FitchRatings

State of Texas

Public Finance
Tax-Supported
U.S.A.

New Issue Summary

Sale Date: Sept. 15, 2021, via negotiation	
Series: $41,590,000 General Obligation Water Financial Assistance Bonds, Series 2021A; $164,005,000 General Obligation Water Financial Assistance Refunding Bonds, Series 2021B; and $16,430,000 General Obligation Water Financial Assistance Refunding Bonds, Series 2021C	
Purpose: The bond proceeds will be used to finance water conservation and infrastructure projects in the State of Texas (the state) and to refund outstanding bonds for debt service savings.	
Security: General obligations to which the state pledges its full faith and credit.	

The State of Texas' 'AAA' Issuer Default Rating (IDR) reflects its growth-oriented economy and the ample fiscal flexibility provided both by its conservative approach to financial operations and the maintenance of substantial reserves, including in its budgetary reserve, the economic stabilization fund (ESF).

Economic Resource Base: Texas has been a population magnet and economic growth leader for decades, with a large and diverse economic base. Oil and gas remain significant industries, and their volatility can affect the state's economy and revenues. Growth in employment, personal income and GDP has exceeded that of the nation in recent years, supported by broad economic momentum in trade, technology and other services, together with energy-related activity. While its demographic profile is about middle of the pack for the states, these growth trends place the state among the nation's leaders.

Key Rating Drivers

Revenue Framework: 'aaa': Texas experienced strong revenue growth in line with or above the level of U.S. economic growth following the Great Recession, driven by rapid population and economic gains that Fitch Ratings anticipates will continue over the long term. Like most states, Texas retains nearly unlimited legal ability to raise operating revenues. Sales tax is the dominant revenue source, although franchise, transportation, energy and other levies are also important.

Expenditure Framework: 'aa': Texas retains ample flexibility to cut spending throughout the economic cycle, an attribute the state relies upon to maintain fiscal balance. Spending pressures from education, Medicaid, transportation, water and other growth-related needs are notable, and litigation has periodically been a source of uncertainty. Carrying costs are expected to increase given rising retirement obligations but should remain low.

Long-Term Liability Burden: 'aaa': The combined burden of Texas' debt and net pension liabilities is low relative to its resource base but above the U.S. states median. Fitch anticipates liabilities will increase over time, particularly for pensions, given higher than average funding discount rates. However, legislative changes that now require appropriations on an actuarial basis and increasing employer contribution rates could improve funding over time assuming plan assumptions are met.

Operating Performance: 'aaa': Financial resilience is strong, with superior gap-closing capacity stemming from a willingness to cut even high priority spending and a budgetary reserve that is still solid despite allocations that divert a portion of constitutionally dedicated oil and gas tax revenues. The state has a high level of fundamental financial flexibility despite a historical disinclination to raising operating revenues. To a limited degree, there is some deferral of required spending, including for pension contributions, education and Medicaid.

Ratings

Long-Term Issuer Default Rating	AAA

New Issues

$41,590,000 General Obligation Water Financial Assistance Bonds, Series 2021A	AAA
$164,005,000 General Obligation Water Financial Assistance Refunding Bonds, Series 2021B	AAA
$16,430,000 General Obligation Water Financial Assistance Refunding Bonds (Economically Distressed Areas Program), Series 2021C	AAA

Outstanding Debt

State of Texas General Obligation Bonds	AAA
Constitutional Appropriation Bonds	AAA
State of Texas GO CP Notes	AAA
State of Texas Lease Revenue Bonds	AA+
CP Notes[a]	F1+

[a]Issued by various Texas state agencies.

Rating Outlook

Stable

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2021)

Related Research

Fitch Rates Texas' $222 MM GO Bonds 'AAA'; Outlook Stable (August 2021)

U.S. States Labor Markets Tracker (State Employment Recovery Strengthens in June 2021) (July 2021)

Fitch Affirms Texas' IDR at 'AAA'; Outlook Stable (April 2021)

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Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Not relevant for an 'AAA' rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Unwillingness to address potential funding changes, such as rising education funding, pension contributions and capital spending demands, in a sustainable and timely manner.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	4/19/21
AAA	Revised	Stable	4/5/10
AA+	Affirmed	Stable	4/13/06
AA+	Assigned	—	10/30/92

Current Developments

Economic Update

Widespread business closures at the pandemic's outset resulted in a sharp decline in economic activity; however, activity picked up with a phased reopening starting in May 2020. Nonfarm payrolls declined by about 11% at the beginning of the pandemic (from February to April 2020), compared to a national decline of about 15%. Since then, Texas has seen a recovery in employment, with about 76% of lost jobs regained through June 2021. This is higher than the national average (about 70% of lost jobs regained).

State unemployment has decreased from higher levels at the onset of the pandemic but is currently higher than the national rate. Texas' official monthly unemployment rate was 6.5% in June, above the comparable national rate (5.9%). However, Texas' 7.2% Fitch-adjusted unemployment rate, which adds back declines in the labor force since February 2020, indicates some continuing labor market challenges. For additional details on the state's employment losses and recovery, see Fitch's "U.S. States Labor Markets Tracker (State Employment Recovery Strengthens in June 2021)," published July 21, 2021 at www.fitchratings.com.

Budget Update

Texas' enacted 2022–2023 biennial budget, which takes effect on Sept. 1, 2021, is based on the state comptroller's forecast of a return to revenue growth in the fiscal 2022–2023 biennium that is slower than historical growth but still a sound rebound from the pandemic-related revenue weakness. The forecast reflects continued but moderating impacts from the pandemic, as well as from continuing decreased oil production and prices.

The rebound in general revenues will support a 5.5% increase in biennial spending to $116.4 billion. According to the Legislative Budget Board's analysis of the appropriation bills, K–12 education spending will increase 4.5%, with the state's statutory commitment for public education fully funded and a variety of targeted programs receiving additional funding. General revenue support for higher education will increase 2.2%. There are programmatic increases in other areas, including health-related programs, public safety and a 7.4% increase in natural resources spending.

The state is making a commitment to paying down liabilities, supplementing the Employees Retirement System (ERS) with actuarially determined contributions and increasing its contribution rate for the Teacher Retirement System, which will rise from 7.5% in fiscal 2021 to 7.75% in fiscal 2022 and then to 8% in fiscal 2023. The state also created a defined benefit plan for future ERS employees hired after Sept. 1, 2022.

The budget anticipates additional transfers to the ESF, bringing its total to $12 billion by the end of the biennium. Although the state did not draw on the ESF for budget balancing purposes in the last biennium, it did appropriate funds from the ESF for capital projects and disaster recovery, including for issues that arose in the state's electrical grid due to winter storms in 2021.

The enacted appropriation bills do not yet consider the significant funding that will be provided by the American Rescue Plan Act (ARPA). Texas' state and municipal governments expect to receive $27 billion from ARPA's Coronavirus State and Local Fiscal Recovery Funds, of which the state's portion is $17 billion. The state has not yet determined how it will utilize ARPA receipts. The combination of direct aid and a significant amount of economic stimulus should have a positive near-term impact on state revenues.

Credit Profile

Texas' GO bonds are issued by various state agencies and payable from a constitutional appropriation out of first moneys coming into the state treasury that are not otherwise appropriated. The Texas Water Development Board (TWDB) issues GO water financial assistance bonds under various constitutional provisions to support water conservation and infrastructure projects throughout the state. Most GO water financial assistance bonds are self-supporting from repayments of project loans and income received from investments.

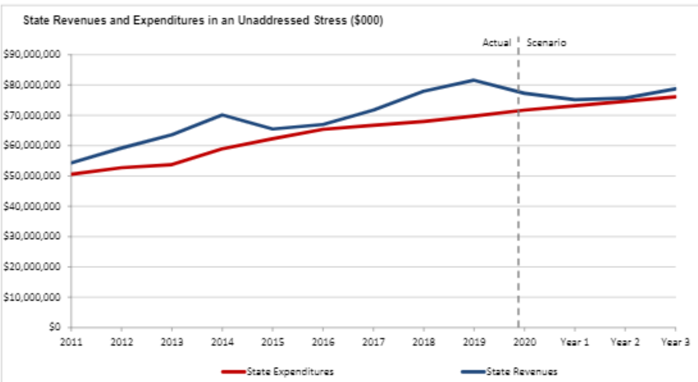
For more information on the State of Texas, see "Fitch Affirms Texas' IDR at 'AAA'; Outlook Stable," published April 19, 2021 at www.fitchratings.com.

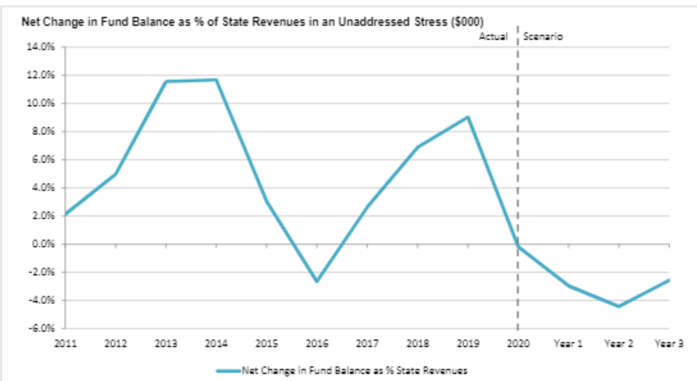
ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, due to either their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Texas, State of (TX)

Scenario Analysis





Analyst Interpretation of Scenario Results:

Texas' financial resilience is high, driven both by the large ESF balance ($10 bn at the end of fiscal 2020, 17% of revenues) and by a willingness to make deep cuts to spending or transfers in the event that current or forecast revenues are insufficient. The comptroller's office is required to make formulaic transfers to the ESF within 90 days after the end of each fiscal year up to a fund cap of 10% of general revenue in the previous biennium. Effective in fiscal 2015, half of required deposits to the ESF from oil and gas severance taxes are instead deposited in the SHF, through Aug. 31, 2034. Appropriations from the ESF can be made with a two-thirds vote of the legislature or by a three-fifths vote of the legislature when addressing a deficit or to make appropriations in a biennium where a decline in revenues from the prior biennium is forecast.

Over time, the legislature has appropriated ESF funds for a variety of purposes. SB500 in 2019 appropriated $6.1 billion from the ESF, almost half of the $12.6 billion balance for that year to fund construction and remediation projects related to Hurricane Harvey, resiliency and flood control initiatives, a boost to the state's contribution to TRS for the biennium and a one-time payment to current retirees, state hospital improvements, school safety initiatives and transportation infrastructure. As noted, the state drew $2 billion of the $6.1 billion appropriation from the fiscal 2019 ESF balance with the balance expected to be drawn in fiscal 2020. With this appropriation, the ESF balance in fiscal 2019 approximated 17.4% of fiscal 2019 general revenue-related revenues, a still-solid cushion to absorb unexpected shocks. The comptroller has estimated an ESF balance of just over $8.9 billion (16% of revenues) at the end of the 2020-2021 biennium when including these appropriations and future transfers.

Scenario Parameters:						Year 1	Year 2	Year 3
GDP Assumption (% Change)						(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)						2.0%	2.0%	2.0%
Revenue Output (% Change)	*Minimum Y1 Stress:*	-1%	*Case Used:*	Moderate		(2.7%)	0.7%	4.1%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	95,446,000	90,918,000	91,762,000	98,742,000	104,127,964	109,674,426	110,384,791	114,301,305	116,565,638	127,944,362	130,503,249	133,113,314	135,775,581
% Change in Total Expenditures	5.6%	(4.7%)	0.9%	7.6%	5.5%	5.3%	0.6%	3.5%	2.0%	9.8%	2.0%	2.0%	2.0%
State Expenditures	50,539,000	52,699,000	53,746,000	58,966,000	62,258,844	65,390,464	66,715,243	67,995,529	69,736,725	71,721,610	73,156,042	74,619,163	76,111,546
% Change in State Expenditures	5.4%	4.3%	2.0%	9.7%	5.6%	5.0%	2.0%	1.9%	2.6%	2.8%	2.0%	2.0%	2.0%
Revenues													
Total Revenues	99,165,000	97,461,000	101,583,000	109,861,000	107,350,895	111,259,520	115,336,459	124,213,385	128,414,726	133,479,846	132,502,908	134,160,911	138,417,998
% Change in Total Revenues	8.5%	(1.7%)	4.2%	8.1%	(2.3%)	3.6%	3.7%	7.7%	3.4%	3.9%	(0.7%)	1.3%	3.2%
Federal Revenues	44,907,000	38,219,000	38,016,000	39,776,000	41,869,120	44,283,962	43,669,548	46,305,776	46,828,913	56,222,752	57,347,207	58,494,151	59,664,034
% Change in Federal Revenues	5.7%	(14.9%)	(0.5%)	4.6%	5.3%	5.8%	(1.4%)	6.0%	1.1%	20.1%	2.0%	2.0%	2.0%
State Revenues	54,258,000	59,242,000	63,567,000	70,085,000	65,481,775	66,975,558	71,666,911	77,907,609	81,585,813	77,257,094	75,155,701	75,666,760	78,753,964
% Change in State Revenues	11.0%	9.2%	7.3%	10.3%	(6.6%)	2.3%	7.0%	8.7%	4.7%	(5.3%)	(2.7%)	0.7%	4.1%
Excess of Revenues Over Expenditures	3,719,000	6,543,000	9,821,000	11,119,000	3,222,931	1,585,094	4,951,668	9,912,080	11,849,088	5,535,484	1,999,659	1,047,597	2,642,417
Total Other Financing Sources	(2,564,000)	(3,607,000)	(2,474,000)	(2,935,000)	(1,229,934)	(3,364,110)	(3,068,838)	(4,546,405)	(4,483,814)	(5,677,839)	(4,228,201)	(4,401,019)	(4,667,456)
Net Change in Fund Balance	1,155,000	2,936,000	7,347,000	8,184,000	1,992,997	(1,779,016)	1,882,830	5,365,675	7,365,274	(142,355)	(2,228,542)	(3,353,423)	(2,025,038)
% Total Expenditures	1.2%	3.2%	8.0%	8.3%	1.9%	(1.6%)	1.7%	4.7%	6.3%	(0.1%)	(1.7%)	(2.5%)	(1.5%)
% State Expenditures	2.3%	5.6%	13.7%	13.9%	3.2%	(2.7%)	2.8%	7.9%	10.6%	(0.2%)	(3.0%)	(4.5%)	(2.7%)
% Total Revenues	1.2%	3.0%	7.2%	7.4%	1.9%	(1.6%)	1.6%	4.3%	5.7%	(0.1%)	(1.7%)	(2.5%)	(1.5%)
% State Revenues	2.1%	5.0%	11.6%	11.7%	3.0%	(2.7%)	2.6%	6.9%	9.0%	(0.2%)	(3.0%)	(4.4%)	(2.6%)

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.