

June 3, 2020

City of Granite Shoals
2221 North Phillips Ranch Road
Granite Shoals, TX 78654
Attention: Mr. Jeff Looney, City Manager

Re: *US\$8,410,000 City of Granite Shoals, Texas, General Obligation And Refunding Bonds, Series 2020, dated: June 01, 2020, due: August 01, 2040*

Dear Mr. Looney:

Pursuant to your request for an S&P Global Ratings rating on the above-referenced obligations, S&P Global Ratings has assigned a rating of "AA-". S&P Global Ratings views the outlook for this rating as stable. A copy of the rationale supporting the rating is enclosed.

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Please send hard copies to:

S&P Global Ratings
Public Finance Department
55 Water Street
New York, NY 10041-0003

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cc: ***Mr. J. Rafael Martinez, Vice President***
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RatingsDirect®

Summary:

Granite Shoals, Texas; General Obligation

Primary Credit Analyst:

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Summary:

Granite Shoals, Texas; General Obligation

Credit Profile

US\$8.41 mil GO and Rfdg Bnds ser 2020 dtd 06/01/2020 due 08/01/2040

Long Term Rating AA-/Stable New

Granite Shoals GO

Long Term Rating AA-/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' rating to Granite Shoals, Texas' \$8.41 million series 2020 general obligation and refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA-' rating on the city's certificates of obligation outstanding. The outlook is stable.

The bonds are payable from a continuing and direct annual ad valorem tax levied against all taxable property within the city, within the limits prescribed by law. The city's series 2008 certificates of obligation are additionally secured by a limited pledge not to exceed \$1,000 of the surplus net revenues of the city's waterworks and sewer system. Given the limited nature of the revenue pledge, we rate the certificates based on the city's ad valorem pledge alone. Per state statute, the city's total tax rate is limited to \$2.50 per \$100 of assessed value (AV), \$1.50 of which can be dedicated for debt service. For fiscal 2020, the city's tax rate is 59.922 cents (35.15 cents for operation and 24.772 cents for debt service), which is well below the state's limitations. The ad valorem taxes are not levied on a narrower or distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service. Therefore, we view the limited-tax pledge to be on par with the issuer credit rating, which reflects the city's general creditworthiness. Approximately \$2.8 million of the bond proceeds will be used to refund the city's series 2010 certificates of obligation and 2018 GO bonds, with the remaining bond proceeds funding various water infrastructure improvements. After this issuance, the city will have approximately \$12.2 million in net direct debt outstanding, accounting for self-supporting debt from its waterworks and sanitary sewer system.

Credit Overview

Through strong tax base growth, driven primarily by residential development, the city has built up its available reserves, which totaled \$1.4 million, or 45% of operating expenditures, at fiscal 2019 year-end. We therefore believe the city should have sufficient reserves and liquidity to withstand a short-term decline in revenue brought on by the recession and the COVID-19 pandemic (see, "An Already Historic U.S. Downturn Now Looks Even Worse," published on RatingsDirect on April 16, 2020). With its reliance on property tax revenue, which accounted for 61% of general fund revenue in fiscal 2019, we believe the city is less likely to experience significant near-term revenue declines, due to the current recession and observance of social distance practices, as other cities that rely on more volatile revenue sources, such as sales or income tax. However, pressures resulting from the pandemic and recession could still pose budgetary challenges, particularly if sales tax or charges for services decline, or if a slowdown in development leads to

a decline in license and permits revenue. We will thus continue to monitor the effects of economic conditions on the city's revenues and expenses.

The rating also reflects our view of the city's:

- Adequate economy, with market value per capita of \$115,686 and projected per capita effective buying income at 71.9% of the national level;
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 45% of operating expenditures;
- Very strong liquidity, with total government available cash at 87.2% of total governmental fund expenditures and 3.9x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 22.1% of expenditures and net direct debt that is 254.6% of total governmental fund revenue, but rapid amortization, with 66.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We analyzed the city's environmental, social, and governance risks relative to the economy, financial management, budgetary performance, and flexibility as well as its debt and liability profile, and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

Stability of the rating will depend on management's ability to adjust to potential budgetary pressures brought on by economic disruptions from the COVID-19 pandemic. Therefore, if budgetary pressures are more severe than expected, leading to the city's available fund balance to decline to levels we consider nominally low, we could consider lowering the rating.

Upside scenario

Although unlikely to occur during the outlook period, we could consider raising the rating if the city's debt profile and income indicators were to improve, the latter resulting in an improvement in our view of the city's economy, while continuing to maintain a very strong available fund balance.

Credit Opinion

Adequate economy

We consider Granite Shoals' economy adequate. The city, with an estimated population of 5,268, is located in Burnet County. The city has a projected per capita effective buying income of 71.9% of the national level and per capita market value of \$115,686. Overall, the city's market value grew by 10.7% over the past year to \$609.4 million in 2020.

The roughly 5.7-square-mile city is about 60 miles northwest of Austin in Texas' Hill Country region. Granite Shoals is located along the shores of Lake LBJ, one of seven Texas Highland Lakes. The region contains numerous waterways and several golf courses within a 20-mile radius. Wealth and income reflect the city's primarily residential and limited economy.

Building activity in the city has increased during the past five years. The city voluntarily annexed Beaver Island and Web Isle during 2017, which contributed to the 31% increase in assessed value (AV) over the last two years. For fiscal 2021, management is expecting AV to increase by about \$15 million, or 2.4%. We believe this level of growth is reasonable given historical growth and the timing of assessments (assessments are as of Jan. 1, therefore AV for fiscal 2021 will be based on property value prior to the recession brought on by the COVID-19 pandemic), but future growth may slow depending on the effect the current recession has on housing development in the city.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key practices include management's use of conservative revenue and expenditure projections that take into account historical data and information from outside sources, where applicable. Management provides quarterly reports on budget-to-actual financial results to the city council. The city employs an annually reviewed investment policy that mirrors the Texas Public Funds Investment Act. Management provides quarterly investment reports to the city council that detail investment holdings and returns. The city's basic debt management policy limits debt to no more than 10% of AV, and its formal policy maintains at least 25% of general fund expenditures in reserve. While the city does not maintain a long-term financial plan, management is in a process of developing a capital improvement plan, centered on water sewer infrastructure improvements and annual street repairs.

Adequate budgetary performance

Granite Shoals' budgetary performance is adequate in our opinion. The city had operating surpluses of 3.7% of expenditures in the general fund and of 10.2% across all governmental funds in fiscal 2019. These figures have been adjusted for recurring transfers and capital expenditures funded with bond proceeds.

Including fiscal 2019, the city has reported operating surpluses in each of the last five audited fiscal years. In fiscal 2019, property taxes accounted for 61% of general fund revenue (69% of total governmental fund revenue), followed by intergovernmental revenue at 9%, and franchise and local taxes at 6%. For fiscal 2020, the city adopted a near balanced budget, and management expects to end the year with a general fund surplus near \$100,000. With its reliance

on property tax revenue, we believe the city is less likely to experience significant near-term revenue declines, due to the current recession and observance of social distance practices, as other cities that rely on more volatile revenue sources, such as sales or income tax. However, the budgetary performance score of adequate reflects our view that pressures resulting from the pandemic and recession could still pose budgetary challenges, particularly if sales tax or charges for services decline, or if a slowdown in development leads to a decline in license and permits revenue.

Very strong budgetary flexibility

Granite Shoals' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 45% of operating expenditures, or \$1.4 million.

The city has continued to build up reserves from a negative position in fiscal 2013 and has maintained reserves above its formal balance reserve policy since fiscal 2017. While the city's fund balance may decline depending on how severely tax collections are negatively affected by the recession, we expect the fund balance to remain at levels we consider very strong (that is above 15% of expenditures).

Very strong liquidity

In our opinion, Granite Shoals' liquidity is very strong, with total government available cash at 87.2% of total governmental fund expenditures and 3.9x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Granite Shoals' five privately placed loans amount to about \$8 million or 47% of the city's net direct debt. The series 2010 private placement with Texas Independent Bank has a variable interest rate and represents just 0.5% of total direct debt. The minimum interest rate allowed on the certificates is 4.25% and the maximum rate is 6%; the interest rate resets in August 2020 and again in August 2025. Should the interest rate be reset to the maximum allowed rate, we believe the city has sufficient liquidity to meet the required debt payments. In addition, we do not believe the city's private placements have permissive remedies that could result in a material reduction in its very strong liquidity position in the next two years.

All of Granite Shoals' investments comply with Texas statutes and the city's internal investment policy. At fiscal year-end 2019, investments included certificates of deposit and the TexPool Investment Pool, neither of which we consider aggressive.

Weak debt and contingent liability profile

In our view, Granite Shoals' debt and contingent liability profile is weak. Total governmental fund debt service is 22.1% of total governmental fund expenditures, and net direct debt is 254.6% of total governmental fund revenue.

Approximately 66.8% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor. The city does not have any tax-secured additional debt plans but it is in the early phases of planning for a potential revenue-backed bond to finance water system improvements.

We do not view pension and OPEB obligations as likely to pressure the city's budget over the outlook period, given the pension plan's adequate funding level and the city's limited OPEB liability.

The city participates in the following plans:

- Texas Municipal Retirement System (TMRS), with a funded ratio of 93% and a net pension liability of \$121,072.
- TMRS Supplemental Death Benefits Fund, with a net liability of \$57,206.

Granite Shoals' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 2.0% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

TMRS is an agent plan with assets jointly managed. Although the city funds 100% of its actuarially determined contribution, fiscal 2019 actual contributions fell slightly short of our static and minimum funding progress metrics. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, though there are offsetting factors. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020 on RatingsDirect.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

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.

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