



Fitch Rates Lubbock, Texas' \$96.1MM Series 2018 GO Rfdg Bonds 'AA+'; Outlook Stable

Fitch Ratings-Austin-29 March 2018: Fitch Ratings has assigned a 'AA+' rating to the following Lubbock, Texas (the city) general obligation bonds (GOs):

--\$96.1 million GO refunding bonds, series 2018.

The series 2018 GO refunding bonds are expected to price via negotiation April 4th. Proceeds from the series 2018 bonds will refund certain outstanding taxable obligations of the city for debt service savings and pay issuance costs.

Lubbock's Issuer Default Rating (IDR) is 'AA+'.

The Rating Outlook is Stable.

SECURITY

The 2018 GO refunding bonds are payable from a limited ad valorem tax pledge of the city, not to exceed \$2.50 per \$100 taxable assessed valuation (TAV).

ANALYTICAL CONCLUSION

The 'AA+' IDR and GO rating reflect the city's high level of demonstrated and anticipated operating financial resilience through a typical economic cycle. This assessment is underpinned by a generally favorable revenue profile and superior inherent budget flexibility. Fitch believes general fund revenue growth prospects are solid with limited expected volatility; the revenue profile is augmented by the city's ample revenue-raising ability. Continued population and economic growth should also keep the liability burden moderate. Carrying costs are expected to remain manageable given the rapid principal amortization of the city's debt and comparable levels of self-support from various enterprise funds.

Economic Resource Base

The city of Lubbock is located in northwest Texas, and it serves as the retail/trade,

educational, and health care hub for the surrounding, largely rural, region. The steadily growing population base is presently estimated at 253,000, reflective of a somewhat stronger pace of expansion in recent years that is closer to statewide trends. Local educational attainment levels are comparable to those of the U.S. due in part to the outsized presence of Texas Tech University.

Health care, education, and government comprise the area's largest non-agricultural employment sectors. Cotton production and the oil/gas energy sector are also important drivers of the local economy. Unemployment remains low, slightly below state and national averages. Fitch expects the local economy will continue to exhibit its historically stable profile, and expand at a moderate pace with further population, job, and income gains.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects general fund revenues to naturally grow at a pace that exceeds inflation, but below U.S GDP due to continued population and economic expansion and despite periodic stagnation in sales taxes historically. The city retains significant ability to raise its property tax rate to generate additional revenue.

Expenditure Framework: 'aa'

Solid expenditure flexibility is derived from management's prudent budgeting practices, ability to adjust its labor costs if needed, and moderately elevated carrying costs. Fitch expects growth related spending demands to be matched by revenue gains, keeping their trajectories generally aligned over time.

Long-Term Liability Burden: 'aa'

The long-term liability burden is moderate at an estimated 13% of 2016 resident personal income. Fitch believes further economic and population growth should keep the burden in line with the 'aa' assessment.

Operating Performance: 'aaa'

The city's ample revenue raising ability, sound expenditure control, and some use of its strong reserve cushion should enable the maintenance of a high level of financial flexibility through a moderate economic downturn.

RATING SENSITIVITIES

Financial Flexibility: The rating is sensitive to material deterioration of the city's

operating flexibility and revenue raising ability in its property tax rate as these credit strengths provide an important counter-balance to the possibility of future sluggishness or decline in sales taxes, the city's largest operating revenue source.

CREDIT PROFILE

The city's tax base is largely residential with minimal taxpayer concentration. TAV trends typically reflect a moderate pace of expansion. TAV grew by roughly 7% in fiscal 2018, with slightly over half of the year's gain due to new development. Fitch believes the generally stable local economy and a steadily growing population base support the likelihood of further, moderate TAV growth. This is underpinned by continued growth in new hotels citywide and a variety of residential and other retail/commercial projects underway or planned on the west/northwest side of the city and near Texas Tech University's large and still growing 37,000 student campus. This trajectory should also be augmented by the priority of new city management to update a long-standing land use plan in order to better shape the city's future economic and downtown development.

Revenue Framework

The general fund relies heavily on sales taxes. The 1% sales tax levy comprised approximately 38% or about \$64.6 million of total operating revenue in fiscal 2017, followed by property taxes (33%) and payments in lieu of taxes from enterprises (19%). Sales tax performance ticked up in fiscal 2017, growing by approximately 3.6% or \$2.4 million after the prior year's flat performance. Management attributes the year's results largely to ongoing development trends.

On average, historical annual revenue growth of 3.1% in the 10-year period of fiscal 2007 - 2017 outpaced U.S. GDP, although this is attributable in part to fairly consistent, modest increases to the city's operating property tax rate and a voted increase in the operating sales tax rate during this time period. Nonetheless, Fitch anticipates further, moderately paced population expansion, tax base gains, and economic activity should yield solid, future revenue gains without rate increases given the ability of city property and sales taxes to capture that growth.

At a total property tax rate of \$0.54 in fiscal 2018, ample taxing margin remains under the \$2.50 per \$100 AV cap for operations and limited tax debt service. Outside of this statutory cap, there are no legal limits to management's ability to implement annual property tax increases. If a proposed tax rate results in an 8% year-over-year levy increase (based on the prior year's values), the rate increase may be subject to election if petitioned by voters.

Public safety is the city's largest operating expenditure, consuming about 65% of fiscal 2017 expenditures and transfers out. Fitch believes the pace of spending growth, absent policy actions, should remain equal to or slightly exceed revenue gains, tempered by a history of moderate, steady investments in personnel and capital not projected to require significant catch-up.

The city has demonstrated its ability to control key expenditure items in times of fiscal stress, utilizing a combination of salary and position reductions/freezes and deferral of annual pay-go capital spending. Expenditure flexibility is aided by the city's lack of contracts with any of its personnel. The city's fixed cost burden is moderately elevated. Carrying costs (debt service, net of self-supporting enterprise debt, actuarially-based pension payments, and pay-go OPEB costs,) that totaled about 23% of fiscal 2017 governmental spending are in large part a function of the city's policy-determined, rapid pace of principal amortization (71% retired in 10 years).

Long-Term Liability Burden

The long-term liability burden is moderate at about 13% of 2016 resident personal income and about 45% is overlapping debt. Continued overlapping debt issuances are likely to be accompanied with steady gains in personal income. This leads Fitch to expect the city's long-term liability burden will remain in line with the 'aa' assessment, inclusive of future debt plans in the city's own multi-year capital improvement plan and pension trends.

The majority of city employees participate in the Texas Municipal Retirement System (TMRS), a statewide, agent multiple-employer defined benefit plan. Under GASB 67 and 68, the city reports a fiscal 2017 net pension liability (NPL) of \$126.1 million, with fiduciary assets covering 81.5% of total pension liabilities based on the plan's 6.75% investment return assumption. The city also has a single-employer pension plan for its firefighters (Lubbock Fire Pension Fund or LFPF). Under GASB 68, the city reports the LFPF net pension liability (NPL) at about \$92 million, with fiduciary assets covering about 66% of total pension liabilities at the plan's 7.75% return assumption.

Adjusting for Fitch's lower standard 6% investment return assumption, the aggregate NPL for the city's plan totals about \$342.5 million, with fiduciary assets covering about 68% of total estimated pension liabilities. The adjusted NPL represents 3.6% of 2016 personal income.

OPEB offered by the city include an implicit rate subsidy for health and dental insurance coverage for retirees and their dependents. The city funds OPEB annually

on a pay-go basis (\$5 million in fiscal 2017), which covered a higher portion or about 53% of the actuarially determined annual OPEB cost due to recent plan and actuarially valuation changes.

Operating Performance

Fitch believes the city maintains an exceptionally strong capacity to manage challenges associated with a moderate economic downturn. The city's high level of fundamental financial flexibility is a result of the various budgetary tools at its disposal, which include revenue raising authority, the ability to use its historically strong reserve cushion in excess of Fitch's calculated reserve safety margin, and solid expenditure flexibility. The city's superior financial resilience is also underpinned by historically low general fund revenue volatility, inclusive of sales tax performance.

Surplus operations after transfers boosted fiscal 2017 year-end reserves modestly; unrestricted general fund balance rose slightly to \$37.5 million or nearly 23% of spending from \$35.6 million or 20% of fiscal 2016 spending. Fitch anticipates city management will continue to adhere to its adopted policy which requires reserve levels at no less than 20% of operating revenues (excluding annual transfers from city-owned enterprises) while allowing excess reserves to fund pay-go capital spending, similar to its historical performance. Management reports year-to-date revenue and expenditure performance remain generally aligned with the structurally balanced fiscal 2018 general operating budget. Sales taxes trends through December 2017 collections are running about 3% over prior year's actuals while thinly exceeding budget.

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Date of Relevant Rating Committee: March 20, 2018

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)

(<https://www.fitchratings.com/site/re/898466>)

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