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## Fitch Rates Lubbock, TX's Taxable Series 2019A GO Rfdg Bonds 'AA+'; Outlook Stable

Fitch Ratings-Austin-01 October 2019: Fitch Ratings has assigned a 'AA+' rating to the following Lubbock, TX obligations:

--\$50.795 million general obligation (GO) refunding bonds, taxable series 2019A.

The taxable series 2019A GO refunding bonds are expected to price via negotiation Oct. 10. Proceeds will refund certain outstanding debt obligations for savings and pay issuance costs.

In addition, Fitch has affirmed the city's Issuer Default Rating (IDR) at 'AA+' and the rating on the approximately \$919 million in outstanding GOs and certificates of obligation (COs) (post-refunding) at 'AA+'.

The Rating Outlook is Stable.

### SECURITY

The taxable series 2019A GO refunding bonds and the outstanding COs and GO 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, CO and GO bond 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 high 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 expectation for consistent levels of self-support from various enterprise funds going forward.

### Economic Resource Base

The city of Lubbock is located in northwest Texas and 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 256,000, reflective of a somewhat stronger pace of expansion in recent years that is closer to statewide trends. Local educational attainment levels are comparable to national levels 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 (primarily oilfield services) are also important drivers of the local economy. Unemployment remains 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. Lubbock's independent legal ability to raise property tax revenues, fees, charges for services and other locally controlled revenues provide ample flexibility.

### 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 2017 resident personal income. Fitch believes further economic and population growth, in conjunction with the city's future borrowing plans and the rapid amortization of its existing debt, should keep the burden in line with the 'aa' assessment.

### Operating Performance: 'aaa'

High revenue-raising ability, solid expenditure control, and a strong reserve cushion relative to expected revenue volatility should enable the city to maintain the highest 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, including its high revenue-raising ability, which is now subject to a more constrained property tax revenue environment. 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 reflect a moderate

pace of expansion, and this continued in fiscal 2020 with a solid 6% gain to nearly \$18.7 billion. 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 a variety of residential and other retail/commercial projects occurring on the west/northwest side of the city and near Texas Tech University's large and still growing 39,000 student campus. Recently announced development plans highlight further investment in the city's health care/medical sector with a tower expansion by Covenant Hospital, estimated at \$125 million in valuation at build-out, in addition to a full-service Veterans Affairs Hospital. This trajectory should also be augmented by a recently refreshed land use plan that management anticipates will better shape the city's future economic and downtown development.

#### Revenue Framework

The general fund relies heavily on sales taxes, and this key revenue stream continues to trend upward, rising approximately 4.5% or nearly \$3 million in fiscal 2018. The 1% sales tax levy comprised approximately 31% or about \$67 million of total operating revenue in fiscal 2018, followed by property taxes (28%) and payments in lieu of taxes from city-owned enterprises (20%). Significantly stronger than usual fiscal 2018 general fund revenue growth was largely the result of the city's policy decision to incorporate the solid waste fund into the general fund.

On average, annual general fund revenue growth of 5% in the ten-year period of fiscal 2008-2018 outpaced U.S. GDP. Fitch notes historical revenue performance 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, as well as the aforementioned decision to incorporate the solid waste fund into the general fund. Nonetheless, Fitch anticipates further, moderately-paced population expansion, tax base gains, and economic activity should continue to yield solid natural revenue gains given the ability of city property and sales taxes to capture that growth.

At a total property tax rate of approximately \$0.55 in fiscal 2019, ample taxing margin remains under the \$2.50 per \$100 TAV cap for operations and limited tax debt service. However, the recently enacted Texas Senate Bill 2 (SB 2) makes a number of changes to local governments' property tax rate setting process. Most notably, SB 2 will reduce the rollback tax rate (now the 'voter approval tax rate') from 8% to 3.5% for most local taxing units and require a ratification election (replacing the current petition process) if any local taxing unit exceeds its voter approval rate, effective fiscal 2021.

The tax rate limitation in SB2 excludes new additions to tax rolls and allows for banking of unused margin for up to three years. Lubbock's remaining control over property taxes as well as other local revenues such as fines, fees, and charges for services is still sufficient to generate high revenue-raising flexibility relative to Fitch's assessment of expected modest revenue volatility in a typical downturn.

Public safety is the city's largest operating expenditure, consuming about 55% of fiscal 2018 expenditures and transfers out. Fitch believes the pace of spending growth, absent policy actions, should remain equal to or

slightly exceed revenue gains, based on 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 labor 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 22% of fiscal 2018 governmental spending are in large part a function of the city's policy-determined, rapid pace of principal amortization.

#### Long-Term Liability Burden

The long-term liability burden is moderate at about 13% of 2017 resident personal income with roughly half of the total liability burden related to overlapping debt of other local governments. Continued overlapping debt issuances are likely to be accompanied by 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 as reported in the city's multi-year capital improvement plan and pension trends. A GO bond election is under preliminary consideration according to city management.

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 2018 net pension liability (NPL) of \$86.5 million, with fiduciary assets covering nearly 88% of total pension liabilities based on the plan's 6.75% investment return assumption. In addition, the city has a single-employer pension plan for its firefighters (Lubbock Fire Pension Fund or LFPF). Under GASB 68, the city reports the LFPF NPL at about \$84 million, with fiduciary assets covering about 70% of total pension liabilities at the plan's 7.75% return assumption. Adjusting for Fitch's standard 6% investment return assumption, the aggregate NPL for both plans exceeds \$302 million with fiduciary assets covering about 73% of total estimated pension liabilities. 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 (\$5.3 million or 2% of governmental spending in fiscal 2018).

#### Operating Performance

Fitch believes the city maintains the highest 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, a historically strong reserve cushion, 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. The Fitch Analytical Sensitivity Tool (FAST) produces a single-year 1% revenue decline in the standard -1% U.S. GDP scenario.

General fund operations have notably incorporated annual pay-go spending for capital projects that averaged about \$5 million per year over the last four fiscal years (fiscal years 2015-2018) while maintaining stable-to-

growing reserves. Surplus operations after transfers boosted fiscal YE 2018 year-end reserves modestly; unrestricted general fund balance increased to nearly \$48 million or about 24% of 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 expects to further utilize cash funding and some shorter-length debt (such as tax notes at year-end) to fund fleet replacement and street maintenance capital needs in recent efforts to slim the city's long-term debt load and capital leasing program. Year-to-date fiscal 2019 revenue and expenditure performance has generally improved upon the structurally balanced general operating budget according to city management. Sales tax collections year to date reportedly exceed budget by about 4% , which is expected to help reduce the planned use of general fund reserves for pay-go capital spending to no more than \$2 million at fiscal 2019 year-end.

The roughly \$230 million adopted fiscal 2020 general operating budget includes approximately 26 new positions and a 2.5% cost of living salary increase, which are estimated to total nearly \$5 million. Further growth in both property and sales taxes (inclusive of a 1 cent increase to the city's total property tax rate) is projected to largely fund these and other spending priorities. City management indicates a modest, nearly \$4 million use of reserves (about 2% of spending) will fund various pay-as-you-go capital projects.

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### **Applicable Criteria**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 03 Apr 2018\)](#)

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