DATE June 14, 2019

TO Honorable Mayor and Council Members

SUBJECT Rating Agencies Comment on Property Tax Reform Legislation - INFORMATION

On June 12, 2019, the Texas Property Tax Reform and Transparency Act of 2019 (SB 2) was signed into law, taking effect on January 1, 2020. The legislation limits the rollback rate to 3.5 percent from 8 percent, reducing property tax revenue increases certain local governments can levy without voter approval for Maintenance and Operations. Rating agencies, including Moody’s Investor Services (Moody’s), S&P Global Ratings (S&P), and Fitch Ratings (Fitch) have provided commentary on the effect of SB 2 on credit ratings.

Fitch stated that the legislation, “could negatively impact Fitch’s assessment of certain local governments’ independent revenue raising ability,” although, “the strength or weakness of other considerations (revenue growth prospects, expenditure flexibility, long-term liability burden, and operating performance) will determine how much a shift in the revenue-raising ability assessment will affect an entity’s overall rating.” Moody’s also noted that the property tax reform was, “a credit negative for bulk of local governments,” however, “despite the limitations in Senate Bill 2, most local governments in Texas will continue to benefit from new investment resulting in taxable property not subject to the 3.5% revenue-increase limit.” Following the bill being signed into law, S&P explained that, “this constraint, coupled with expanding infrastructure demands, could reduce financial flexibility and stress Texas municipalities’ creditworthiness.”

The legislation does not place the same restriction on the Debt Rate and as Moody’s states, “given that the debt service levy is legally separate from the amount restricted under the 3.5 percent Senate Bill 2 limit, local governments will maintain direct control over the rate necessary to service debt.” Additionally, the City is currently rated A1 (Stable) by Moody’s, AA- (Stable) by S&P, and AA (Stable) by Fitch, backed by prudent financial management and policies, a strong local economy, and robust financial reserves.
DATE       June 14, 2019

SUBJECT   Rating Agencies Comment on Property Tax Reform Legislation – INFORMATION

Please let me know if you need additional information.

M. Elizabeth Reich
Chief Financial Officer

[Attachments]

C: T.C. Broadnax, City Manager
   Chris Caso, City Attorney (Interim)
   Mark Swann, City Auditor
   Bilierae Johnson, City Secretary
   Preston Robinson, Administrative Judge
   Kimberly Bizar Tolbert, Chief of Staff to the City Manager
   Majed A. Al-Ghafry, Assistant City Manager

   Jon Fortune, Assistant City Manager
   Joey Zapata, Assistant City Manager
   Nadia Chandler Hardy, Assistant City Manager and Chief Resilience Officer
   Michael Mendoza, Chief of Economic Development and Neighborhood Services
   Laila Alequresh, Chief Innovation Officer
   Directors and Assistant Directors
Fitch Ratings: TX Tax Proposals Could Limit Local Government Revenue Flexibility

Fitch Ratings-Austin-07 February 2019: Bills recently filed in both chambers of the Texas legislature (HB 2 and SB 2) propose to significantly lower the rollback property tax rate for local Texas taxing entities with a certain amount of annual tax revenue and require ratification elections if rollback rates are exceeded. According to Fitch Ratings, this legislation if enacted could negatively impact Fitch's assessment of certain local governments' independent revenue raising ability—a component of one of Fitch's four key rating drivers in its U.S. public finance tax supported rating criteria.

The rollback rate in Texas currently is a calculated rate that produces an increase in operating tax levy of 8% from the prior year's levy. If local taxing jurisdictions exceed the rollback rate they are subject to a petition and, if the petition garners enough signatures, an election to reduce the rate back to the rollback rate. HB 2 and SB 2, which are backed by the governor, lieutenant governor and speaker of the house, would both reduce the rollback rate from 8% to 2.5% for local taxing units with combined annual property and sales tax revenue of at least $15 million. Taxing units below the $15 million threshold would retain the current 8% rollback rate. School districts, which have separate operating tax rate constraints, are excluded from the proposed changes. The bills would also require a ratification election—replacing the current petition process—if any local taxing unit exceeds its rollback rate (either 2.5% or 8%). Local rollback petitions and elections historically have been relatively rare.

In analyzing a local government's revenue framework, Fitch considers the entity's ability to independently increase operating revenues (without voter or other jurisdiction approval). For Texas cities, counties, community college and special districts, Fitch views the current rollback tax structure as only a potential threat to revenue-raising ability, noting that a restriction on tax revenue increases would require both a successful petition effort and subsequent election. Fitch considers the limit on operating revenues to be the more restrictive of the constitutional and statutory tax limits (e.g. $2.50 for cities, $0.80 for counties, $1.00 for community college districts), or the voted or charter caps on local government tax rates and/or revenue growth. Nearly all of the Texas local governments rated by Fitch are well below their tax rate or revenue limits. As a result, the assessments for independent revenue-raising ability for Texas cities, counties, community college and special districts are with few exceptions at the 'aaa' level.

The magnitude of the reduction to independent revenue-raising ability for targeted Texas local governments will depend on the requirements of any legislation ultimately signed into law. Previous efforts to reduce the rollback rate have failed, due in no small part to concerted opposition from local governments around the state; lobbying efforts to defeat the current proposal are already underway. Legislators also may negotiate a reduction in the rate to a level between the current 8% and 2.5%; other bills have been introduced that would reduce the rollback rate to 4%.
Most local governments retain the ability to increase non-tax revenues (e.g. fines, service charges and fees), which could offset the impact of a lower rollback rate as it relates to revenue-raising ability. In addition, Fitch considers the amount that can be raised relative to expected revenue volatility in a typical downturn; as a result, application of a uniform rollback rate limitation would not have the same effect on all governments. Finally, the assessment of independent revenue-raising ability is only one component of Fitch's analytical framework. The strength or weakness of other considerations (revenue growth prospects, expenditure flexibility, long-term liability burden, and operating performance) will determine how much a shift in the revenue-raising ability assessment will affect an entity's overall rating.

Contact:

Steve Murray
Senior Director
+1-512 215-3729
Fitch Ratings, Inc.
111 Congress Ave., Suite 2010
Austin, TX 78701

Amy Laskey
Managing Director
+1-212 908-0568

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY’S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH’S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN
exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

---

**ENDORSEMENT POLICY** - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.
Local government – Texas

Property tax reform limits revenue-raising ability, a credit negative for bulk of local governments

On May 25, the Texas (Aaa stable) legislature passed property tax reform legislation (Senate Bill 2) that further limits most local governments' ability to raise revenue, a credit negative. The governor is expected to sign the bill into law, which would then take effect on January 1, 2020.

The bill reduces property tax revenue increases without voter approval to 3.5% from 8% annually on existing properties (new construction is excluded from the limit). Voter approval to override the limitation requires a simple majority. The restriction applies to the portion of municipal revenue used for government operations; it does not restrict revenue for debt service. The legislation offers some flexibility by allowing local governments to “bank” up to three years of unused margin for an increase greater than 3.5% in a year.

The measure lowers the limit for cities, counties, municipal utility districts (MUDs) and other entities that can levy a property tax, but the limit will remain at 8% for community college and hospital districts. At the same time, the bill reduces the number of signatures required to petition a rollback in the event the 8% limit is exceeded by the districts. Small local governments can increase their operational levy up to $500,000 as long as the amount does not equate to more than an 8% revenue increase derived from existing property. If the amount is above that limit, only 3% of voters are required to initiate a rollback election under Senate Bill 2, down from 7% or 10%. Under separate legislation, also expected to be signed by the governor, school districts would have to reduce tax rates if property value growth exceeds 2.5% in fiscal 2021.

With Senate Bill 2 set to take effect in fiscal 2021, local governments have time to adjust budgets, though most have already begun to prepare. The bill will mostly affect budgets that take effect in August and September of 2020.

The bill also aims to increase transparency by creating an online database that defines, simplifies and highlights proposed levy changes and provides for immediate citizen input with an online comment form and information on when public hearings will be held.

Revenue-raising ability to pay debt service not affected by legislation

Limitations on revenue-raising restrict financial flexibility, hampering credit quality. However, Senate Bill 2 does not hinder the ability to raise revenue to pay debt service.
In Texas, property taxes are set based on two legally separate rates that combine to form an overall governmental unit’s levy: an “operational rate,” which is subject to the revenue limit in Senate Bill 2, and a “debt service rate,” which is not subject to the limit. Expenditures using funds raised under the debt service rate are defined by statute and approved and enforced by the attorney general. Revenue raised under this rate cannot be used for operational expenditures.

Given that the debt service levy is legally separate from the amount restricted under the 3.5% Senate Bill 2 limit, local governments will maintain direct control over the rate necessary to service debt. In Texas, most school and municipal utility debt carries a general obligation unlimited tax (GOULT) pledge; most city and county debt has a general obligation limited tax (GOLT) pledge.

**Homeowner savings minimal, but budgetary impact on governments would be significant**

The new legislation stands to reduce individual tax burdens minimally but hurt local governments substantially. The median home price in Texas is $150,000; the median operational tax rate is $4.30 per $1,000 of assessed value. An 8% increase in the revenue would lead to the owner of a $150,000 home paying $696.60, assuming the rate in the previous tax year was $4.30. Under the 3.5% limitation in Senate Bill 2, the homeowner would pay slightly less at no more than $667.58 — a difference of only $29.00. Under that scenario, the homeowner’s cumulative savings over 10 years would be just $2,260 (see Exhibit).

For a local government with property tax operating revenues of $25 million, however, the difference between a 3.5% increase annually versus an 8% increase would translate to a cumulative 10-year loss of over three times the current year’s revenues. More specifically, the 3.5% restriction would result in an $87.6 million loss in potential property tax collections over 10 years. However, the short-term impact would be much less dramatic. In the first year with municipal revenue increases subject to the 3.5% limit, the reduction in potential revenues would be only $1.1 million.

**Senate Bill 2 provides homeowners with marginal property tax relief, while limiting local governments ability to raise revenue**

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Cumulative lost property tax revenue for local government (left axis)</th>
<th>Cumulative homeowner savings (right axis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2021</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2022</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2023</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2024</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2025</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2026</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2027</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2028</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2029</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>

**Economic slowdown would magnify impact of Senate Bill 2**

Texas cities have relatively high debt burdens compared with their national peers — 2.0% vs. 1.1%, respectively, for Moody’s-rated cities. Senate Bill 2 stands to increase debt burdens if reduced excess tax revenue forces cities to use the capital markets more frequently to address infrastructure needs versus the cash funding that traditionally has offset rising debt burdens.

If debt ratios rise while tackling capital needs, a prolonged economic slowdown and escalating debt service schedule could reduce a government’s political will to increase taxes. As a result, a government may be forced to tap dwindling reserves or cut services, leading to considerable credit challenges.

Despite the limitations in Senate Bill 2, most local governments in Texas will continue to benefit from new investment resulting in taxable property not subject to the 3.5% revenue-increase limit. However, if the economy cools significantly, the restriction would
become much more of a burden. For example, cities that face rising pension liabilities, debt service payments and other necessary operational costs, such as emergency response employees, would likely have fewer expenditure-cutting options.
MOODY’S INVESTORS SERVICE

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000, stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) fees.

MOODY’S CREDIT RATINGS and MOODY’S PUBLICATIONS are NOT INTENDED FOR USE BY RETAIL INVESTORS and it would be reckless and inappropriate for retail investors to use MOODY’S CREDIT RATINGS or MOODY’S PUBLICATIONS when making an investment decision. If in doubt you should contact your financial or other professional adviser. All information contained herein is protected by law, including but not limited to, copyright law, and none of such information may be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed, or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without MOODY’S prior written consent.

CREDIT RATINGS AND MOODY’S PUBLICATIONS are NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES and MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY’S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided “AS IS” without warranty of any kind. MOODY’S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY’S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY’S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody’s publications.

To the extent permitted by law, MOODY’S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY’S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY’S.

To the extent permitted by law, MOODY’S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY’S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY’S IN ANY FORM OR MANNER WHATSOEVER.

Moody’s Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody’s Corporation (“MCO”), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody’s Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody’s Investors Service, Inc. fees ranging from $1,000 to approximately $2,700,000. MCO and MIS also maintain policies and procedures to address the independence of MIS’s ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading “Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy.”

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY’S affiliate, Moody’s Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody’s Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to “wholesale clients” within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY’S that you are, or are accessing the document as a representative of, a “wholesale client” and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to “retail clients” within the meaning of section 761G of the Corporations Act 2001. MOODY’S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody’s Japan K.K. (“MJKK”) is a wholly-owned credit rating agency subsidiary of Moody's Group Japan K.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of Moody’s. Moody’s Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization (“NRSRO”). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) fees ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.
Texas Local Governments Could Face Budget Headwinds--And Credit Quality Strain--From Property Tax Reform

Jun 12, 2019

Key Takeaways

- New legislation limits Texas governments’ ability to raise maintenance and operations (M&O) property tax revenues above 3.5% without voter approval.
- Cities and counties likely will explore various strategies to manage the new revenue restriction.
- We believe that this constraint, coupled with expanding infrastructure demands, could reduce financial flexibility and stress Texas municipalities’ creditworthiness.

On June 12, 2019, the governor of Texas signed the Texas Property Tax Reform and Transparency Act of 2019, a law requiring certain local government units to obtain voter approval to increase maintenance and operations (M&O) property tax revenues more than 3.5% above the previous year, excluding new construction. The effective date of the legislative change is tax year 2020, and S&P Global Ratings notes that the law does not affect the levy of property taxes for debt service. The legislation does provide carve-outs for low M&O rate taxing units, such as hospital districts, junior colleges, and certain taxing entities--including cities with a population of less than 30,000--to have a de minimis rate; and an unused increment rate to be added to the 3.5%.

The potential reduced flexibility associated with the new voter-approval requirement could hurt/stress credit quality for cities, counties, and other taxing entities affected by the legislation. For many years, local governments could collect up to 8% more in annual M&O property tax revenues without the risk of a petition process by voters to trigger an election to increase the rate above the revenue-neutral tax rate. S&P Global Ratings believes that lowering the voter-approval threshold for M&O property tax revenues could restrict many local governments’ ability to collect revenues to meet growing budgets and service demands. While proponents of the bill argue that the legislation provides taxpayer relief and local governments should find ways to reduce wasteful spending to manage budgets, many local governments are already allocating money to high or rising fixed costs such as debt and pension obligations. Texas cities and counties maintain higher-than-average debt burdens compared with local governments across the country, spurred by required infrastructure investment due to above-average population growth. Some options to offset the revenue-raising constraints are cutting services, deferring maintenance, and reducing payroll and benefits.

For example, over the past 25 years, Travis County (AAA/Stable) levied property taxes at a rate much lower than the previous 8% allowed while maintaining budget balance and financial flexibility. Only once in the past 25 years has the county needed to levy 8% above the effective M&O rate. However, in many years the county levied more than the 3.5% voter-approval threshold, to keep up with rising budgets and demand for services tied to rapid population growth (see chart). Travis County is not unique in this case: many cities, counties, and taxing jurisdictions would have similar outcomes.
Some Flexibility Is Available To Manage Tax Rates

The law allows for an unused increment to factor into the calculation. For example, if a local government adopts a tax rate below the 3.5% voter-approval rate, the unused difference can be carried forward for up to three years. This is similar to other states where tax caps exist, providing future revenue-raising flexibility. Despite this provision, there is an argument that in years where a local government could levy well below the 3.5% voter-approval rate, it would be incentivized to levy at least 3.5% to ensure it could capture maximum revenues and protect against future budgetary pressures. In the example of Travis County, this would have occurred in 16 of the past 25 years.

Another consequence of the revenue-limiting legislation could be higher-than-normal transfers into general operating funds from water and sewer or enterprise funds, which could be supported by rate increases. This alternative to funding expenditures would likely be more prevalent in the case of smaller local governments that manage general and enterprise funds more holistically.

Officials from major cities and counties, including Dallas and Houston, spoke out against the legislation while it was being debated during the legislative session. Officials from Fort Worth noted that recent changes to the city’s funding of pension obligations, which included increased contributions, would have been extremely difficult in the environment that the new law creates.

The Legislation Has Potential To Strain Municipalities’ Creditworthiness

We believe local governments in Texas benefit from a general lack of statutory property tax levy limits, which is reflected in our institutional framework score and above-average ratings on rated Texas local governments. Revenue loss from the new legislation has the potential to create structural gaps in future years, particularly in circumstances where economic growth is stagnant. While municipalities with strong economic development initiatives are better positioned to deal with the legislative change, we believe that areas of slow growth with moderately-sized property tax bases could begin to rely more heavily on alternative forms of revenue like sales taxes and service charges/fees, which can be more volatile. In addition, local governments that use pay-as-you-go financing to cash fund portions of their capital budget may begin redirecting excess revenues to cover recurring and inflationary costs and instead issue debt financing for capital projects, subsequently raising their debt service tax rate. Considering new election requirements to surpass the 3.5% limit as well as reduced revenue-raising flexibility, coupled with increasing service and infrastructure demands, we believe the legislation could adversely affect Texas local governments’ credit quality.

Related Research
Texas Budget Talks Involve Wrangling Property Taxes, School Funding, And Other Long-Term Liabilities, April 11, 2019

This report does not constitute a rating action.