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Ratings

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Summary:

Alamo Heights, Texas; General Obligation

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Table Of Contents

Summary:

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Credit Profile		
US$4.36 mil GO rfdg bnds ser 2020 dtd 10/15/2020 due 08/15/2032		
Long Term Rating	AAA/Stable	New
Alamo Heights GO bnds		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Ratings assigned its 'AAA' long-term rating to the City of Alamo Heights, Texas' $4.4 million series 2020 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the city's previously issued GO debt. The outlook is stable.

The series 2020 bonds, as well as the city's GO debt outstanding, constitute direct obligations of the city, payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within its borders. Despite state statutory tax rate limitations, we make no distinction between the city's limited-tax debt rating and its general creditworthiness because the ad valorem taxes are collected from a broad tax base, and because there are no restrictions on what the limited tax can be used for, which supports our view of the city's overall ability and willingness to pay debt service. State statutes limit the ad valorem tax rate for cities to $2.50 per $100 of taxable assessed value (AV) for all purposes. In addition, the Texas attorney general will permit the allocation of $1.50 of the $2.50 maximum tax rate for ad valorem tax debt service. In fiscal 2020, the city's total levy was well below the maximum at 38.6 cents per $100 of AV, 5 cents of which is dedicated to debt service. Bond proceeds will be used to refund existing debt for an expected net present value savings.

Alamo Heights' GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013 on RatingsDirect, the city has predominantly (96%) locally derived general fund revenue sources with independent taxing authority and independent treasury management from the federal government.

Credit overview

With a largely residential base in the San Antonio metropolitan statistical area (MSA), the city is somewhat insulated from the near-term pressures related to the ongoing COVID-19 pandemic. The city's primary source of revenue is property taxes, and its second-largest is sales tax. Although sales taxes can be volatile, the city's largest sales tax remitter is a large grocery store whose sales have increased sales throughout the pandemic. This, combined with available reserves in excess of 50% of expenditures, should allow the city to weather any near-term pressures related to the pandemic. Longer term, the city's strong management practices and policies and minimal fixed cost burdens should enable it to maintain its very strong financial profile. Given this, we believe that the city's outlook will remain stable over the next one to two years.

For more information on the coronavirus' effect on U.S. public finance, see the reports "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions," published April 2, 2020, and "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020.

The rating further reflects our view of the city's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 54% of operating expenditures;
- Very strong liquidity, with total government available cash at 82.5% of total governmental fund expenditures and 11x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 7.5% of expenditures and net direct debt that is 34.2% of total governmental fund revenue, as well as rapid amortization, with 84.5% of debt scheduled to be retired in 10 years, but significant medium-term debt plans; and
- Strong institutional framework score.

Environmental, social, and governance factors

Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic, specifically how stay-at-home orders and an extended economic slowdown may weaken the city's revenue. However, we do not view the city as at heightened risk compared with the rest of the sector. Otherwise, we consider social risks as in line with the sector. We also view governance and environmental risks as in line with the sector.

Stable Outlook

Downside scenario

We could consider a lower rating if the COVID-19 pandemic and economic recession lead to financial pressures and a substantial decline in reserves or if debt issuances outpace estimates, resulting in a material weakening of the city's debt profile.

Credit Opinion

Very strong economy

We consider Alamo Heights' economy very strong. The city, with an estimated population of 7,232, is located in Bexar County in the San Antonio-New Braunfels MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 214% of the national level and per capita market value of $264,829. Overall, the city's market value grew by 2.3% over the past year to $1.9 billion in 2021. The county unemployment rate was 3.1% in 2019.

The city is a residential bedroom community 4.5 miles north of downtown San Antonio. Although the city does have a modest commercial presence, along two main thoroughfares, the tax base largely reflects the residential nature: 87% of AV comes from single-family homes. Additionally, the City of San Antonio fully encapsulates Alamo Heights, with no room for expansion. Given this built-out status, the city relies on redevelopment and on appreciation of values. The city expects one such project to be complete by the end of the year. Magnolia Heights is a mixed-use development consisting of 150 upscale apartment units, with retail space on the ground floor. Another project consists of a four-story office building. Outside of these projects, officials report that activity is largely confined to residential remodels.

Given the city's largely residential nature, officials report minimal impact as a result of the continuing pandemic. The city's largest taxpayer, both property and sales, is an H-E-B grocery store that has benefited from stay-at-home orders. While the city's economy is stable, we note that the recession may temper this stability somewhat if unemployment grows and demand for housing wanes. However, given the certified valuation growth for fiscal 2021 and ongoing redevelopment projects, we expect the city's tax base to remain stable over the next two years.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our financial management assessment methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

The city bases its revenue and expenditure assumptions on an analysis of historical data and consultations with the appraisal district. Detailed budgetary performance reports are presented to elected officials quarterly, along with a report on investment holdings and earnings. As part of the annual budget process, the city updates its five-year projections for the general and utility funds, which it uses to identify potential shortfalls or budget gaps in out years. The city also maintains a five-year capital improvement plan that it updates as part of the budget process, with projects primarily funded with operating revenue. This is because the city also has a formal debt management policy that not only outlines the types and purposes of debt that can be issued, but also limits the city's debt to no more than 1% of AV. With regard to its minimum fund balance, the city has adopted a general fund target of no less than 25% of expenditures, which it has remained in compliance with.

Adequate budgetary performance

Alamo Heights' budgetary performance is adequate, in our opinion. The city had operating surpluses of 12.5% of expenditures in the general fund and of 2.0% across all governmental funds in fiscal 2019. Our assessment accounts for our expectation that budgetary results could deteriorate somewhat in the near term. Furthermore, we believe that the pandemic and recessionary pressures could weaken our view of future performance.

Our view of the city's budgetary performance includes adjustments to account for recurring transfers in and out, as well as to adjust for a nonrecurring transfer to the capital projects fund in fiscal 2019. The city has historically maintained strong budgetary performance, largely as a result of AV (AV) growth. Given that property taxes are the largest revenue stream, accounting for around 52% of general fund resources, this growth is the primary driver behind the strong results. Additionally, the city's sales tax revenue continues to grow, though it accounts for a much more modest share of the budget (at just 11%). Fiscal 2019 results continued this trend, with a $1.2 million operating surplus when accounting for the aforementioned one-time transfer. Sales taxes and building permit revenue (related to a sizable development) exceeded budgeted estimates. Expenses, meanwhile, came in under budget largely as a result of personnel turnover.

The city's fiscal 2020 budget anticipated a surplus of around $326,000. With the onset of the pandemic in March, the city has faced increasing expenses in the form of personal protective equipment purchases and employee overtime costs. However, the city expects to be fully reimbursed from federal relief funds. Favorably, the city had largely collected property taxes before March and sales taxes grown year to date, offsetting plummeting interest earnings on the city's investments. Officials attribute the sales tax growth to H-E-B's status as the largest sales tax remitter and to increased sales at the grocery store as residents have been working from home and/or quarantined over the past six months. The city anticipates ending the year with a surplus of $200,000 to $400,000, despite the uncertainty that the pandemic and recession have brought about.

The city's proposed fiscal 2021 budget anticipates another surplus. The budget reflects a modest increase in revenue given AV growth of more than 2%, amid a slight reduction in expenditures as the city remains cautious about filling vacant positions. While we believe that the uncertainty stemming from the continuing pandemic and recessionary pressures is significant, we believe that the city's revenue structure provides some near-term relief. If property values begin to stagnate or decline as a result of elevated unemployment and a weaker housing market, we expect that future budgets could become strained. However, we don't expect budgetary performance to fall below adequate levels.

Very strong budgetary flexibility

Alamo Heights' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 54% of operating expenditures, or $5.4 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The city has historically maintained very strong budgetary flexibility, above 30% of expenditures. Surpluses in each of the past three fiscal years drove reserves in excess of 50% as of fiscal 2019. Officials report that they may spend approximately $800,000 to augment bond proceeds for a drainage and stormwater project within the next two years. With an expected surplus in fiscal 2020 , we believe that general fund balance will be maintained in excess of 30% and in line with city's formal policy.

Very strong liquidity

In our opinion, Alamo Heights' liquidity is very strong, with total government available cash at 82.5% of total governmental fund expenditures and 11x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary as demonstrated through somewhat infrequent debt issuances over the past two decades. As of Sept. 30, 2019, investments were primarily held in various local government investment pools, with the remainder in certificates of deposit. We do not consider these investments aggressive. We understand that the city has no privately placed debt or other contingencies that would weaken our assessment of the city's liquidity profile.

Strong debt and contingent liability profile

In our view, Alamo Heights' debt and contingent liability profile is strong. Total governmental fund debt service is 7.5% of total governmental fund expenditures, and net direct debt is 34.2% of total governmental fund revenue. Approximately 84.5% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor. The city's significant medium-term debt plans dampen our view of its debt profile.

Following this issuance, the city will have $5.4 million in debt outstanding. However, officials are calling an election to authorize the issuance of $13.25 million to fund stormwater and drainage improvements. The city will leverage grant funding to complete the project, combined with the GO issuance and $2.1 million in certificates of obligation. While the potential issuance will result in an elevated debt load, we don't expect this to materially weaken our view of the city's debt profile.

Pension and other postemployment benefit (OPEB) liabilities

We do not view pension and OPEB liabilities as an immediate source of credit pressure, as required contributions represent an affordable share of total governmental expenditures. Alamo Heights' required pension and actual OPEB contributions totaled 7.8% of governmental fund expenditures in 2019. The city made its full annual required pension contribution.

The city participated in the following plans as of Dec. 31, 2018:

- Texas Municipal Retirement System (TMRS): 73% funded with a net pension liability of $7.3 million
- TMRS Supplemental Death Benefit OPEB Plan: unfunded with a net OPEB liability of $324,000

TMRS' actuarially determined contributions fell slightly short of our minimum funding progress (MFP) metric. The MFP metric assesses whether the most recent employer and employee contributions cover total service cost, plus unfunded interest cost, plus one-30th of the principal. When MFP is achieved, this indicates that an issuer has strong funding discipline that aims to ensure timely progress on reducing its plans' liabilities. Given that this is an agent plan, assets are jointly managed. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, though there are offsetting factors. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020.

The city also participates in the cost-sharing, multiple-employer defined benefit group-term life insurance coverage operated by TMRS, known as the Supplemental Death Benefits Fund. The city may terminate coverage and discontinue participation by adopting an ordinance before Nov. 1 of any year to be effective the following Jan. 1. It has historically contributed 100% of the contractually required rate as determined by an annual actuarial valuation.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments