

RatingsDirect®

Summary:

Schertz, Texas; General Obligation

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Credit Profile

US\$7.705 mil GO rfdg bnds ser 2020 dtd 11/15/2020 due 02/15/2036

Long Term Rating

AA+/Stable

New

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Schertz, Texas' series 2020 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's previously issued GO bonds and certificates of obligation. The outlook is stable.

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 51.21 cents, 16.50 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 Nov. 20, 2019), we view the limited-tax GO debt pledge on par with 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.

The bonds will be used to refund a portion of the city's debt outstanding for debt service savings.

Credit overview

Despite the headwinds posed by the COVID-19 pandemic, the immediate economic and financial impacts to Schertz have been minimal. Given relatively stable revenue performance for fiscal 2020, management expects to report better-than budgeted operating performance, reflected in a less-than-anticipated use of reserves to fund one-time capital projects. In particular, in 2020 the city reported double-digit sales tax growth, which has the potential to moderate over time. City officials have attributed the strong sales tax trends to a primarily essential-services driven sales tax base. Given the city's history of stable operating performance, framework of frequent budget monitoring, and significant available reserves, we do not expect material changes in the city's financial position over the near term, supporting the stable outlook.

The rating reflects our view of Schertz's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 53% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.1x total governmental fund expenditures and 11.4x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 18.3% of expenditures and net direct debt that is 139.1% of total governmental fund revenue, but rapid amortization, with 71.1% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating and analysis incorporate our view regarding the health and safety risk posed by the COVID-19 pandemic, which we believe could pressure budgets in the short term. Overall, we consider the city's social risks in line with those of the sector. We also analyzed Schertz's environmental and governance risks relative to its credit factors, and we determined that both are in line with our view of the sector standard.

Stable Outlook

Downside scenario

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

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 were to improve materially while strong financial performance is maintained.

Credit Opinion

Very strong economy

We consider Schertz's economy very strong. The city, with an estimated population of 41,130, is located in Bexar, Comal, and Guadalupe counties in the San Antonio-New Braunfels, TX MSA, which we consider broad and diverse. The city has projected per capita effective buying income of 112% of the national level and per capita market value of \$110,667. Overall, its market value grew by 5.3% over the past year to \$4.6 billion in 2021. The weighted-average unemployment rate of the counties was 2.9% in 2019.

Schertz is located 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. It also attracts key industries such as distribution and warehousing, which further expand the local employment base. Schertz's leading employers include the Schertz/Cibolo/Universal City Independent School District (1,837), Amazon (900), Sysco Central Texas (807), The Brandt Companies (476), and FedEx Ground (462).

Despite the difficulties posed by the COVID-19 pandemic, economic growth in Schertz remains steady, reflected in construction and development activity in residential, retail, and industrial. The development pipeline includes several residential subdivisions, commercial and office space construction, and a hotel. As a result of ongoing development, the tax base has grown robustly, averaging 6% per year in the past five years. We consider the local tax base diverse, with the 10 leading taxpayers accounting for only 13.5% of taxable assessed value.

Although the early returns are positive, we anticipate that growth trends could moderate in the short term, particularly if pandemic-related unemployment remains elevated and consumer spending wanes under weaker economic conditions. Unemployment in the San Antonio MSA peaked at 13% before improving to approximately 6.6% in August. However, 2020 sales tax receipts were more than 10% higher than in the prior year. For more information on S&P Global Economics' view on the recovering U.S. economy, see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect.

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.

Schertz city 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 budget-to-actual updates are shared with city council 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. Schertz'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% operating expenditures plus an additional 1% to be used to mitigate economic fluctuations.

Adequate budgetary performance

Schertz's budgetary performance is adequate in our opinion. The city had operating surpluses of 6.8% of expenditures in the general fund and of 17.9% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2019 results in the near term.

Our forward-looking view of adequate budgetary performance incorporates the risk that near-term results could moderate from fiscal 2019 levels under the weaker revenue environment created by the COVID-19 pandemic, particularly given some exposure to economically sensitive revenues. Schertz's largest sources of revenue are property taxes (41%) and sales taxes (28%). However, given the city's strong budget monitoring framework and history of stable results, we anticipate that results under current conditions will remain at least breakeven.

The fiscal 2020 budget was balanced including a \$5 million reserve appropriation for one-time capital. Based on year-end estimates, management expects to report better-than-budgeted results primarily due to a combination of departmental expenditure savings and stable revenue performance, despite pandemic pressures. Sales taxes, for example, were 7% higher than budgeted. The estimated use of reserves for fiscal 2020 is approximately \$2 million. The fiscal 2021 budget is balanced.

Before fiscal 2020, the city recorded five consecutive years of positive general fund results, more than doubling its fund balance. Positive results have allowed it to build its reserve position to a level commensurate with growth in the overall budget while funding one-time projects with funds above established policy thresholds.

Very strong budgetary flexibility

Schertz's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 53% of operating expenditures, or \$14.8 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% operating expenditures in each of the past four fiscal years and providing substantial flexibility above its formal policy threshold 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 that level. Therefore, we expect budgetary flexibility will 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 2.1x total governmental fund expenditures and 11.4x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Schertz's strong access to external liquidity is demonstrated by its numerous GO-backed bond issuances in the past two decades. 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. As of August 2020, investments were held in certificates of deposit, bank deposits, and local government investment pools--none of which we consider aggressive.

We understand that the city has six series of debt that have been privately placed, with principal outstanding of \$11.5 million (15% 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.

Weak debt and contingent liability profile

In our view, Schertz's debt and contingent liability profile is weak. Total governmental fund debt service is 18.3% of total governmental fund expenditures, and net direct debt is 139.1% of total governmental fund revenue.

Approximately 71.1% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Schertz does not have any swaps or variable-rate debt. Its direct debt burden consists of \$75.2 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 2020 bonds, the city plans to issue an additional \$11.4 million in debt to support roadway improvements. Should the additional debt issuance push the 10-year debt amortization below 65%, our view of the debt profile could weaken. Currently, debt amortization is rapid, in our opinion, at 71%.

Pension and other postemployment benefits obligations

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate credit risk for the city. Despite a somewhat extended amortization, the city's pension plan is adequately funded, and annual OPEB costs remain manageable. As a result, we do not expect a material increase in pension and OPEB contributions that could threaten the city's fiscal stability. Schertz's combined required pension and actual OPEB contributions totaled 8.8% of total governmental fund expenditures in 2019.

The city participates in the following plans as of Dec. 31, 2018 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 72.65% funded with a net pension liability equal to \$19.7 million. Contributions are actuarially determined, and the city has recently paid more than the annual required costs. Actuarial assumptions include a 6.75% discount rate and 27-year closed amortization period. Contributions to the plan for the 2018 measurement year fell short of both our static funding and minimum funding progress metrics, reflecting a lack of progress in paying down the long-term liability.
- Supplemental Death Benefits Fund (SDBF), which provides group-term life insurance benefits to active and retired members of the TMRS pension plan. The plan is funded on a pay-as-you-go basis, and the city's total OPEB liability for SDBF was \$710,387. In 2019, benefit payments were \$3,779.
- Single-employer defined benefit health care plan, which offers an implicit rate subsidy to retirees until they achieve Medicare eligibility. The total OPEB liability for retiree health care was \$2 million, while benefit payments were \$57,530 in 2019.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Ratings Detail (As Of October 20, 2020)		
Schertz comb tax and ltd pledge rev certs of oblig		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 20, 2020) (cont.)

Schertz comb tax and ltd pledge rev certs of oblig (Taxable)		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Schertz GO		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Schertz GO and rfdg bnds		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

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