

# RatingsDirect®

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## Summary:

# Fredericksburg, Texas; General Obligation

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## Table Of Contents

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Credit Highlights

Outlook

Credit Opinion

Related Research

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Credit Profile		
US\$9.5 mil comb tax and rev certs of oblig ser 2024 dtd 08/22/2024 due 02/15/2044		
Long Term Rating	AA+/Stable	New
Fredericksburg GO		
Long Term Rating	AA+/Stable	Affirmed

## Credit Highlights

- S&P Global Ratings assigned its 'AA+' long-term rating to the city of Fredericksburg, Texas' proposed \$9.5 million series 2024 combination tax and revenue certificates of obligation (COs).
- At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's outstanding series 2017 COs.
- The outlook is stable.

## Security

The certificates are secured by, and payable from, an ad valorem tax levied annually, within the limits prescribed by law, on all taxable property within the city. The 2017 certificates are also secured by a limited pledge, not to exceed \$1,000, of the net revenues of the operation of the city park and recreational facilities while the series 2024 COs are also secured by a limited pledge, not to exceed \$1,000, of the net revenues of the city's water and sewer system. Due to the limited revenue pledges for each series, we rate the certificates based on Fredericksburg's ad valorem pledge.

The maximum allowable ad valorem tax rate in the state of 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 levy is well below the maximum at 16.52 cents in fiscal 2024, 1.26 cents of which is dedicated to debt service. Despite state statutory tax rate limitations, we do not differentiate between the city's limited-tax debt and its general creditworthiness, because the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the city's overall ability and willingness to pay debt service.

Certificate proceeds will be used to fund a new municipal facility for the public works and park departments as well as upgrades to existing facilities for the police, fire, and emergency services departments.

## Credit overview

Fredericksburg's improving economic metrics and low debt are offset by its exposure to the tourism industry and a reliance on more volatile revenue streams, such as sales taxes and hotel taxes, compared to those of many similarly rated and higher-rated credits. We believe the city's debt will likely remain manageable and that its economic metrics will continue to improve, though reserves as a percentage of expenditures could continue to decline closer to a formal reserve level of 25% given a growing budget and management's projections for breakeven general fund results for fiscal 2024.

The rating also reflects our view of Fredericksburg's:

- Strong local economy, with a growing tax base and property wealth that is boosted by agricultural land and tourism;
- Very strong reserves, supported by growing operating revenues and conservative budgeting efforts, though reserves have declined as a percentage of operating expenditures due to a growing budget;
- Good financial management policies and practices, and a strong institutional framework score; and
- Very strong and manageable debt profile and manageable pension costs.

### **Environmental, social, and governance**

We view the city's environmental, social, and governance factors as neutral in our credit rating analysis.

## **Outlook**

The stable outlook reflects our expectation that Fredericksburg will maintain very strong reserves and manageable debt while its economic metrics remain stable or improve.

### **Downside scenario**

We could lower the rating if the city's financial performance deteriorates, leading to sustained drawdown on reserves, or if the city issues significant additional debt, weakening our view of its debt-and-liability profile.

### **Upside scenario**

We could raise the rating if the city's economy continues to expand and diversify, leading to economic metrics more comparable with those of higher-rated peers and reducing reliance on more volatile activity-based revenues such as sales and hotel taxes.

## **Credit Opinion**

### **Strong and growing resident incomes and market value per capita, spurred by continued economic growth**

We consider Fredericksburg's economy strong, with ongoing economic development that is increasing the tax base, improving incomes, and boosting a high market value per capita metric compared to that of many similarly rated peers.

Fredericksburg is 70 miles west of Austin and 70 miles northwest of San Antonio and is the county seat and commercial center of Gillespie County. The city benefits from the outward expansion of Austin and San Antonio, supporting consistent year-over-year double-digit AV growth and management's projections for continued growth. The local economy is primarily based on agriculture and manufacturing; in addition, the city is a weekend destination for visitors from Austin and San Antonio.

Fredericksburg has experienced strong AV growth totaling 70.5% in the past five fiscal years (2018 to 2024). Growth was particularly strong over the past three years, averaging just over 15% annually from fiscal 2022 to fiscal 2024. Management attributes the recent growth to both increasing values of existing property and new property being added

to the tax roll as a result of development activity in the area.

### **Good financial management policies and practices supporting strong operating performance**

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment (FMA) methodology, indicating that, while the city has financial practices in place for most areas, it might not formalize or monitor all of them on a regular basis.

Highlights of the city's financial policies and practices includes an annually updated comprehensive capital improvement plan (CIP) as well as formal fund balance and debt management policies. In developing its budget, the city evaluates historical trends, uses conservative revenue growth assumptions, and works with both the property appraiser and the convention and visitors' bureau when preparing revenue estimates. The city provides monthly financial reports to the council that include year-to-date budget-to-actual performance as well as investment holdings and returns. The city can make budget amendments as needed at any time throughout the year. The comprehensive five-year CIP includes detailed costs and sources of funding for each project. The city has a formal investment management policy that prioritizes preservation of principal and liquidity over returns. In addition, its formal reserve policy requires maintaining at least three months' operating expenditures, which the city typically exceeds. Somewhat offsetting these management strengths are the lack of a formal long-term financial plan that includes multiyear projections of revenues and expenditures and the absence of specific quantitative metrics in the debt management plan.

The institutional framework score for Texas cities is strong.

### **Consistently strong operating results and maintenance of very strong reserves**

Fredericksburg has typically produced positive operating results, supported by growing operating revenues and conservative budgeting. Prior to fiscal 2023, the city reported five consecutive general fund surpluses. Going forward, however, we believe general fund operating performance could trend more towards breakeven or slightly positive results due to increasing expenditures to support a growing tax base. Our budgetary performance calculations include adjustments for recurring transfers and one-time capital projects. Sales-and-use taxes accounted for about 31% of general fund revenues in fiscal 2023, followed by hotel occupancy taxes (20%), and property taxes (18%).

Fiscal 2024 year-to-date results are trending favorably relative to budget, with expenses coming in under and revenues mainly flat, leading to a projected breakeven result. Fiscal 2023 results reflect some one-time spending for capital projects but also continued growth in primary operating revenues. The city's reserves, despite declining as a percent of operating expenditures over the past three years, remain above a formal fund balance minimum of 25%. Based on management's fiscal 2024 projections, and its history of budget outperformance due to generally conservative assumptions, we expect budgetary performance to remain at least adequate and reserves to remain very strong during the outlook period.

### **Low debt burden as a percent of market value, with rapid amortization and no near-term debt plans**

Including this issuance, the city has \$37.5 million in direct debt outstanding, including COs, revenue bonds, and capital leases. The city has no concrete debt plans going forward but does expect to issue COs at some point during the next few years, which could lead to increased debt metrics depending on final sizing and issuance timing. Following the current issuance, we no longer view debt repayment as rapid.

The city privately placed its series 2012 GO bonds but we do not view the obligation as a contingent liquidity risk given that the terms do not include nonstandard events of default and acceleration is not a default remedy.

### Pension and OPEB costs not an immediate credit pressure

We do not view pension contributions as an immediate credit pressure given the contribution cost amount compared to the budget and relatively well-funded status of the state plan the city participates in.

The city participates in the following plans as of Dec. 31, 2022 (the most recent measurement date):

- Texas Municipal Retirement System, with a funded ratio of 71.5% and a net pension liability of \$21 million;
- Texas Emergency Services Retirement System, with a funded ratio of 75.2% and a net pension liability of just over \$200,000.

Fredericksburg, Texas--Key credit metrics				
	Most recent	Historical information		
		2023	2022	2021
<b>Strong economy</b>				
Projected per capita EBI % of U.S.	126			
Market value per capita (\$)	306,929			
Population	11,760	12,012	12,092	
County unemployment rate (%)		2.6		
Market value (\$000)	3,609,485	3,187,521	2,686,261	
Ten largest taxpayers % of taxable value	4.8			
<b>Strong budgetary performance</b>				
Operating fund result % of expenditures	(0.5)	11.3	24.5	
Total governmental fund result % of expenditures	(0.7)	12.8	29.6	
<b>Very strong budgetary flexibility</b>				
Available reserves % of operating expenditures	45.5	55.7	72.6	
Total available reserves (\$000)	14,739	13,729	13,924	
<b>Very strong liquidity</b>				
Total government cash % of governmental fund expenditures	119	155	180	
Total government cash % of governmental fund debt service	2,896	2,871	3,086	
<b>Strong management</b>				
Financial Management Assessment	Good			
<b>Very strong debt &amp; long-term liabilities</b>				
Debt service % of governmental fund expenditures	4.1	5.4	5.8	
Net direct debt % of governmental fund revenue	51			
Overall net debt % of market value	1.6			
Direct debt 10-year amortization (%)	57			
Required pension contribution % of governmental fund expenditures	9.3			
OPEB actual contribution % of governmental fund expenditures	0.1			

Fredericksburg, Texas--Key credit metrics (cont.)				
	Most recent	Historical information		
		2023	2022	2021
Strong institutional framework				
EBI--Effective buying income. OPEB--Other postemployment benefits.				
Data points and ratios may reflect analytical adjustments.				

Related Research

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

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