S&P Global
Ratings

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Summary:

Texas
Texas Water Development Board; General Obligation

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Credit Profile		
US$73.13 mil wtr financial assistance bnds (Economically Distressed Area Program) ser 2023C due 08/01/2042		
Long Term Rating	AAA/Stable	New
US$36.23 mil wtr financial assistance rfdg bnds ser 2023B due 08/01/2033		
Long Term Rating	AAA/Stable	New
US$23.005 mil wtr financial assistance bnds ser 2023A due 08/01/2048		
Long Term Rating	AAA/Stable	New
US$21.58 mil wtr financial assistance bnds (Exonomically Distressed Areas Program) ser 2023D due 08/01/2042		
Long Term Rating	AAA/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to the State of Texas' approximately $23.0 million general obligation (GO) water financial assistance bonds, series 2023A; approximately $36.2 million GO water financial assistance refunding bonds, series 2023B; approximately $73.1 million (tax-exempt) GO water financial assistance bonds, series 2023C (economically distressed areas program); and approximately $21.6 million (federally taxable) GO water financial assistance bonds, series 2023D (economically distressed areas program).
- The bonds are being issued by the Texas Water Development Board.
- The outlook is stable.

Security

The series 2023A-D GO water financial assistance bonds constitute general obligations of the state pursuant to its constitution and are secured by the state's full faith and credit.

The state will use proceeds from the series 2023A, series 2023C, and series 2023D bonds to finance various water resource conservation and development projects funded from the financial assistance account for water assistance projects, or the economically distressed areas program (EDAP) account for EDAP projects. Proceeds from the series 2023B bonds will be used to refund previously issued water financial assistance bond debt for debt service savings.

Credit overview

The 'AAA' GO rating and stable outlook on Texas incorporate our view of favorable demographic trends, a broad and diversified economic expansion, and the state's long history of proactive financial management that has yielded strong and resilient budgetary performance across economic cycles. The state's general credit quality also reflects our expectation that economic and financial fundamentals will continue to outperform its conservatively built forecasts and support Texas' maintenance of substantial reserves and strong available liquidity.

Despite evolving economic conditions, the state's revenue available for general spending for the next biennium continues to rise, largely fueled by strong revenue growth across sales tax and other categories. Texas' general revenue-related funds for the 2024-2025 biennium are estimated to total $188.2 billion, which includes a potentially historic $32.7 billion in 2023 fiscal year-end (Aug. 31) revenues available for general spending (net of required transfers). This projected biennium-end revenue for general fund spending reflects current policy, which could change if the legislature chooses to use a portion of this estimated amount in a supplemental budget for the current biennium.

Budget development for the fiscal 2024-2025 biennium continues against a backdrop of slowing economic momentum, stubborn inflation, and tightening monetary policy. On April 6, 2023, Texas' House of Representatives passed its $136.9 billion version of the fiscal 2024-2025 budget. In addition to the budget, the House approved some executive budget priorities, including $17.3 billion in property tax relief, an additional $5.0 billion for the state school funding formula, $1.6 billion for school safety, and $3.5 billion for cost-of-living pension adjustments for retired teachers. The Texas Senate approved its $141.3 billion version of the general revenue budget on April 17, 2023, with $4.4 billion (or 3.2%) more in spending than the House Bill; both bills will be negotiated in conference committee, with approximately one month remaining in the legislative session. For more information, see "U.S. States' Fiscal 2024 Budgets Expected To Weather Economic Uncertainty," published April 27, 2023, on RatingsDirect.

The comptroller of public accounts (CPA) reports that for fiscal 2023, total general revenues are up approximately 13.5% compared with fiscal 2022 (excluding federal and other relief funds). The state's leading revenue source--sales tax--is up 10.7% compared with the previous fiscal year. Based on the state's latest Biennial Revenue Estimate (BRE), all-funds sales taxes are projected to grow by 7.1% for fiscal 2023, 2.5% for fiscal 2024, and 5.1% for fiscal 2025. Currently, the ending balance in the state's economic stabilization fund (ESF) for biennium ending fiscal 2023, is estimated to total approximately $13.72 billion, or approximately 22% of annual general revenue appropriations, a level that we view as very strong. Based on BRE projections, the CPA estimates a $9.02 billion deposit of unencumbered and unobligated general fund and severance tax transfer to the ESF in fiscal 2024 and $2.86 billion in fiscal 2025. By biennial end (fiscal 2025), the CPA estimates the ESF balance will exceed its statutory cap of $26.38 billion by approximately $700 million. Assuming no changes to law or program outlays, this excess $700 million would remain available for general purpose appropriations.

S&P Global Economics' baseline forecast U.S. GDP projects more subdued 0.7% (annual) growth in 2023, albeit above the forecasted contraction of 0.1% in its November forecast. With increasing pressure from the Federal Reserve's interest rate hikes to tame persistent high inflation, S&P Global Ratings' economists forecast a shallow recession with 0.3% decline in in GDP from peak to trough (Q1-Q3). By 2024, GDP is forecast to expand 1.2%. (For additional information see "Economic Outlook U.S. Q2 2023: Still Resilient, Downside Risks Rise," published March 27, 2023.) BRE estimates that Texas' real GSP growth will average 1.9% annually over the 2024-2025 biennium; the state's economic assumptions are built with a similar U.S. growth forecast, which expands 0.3% in 2023 followed by 1.4% in 2024.

In our view, the state's overall debt profile is expected to remain relatively low with its pension liability pressures anticipated to decline over the long-term while remaining manageable following the passage of pension reforms for the

Employee Retirement System (ERS).

The ratings reflect our view of the state's:

- Diverse and resilient economy, which outpaced that of the nation in terms of economic output and job growth;
- 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 with 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 increasing 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.

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" (published 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.

Environmental, social, and governance

ESG credit indicators: E-3, S-2, G-2

Given Texas' large geographic footprint and location along the U.S. Gulf Coast, we consider the state to have a higher exposure to acute physical risks within our credit rating analysis, including severe weather events, intermittent flooding, and extreme heat, as well as exposure to chronic physical risks, including sea-level rise and drought. Although severe weather events are typically temporary, recurrence and prolonged exposure of these events could add credit pressure to the state's economic development should the state overlook inclusion of adaptation and mitigation initiatives in its long-term planning activities. In addition, the state has a comparatively greater proportion of energy related activities from the oil and gas sector, which could lead to increasing regulatory challenges from energy transition or costs as some sectors of the global economy focus on reducing greenhouse gas emissions through renewable energy.

We note that the state's demographic trends generally contribute to lower social capital risk given that population growth over the past decade exceeded the national level, which we view favorably as it can provide for greater economic development potential relative to its peers. However, we believe corresponding service demands and growth-related infrastructure needs might require the state to incorporate additional debt issuance and operating costs within its budget. We view Texas' governance risks as being neutral, although we note its history of maintaining a strong management and policy framework to respond to developing risks. Long term, the state's capacity to evolve its resiliency efforts from responsive to preventative will be a key credit consideration.

Outlook

The stable outlook reflects our expectation that Texas' financial forecasting and strong budgetary management will help guide executive and legislative actions to make timely adjustments that realign expenditures and revenues over the outlook period, although the rating also incorporates our belief that a potential economic slowdown could lead fluctuations in financial performance. The outlook also reflects our view that Texas will continue to exhibit favorable economic and population growth that exceeds the U.S., further supporting our view of the state's long-term credit stability.

Downside scenario

We believe Texas could experience challenges in containing long-term liability growth related to pensions and retiree health care costs that could lead to downward pressure on the rating. However, we believe the state has substantial statutory flexibility to enact and implement postemployment benefit reforms, as was evidenced by significant steps to curb growing ERS pressures during its 2021 legislative session. In addition, we could lower the rating if officials fail to adopt timely corrective actions in response to potential future budget gaps, resulting in substantial draws on the ESF without a plan to replenish reserve levels, or if the state's economic growth reverses from recently improving trends and metrics substantially decline compared with the U.S., leading to materially weaker revenue performance on a sustained basis.

Under our state ratings methodology, we assigned Texas a score of '1.6' on a four-point scale, with'1.0' being the strongest and '4.0' being the weakest, resulting in an indicative 'AA+' rating. However, we apply a one-notch holistic adjustment above the indicative credit level as allowed according to our state rating methodology criteria, reflecting the state's 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.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022