FitchRatings

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Fitch Rates Sugar Land, TX $22 MM Series 2019A GO Ref & Imp Bonds and $16.5 MM in COs 'AAA'

Fitch Ratings-Austin-02 October 2019: Fitch Ratings has assigned a 'AAA' rating to the following Sugar Land, TX (the city) limited tax obligations:

--$22.11 million general obligation (GO) refunding and improvement bonds, series 2019A;
--$16.51 million combination tax and revenue certificates of obligation (CO), series 2019A.

Fitch has also affirmed the following ratings of Sugar Land at 'AAA':

--Issuer Default Rating (IDR);
--Approximately $300 million GO bonds and COs outstanding (prior to refunding).

The Rating Outlook is Stable.

The GO bonds and COs are expected to price via competition on or around Oct. 15, 2019. Roughly $14 million of the GO bond proceeds will refund a portion of the city's outstanding tax-supported debt for interest savings; the remaining portion of proceeds will be used to finance capital improvements. The COs, along with a portion of GO proceeds, will be used to finance several capital projects, including but not limited to: street and drainage improvements, facility rehabilitation and public safety equipment.

SECURITY
The GO bonds are payable from an ad valorem tax levied on all taxable property within the city, limited to $2.50 per $100 taxable assessed valuation (TAV). COs are additionally secured by a nominal pledge of subordinate net revenues (limited in amount to $1,000) from the city's waterworks and sewer system.

ANALYTICAL CONCLUSION

The 'AAA' IDR and limited tax obligation rating are based on Sugar Land's strong operating profile, supported by its ability to independently raise revenues, solid expenditure flexibility and ample reserves. The rating also reflects the city's moderate long-term liability burden.

Economic Resource Base
Sugar Land is part of the deep and diverse Houston metropolitan statistical area (MSA) economy, which has outpaced the nation in job and income growth due to a strong energy sector and diversification in other sectors. Following the annexation of two master planned communities over the past couple of years, the city's population has increased by more than 25% and as of 2018 is estimated at about 119,000. The city's population is highly educated with above average income. The regional economy remains sensitive to energy sector trends.

KEY RATING DRIVERS

Revenue Framework: 'aaa'
Revenue growth prospects are strong, as indicated by recent growth rates comfortably above that of U.S. economic performance. Ongoing economic growth has continued at a healthy pace, driven by both residential and commercial development and despite the energy sector downturn several years ago. The city has ample independent ability to raise revenues without external approval.

Expenditure Framework: 'aa'
Fitch expects the natural pace of spending to be in line with revenue growth. Notable discretion over workforce costs and moderate carrying costs support a solid expenditure flexibility assessment.

Long-Term Liability Burden: 'aa'
The city's long-term liability burden is moderate in relation to personal income, and pensions are well-funded. Fitch expects the burden to remain moderate, as population and income are expected to grow at a pace similar to regional debt needs.

Operating Performance: 'aaa'
Fitch expects the city to demonstrate very strong financial resilience during a moderate economic downturn based on its revenue raising capacity, solid expenditure flexibility and currently healthy financial cushion.

RATING SENSITIVITIES
Strong Fiscal Health: The rating is sensitive to shifts in fundamental credit characteristics, including the city's ongoing economic expansion and strong operating performance.

CREDIT PROFILE
Sugar Land is located in the expansive Houston MSA and residents have direct access to Houston's

central business district via a major highway. The broad area economy includes biomedical research, healthcare, aerospace, and international trade, supplementing its energy and petrochemical roots. The MSA is home to 22 Fortune 500 corporate headquarters.

Top Sugar Land employers include Houston Methodist Sugar Land Hospital, Fluor, Schlumberger and Nalco/Champion. Management continues to report additional investment in the form of current expansion by several employers, including Methodist Hospital and the University of Houston at Sugar Land.

The recent annexation of the two largely residential master planned communities--Greatwood and New Territory--has helped lead to a sizable increase in the city's property tax base. In fiscal 2019, taxable assessed value (TAV) increased by 24% to $16 billion. Fiscal 2020 TAV reflects a marginal increase over fiscal 2019 TAV at $16.2 billion. The tax base remains very diverse with the 10 principal taxpayers accounting for about 5% of TAV.

Revenue Framework
Sales tax receipts contributed 47% to the city's fiscal 2018 general fund revenues, followed by property tax revenues (27%) and charges for services (14%).

Strong growth prospects reflect current economic development trends and the inherent volatility of the energy sector. The city's general fund revenues grew by a strong compound annual growth rate (CAGR) of more than 4% in the 10-year period ending in fiscal 2018, benefitting from strong sales tax growth and expansion of the ad valorem property tax base.

Following the recent annexations over the past 18 months, management indicates that sales tax receipts will likely experience an uptick, which will be reflected in the fiscal 2019 audit.

Sugar Land's fiscal 2020 tax rate of $0.3320 per $100 of TAV provides ample capacity below the statutory cap of $2.50. However, the Texas legislature recently approved and the governor signed into law Senate Bill 2 (SB2), which makes a number of changes to local governments' property tax rate setting process. Most notably, SB2 will reduce the rollback tax rate (now the 'voter approval tax rate') to 3.5% from 8.0% 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. The tax rate limitation in SB2 excludes new additions to tax rolls and allows for banking of unused margin for up to three years. Remaining control over the property tax rate plus other local revenues such as fines, fees and charges for services is sufficient to generate still ample revenue-raising flexibility relative to Fitch's assessment of expected modest revenue volatility in a typical downturn. The revenue cap does not apply to debt service tax levies.

Expenditure Framework

Similar to most municipalities, public safety accounts for almost half of Sugar Land's general fund operating budget (46% of fiscal 2018 total spending). General government (19%) and public works (13%) were the next largest spending components.

The city's natural pace of spending is expected to be generally in line with revenue growth, as a growing population will generate additional service demands from the city's resource base. The recent annexations have led to additional service demands; however, the additional operating revenues compensate for the additional expenses incurred.

Sugar Land maintains flexibility with respect to headcount and salary arrangements and through discretionary pay-as-you-go capital spending. Carrying costs represent about 20% of fiscal 2018 governmental spending, driven primarily by debt service (15%), and reflecting a 10 year debt amortization of about 50%. The city has a multiyear capital improvement program, and plans to seek additional voter authorization over the next several weeks. Given future debt and capital needs, Fitch anticipates that carrying costs will remain around 20% of governmental spending over the next couple of years.

Long-Term Liability Burden

Sugar Land's long-term liability burden is a moderate 13% of estimated personal income. The city's long-term liability burden consists primarily of overlapping debt.

On Nov. 5, 2019 officials will hold a $90 million GO bond election. If approved, proceeds will help support the city's multi-year capital improvement plan to address drainage, roadway construction and public safety. The city's five-year capital plan for 2020 to 2024 indicates that roughly $122 million in GO debt will be issued, compared with $339 million in tax-supported debt outstanding (following this issuance). Fitch expects Sugar Land's long-term liability burden, inclusive of direct and overlapping debt, to remain moderate.

The city's pensions are provided through the Texas Municipal Retirement System, an agent multiple-employer defined benefit plan. Under GASB Statement 68, the city reports a fiscal 2018 net pension liability of $21 million, with fiduciary assets covering 91% of total pension liabilities at the plan's 7% investment return assumption. Applying Fitch's more conservative 6% investment return assumption reduces the ratio of assets to liabilities to an estimated 82%.

Operating Performance

Fitch expects Sugar Land to demonstrate the highest level of financial resilience during an economic downturn, consistent with past performance. The 'aaa' resilience assessment is informed by the city's revenue raising capabilities, solid expenditure flexibility and its currently ample financial cushion.

The city closed fiscal 2018 with an unrestricted general fund reserve balance of about $35 million, or 40% of operating expenditures. Officials adopted a general fund budget with a deficit of about $2 million for fiscal 2019; however, based on unbudgeted revenues and expenditure adjustments, management expects a surplus of more than $250,000.

The city's strong budget management practices are evidenced by reserve replenishment during periods of economic expansion and no deferral of required spending. Management also has a history of prompt responses to changing economic conditions. Based on the adopted budget for fiscal 2020, which begins Oct. 1, general fund expenditures outpace revenues by more than $5 million. The city has historically posted better-than-budgeted results by fiscal year end, as management conservatively estimates key revenue streams and typically over-budgets for one-time expenditures. Fitch expects the city will continue to prudently manage its costs in order to maintain a financial cushion consistent with assessment of financial resilience.

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ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to 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.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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Additional information is available on www.fitchratings.com

Applicable Criteria

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

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy