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Ratings

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Summary:

Rollingwood, Texas; General Obligation

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Credit Profile		
US$9.095 mil GO rfdg bnds ser 2019 dtd 06/01/2019 due 09/30/2045		
Long Term Rating	AA/Stable	New
Rollingwood GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating to Rollingwood, Texas' series 2019 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA' rating on the city's previously issued GO debt. The outlook is stable.

The bonds are secured from the receipts of a continuing, direct annual ad valorem tax levied, within the limits prescribed by law, against all taxable property within the city. Article XI, Section 4, of the Texas Constitution is applicable to the city, and limits its maximum ad valorem tax rate to $1.50 per $100 assessed valuation for all city purposes. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," (published Jan. 22, 2018, on RatingsDirect), 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 GO debt pledge on par with our view of the city's general creditworthiness.

Bond proceeds will be used to refund the city's series 2012B bonds to generate interest savings.

Rollingwood is characterized by its exceptionally strong income levels and robust market values, which are further supported by the city's proximity to Austin's growing metropolis. At the same time, the city operates on a small budget, and any unexpected costs can pressure it, as has been the case over the last three years, resulting in reserve drawdowns. The new management team is proactively taking steps to plan for the future in identifying and pursuing new revenue sources while at the same time, assessing emerging environmental and IT risks, but lacks formal policies and procedures at this point. Although further drawdowns on reserves resulting from lack of planning to levels we consider nominally low could pressure the rating, the city's extremely strong local tax base provides it with the ability to raise necessary revenues to maintain credit quality.

The 'AA' rating reflects our opinion of the city's:

- Very strong economy, with access to the Austin-Round Rock broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Adequate budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 33% of operating expenditures;
- Very strong liquidity, with total government available cash at 78.3% of total governmental fund expenditures and 13.9x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 5.7% of expenditures and net direct debt that is 380.8% of total governmental fund revenue, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Rollingwood's economy very strong. The city, with an estimated population of 1,513, is a 0.7-square-mile landlocked community in Travis County, approximately 10 miles southwest of Austin off of MOPAC Expressway (Loop 1). It is in the Austin-Round Rock MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 255% of the national level, which we view as extremely high and a positive credit factor and per capita market value of $641,561. Overall, market value grew by 9.2% over the past year to $970.7 million in 2019. The county unemployment rate was 3.0% in 2017.

Rollingwood's population has grown to just over 1,500 residents who have access to Austin's broad and diverse economy. The city is currently undergoing residential development and is also optimizing the advantages of its commercial district through the development of an office building, which the city reports is almost entirely pre-leased. Given the exceptional income levels and the high property values (which approach $1 billion), we do not anticipate any material changes to the city's economic fundamentals over the next two years.

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

When crafting budget assumptions, officials use five years of historical data, tracking the tax base as well as revenue and expenditure trends. The city has a formal budget review policy in place for amendments, and there is also a quarterly budget review meeting with the mayor and city council, who receive monthly budget-to-actual reports.

Rollingwood does not have a capital improvement plan (CIP) in place, but it has hired a third party to produce a five-year plan to identify future projects, costs, and potential funding sources, which will be ready in June 2019. These include the potential sale and conversion of a building from a nonprofit organization to a hotel, as well as infrastructure improvements and retail development in the adjacent park, in partnership with the city of Austin and the U.S. Corp of Engineers. The purpose of this will include developing a boundary as one of several preventative measures against more frequent flooding, which occurs in the city given the exposed topography, as well as new potential revenue sources. It should be noted that while the absence of a formal CIP is not commensurate with a better assessment, we acknowledge that the city does address emerging risks, as demonstrated by the consideration of environmental factors in its planning, as well as attempts to safeguard the city--and the police department in particular--against cyber attacks in the previous budget round through staff training, regular data backups to the cloud, outsourcing IT oversight to a third party, and ensuring that the insurance policy covers against financial losses due to cyber attacks.

The city currently does not have a formal long-term financial plan, investment policy, or a debt management policy. An informal reserve policy requires the maintenance of three months of expenditures in general fund reserves, which the city has exceeded over the last three fiscal years.

Adequate budgetary performance

Rollingwood's budgetary performance is adequate, in our opinion. The city had deficit operating results in the general fund of negative 21% of expenditures, but a surplus result across all governmental funds of 37.3% in fiscal 2018.

In our view, given the relative size of the city's budget, modest changes tend to have a pronounced effect as expressed on a percentage basis. Rollingwood has had three years of deficits as a result of unbudgeted capital expenditures. Despite improvements in tax collections, the 2018 deficit primarily reflected a $428,000 expense regarding the relocation of water lines off private property.

The city's primary revenue sources include property taxes (43% of general fund revenues), sales taxes (26%), and licenses and fees (14%). Property and sales tax revenue have demonstrated consistent growth in recent years, and management believes this trend will continue in tandem with economic growth.

The city adopted a balanced budget for 2019, and year-to-date results indicate that revenue and expenditures are on target; officials expect to end the year with a slight surplus. Given these projections, we anticipate that budgetary performance should remain at least stable over the two-year horizon. However, given the relatively small size of the annual budget, small variations in revenue and expenditures can drastically affect performance. Continued unexpected expenditures and an inability to make intrayear corrections to address potential shortfalls could pressure the rating.

Very strong budgetary flexibility

Rollingwood's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 33% of operating expenditures, or $748,000.

The city maintained relatively strong fund balances in fiscal years 2016 and 2017 until the unexpected drawdown in fiscal 2018 due to the water line relocation. The city advises it does not plan to continue drawing down on fund balances, which remain above the nominally low levels, despite being close to our $500,000 negative adjustment level.

We believe that unforeseen expenditures could pressure the city's budgetary flexibility and thus our overall view of its credit quality. However, based on its track record of maintaining at least adequate performance over a longer time and adherence to its informal reserve requirements, we anticipate that the city should be able to maintain its strong flexibility on a percentage basis.

Very strong liquidity

In our opinion, Rollingwood's liquidity is very strong, with total government available cash at 78.3% of total governmental fund expenditures and 13.9x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

The city's strong access to external liquidity is demonstrated through its access to the market and issuance of GO and revenue bonds over the past 10 years.

Currently, all of Rollingwood's investments comply with Texas statutes and the city's investment policy. At fiscal year-end 2018, its investments consisted of certificates of deposit and TexPool, a state investment pool, which we do not consider aggressive. The city does not have any privately placed debt.

Weak debt and contingent liability profile

In our view, Rollingwood's debt and contingent liability profile is weak. Total governmental fund debt service is 5.7% of total governmental fund expenditures, and net direct debt is 380.8% of total governmental fund revenue. Overall net debt is low at 2.2% of market value, which is, in our view, a positive credit factor.

Rollingwood's net direct debt totals $12.6 million. Debt partially supported through the city's enterprise fund has been adjusted in our calculations. The city has no authorized but unissued bonds, and officials have no plans to issue any new-money debt over the next two years, although this may change on review of the new CIP in June 2019, which could become a constraining factor.

Rollingwood's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.9% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

The city made its full annual required pension contribution in 2018. It contributes to a nontraditional, joint contributory, hybrid defined-benefit pension plan administered by the Texas Municipal Retirement System (TMRS). Under state law governing the TMRS, an actuary determines the contribution rate annually. Assuming a 6.75% discount rate, the city recorded a net pension asset of $30,892 as of Dec. 31, 2017, the most recent actuarial valuation date. The plan reported a funded ratio of 98.6%. We do not believe the city's pension obligations present material risk given the conservative plan assumptions and the expectation that it will continue to fully fund the actuarially determined contribution amounts.

The city also participates in the cost-sharing, multiple-employer defined-benefit group-term life insurance plan operated by TMRS known as the Supplemental Death Benefits Fund. It contributes to the plan at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. In fiscal 2018, the city contributed $1,862 to the plan, equal to its annual required contribution. It may terminate coverage and discontinue participation in the Supplemental Death Benefits Fund by adopting an ordinance before Nov. 1 of each calendar year. We do not anticipate pension and OPEB costs becoming a budgetary challenge for the city during the next two years.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our opinion that Rollingwood's local economy will continue to provide sufficient revenues for its operations. It further reflects our view that despite recent use of reserves, levels remain very strong as a percentage of the city's budget, despite being relatively small on a nominal basis. Therefore, we do not expect to change the rating during the two-year outlook period.

Upside scenario

We could raise the rating if the city were to experience improved budgetary performance over the longer term, in combination with a sustained improvement in operating performance that increases reserves levels in line with those of higher-rated peers, particularly if supported by formalized policies and practices.

Downside scenario

If the city were to face budgetary pressures, either operational or capital related, or management were to continue drawing down on available reserves to levels we consider nominally low, without a plan to restore them, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015