Lubbock, Texas

Limited Tax Bonds
New Issue Report

Ratings

New Issues

General Obligation Refunding Bonds, Series 2016	AA+
Tax and Waterworks System Surplus Revenue Certificates of Obligation, Series 2016	AA+
Outstanding Debt	
Certificates of Obligation	AA+
General Obligation Bonds	AA+

Rating Outlook

Stable

Related Research

Fitch Rates Lubbock Power & Light, TX's $7.7MM Power System Rev Bonds 'A+'; Outlook Stable (March 2016)

Texas Tech University System (March 2015)

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New Issue Details

Sale Information: $25,965,000 General Obligation Refunding Bonds, Series 2016, and $97,120,000 Tax and Waterworks System Surplus Revenue Certificates of Obligation, Series 2016, scheduled to sell the week of April 4 via negotiation.

Security: A limited ad valorem tax pledge, not to exceed $2.50 per $100 taxable assessed valuation (TAV). The 2016 certificates of obligation are additionally secured by a nominal pledge of surplus net revenues (limited to $1,000) of Lubbock's (the city) waterworks system.

Purpose: To fund capital projects that largely benefit wastewater enterprises and municipal facility improvements. The GO refunding bonds will be used to refund certain outstanding obligations for debt service savings and to pay costs of issuance.

Final Maturity: GO refunding bonds: Feb. 15, 2034; certificates of obligation: Feb. 15, 2036.

Key Rating Drivers

Strong Financial Profile: The city maintains a solid financial position, characterized by healthy revenue-raising ability and robust reserve levels that exceed adopted policy. Fiscal performance is assisted by management's proactive forecasting and ongoing monitoring of financial results as well as consistent sales tax growth over fiscal years 2010–2015.

Reliance on Sales Taxes: The general fund relies heavily on economically volatile sales taxes, although credit concerns are partially mitigated by the city's healthy reserve levels and resilient economy.

Healthy Tax Base: The city's TAV is stable and diverse. TAV continues to grow at a steady pace annually. Fitch Ratings believes continued, moderate TAV gains over the near term are likely given current development trends.

Stable Regional Economy: Lubbock serves as the education and medical center as well as retail/commercial hub for this highly mechanized agricultural area. Unemployment remains low.

High Debt; Manageable Carrying Costs: The overall debt burden is moderately high relative to market value. Fitch believes this position will likely persist in the near term given the future borrowings required to implement the city's large, multiyear capital improvement program (CIP). Nonetheless, the city's long-term liabilities remain manageable on a budgetary basis even while maintaining a rapid pace of amortization.

Rating Sensitivities

Stability of Financial Profile: Maintenance of fiscal balance and stability in the city's reserve cushion underpin the 'AA+' rating.

Debt, Capital Program: Fitch expects some flexibility in the implementation of the city's debt and capital program as projected over the near term. Healthy enterprise operations, previously implemented utility and tax rate increases for capital needs and proactive forecasting also somewhat offset credit concerns.

Credit Profile

With an estimated population of about 241,000, the city is located in west Texas and covers about 119 square miles in Lubbock County. Steady population gains since 2000 average 1.5% annually, which is slightly below the state average. Educational attainment is comparable with national levels due in part to the outsized presence of Texas Tech University. The large student population contributes to income/wealth levels as measured by median household income between 15% and 20% below state and national averages.

Stable Economy; Moderate TAV Gains Continue

Year-over-year unemployment remained stable and very low at 3% in December 2015 with modest employment loss (1%) offset by comparable labor force decline. The city's unemployment rate was below the state (4.2%) and national (4.8%) averages for the same time period. Healthcare, education and government comprise the area's largest non-agricultural employment sectors.

TAV continues to steadily expand at a moderate pace. Gains have averaged nearly 4% annually over the past seven fiscal years, which brought TAV to $15 billion in fiscal 2016. Management attributes about one-half of the 6% TAV gain in fiscal 2016 to new construction. The city's tax base is largely residential with minimal taxpayer concentration. Fitch believes management's expectations for further, moderate TAV gains appear reasonable with various residential and retail/commercial projects under way or planned on the west side of the city and near Texas Tech University's large 35,000 student campus.

Property Value and Sale Tax Trends

Fiscal Year	Market Valuation	% Change	Sales Tax Revenues	Change
2010	12,766,189	4.2	51,008	0.6
2011	13,022,498	2.0	53,673	2.6
2012	13,373,603	2.7	57,304	6.8
2013	13,778,537	3.0	62,250	8.6
2014	14,145,194	2.7	64,651	3.9
2015	14,735,925	4.2	68,037	5.2
2016	15,580,847	5.7	N.A.	—

N.A. – Not available.

Near-term TAV trends should also be boosted by the recently announced construction plans of Monsanto Company. An approximately $140 million state-of-the art cotton seed processing facility is projected to open in late 2017. The site is expected to become Monsanto's primary U.S. hub for all commercial cotton seed processing operations.

Solid Finances Maintained

The city's financial position is strong, aided by formula-driven transfers to the general fund from the city-owned enterprises and management's continued attention to cost control and conservative budgeting. In addition, long-range fiscal and capital planning have been key components of management's sound financial practices. General fund operations have notably incorporated annual pay-as-you-go spending for capital projects that averaged about $6 million per year over the past seven fiscal years while maintaining stable to growing reserves. Historically, sales taxes from a 1% levy comprise the largest general fund resource, accounting for an above-average 37%, or $62 million, in fiscal 2015, followed by property taxes (30%) and payments in lieu of taxes from enterprises (19%).

Year-end fiscal 2015 results improved upon budget with healthy expenditure savings and some modest revenue outperformance from sales taxes (about $2 million, or 1.3% of spending). A

Select Rating History — GO and CO

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	3/22/16
AA+	Affirmed	Stable	3/19/15
AA+	Affirmed	Stable	4/10/14
AA+	Affirmed	Stable	3/12/12
AA+	Affirmed	Stable	3/4/11
AA+	Revised	Stable[a]	4/30/10
AA	Affirmed	Stable	1/5/10
AA	Affirmed	Stable	1/14/08
AA	Upgraded	Stable	6/5/07
AA–	Affirmed	Positive	4/19/06
AA–	Affirmed	Stable	7/25/05
AA–	Affirmed	Stable	2/22/05
AA-	Affirmed	Negative	9/22/04
AA-	Downgraded	Stable	7/15/03
AA+	Affirmed	RWN	4/29/03
AA+	Affirmed	—	2/21/02
AA+	Upgraded	—	5/23/00
AA	Affirmed	—	3/9/00
AA	Assigned	—	3/31/99

[a]Reflects rating recalibration. RWN – Rating watch negative.

Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from CreditScope, Lumesis, IHS and Zillow Group.

Related Criteria

Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings (February 2016)

Exposure Draft: U.S. Tax-Supported Rating Criteria (September 2015)

Tax-Supported Rating Criteria (August 2012)

U.S. Local Government Tax-Supported Rating Criteria (August 2012) resulting $8.6 million net surplus brought the unrestricted general fund balance up to $39 million at year-end fiscal 2015, or a sound 24.3% of spending from $30.5 million, or 19% of spending in fiscal 2014. General fund cash/investments totaled $32.6 million at year-end fiscal 2015 or slightly over two months of operations.

For fiscal 2016, the $168.8 million operating budget was adopted with a modest use of reserves ($2.7 million) to fund street improvements. Additional projected property tax revenue (totaling $5.6 million) from increases to the operating and debt service tax rate in combination with the year's TAV growth, along with various utility rate increases, support the year's budget priorities. Compensation adjustments (approximately $3 million) and the inclusion of $5.4 million in cash-funded capital projects consumed much of the year's increased revenues.

However, the total tax rate remained well below the $2.50 per $100 TAV limit, at just under $0.54 per $100 TAV in fiscal 2016. Meaningful local revenue-raising ability exists for most Texas cities with an increase to the operating property tax levy allowed annually as approved by a council majority.

Operations remain in line with budget year to date, although management indicates fiscal 2016 sales tax performance through December 2015 has softened. Receipts are down slightly year over year, trailing the year's $3 million, or 3% budgeted growth. Nonetheless, Fitch believes the city's extensive financial planning efforts and historically conservative budgeting practices should serve to mitigate any negative budgetary impact from this modest revenue downturn year to date.

The council recently approved additional reserves to be used in fiscal 2016 (approximately $5 million, or 3% of budgeted spending) for further capital spending on street improvements. General fund reserves are presently projected to total $32.9 million, or a still-sound 19.5% of budgeted spending at year-end fiscal 2016. This council decision remains consistent with adopted city policy requiring reserve levels at no less than 20% of operating revenues (excluding annual transfers from city-owned enterprises) while allowing excess reserves to fund pay-as-you-go capital spending. The city forecasts maintaining this reserve threshold throughout its five-year operating forecast to fiscal 2021.

General Fund Financial Summary

($000, Audited Fiscal Years Ended Sept. 30)

	2011	2012	2013	2014	2015
Revenues	106,318	113,361	120,424	123,222	133,290
Expenditures	128,649	136,113	144,908	151,519	154,063
Operating Surplus/(Deficit)	**(22,331)**	**(22,752)**	**(24,484)**	**(28,297)**	**(20,773)**
Transfers In	24,741	26,161	28,306	29,845	31,362
Other Sources	3,588	5,538	5,779	5,842	4,555
Transfers Out	3,939	2,656	3,926	10,616	6,565
Net Operating Surplus/(Deficit) After Transfers	**2,059**	**6,291**	**5,675**	**(3,226)**	**8,580**
Total Fund Balance	21,870	28,161	33,837	30,611	39,190
As % of Expenditures, Transfers Out and Other Uses	16.5	20.3	22.7	18.9	24.4
Unrestricted Fund Balance	21,715	28,056	33,721	30,484	39,072
As % of Expenditures, Transfers Out and Other Uses	17.4	20.2	22.7	18.8	24.3

Note: Numbers may not add due to rounding.

Moderately High Debt Burden; Healthy Enterprises Temper Large CIP

The city's overall debt burden is high relative to market value at approximately 6.3% in fiscal 2016, but somewhat more moderate on a per capita basis at about $4,100. Direct debt amortization is above average, with 70% of principal retiring in 10 years. Much of the city's outstanding tax-backed debt is fully supported by enterprise system revenues and, therefore, not included in Fitch's debt burden or carrying cost calculations. In the past, the city has not issued revenue bonds for its various enterprise systems with the exception of Lubbock Power & Light (LP&L; revenue bonds rated 'A+'/Stable by Fitch).

The city continues to implement a large CIP. The city council adopts only the current fiscal year of its CIP, which totaled $181 million in fiscal 2016 and is largely driven by various water, wastewater and electric utility projects. The city's rolling CIP (inclusive of the electric utility) for fiscal years 2016–2019 totals $432 million.

Fitch has some concern over the size of the city's tax-supported capital program, while recognizing some flexibility exists in its implementation over future years. Many projects are planned to be financed with self-supported debt. The city models in its five-year financial forecast increased rates and charges corresponding with the additional cost to support the enterprises' future capital projects. The proposed rate increases were adopted by the city council in its fiscal 2016 budget action for the water, wastewater and electric utility enterprise funds.

Manageable Retiree Costs

The majority of city employees participate in the Texas Municipal Retirement System (TMRS), a statewide, joint contributory, hybrid defined benefit pension plan. Under GASB68, the city reports its share of the TMRS net pension liability (NPL) at $91.8 million, with fiduciary assets covering 85.4% of total pension liabilities at the plan's 7% investment rate of return assumption. The city made its full actuarially determined pension contribution of $16.8 million in fiscal 2015.

The city also participates in a single-employer pension plan for its firefighters (Lubbock Fire Pension Fund, or LFPF). Under GASB68, the city reports its share of the LFPF NPL at $64 million, with fiduciary assets covering 74% of total pension liabilities at the plan's 7.75% investment rate of return assumption, or a slightly lower estimated 70% using a more conservative 7% investment rate of return. The city made its full actuarially approved pension contribution of $6.3 million in fiscal 2015.

Other post-employment benefits (OPEBs) offered by the city include an implicit rate subsidy for health and dental insurance coverage for retirees and their dependents. The city funds OPEBs annually on a pay-as-you-go basis ($5 million in fiscal 2015), which typically covers about 30% of the actuarially determined annual OPEB cost. The unfunded actuarial accrued liability (UAAL) for OPEBs totaled $155 million at the Oct. 1, 2013 actuarial date, or about 1% of market value. In total, the combined pension NPLs and OPEB UAAL represent about 2% of the city's fiscal 2016 market value. Carrying costs for the city (debt service, net of self-supporting enterprise debt, pension and pay-as-you-go OPEB costs) totaled a moderate 21% of governmental spending in fiscal 2015 despite the above-average pace of debt principal amortization.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.