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Ratings

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Summary:

Round Rock, Texas; General Obligation

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Credit Profile		
US$7.0 mil comb tax and rev certs of oblig ser 2018 dtd 12/04/2018 due 08/15/2038		
Long Term Rating	AAA/Stable	New
Round Rock GO		
Long Term Rating	AAA/Stable	Upgraded
Round Rock GO		
Long Term Rating	AAA/Stable	Upgraded
Round Rock GO		
Unenhanced Rating	AAA(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

Rationale

S&P Global Ratings raised its long-term and underlying (SPUR) ratings on Round Rock, Texas' general obligation (GO) bonds and certificates of participation to 'AAA' from 'AA+'. The total par amount outstanding is $188.3 million. At the same time, S&P Global Ratings assigned its 'AAA' long-term rating to the city's series 2018 combination tax and revenue certificates of obligation. The outlook is stable.

The upgrade reflects Round Rock's very strong economy and maintenance of a strong financial position and high reserves, which have historically been used to mitigate the city's exposure to its largest corporate presence, Dell Inc. The city's largest source of general fund revenues is sales taxes (44%) and Dell, whose corporate headquarters are located in Round Rock, is a major component of the sales tax base. While sales taxes remain an integral source of revenue, we note that Round Rock's revenue base has diversified since 2008 when sales taxes generated 61% of the city's general fund revenues. Still, in recognizing the potential volatility associated with its largest revenue stream, Round Rock revised its fund balance policy, which now requires the city to maintain separate reserve accounts to offset the net revenue exposure to any sales tax payer that accounts for more than 5% of general fund revenues. Furthermore, Round Rock instituted a revenue policy that caps net sales tax revenues from Dell at no more than 20% of sales taxes designated for operations. In total, sales tax revenues generated by Dell are projected at 9% of general fund operating revenues for fiscal 2019, down from as much as 22% in 2005. In our opinion, strong management practices and a commitment to maintaining very strong reserve levels should support the maintenance of stable operating performance over the near-to-medium term. The debt profile, while somewhat elevated compared with peer medians, should remain stable due to the city's limited debt needs and funding strategy that seeks to use pay-as-you-go funding, potential roadway impact fees, and grants to finance the majority of the city's major outstanding capital needs.

Round Rock'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 42 cents, 12.19 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 are further secured by a pledge of surplus revenues of the city's waterworks, sewer and drainage system--not to exceed $1,000. Given the limited revenue pledge, we rate the certificates based on Round Rock's ad valorem tax pledge. Proceeds from the series 2018 certificates will fund the construction of a new public works facility for the city's utilities and transportation departments.

Round Rock's GO debt is eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, we consider U.S. local governments to have moderate sensitivity to national risk. The city's GO pledge is the primary source of debt security, which severely limits the possibility of negative sovereign intervention in the payment of the debt or in the city's operations. The nation's institutional framework for local governments is predictable, allowing the city significant autonomy and independent treasury management. In addition, there is no history of government intervention.

The ratings reflect our opinion of Round Rock'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;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 51% of operating expenditures;
- Very strong liquidity, with total government available cash at 137.2% of total governmental fund expenditures and 9.4x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability profile, with debt service carrying charges at 14.6% of expenditures and net direct debt that is 147.2% of total governmental fund revenue; and
- Strong institutional framework score.

Very strong economy

We consider Round Rock's economy very strong. The city, with an estimated population of 118,729, is located in Travis and Williamson counties in the Austin-Round Rock MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 119% of the national level and per capita market value of $113,281. Overall, the city's market value grew by 6.7% over the past year to $13.4 billion in 2019. The weight-averaged unemployment rate of the counties was 3.2% in 2017.

Round Rock is approximately 15 miles north of Austin along Interstate 35 (I-35). The city is almost wholly located within Williamson County, although a small portion falls within Travis County to the south. Round Rock is among the principal localities that make up the Austin-Round Rock MSA, and the city's location along I-35 provides residents with convenient access to additional employment opportunities beyond the city's boundaries. However, the city is home to several large companies, anchored by the international corporate headquarters for Dell, Inc. While Dell has historically been an anchor for the local economy, in recent years, the city's economy has diversified through extensive expansion of its medical facilities and higher education campuses.

Medical facilities include St. David's Round Rock Medical Center, Baylor Scott & White Healthcare, Seton Medical Center Williamson, and Cornerstone Healthcare. Baylor Scott & White Healthcare opened a new cancer care facility in September 2017. In addition, Texas State University recently completed a $70 million expansion of its health professional buildings in Round Rock. Other higher education campuses include Round Rock Higher Education Center, a Texas A&M University System Health Science Center clinical campus, and an Austin Community College campus, which completed a $33 million expansion project in September 2018.

Primary employers in Round Rock include Dell (12,000 employees), Round Rock Independent School District (5,800), as well as the city (956). As a result of the city's ongoing economic development efforts, several new companies have relocated there over the past 10 years. In addition, Kalahari Resorts and Convention Center recently broke ground on a theme park and convention center project that is expected to be completed in late 2020. The project will feature a 975-room resort, a convention center, multiple restaurants, and a water park. The 352-acre development is expected to be a tourist draw and generate additional revenues for the city. Mixed-use developments and commercial office space are being constructed in the near future, supporting continued growth and development in the downtown core.

Round Rock has continued to experience strong taxable AV growth, averaging 9% per year over the past five years. In aggregate, the city's tax base has increased $4.8 billion or 55% since tax-year 2013. Based on current trends, the city expects its taxable AV to reach $15.3 billion by fiscal 2021. Given the ongoing economic development, we expect these trends to continue, supporting our expectation that the economy will remain very 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.

Strengths of our assessment of Round Rock's financial policies and practices include historical trend analysis and regular budget-to-actual updates provided to the city council. Management uses conservative revenue and expenditure assumptions based not only on trend analysis, but also on economic modeling from internal and external input from external expert consultants. The city monitors and reports its budgetary performance, including year-to-date actuals against budgeted, and investment portfolio on a quarterly basis to the city council.

Management also has a formally adopted debt policy that identifies types of debt issuances that can be used and minimum savings targets for when it is looking to refund. In addition, the city maintains a five-year rolling capital plan that identifies funding sources for projects and equipment outlays. A five-year financial model forecasts revenues based on projected annual changes in property valuations, sales tax, program revenues, transfers, and all other major revenue sources. Projected expenditures reflect anticipated staff additions as well as increases in healthcare costs, public safety, and salary adjustments. All of the assumptions can be changed directly in the model, which allows the model to immediately calculate the impact of the changes and enables the city to take corrective action, if needed.

In fiscal 2018, the city updated its general fund reserve policy to 90 days of annual budgeted general fund expenditures from 120 days. In addition, the policy creates a separate concentration risk account that is used to cover the city's net revenue exposure to its largest sales tax payers. Round Rock holds its reserves for cash flow purposes and to hedge against the city's exposure to Dell and general sales tax volatility.

Strong budgetary performance

Round Rock's budgetary performance is strong, in our opinion. The city had operating surpluses of 4.3% of expenditures in the general fund and of 2.5% across all governmental funds in fiscal 2017.

We adjusted revenues and expenditures to account for recurring revenue transferred into the general fund from the water and sewer fund, and bond proceeds expended on capital projects across all governmental funds. We also adjusted general fund expenditures to account for recurring operating transfers from the general fund to the self-financed construction fund. Beyond annual operating transfers to the self-financed construction fund, Round Rock has historically used operating surpluses and excess reserves to fund additional discretionary transfers to fund large one-time capital expenditures that would otherwise be funded with debt. We have adjusted our ratios to reflect the discretionary nature of the additional transfers, given the city's ability to decrease future transfers should there be any budgetary stress.

Round Rock has historically budgeted conservatively, as evidenced by positive revenue and expenditure variances, resulting in better-than-budgeted actual results. The fiscal 2018 adopted budget projected a general fund deficit of $6 million, or 5.4% of expenditures. However, based on year-end estimates, the city is projected to end fiscal 2018 with a net surplus of approximately $6 million in the general fund. Factors that contributed to the surplus results include revenues coming in $3.8 million higher than budgeted and expenditures that are projected to finish $2.3 million below budget.

The city's primary sources of general fund revenues are sales taxes (44%) and property taxes (33%). Sales tax revenues, which have historically been tied to the activities of the city's leading employer, Dell Inc., have continued to strengthen and diversify. Since 2005, Dell's contribution to the city's operating sales tax revenues has decreased to 20% from 38%, and Dell's sales tax revenues as a percentage of total revenues is now 9%, down from 22% in 2005. However, Dell remains a major contributor to the city's sales tax base with the company's recent resurgence contributing to a 15.2% year-over-year increase in collections. The property tax levy, which is largely determined by changes in AV and tax rates, was $54 million in fiscal 2018, representing an increase of 36% since fiscal 2015. The property tax rate for fiscal 2018 was 43 cents per $100 of AV, which is well below the maximum tax rate of $2.50, highlighting the city's significant revenue-raising flexibility.

The adopted budget for fiscal 2019 conservatively projects a $12.5 million net use of fund balance. However, we note that $6.5 million of that amount represents a transfer of excess revenues to fund one-time capital projects, including partial cash funding for the city's new library. Despite a minor decrease in the property tax rate to 42 cents per $100 of

AV, we expect strong tax base growth and healthy sales tax collections will allow the city to generate sufficient revenues to continue funding its growing budget. Given strong revenue growth and conservative budgeting practices, we expect Round Rock to continue posting better-than-budgeted results, supporting our view that the city's budgetary performance is strong.

Very strong budgetary flexibility

Round Rock's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 51% of operating expenditures, or $50.1 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.

Round Rock has historically maintained available reserves as a percent of expenditures above 40%, and in line with the city's formal fund balance policy. However, we note that the city changed its general fund reserve policy in fiscal 2018 to 90 days of annual budgeted expenditures from 120 days. In addition, the city will establish a separate concentration risk account to maintain balances sufficient to offset the net exposure to the city's largest sales tax payers. The concentration risk account is established for any sales tax payer that accounts for more than 5% of general fund revenues. The combined total of the general fund reserve and concentration risk account for fiscal 2019 is $38.7 million, or 122 days of budgeted expenditures. Although we anticipate that the city will continue to use excess fund balances to cash fund large one-time capital expenditures, the city has no plans to draw reserves below the established policy thresholds. As a result, we expect budgetary flexibility to remain very strong.

Very strong liquidity

In our opinion, Round Rock's liquidity is very strong, with total government available cash at 137.2% of total governmental fund expenditures and 9.4x governmental debt service in 2017. In our view, the city has exceptional access to external liquidity if necessary.

We believe the city has exceptional access to external liquidity, having issued bonds frequently during at least the past 15 years; issuances have consisted of GO bonds, sales tax bonds, hotel occupancy revenues bonds, and waterworks and sewer system-supported debt. Round Rock has historically had what we consider very strong cash balances and, given management's demonstrated ability to maintain balanced operations, we do not believe its cash position will materially weaken over the next two years. All of the city's investments comply with Texas statutes and the city's internal investment policy. At fiscal year-end 2017, the city's investments were diversified in U.S. government securities, certificates of deposit, and state investment pools, which we do not consider aggressive. The city does not have any direct-purchase agreements or privately placed debt that could pressure its liquidity.

Weak debt and contingent liability profile

In our view, Round Rock's debt and contingent liability profile is weak. Total governmental fund debt service is 14.6% of total governmental fund expenditures, and net direct debt is 147.2% of total governmental fund revenue.

Round Rock does not have any swaps or variable-rate debt. The city's total direct debt includes debt secured by sales tax and hotel taxes, which, consistent with our debt statement analysis criteria, we do not consider to be self-supporting. Amortization is average, with about 52.3% of the city's total direct debt to be retired over the next decade.

We understand the city may issue approximately $21.7 million in additional GO bonds and a $3 million capital lease within the next two years for various capital improvements. In addition, we note that the Round Rock Transportation and Economic Development Corporation, which is a blended component unit of the city, expects to issue about $55 million in type B sales tax revenue bonds over the next two years to fund the construction of a convention center and additional improvements for the Kalahari Resort and Convention Center project. Although debt service on the bonds will be secured and funded through project revenues, the expenditures and par amounts would be reflected in Round Rock's future debt metrics, potentially weakening our view of the city's debt profile.

Round Rock's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 6.4% of total governmental fund expenditures in 2017. The city made 102% of its annual required pension contribution in 2017.

The city provides retiree benefits through the Texas Municipal Retirement System, a defined-benefit pension plan. Contributions are determined at an actuarially determined rate. Round Rock has historically made the full annual required pension contribution. The city reported a net pension liability of $44.9 million as of Dec. 31, 2016, the most recent actuarial valuation date, and the plan reported a funded ratio of 81%.

The city also participates in the cost-sharing, multiple-employer, defined-benefit group-term life insurance plan offered to both current and retired employees, which is operated by TMRS, known as the supplemental death benefits fund. The city may terminate coverage and discontinue participation by adopting an ordinance before Nov. 1 of any year to be effective the following Jan. 1. The city has historically contributed 100% of the contractually required rate as determined by an annual actuarial valuation.

In addition, Round Rock provides a single-employer plan for certain OPEB to its retirees. OPEBs include access to medical and dental insurance for the retiree and the retiree's family. OPEB benefits are funded on a pay-as-you-go basis and the city recorded an unfunded liability of $12.2 million as of Sept. 30, 2017.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our expectation that Round Rock will maintain its very strong budgetary flexibility and liquidity supported by continued strong budgetary performance. We expect the local economy to remain very strong, supported by the stable corporate presence of Dell, and the city's participation in the Austin-Round Rock MSA. We expect Round Rock's strong management practices to allow the city to continue to monitor and manage its exposure to sales tax volatility, while maintaining a debt profile that is commensurate with overall economic growth. However, should significant volatility in sales taxes or an increased debt burden place undue stress on the city's operating budget resulting in material declines in reserves, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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