S&P Global
Ratings

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Summary:

Lubbock, Texas; General Obligation

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Credit Profile		
US$50.795 mil GO rfdg bnds ser 2019A dtd 10/15/2019 due 02/15/2034		
Long Term Rating	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Lubbock, Texas' taxable series 2019A general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term ratings on the city's previously issued GO bonds and certificates of obligation. The outlook is stable.

The 'AA+' rating reflects Lubbock's strong financial position that is supported by strong and well-embedded financial management practices as well as a growing and diversified economic base. Lubbock's position as a regional economic center in west Texas and a local economy that is anchored by health care and higher education, including Texas Tech University, are expected to contribute to long-term stability. Ongoing growth has heightened the need for significant levels of debt to support necessary facility and infrastructure improvements. However, we understand that the city's preference for funding routine capital has shifted toward a more cash-funded approach, which could temper the need for continued elevated levels of debt to support the ongoing capital improvement program. Although this could result in gradual improvement in Lubbock's debt and liability profile, we anticipate that near-term fixed costs, including debt and pension, will remain elevated, which is a credit weakness compared with higher-rated peers.

Lubbock'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 55.8 cents, 13.18 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 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 surplus net revenues of the city's waterworks system--not to exceed $1,000. Given the limited revenue pledge, we rate the certificates based on the city's ad valorem pledge.

The city will use proceeds of the series 2019A bonds to refund certain of its obligations outstanding for the purpose of debt service savings.

The rating reflects our opinion of Lubbock's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with balanced operating results in the general fund and an operating surplus at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 23% of operating expenditures;
- Very strong liquidity, with total government available cash at 101.8% of total governmental fund expenditures and 5.3x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability profile, with debt service carrying charges at 19.2% of expenditures and net direct debt that is 172.2% of total governmental fund revenue, but rapid amortization, with 79.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Strong economy

We consider Lubbock's economy strong. The city, with an estimated population of 256,417, is located in Lubbock County in the Lubbock, TX MSA, which we consider to be broad and diverse. It also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 83.9% of the national level and per capita market value of $72,756. Overall, the city's market value grew by 4.6% over the past year to $18.7 billion in 2020. The county unemployment rate was 3.1% in 2018.

The city is located in west Texas, and the nearest major cities are Amarillo (about 119 miles north) and Midland (about 118 miles south). Lubbock is the county seat and serves as the regional economic, education, and health care center for a 26-county region that is home to more than a half-million people. The local economy is diverse, although it remains anchored by the agriculture, education, and health care sectors. Lubbock is home to three universities and one community college, the largest of which is Texas Tech University, which we believe provides a stabilizing presence for the local economy. Total student enrollment at Texas Tech was approximately 38,800 as of fall 2019. In addition, Texas Tech is the Lubbock's largest employer with about 9,000 employees, including the Health Sciences Center.

The city's tax base continues to grow robustly, spurred by residential and commercial development. Taxable AV increased by an average of 5.2% per year since fiscal 2013. In aggregate, the tax base expanded by $5.8 billion or 44% between tax years 2012 and 2019. The tax base is very diverse, with the top 10 taxpayers comprising 3.1% of AV. In addition, strong retail development trends, including steady building permit activity, provide additional support to the city's second-largest revenue source, sales taxes. Sales tax collections have averaged 3% growth in the past five years. Given the outlook for continued residential and commercial development, we expect our view of the city's economy will remain strong over the next two years.

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 prepares the annual budget using conservative revenue and expenditure assumptions based on both trend analysis and economic modeling and input from external expert consultants. Regular monitoring and reporting of the city's budgetary performance and investment portfolio are provided to the city council and the city's ad hoc audit committee. Lubbock maintains reserve policies that establish high performance standards, including maintaining at least 20% of operating revenues in the unreserved general fund balance. It prepares long-term financial forecasts for its operating fund as well as its enterprise funds. The comprehensive long-term capital planning identifies funding sources for projects and equipment outlays. The debt policy is included in the annual budget document; the policy includes guidance on the appropriate funding source for different project types as well as targets for the average life and maximum maturity of debt, but does not address key issues such as maximum debt levels or minimum savings for refundings. While the policy does not address the appropriate balance of variable- and fixed-rate debt, the city has not historically issued variable-rate debt.

Strong budgetary performance

Lubbock's budgetary performance is strong in our opinion. The city had balanced operating results in the general fund of 0.2% of expenditures, and surplus results across all governmental funds of 4.1% in fiscal 2018. General fund operating results of the city have been stable over the last three years, with a result of negative 0.6% in 2017 and a result of 1.5% in 2016.

Historically, Lubbock has maintained strong budgetary performance resulting from a combination of conservative budgeting and strong revenue growth. The budget is monitored regularly throughout the year, and final results are often better than budgeted. Management indicated that it plans to maintain elevated levels of cash-funded capital as part of the annual operating budget, resulting in budgeted uses of fund balance in excess of the formal reserve policy. Given the city's strong historical performance, stable revenue growth, and consistent budget monitoring, we expect our opinion of Lubbock's budgetary performance will remain strong to adequate over the next two years.

Despite budgeting to use fund balance in fiscal 2018, the city ended the year with relatively balanced results in the general fund. Our assessment accounts for the fact that we adjusted the city's revenues and expenditures to treat recurring transfers as either revenues or expenditures, and subtracted significant one-time expenditures particularly related to Lubbock's refinancing of its prior master lease program in 2018. The city reported a net increase in the total general fund balance of approximately $13 million in fiscal 2018, due to a combination of positive operating performance and a one-time transfer of cash corresponding with the consolidation of the solid waste system into the general fund. The primary sources of general fund revenues are sales taxes (31%), property taxes (28%), and interfund transfers from the utility funds (20%). Property taxes, which are largely determined by changes in AV and tax rates, were $60.2 million in fiscal 2018, representing an increase of 19% since fiscal 2015. Sales tax revenues, indicative of increasing commercial or retail activity, rose 8% since fiscal 2015 to $67.4 million.

The budget for fiscal 2019 projects a $6.2 million use of fund balance for capital. Based on historical performance and year-to-date actuals, we understand that departmental expenditure savings and excess revenues, particularly for sales taxes, will offset a majority of that planned drawdown. To that extent, the city expects to outperform its original budget estimates, resulting in a use of fund balance of approximately $1 million. The fiscal 2020 budget does not mark a material shift from prior years' budgets, and reinforces the city's commitment to self-funded capital. The 2020 general fund budget includes a $3.5 million reserve appropriation, and budgeted expenditures include about $12 million in pay-as-you-go capital financing and $2.5 million in fleet replacement.

Very strong budgetary flexibility

Lubbock's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 23% of operating expenditures, or $48.0 million.

In fiscal 2018, Lubbock consolidated its solid waste system into the general fund, ultimately contributing to a $13 million increase in the total general fund. In recent years, the city's funding philosophy for annual capital has shifted toward a more cash-funded approach, often resulting in budgeted uses of fund balance. For fiscal 2019, the budget calls for the use of approximately $6.2 million of available reserves to support higher capital spending. However, given current trends in revenues and expenditures and past historical performance, the city expects to use just $1 million of the original appropriation. The use of excess reserves to cash fund capital projects is built into the city's budget due to current reserve levels being higher than what management aims to maintain. Lubbock has historically maintained reserves in excess of 15% of its operating expenditures, and therefore, we project its budgetary flexibility will remain very strong over the next two years despite a planned reduction.

The property tax rate for fiscal 2020 is $0.54802 per $100 of AV. The current tax rate distribution is $0.40309 for the general fund, $0.13178 for debt service, and $0.02315 for economic development.

Very strong liquidity

In our opinion, Lubbock's liquidity is very strong, with total government available cash at 101.8% of total governmental fund expenditures and 5.3x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

The city has historically maintained what we consider very strong cash balances and, given management's demonstrated ability to maintain balanced operations, we do not believe its liquidity position will worsen. In fiscal 2018, unrestricted cash and investments comprised 63% of general fund assets and 42.5% of total governmental fund assets. All investments comply with Texas statutes and the city's internal investment policy. At year-end fiscal 2018, the majority of investments were in state investment pools, none of which we consider aggressive. The city's exceptional access to external liquidity is demonstrated through its access to the market over the past 15 years. Lubbock frequently issues GO- and revenue-backed bonds, and has also has engaged in tax increment financing. The city has six privately placed debt issues outstanding (8% of total direct debt). However, the debt does not contain any provisions, such as acceleration, that we view as a potential liquidity risk.

Weak debt and contingent liability profile

In our view, Lubbock's debt and contingent liability profile is weak. Total governmental fund debt service is 19.2% of total governmental fund expenditures, and net direct debt is 172.2% of total governmental fund revenue. Approximately 79.9% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city does not have any swaps or variable rate debt. Total direct debt includes $896.6 million of tax-backed debt, $9.3 million of capital leases, and $281.5 million of utility-revenue secured debt. In our calculations, we adjusted for the portion of utility-revenue secured debt and tax-backed debt supported by utility funds. Debt amortization is rapid, with 80% of principal scheduled to retire within the next 10 years. Over the near term, Lubbock plans to issue approximately $13.5 million in new debt to fund two street projects, vehicle purchases, and software upgrades. We do not expect our opinion of the city's debt profile to weaken in the near term unless the amount of debt amortized over the next 10 years falls below 65%.

Lubbock's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 11.3% of total governmental fund expenditures in 2018. Of that amount, 9.3% represented required contributions to pension obligations, and 2.0% represented OPEB payments. The city made its full annual required pension contribution in 2018.

Lubbock participates in the Texas Municipal Retirement System, an agent multiple-employer public employee retirement system. It is required to contribute at an actuarially determined rate, and has historically contributed 100% of the annual required cost. The city's net pension liability measured $86.4 million as of Dec. 31, 2017, representing a decrease of $39.6 million from the Dec. 31, 2016 measurement date. The plan maintained a funded level of 87.76%, using the plan's fiduciary net position as a percentage of the total pension liability.

The city also administers the Lubbock Fire Pension Fund, which is a single-employer defined benefit pension plan. Contribution rates are set as a percentage of pay by each firefighter and as a percentage of payroll by the city. Lubbock fully funded the actuarially determined contribution in each of the last four years. Its net pension liability measured $84.3 million as of Dec. 31, 2017, a decrease of $7.7 million from the Dec. 31, 2016 measurement date. The plan maintained a funded level of 69.79%, using the plan's fiduciary net position as a percentage of the total pension liability. In an effort to improve the overall health of the fire plan, all members opted to increase their contributions to the plan in lieu of a scheduled raise in 2019. While we acknowledge the positive impact of the additional employee contributions, the plan's optimistic discount rate (7.75%) and higher-than-average amortization could result in increased contributions in the future.

Lubbock also offers continuing health and dental care benefits to retirees through a single-employer defined benefit OPEB plan. As of the most recent actuarial valuation (Dec. 31, 2017), the city's total OPEB liability was $140.9 million using Governmental Accounting Standards Board No. 75 and assuming a 3.31% discount rate. These benefits are funded on a pay-as-you-go basis and in fiscal 2018, benefit payments for OPEB were $5.3 million or 2% of total governmental funds expenditures.

While we note that annual combined pension and OPEB costs are high relative to total governmental expenditures, approximately one-third of the city's annual contribution to TMRS is attributable to covered employees in the city's enterprise funds, which is offset by recurring transfers into the general fund. As a result, we believe the 9.3% pension costs-to-total governmental expenditures ratio is somewhat skewed. At this time, we believe pension costs are manageable given budgetary flexibility, active plan management, and the current funding status, which has remained stable to improving over the past three years. If pension costs grow such that we believe the budget may be affected, or weak investment returns weaken the pension funding ratios, we could view pension and OPEB obligations as a credit negative, and our view of the city's debt and liability profile could weaken.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our expectation that the city will maintain very strong budgetary flexibility and liquidity supported by very strong management practices. In addition, the outlook reflects our opinion that Lubbock will continue to remain what we consider to be a broad and diverse MSA, and that it will continue to experience steady growth. We do not expect to change the rating over the two-year outlook horizon.

Upside scenario

A higher rating would likely follow a significant improvement in the city's debt and liability profile and an expansion of the economic base, all else being equal, that enables Lubbock's wealth and income levels to be comparable with those of higher-rated peers.

Downside scenario

We would likely lower the rating if available reserves fall below the city's formal adopted policy, triggered by a weakening in the city's budgetary performance.

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

Ratings Detail (As Of October 1, 2019)		
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of October 1, 2019) (cont.)		
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock GO		
Long Term Rating	AA+/Stable	Affirmed
Lubbock		
Long Term Rating	AA+/Stable	Affirmed

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.