

CREDIT OPINION

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New Issue

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Boerne (City of), TX

New Issue - Moody's Assigns Aa2 to City of Boerne's, TX Tax Notes

Summary Rating Rationale

Moody's Investors Service assigns a Aa2 to the City of Boerne's, TX \$22 million Tax Notes, Series 2017. Moody's maintains a Aa2 on \$32.3 million of the city's outstanding limited tax debt.

The Aa2 rating reflects the city's strong financial position maintained by conservative budgeting, consistent tax base growth benefiting from its proximity to San Antonio (Aaa stable), and above median but manageable debt profile.

The Aa2 limited tax rating is the same as Moody's internal assessment of the hypothetical general obligation unlimited tax rating reflecting the city's taxing headroom, which offsets the lack of full faith and credit pledge and inability of the council to override the statutory limitation.

Credit Strengths

- » Healthy reserve position maintained through conservative budgeting and strong performance
- » Continued tax base growth as city benefits from its location near San Antonio

Credit Challenges

- » Tax base is smaller than peers
- » Elevated debt profile

Rating Outlook

Moody's generally does not assign outlooks to local governments with this amount of debt outstanding.

Factors that Could Lead to an Upgrade

- » Substantial tax base growth
- » Significantly improved income levels

Factors that Could Lead to a Downgrade

- » Materially weaker reserves

- » Inability to refund tax note balloon payments
- » Tax base contraction
- » Significant debt issuance absent corresponding tax base growth

Key Indicators

Exhibit 1

Boerne (City of) TX	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$ 1,125,195	\$ 1,202,969	\$ 1,269,687	\$ 1,340,151	\$ 1,429,334
Full Value Per Capita	\$ 105,971	\$ 107,437	\$ 108,762	\$ 109,204	\$ 99,315
Median Family Income (% of US Median)	124.4%	115.3%	105.9%	101.9%	101.9%
Finances					
Operating Revenue (\$000)	\$ 15,037	\$ 14,388	\$ 14,930	\$ 18,052	\$ 18,756
Fund Balance as a % of Revenues	44.6%	53.1%	43.3%	47.0%	54.4%
Cash Balance as a % of Revenues	44.0%	52.5%	41.9%	49.1%	50.0%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 26,840	\$ 27,415	\$ 26,180	\$ 25,185	\$ 23,285
Net Direct Debt / Operating Revenues (x)	1.8x	1.9x	1.8x	1.4x	1.2x
Net Direct Debt / Full Value (%)	2.4%	2.3%	2.1%	1.9%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.1x	1.3x	1.3x	1.2x	1.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.5%	1.5%	1.5%	1.6%	1.7%

Source: City of Boerne, TX Comprehensive Annual Financial Reports FY 2012 - 2016, Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Moderately Sized Tax Base Near San Antonio Sees Consistent Growth

The city will continue to benefit from its location near San Antonio and economic development initiatives. Located about 30 miles north of [San Antonio](#) (Aaa stable) and serving as the county seat for [Kendall County](#) (Aa2), the city's assessed values have experienced continued steady growth in recent years, reaching a moderately sized \$1.55 billion for fiscal year 2017. Growth over the past five years has averaged 6.7% annually. The certified value for fiscal year 2018 increased 4.5% to \$1.62 billion, excluding about \$50 million still under protest. The city is primarily residential but is also focused on attracting retail and light manufacturing. Major industries include light manufacturing, tourism, outdoor recreation, and agribusiness. The population grew a substantial 69.5% between 2000 and 2010, and the growth has continued to an estimated population of 14,392 as of 2016 per the city, up 37% since the 2010 census. Officials report about 5,000 residential lots are available for development, with prices starting at \$250,000 and averaging \$350,000, and anticipate growth of about 250-275 homes per year for many years. The city, along with the county, has had renewed focus over the past five years on economic development. Officials noted that strategic decisions to provide matching funds for roadwork projects with the Texas Department of Transportation are improving the city's transportation network and creating additional economic development opportunities. Building permit trends year to date remain strong compared to the prior year, reflecting continued residential, multi-family, commercial, and mixed use development. Several large commercial developments will break ground within the next few months including a medical office, surgical center, and hotel and conference center.

Income indicators as measured by the 2015 American Community Survey of per capita income and median family income are 99.4% and 101.9% of the US respectively. The unemployment rate within the county was a low 3.2% as of May 2017 compared to the state (4.4%) and nation (4.1%).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Financial Operations and Reserves: Consistently Strong Financial Management Yields Stable and Healthy Reserves

Boerne will maintain healthy, above average reserve levels given strong financial management and conservative budgeting. The city has consistently maintained operating reserves exceeding 45% of revenues, realizing surpluses over the past five years even while completing some capital outlay. For fiscal year 2016, the city reported a large operating surplus of approximately \$1.8 million, primarily driven by very strong revenue performance. The ending available operating (General and Debt Service funds) reserve of \$10.2 million was 54.4% of revenues, notably higher than similarly rated peers. The city anticipates ending fiscal year 2017 with stable reserves compared to the budgeted draw \$584,000 due to favorable variance for both revenues and expenditures. The proposed fiscal year 2018 budget includes the use of approximately \$225,000 of reserves and \$610,000 of one-time capital projects. Given historically strong performance relative to conservative budgets, the city will likely continue to maintain very healthy reserves.

The city utilizes five year financial projections in all funds and formal fund balance policies to maintain strong performance. City policies require a three to six month reserve in the General Fund and one month reserve in the debt service fund. The annual budget as well as five year projections include conservative revenue and expenditure assumptions that the city has consistently outperformed over the last several years. Revenues are primarily derived from sales taxes and property taxes, which comprised 38.1% and 23.7% of total operating revenues in fiscal year 2016, respectively. The city is limited to a total property tax rate of \$25 per \$1,000 of assessed value, and the Texas Attorney General will not approve debt requiring a levy exceeding \$15 per \$1,000 of the \$25. Boerne maintains ample flexibility, currently levying \$1.29 for debt service and \$3.43 for operations for a total of \$4.72 per \$1,000 of assessed values.

LIQUIDITY

The operating cash balance as a percent of revenues (50%) is healthy, and has remained stable in line with the operating performance.

Debt and Pensions: Above Median Debt Profile is Manageable with Utility Support

The city has above median debt and moderate pension liabilities that will remain manageable given ongoing tax base growth and support from the utility system. Following the current sale, the city will have \$54.9 million in outstanding limited tax debt, equating to an above median 3.4% of the fiscal year 2018 certified value. A portion of the outstanding debt is supported by the city's utility system which, if netted out, reduces the city's debt profile to 2.7%. The city intends to support \$750,000 of the annual debt service of the current sale for the new city hall complex with transfers from the utility system's quality of life fund and \$250,000 of annual debt service on the road projects from other utility funds. This support will enable the city to maintain a level debt service tax rate.

The five year capital improvement plan reflects pay-go funding for capital needs. Officials report various projects are being considered for a bond election, though no firm plans have yet been determined.

DEBT STRUCTURE

All of the city's debt is fixed rate. The current sale has a seven year maturity with two large debt service payments in 2023 and 2024 of \$9.5 million each (\$10.5 million in total debt service). The city intends to refund the two final maturities in 2022 with general obligation limited tax bonds with a maturity of 2043. An inability to access the market to refund the 2023 and 2024 maturities would likely place negative pressure on the rating as it would require the substantial use of reserves and/or a significant tax rate increase for the city to make debt service payments.

With the addition of the current tax notes, payout is strong with 83.4% of principal retired within 10 years. Based on projections following the anticipated refunding of the balloon tax notes, payout is below average with 52.5% of principal retired within ten years.

The city does have a modest amount of outstanding tax notes that were privately placed. The tax notes are not subject to acceleration and mature in 2019.

DEBT-RELATED DERIVATIVES

The city is not party to any swap or derivative agreements.

PENSIONS AND OPEB

The city has a moderate pension liability from its participation in the Texas Municipal Retirement System (TMRS), an agent multi-employer joint contributory hybrid defined benefit plan. Moody's fiscal year 2016 adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported data, was about \$27.1 million, net of enterprise support, or a moderate 1.44 times operating revenues. The three year average of ANPL to operating revenues is 1.29 times. Moody's ANPL reflects certain adjustments we

make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

For fiscal year 2016, the city contributed approximately \$1.8 million to the retirement system (net of contributions made by the utility systems). This contribution was above the Moody's calculated "tread water" level of \$1.6 million. The "tread water" indicator measures the annual government contribution required to prevent the reported net pension liability from growing, under reported assumptions. Contributions above this level cover all net pension liability interest plus pay down some principal. Ratios comparing government contributions to the "tread water" level and "tread water" costs to government revenues shed light on budgetary fixed cost burdens.

The city's OPEB costs are minimal, with total contributions of about \$43,000 to the TMRS Supplemental Death Benefits Fund and retiree health plan, both funded pay-as-you-go.

Total fixed costs including debt service, pensions, and OPEB were \$4.1 million for fiscal year 2016 or 21.8% of total operating revenues.

Management and Governance: Strong Financial Performance Reflects Tenured Staff and Formal Policies

Boerne operates under a council-manager form of government. The council is comprised of the mayor and five other members elected by district. Members are elected to two year staggered terms. The city manager is responsible for the day-to-day operations. The city enjoys a well-tenured and experienced staff. Strong financial performance reflects conservative financial practices and formal policies.

Texas Cities have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property taxes, one of the sector's major revenue sources are subject to a cap, which cannot be overridden. However, the cap of \$25 per \$1,000 of assessed values with no more than \$15 allocated for debt, still allows for significant revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Texas is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Legal Security

The tax notes are secured by a direct and continuing ad valorem tax within the limits prescribed by law on all taxable property within the city.

Use of Proceeds

Proceeds of the notes will be used for the design, construction, and equipping of a new city hall complex as well as several street improvement projects.

Obligor Profile

The City of Boerne is located in Kendall County in central Texas, approximately 30 miles northwest of San Antonio. The city serves a population estimated at 14,392 as of 2016, up 37% since the 2010 census.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

Ratings

Exhibit 2

Boerne (City of) TX

Issue	Rating
Tax Notes, Series 2017	Aa2
Rating Type	Underlying LT
Sale Amount	\$22,000,000
Expected Sale Date	08/16/2017
Rating Description	General Obligation Limited Tax

Source: Moody's Investors Service

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