S&P Global
Ratings

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Summary:

Texas
Texas Water Development Board; Appropriations; CP; General Obligation; General Obligation Equivalent Security

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Credit Profile		
US$164.005 mil GO bnds wtr finl asst rfdg bnds (Texas) ser 2021B due 08/01/2038		
Long Term Rating	AAA/Stable	New
US$41.59 mil GO bnds wtr finl asst bnds (Texas) ser 2021A due 08/01/2046		
Long Term Rating	AAA/Stable	New
US$16.43 mil GO bnds wtr finl asst rfdg bnds (Texas) (Economic Distressed Areas Prog) ser 2021C due 08/01/2029		
Long Term Rating	AAA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to the State of Texas':

- Series 2021A water financial assistance general obligation (GO) bonds;
- Series 2021B GO water financial assistance refunding bonds; and
- Series 2021C GO water financial assistance refunding bonds (economically distressed areas program).

The bonds are being issued by the Texas Water Development Board (TWDB).

At the same time, S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on the state's previously issued GO bonds, its 'AA+' long-term rating on the state's appropriation-backed debt outstanding, its 'A-1+' rating associated with its self-liquidity support for various commercial paper (CP) programs, and its 'AAA/A-1+' dual rating reflecting the short-term self-liquidity component on the state's variable-rate demand obligations outstanding. The outlook is stable.

The series 2021A, 2021B, and 2021C bonds are secured by the state's full faith and credit pledge. Series 2021A bond proceeds will provide funding for water assistance projects as a part of TWDB's efforts to conserve and develop the state's water resources. The series 2021B and 2021C proceeds will be used to refund a portion of outstanding debt for debt service savings.

Credit overview

With the state's next biennium in sight, the legislature's work continues against a bifurcated backdrop of improving economic conditions and persistent uncertainty regarding the trajectory of the pandemic. While economic headwinds have moderated in their intensity, the state's comparatively strong financial performance throughout the recession, combined with its strong financial management and oversight, continues to afford it a degree of flexibility to manage challenges as they arise, in our view.

Supported by favorable demographic trends, broad and diversified economic expansion, and strong budgetary performance, Texas entered the pandemic-induced recession with overall strong credit fundamentals, which helped blunt the initial blow to its economy and budget. This included its sizable reserves and maintenance of strong available liquidity. As the state transitions into its next biennium (2022-2023), beginning Sept. 1, its comptroller of public accounts revised his revenue estimate up to $123.02 billion from $115.65 million, or 6.4% available for general-purpose spending. Relative to the certified revenue estimate in January, which guided the legislature's initial budget development during the regular session, funds available for general-purpose spending are up 9.3%.

The legislature is currently in its second special legislative session, following the governor's addition of emergency items to be reviewed by the body following the end of the regular session on May 31. The emergency items include funding for Article X (legislature and legislative agencies) of the biennial budget which the governor vetoed following the regular session. Other items, though not exclusive, for legislative consideration include the appropriation of federal funds for health care related expense stemming from the pandemic; strategies for safe and effective K-12 operations during the pandemic; property tax relief and additional cyber security safeguards supported from unappropriated funds available. Should the exclusion of Article X from the biennial budget extend past the start of the next fiscal year and prove disruptive to state operations, we could reassess our view of the state's long-standing strong budgetary management. At this point, our baseline assumption is that Article X will eventually be added back into the appropriations act and recognize that, like other states, negotiations are often resolved near their deadlines.

The comptroller of public accounts reports that for the first 10 months of fiscal year 2021, total general revenues are up approximately 4.4% compared to the same period in fiscal year 2020, excluding federal funds and CARES Act coronavirus relief funds. The state's leading revenue source--sales taxes--are up 3% for the fiscal year. The comptroller estimates the state will end the current biennium (fiscal year 2021) with a general revenue-related ending balance of slightly more than $5 billion or 8.5% of general revenue appropriation for fiscal year 2021 (as originally adopted). By the end of the next biennium (fiscal year 2023), the ending balance is estimated at $7.85 billion. Not accounting for potential appropriations to be enacted in the current special session, the ending balance in the state's economic stabilization fund (ESF) totals approximately $12 billion by biennium end (fiscal year 2023) or nearly 21% of general revenue appropriations (excluding Article X).

While we anticipate the current situation will remain fluid, active management will remain a key credit consideration in addressing developments as they arise. Temporary pressure notwithstanding, the state's overall debt profile is expected to remain relatively low with its pension liability pressures anticipated to moderate longer term while remaining manageable following the passage of pension reform for the Employee Retirement System (ERS).

The ratings reflect our view of the state's:

- Diverse and resilient economy which has outpaced that of the nation in terms of job growth and productivity in recent years, although it is expected to be pressured in the short term;
- Strong revenue forecasting and cash management practices, including comprehensive monthly revenue and expenditure cash monitoring and willingness to maintain strong liquidity to meet constitutionally defined priorities;

- Low overall net debt, although elevated unfunded pension and long-term liabilities, which we believe will require continued active management to ensure that benefit costs remain affordable; and
- Potential long-term budgetary pressures related to growing public education expenses and modifications to the school funding formula in the 2019 legislative session that shifted a greater burden of the cost to the state.

The stable outlook reflects our expectation that state leadership will adhere to the budget and cash management discipline that has enabled Texas to maintain both strong reserves through economic cycles. Additionally, we anticipate the state's economic performance will revert to comparatively stronger economic growth relative to its peers, given the underlying strength of its structural features.

Environmental, social, and governance factors

We consider Texas to have higher environmental risk compared to others in the U.S. states sector. Environmental risks are primarily two-fold: energy transition and physical risks stemming from severe weather events and sea-level rise. The state has a comparatively greater penetration of energy-related activities from the oil and gas sector, which could lead to increasing regulatory challenges or costs as some sectors of the global economy focus on reducing greenhouse gas emissions through renewable energy.

In addition, Texas' location along the U.S. Gulf Coast exposes it to rising sea levels and climate-related events like hurricanes. While infrequent today, winter storms similar to the type in February could add credit pressure should the state overlook inclusion of adaptation and mitigation initiatives in its long-term planning activities. In addition, we view extreme heat, particularly in the more arid portions of the state, as potentially adding stress to the state's environmental risks.

We note that the state's demographic trends contribute to lower social risk given that population growth over the past decade has well exceeded the national level, which we view favorably as it can provide for greater economic development potential relative to its peers. We view Texas' governance risks as being in line with the sector, given its history of maintaining a strong management and policy framework to respond to developing risks. Longer term, the state's capacity to evolve its resiliency efforts from responsive to preventative will be a key credit consideration.

Stable Outlook

Downside scenario

We believe the state may experience challenges in shoring up and containing long-term liability growth related to pensions and retiree health care costs, although it took significant steps to curb growing pension pressures associated with ERS.

In addition, we could lower the rating if officials fail to adopt timely corrective actions to address future budget gaps should they arise or if the economic recovery stumbles, leading to revenues shifting downward materially, resulting in substantial draws on the ESF, without a plan to replenish the amount.

Credit Opinion

Preceding the onset of the shocks to the national economy in early 2020, Texas was among the country's leading economic engines. Now more than a year removed, broad-based job growth is forecast to elevate year-end gross state product (GSP) to 7% relative to 2020, 40 basis points (bps) above the national level, according to IHS Markit. By the end of 2022, the state's economic output is forecast to grow 5.8%, compared to 2021 levels, according to the IHS, again exceeding the national level by 80 bps. The comptroller's economic outlook (summer forecast) reflects a GSP expansion of 6.7% for 2021 and 4.8% in 2022.

S&P Global Economics' baseline forecast is for U.S. GDP to expand 6.7% (annual) in 2021, up from a 3.5% contraction in 2020 relative to 2019. By 2022, the U.S. economy is forecast to grow 3.7%. (For additional information, see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect.) As the economic recovery accelerates, we anticipate Texas' economic metrics and revenues improving in step with broad U.S. economic rebound. In tandem, employment growth is expected to revert to growth in 2021 at 3.4% relative to 2020 and followed by 3.9% in 2022, again exceeding the national level.

Favorably, by June (preliminary 2021), the state's employment base had recovered to roughly 99% of its peak level from February 2020. Reflecting a labor force participation rate that remains below its pre-pandemic levels, its unemployment rate stood at 6.9% in June, albeit well off its peak of 12.9% in April. Across the board, employment by sector is all positive compared to the same period a year prior, including the state's mining sector--which is largely composed of oil and gas activities.

While we anticipate the energy sector will continue to play an important role in Texas' economic health, broad-based economic growth most pronounced in the state's metropolitan statistical areas (MSAs) has helped diversify its employment base and will significantly influence credit stability within the short and longer term, in our view. In context, in terms of total employment, the mining sector has contracted considerably since 2014, while other sectors have more than offset the decline. As reported by the Bureau of Labor Statistics, total employment in the sector (June 2021), stood at roughly 59% of its peak levels in late 2014, representing a 45% decline. By contrast, total nonfarm employment has expanded 7% over the same period, which includes the material slide in employment following the onset of the pandemic.

The reversal of fortune for the state's oil plays, predominantly concentrated in the Permian, is extraordinary, in our view, but serves to highlight how quickly economic winds can change. In a sign of improved conditions in the sector, S&P Global Ratings revised its oil and natural gas assumptions up for the remainder of the year. Our revised price deck raised Brent and West Texas Intermediate price assumptions by $5 per barrel ($/bbl) to $65/bbl and $60/bbl, respectively. Henry Hub and AECO Hub prices per million British thermal units ($0.25/mmBTU) were revised up to $3/mmBTU, from $2.75/mmBTU, and $2.5/mmBTU, from $2/mmBTU, respectively. (For additional information, see "S&P Global Ratings Raises Short-Term Oil And Gas Price Assumptions On Improving Market Conditions," June 16, 2021.) In our view, the improvement in the sector throughout the year will continue to meaningfully help the state's economy heal, particularly in regions with disproportionate concentrations of oil and gas activities.

Weighing favorably for the state is its continued population growth, which we believe can position it to sustain its economic growth and productivity trajectory longer term. As reported by the U.S. Census Bureau, since 2010, Texas leads the nation, adding roughly 4 million new residents, a 16% bump in a decade. As it continues its economic recovery, we believe its favorable demographics will help it sustain stronger economic growth and employment gains relative to its peers, even as its energy sector faces inherent volatility.

We believe the size of the state's accumulated reserves provides a source of flexibility that very few states have maintained throughout economic cycles. Furthermore, we believe that Texas' very strong revenue forecasting and cash-flow monitoring tools, which include comprehensive monthly reports on its general revenue and pooled cash, coupled with state authorities' willingness to maintain strong liquidity to meet Texas' constitutionally defined priorities, including the repayment of debt service, provide an important source of strength and stability to the rating. Finally, we believe the state has relatively broad authority to cut services, which can also provide additional flexibility to manage its liquidity position during periods of budgetary stress.

By constitutional provision, total general revenue-related spending cannot exceed revenue available, and appropriations for the next biennium cannot exceed the estimated rate of growth in personal income. Texas' constitutional requirements on budgeting demand that expenditures remain below the certified revenue estimated amount, thus providing the state with a cushion should revenue not align with estimates.

Texas' unfunded pension liability represents its collective proportionate share in several pension plans, of which the Teachers Retirement System (TRS) and ERS are the largest, as reported in the state's annual financial report (2020). The state is a contributing employer and contributing non-employer to TRS, for which its allocable share is collectively 67.3% (measured as of Aug. 31, 2019, reported in the state's annual financial report). The plan fiduciary net position as a percentage of total pension liabilities was 75.24% and 47.7% for TRS and ERS, respectively. As noted in our "Pension Spotlight: Texas" (Feb. 25, 2020), TRS features poor funding discipline, although legislative changes enacted in 2019 to contributions should improve it with minimal effect on affordability for participating issuers. Similarly, ERS also features poor funding discipline as a result of low statutory contribution rates, which has led to weak funded status and a projected depletion of plan assets. Neither system has met minimum fund progress over the past year. Additionally, in our view, ERS' assumed rate of return of 7.5% is aggressive for a plan with fixed liabilities resting completely on the state. TRS' assumed rate of return of 7.25%, in our view, is high, which could lead to market-driven contribution volatility relative to typical tolerance levels around the country.

To strengthen ERS' long-term stability, the state enacted legislation (Senate Bill 321), which requires it to make actuarially determined contributions necessary to amortize the system's unfunded accrued liability by Aug. 31, 2054 (30 years). Contributions are in addition to the state's standing 9.5% statutory contribution. Additionally, for employees hired after Sept. 1, 2022, they will now be part of a new defined-benefit structure akin to a 401k plan known as a cash balance plan. In our view, this action provides a path to ensure ERS' growing liability is curbed and eventually resulting in stronger funding discipline and actuarial soundness.

Texas manages its other postemployment benefit (OPEB) obligations on a pay-as-you-go basis, typical of most states. Based on 2020 OPEB information, the combined net liability totals $58.68 billion, including 57% of the TRS liability, which is moderately high at roughly $2,000 per capita. The benefits of TRS-Care are financed through a combination of retiree premiums and percentage-of-payroll contributions from active employees, local school districts, and the state. Although OPEB benefits are not constitutionally protected in Texas, we believe the primary constituency covered by the plan makes modification politically difficult.

Fiscal year 2020 results

The state's fiscal year 2020 ended with total revenues (general revenue fund) down 3.7% compared to fiscal year 2019 (excluding resources available from the state's share of Coronavirus Relief Funds and other federal funds). The state's principal revenue stream--sales taxes--was down 1.8% compared to the fiscal year prior. We note that the first five months of fiscal year 2020 realized its highest sales tax collections in the last five fiscal years, so a comparison of collections through January 2021 (fiscal year 2021) are against a comparatively high watermark.

Under our state ratings methodology, we have assigned Texas a score of '1.6' on a four-point scale, with '1' being the strongest and indicative of a 'AA+' rating. We have maintained the rating one notch above the indicative credit level as allowed per our state rating methodology criteria, reflecting Texas' sizable reserves, strong financial management and budgetary practices, and a large and diverse economic base that continues to compare favorably with those of 'AAA' rated peers.

Texas' GO bonds are eligible to be rated above the sovereign, because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions" (Nov. 19, 2013), U.S. states are considered to have moderate sensitivity to country risk. The institutional framework in the U.S. is predictable, with significant state autonomy and flexibility demonstrated by serial bond amortization as well as independent treasury management.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of August 20, 2021)		
Texas college student loan bonds (Texas) ser 2020A due 08/01/2043		
Long Term Rating	AAA/Stable	Affirmed
Texas college student loan rfdg bonds (Texas) ser 2020B due 08/01/2034		
Long Term Rating	AAA/Stable	Affirmed
Texas GO		
Long Term Rating	AAA/Stable	Affirmed
Texas GO		
Long Term Rating	AAA/Stable	Affirmed
Texas GO		
Long Term Rating	AAA/Stable	Affirmed
Texas GO		
Long Term Rating	AAA/Stable	Affirmed
Texas GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of August 20, 2021) (cont.)		
Texas ICR		
Long Term Rating	AAA/Stable	Affirmed
Texas Dept of Transp, Texas		
Texas		
Texas Dept of Transp (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Econ Dev Bank, Texas		
Texas		
Texas Econ Dev Bank (Texas) ser 2005A		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
Texas Econ Dev Bank (Texas) GO ser 2005B		
Long Term Rating	AAA/A-1+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
Texas Hgr Ed Coordinating Brd, Texas		
Texas		
Texas Hgr Ed Coordinating Brd (Texas)		
Long Term Rating	AAA/Stable	Affirmed
Texas Hgr Ed Coordinating Brd (Texas)		
Long Term Rating	AAA/Stable	Affirmed
Texas Hgr Ed Coordinating Brd (Texas) GO bnds coll stud loan rfdg bnds (State of Texas) ser 2019 dtd 06/15/2019 due 08/01/2033		
Long Term Rating	AAA/Stable	Affirmed
Texas Hgr Ed Coordinating Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Hgr Ed Coordinating Brd (Texas) (GO bnds) coll stud loan bnds		
Long Term Rating	AAA/Stable	Affirmed
Texas Hgr Ed Coordinating Brd (Texas) (GO bnds) coll stud loan rfdg bnds		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth, Texas		
Texas		
Texas Pub Fin Auth (Texas) lse rev bnds (taxable) (State of Texas) ser 2021 due 02/01/2041		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) lse rev [and rfdg] bnds (State of Texas) ser 2020 due 02/01/2040		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) lse rev [and rfdg] bnds, taxable (State of Texas) ser 20 due 02/01/2040		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) APPROP		
Long Term Rating	AA+/Stable	Affirmed

Ratings Detail (As Of August 20, 2021) (cont.)		
Texas Pub Fin Auth (Texas) APPROP		
Long Term Rating	AA+/Stable	Affirmed
Texas Pub Fin Auth (Texas) CP		
Short Term Rating	A-1+	Affirmed
Texas Pub Fin Auth (Texas) CP		
Short Term Rating	A-1+	Affirmed
Texas Pub Fin Auth (Texas) CP		
Short Term Rating	A-1+	Affirmed
Texas Pub Fin Auth (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Pub Fin Auth (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm, Texas		
Texas		
Texas Transp Comm (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Transp Comm (Texas) GO (Private Placement)		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd, Texas		
Texas		
Texas Vets Land Brd (Texas) GO equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of August 20, 2021) (cont.)		
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Veterans) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Veterans) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Veterans) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO equiv		
Long Term Rating	AAA/Stable	Affirmed
Short Term Rating	NR	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO Equiv		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets Hsg) GO 2003A		
Long Term Rating	AAA/Stable	Affirmed
Texas Vets Land Brd (Texas) (Vets) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd, Texas		
Texas		
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		

Ratings Detail (As Of August 20, 2021) (cont.)		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GO		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/Stable	Affirmed
Texas Wtr Dev Brd (Texas) GOEQUIV		
Long Term Rating	AAA/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.