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Ratings

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Summary:

Floresville, Texas; General Obligation

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Credit Profile		
US$14.225 mil comb tax and rev certs of oblig ser 2023 dtd 01/15/2023 due 09/01/2042		
Long Term Rating	BBB/Positive	New
Floresville GO (BAM)		
Unenhanced Rating	BBB(SPUR)/Positive	Upgraded

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings raised its underlying rating to 'BBB' from 'BBB-' and revised the outlook to positive from stable on Floresville, Texas' general obligation (GO) debt.
- At the same time, we assigned our 'BBB' long-term rating and positive outlook to the city's approximately $14.2 million combination tax and limited pledge revenue certificates of obligation, series 2023.
- The upgrade reflects the removal of the auditor's going concern opinion in fiscal 2021, which capped the rating at 'BBB-' previously.
- The positive outlook reflects our view that there is at least a one-in-three chance that the rating could be subsequently upgraded within the two-year outlook period if reserves continue to increase and general fund operations remain balanced.

Security

The certificates and outstanding bonds are payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within the city's borders. The 2023 certificates are additionally secured by up to $1,000 of net revenues derived from operation of the city's combined utility system. However, due to the limited nature of this additional pledged revenue, we rate the certificates based on our view the city's ad valorem tax pledge. The maximum allowable ad valorem tax rate in 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 total tax rate is well below the maximum, at 45.5 cents, 26.3 cents of which is dedicated to debt service. We view the limited-tax GO debt pledge on par with the city's general creditworthiness because 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.

Officials intend to use series 2023 certificate proceeds to fund capital projects citywide, including street improvements.

Credit overview

The upgrade reflects the removal of the going concern opinion and positive general fund operations for fiscal 2021, while the positive outlook reflects an expected sizable surplus in fiscal 2022 from American Rescue Plan Act (ARPA) funds totaling $1.9 million that will materially improve the city's reserve position as well as projections for at least balanced general fund operations for fiscal 2023. However, the rating remains capped at 'BBB' due to a negative fund balance of less than -5% of operations for the past three audited fiscal years. There is also an 'A' cap due to a weak management score. While the auditor's going concern opinion was removed for the fiscal 2021 audit (and the 'BBB-' cap is no longer applicable), we think a longer track record of positive, audited, operating results and a positive reserve position will bolster the city's credit profile and likely result in removal of the management rating cap.

We believe the city's location outside of the growing San Antonio-New Braunfels metropolitan statistical area (MSA) will underscore ongoing economic growth and favorable demographic trends. The city's debt and contingent liability profile remains very weak, but there are no near-term debt plans and pension costs remain manageable.

The rating reflects our opinion of the city's:

- Growing local economy, with access to a broad and diverse MSA;
- Weak management that caps the rating at 'A', with standard practices and policies under our Financial Management Assessment (FMA) methodology that have recently improved and coincide with an improving financial position, and a strong institutional framework;
- Budgetary performance that has improved due to budget adjustments, with positive reserves projected for fiscal 2022 due largely to receipt of $1.9 million in ARPA funds; and
- Very weak debt profile, with no additional debt plans and manageable pension and other postemployment benefit (OPEB) costs.

Environmental, social, and governance

We have analyzed the city's environmental, social, and governance risks relative to its economy, budgetary outcomes, management, and debt and long-term liability profile, and view them as generally neutral within our credit rating analysis.

Outlook

The positive outlook reflects at least a one-in-three chance that we could again raise the rating, possibly by multiple notches, within the next two years if the city sustains its improved budgetary balance and continues to grow its reserves by demonstrating a longer track record of balanced or positive operations.

Downside scenario

We could lower the rating or revise the outlook to stable if budgetary performance becomes imbalanced, leading to a sustained decline in reserves.

Upside scenario

We could raise the rating if the city is able to maintain reserves at a level that we view as very strong and in line with its fund balance policy and budgetary performance remains at least adequate without the use of one-time revenues or increased transfers from enterprise funds.

Credit Opinion

Improving budgetary performance combined with a material jump in available reserves expected due to ARPA funds

The city's available general fund balance (assigned and unassigned) has been negative since fiscal 2017 due to ineffective budget assumptions, a lack of corrective budget amendments and adjustments, and the elimination of a due from line item related to the city's 4A corporation. As of the fiscal 2021 audit, the latest available, the available fund balance sits at negative $578,000, or - 12% of general fund expenditures.

However, this negative balance is expected to materially improve when audited fiscal 2022 figures are available because of the receipt of $1.9 million in ARPA funding, which the city decided to use as revenue replacement as allowed under guidance by the U.S. Treasury Department. If this higher level of reserves is maintained and the general fund demonstrates sustained balanced or positive operations, we could raise the rating further.

Alongside the infusion of ARPA funds into the general fund in fiscal 2022, the city has also improved its budget assumptions and financial monitoring to sustainably improve general fund operations and maintain reserves in line with its formal fund balance policy of 30% of expenditures. With the arrival of a new city manager in 2021 and a new finance director in 2020, the city made changes to its budget assumptions, budget adjustment practices, budget monitoring practices, and expenditure controls. These changes are first reflected in fiscal 2021 with a surplus of $281,000 after transfers. For fiscal 2023, officials expect at least breakeven operations.

Despite the negative fund balance over the past four fiscal years, the city has not borrowed for cash flow purposes as it has liquidity in its enterprise funds. Moving forward, if the going concern opinion is removed and the city reports surplus operations as expected in the general fund, leading to increased reserves to a level more in line with those of higher-rated peers, we could raise the rating by one or several notches.

Recently enhanced management practices and policies that are helping improve the city's financial performance, though the management score remains weak

We have revised our view of management from very weak to weak following the removal of the going concern opinion ('BBB-' rating cap) in the fiscal 2021 audit and the addition of a formal capital improvement plan (CIP) and improved budget assumptions and financial oversight. However, the rating remains capped at 'A' as the management score remains weak. While current policies and practices may reflect a stronger view of management, we would like to see additional audited results that reflect such efforts before considering removal of the management rating cap.

Based on our FMA methodology, our view of the city's financial policies and practices has improved from vulnerable to standard. Over the past two years, new city management has focused on revising its budgeting practices to restore structural balance in the general fund and rebuild reserves.

Current practices include management's:

- Revenue and expenditure assumptions based, in part, on three years of historical data and straight-line projections, coupled with the use of outside sources to assist with projections for sales, hotel, and property taxes, although actual year-end expenditures often exceeded budgeted amounts;

- Monthly budget updates provided to the city council that show a budget-to-actual comparison, but addressing necessary intrayear revenue and expenditure changes to meet fiscal targets has been a challenge for the city;
- A formal CIP that looks out five years and includes funding sources and project costs for each year;
- Formal investment policy that follows state guidelines, with monthly reporting of holdings and performance to the council; and
- Formal reserve policy that states a target for the unassigned balance of 30% of operations in the general fund, a level not adhered to as of the fiscal 2021 audit but that is expected to be met once fiscal 2022 figures are final.

Floresville does not currently have a formal debt management policy or a long-term financial plan. However, management has implemented certain procedures and practices to try to mitigate cyber security risks.

The institutional framework score for Texas municipalities is strong.

Stable local economy with access to San Antonio

Floresville's local economy has historically centered on agricultural activities, but residential and commercial growth to the south of San Antonio is changing the economic landscape of the city and region. Floresville is located just 25 miles south of San Antonio along U.S. Highway 181, and residents have access to employment opportunities throughout the MSA. The tax base is expected to grow over the near term due to ongoing residential and commercial developments that include an auto dealership, new fast-food venues, various retail establishments, and over 200 new residential buildings.

Very weak debt profile, though no additional debt plans

The city does not have plans to issue additional debt over the next two years. It privately placed its series 2016 tax notes (outstanding principal of $435,000) for city hall improvements, vehicles and equipment, and engineering fees, along with other citywide improvements. The privately placed debt does not present a contingent liquidity risk in our opinion as principal cannot be accelerated in the event of a default per the bond ordinance.

Pension and OPEB highlights

We do not view pension and OPEB liabilities as an immediate credit risk for the city.

The city participates in the following plan as of Dec. 31, 2020 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 91% funded, with a net pension liability equal to $760,000. Contributions are actuarially determined, and the city has historically fully funded its annual required costs. Actuarial assumptions include a 6.75% discount rate. The city's contribution in fiscal 2021 exceeded 100% of our static funding and minimum funding calculations, indicating that contributions are making progress towards full funding.

The city provides medical benefits to eligible retirees and pays the full individual coverage contributions for retirees meeting certain eligibility requirements. Retirees pay premiums for coverage in the OPEB programs. Retirees are eligible for medical, dental, prescription, and life insurance benefits until death of employee in service.

Floresville, TX: Key Credit Metrics				
	Most recent	**Historical information**		
		2021	**2020**	**2019**
Adequate economy				
Projected per capita EBI % of U.S.	80.2			
Market value per capita ($)	69,190			
Population		7,554	7,105	
County unemployment rate(%)		4.4		
Market value ($000)	605,202	422,965		
Ten largest taxpayers % of taxable value	11.0			
Adequate budgetary performance				
Operating fund result % of expenditures		5.9	(16.6)	3.3
Total governmental fund result % of expenditures		(1.2)	(15.4)	16.4
Weak budgetary flexibility				
Available reserves % of operating expenditures		(12.1)	(20.0)	(32.5)
Total available reserves ($000)		(578)	(1,213)	(1,415)
Very strong liquidity				
Total government cash % of governmental fund expenditures		71.6	34.9	25.5
Total government cash % of governmental fund debt service		402.9	230.8	121.3
Weak management				
Financial Management Assessment	Standard			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		17.8	15.1	21.0
Net direct debt % of governmental fund revenue	292.9			
Overall net debt % of market value	5.7			
Direct debt 10-year amortization (%)	34.3			
Required pension contribution % of governmental fund expenditures		4.1		
OPEB actual contribution % of governmental fund expenditures		0.0		
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