

We could raise the rating if continued economic expansion results in improved wealth and income indicators, compared with those of higher-rated peers, or if the city's overall debt profile improves while it maintains its strong financial performance.

Downside scenario

We could lower the rating if the city's financial performance deteriorates, leading to sustained and significant drawdowns of reserves.

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
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 11, 2019)		
Schertz GO and rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Schertz GO		
<i>Unenhanced Rating</i>	NR(SPUR)	
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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