S&P Global
Ratings

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Summary:

San Antonio, Texas; Appropriations; General Obligation; Note

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Table Of Contents

Summary:

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Credit Profile		
US$24.5 mil gen imp rfdg bnds ser 2019 dtd 01/01/2019 due 08/01/2025		
Long Term Rating	AAA/Stable	New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to San Antonio, Texas' series 2019 general improvement refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating on the city's existing general obligation (GO) debt, its 'AA+' long-term rating on San Antonio Municipal Facilities Corp.'s debt, its 'AA+' long-term rating on San Antonio Public Facilities Corp.'s debt, and its 'AA+' long-term rating on Starbright Industrial Development Corp.'s debt issued on behalf of the city. The outlook is stable.

San Antonio's 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 a predominantly locally derived revenue base, with 67% of general fund revenue derived from local taxes, and independent taxing authority, and we believe that pledged revenue supporting debt service on the bonds has a limited risk of negative sovereign intervention.

The GO bonds, certificates of obligation, and tax notes are secured by the city's revenue from an annual ad valorem tax on all taxable property in San Antonio. The maximum allowable 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 per $100 of AV. In fiscal 2019, the city levies 55.827 cents per $100 of AV, 21.150 cents of which is dedicated to debt service.

Additional security for the certificates is provided by the city's surplus net revenue from its municipal parks system (not to exceed $1,000). Given the de minimis pledge, we rate the certificates based on the city's GO pledge.

We do not differentiate between the city's limited-tax GO debt and its general creditworthiness given that the ad valorem tax is not derived from a measurably narrower tax base and that there are no limitations on the fungibility of resources.

San Antonio Municipal Facilities Corp.'s series 2010 and 2011 lease revenue bonds are secured by lease payments based on the city's annual appropriation from legally available general fund revenue as an ongoing obligation for the lease term.

San Antonio Public Facility Corp.'s series 2012 bonds are secured by and payable from the trust estate, which consists primarily of lease payments to be made by the city to the corporation pursuant to the sublease. The city's obligation to make lease payments is a current expense, payable solely from funds annually appropriated by the city for such use. The sources of payment for the lease payments include primarily hotel occupancy tax receipts and any other lawfully available funds to the extent necessary.

Starbright Industrial Development Corp.'s series 2013 contract revenue refunding bonds are secured by San Antonio's portion of revenue received from City Public Service (CPS). The revenue transfers from CPS to the city are subject to the availability of excess CPS funds, but according to the bond ordinance the utility is required to transfer funds as long as it has debt outstanding. The transfer of funds has occurred since 1963, and the city is reliant on these funds for operations. The maximum amount CPS is required to transfer to the city is 14% of gross revenue less the city's costs for usage of gas and electric services from CPS.

The one-notch difference on the San Antonio Municipal Facilities Corp.'s series 2011 and 2012 bonds, San Antonio Public Facility Corp.'s series 2012 bonds, and the Starbright Industrial Development Corp.'s series 2013 bonds reflects the annual appropriation risk.

Proceeds from the bonds will refund a portion of the city's debt outstanding for savings.

The rating reflects our opinion of the following credit factors for the city:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Very strong management, with strong financial policies and practices under our financial management assessment methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 21.3% of total governmental fund expenditures and 1.5x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 14.0% of expenditures and net direct debt that is 131.9% of total governmental fund revenue; and
- Strong institutional framework score.

Strong economy

We consider San Antonio's economy strong. The city, with an estimated population of 1.5 million, is located in Bexar County in the San Antonio-New Braunfels MSA, which we consider broad and diverse. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 82.1% of the national level and per capita market value of $78,053. Overall, the city's market value grew by 8.5% over the past year to $114.7 billion in 2019. The county's unemployment rate was 3.5% in 2017.

With about 1.5 million residents, San Antonio is Bexar County's seat and the nation's seventh-largest city. The major military installations in the city continue to provide a stabilizing presence for the economy. Tourism also thrives in the city, with attractions, such as the San Antonio Riverwalk, that draw millions of visitors annually. The growing presence of the finance industry, as well as medical and biomedical companies, has helped diversify the area economy, which has historically been anchored by the military and tourism sectors.

San Antonio is expected to grow by approximately 1 million people by 2040. Given these projections, city leadership engaged local citizens, local governments, businesses, the military, and advocacy groups in a collaborative process to address key aspects of sustainable growth such as transportation, housing, education, infrastructure, sustainability, economic diversification, workforce development, and business attraction and retention.

One of the sectors the city actively targets in its economic development efforts is the health care and bioscience industry, one of its leading economic generators. Eight financial institutions' national headquarters are in San Antonio, as are four financial institutions' regional headquarters. The key components of the health care industry are three major medical centers: the South Texas Medical Center, the San Antonio Military Medical Center, and the Southwest Foundation for Biomedical Research.

Redevelopment of the city's downtown has been a major project, with a goal of having 7,500 housing units in the greater downtown area by 2020. The project is ahead of schedule; to date, more than 6,500 units have been completed. Another major initiative, the San Pedro Creek Culture Park improvement project, is under construction and will create 2,100 housing units. Once completed, the project is estimated to have a $1.5 billion economic impact over 10 years from an increase in property value, additional tax revenue, and additional jobs created downtown.

Another major initiative, the Alamo Plaza, is projected to add 4,100 jobs when completed in 2024. The Alamo Master Plan, approved in 2017, seeks to recapture the historical footprint of the Alamo, remove vehicular traffic, reclaim the plaza courtyard, and build a new visitor center and museum. The project will be funded with a combination of city, state, and private endowment funds, and is projected to generate $9.5 million in city revenue and $17.1 million in state revenue annually.

Over the past year, the city has added more than 4,000 new jobs in targeted industries to its employment base, including USAA (1,500), Ernst & Young (600), and Credit Human (485).

Officials report that permitting activity continues to increase and that construction is ongoing. In 2017, 84,400 permits were issued with a total value of $3.4 billion. In January to November of 2018, permits were up slightly compared with the prior-year period, with a total of 85,500 permits totaling $3.2 billion.

The city's tax base has increased steadily since fiscal 2013 following three consecutive declines in fiscal years 2010 to 2012. Over the past five fiscal years (2014 to 2019), AV increased by nearly 9% annually. Given the significant amount of new construction, combined with redevelopment and appreciation of existing values, we anticipate that tax base growth will continue and that the city's economy will remain strong.

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 financial practices are strong, well embedded, and likely sustainable.

San Antonio's city council has adopted a comprehensive set of financial and budgeting policies. Highlights of the city's financial policies include a minimum fund balance requirement for the general fund, limits on the use of reserve funds, and use of a statistical model given that management bases its revenue forecasts on historical trends.

Management prepares monthly budget reports, provides budget status reports to the council, and amends the operating budget as needed. The council annually adopts a five-year rolling capital improvement plan (CIP) and forecasts ongoing costs linked to the operating budget. Management also prepares five-year financial forecasts that it presents annually to the city council.

The council has adopted an investment policy that it reviews annually, and management provides the council with quarterly investment reports on holdings and returns. The city utilizes a comprehensive financial analysis and computer modeling in its debt management plan. The plan incorporates numerous variables such as sensitivity to interest rates, changes in assessed values, annexations, current ad valorem tax collection rates, self-supporting debt, and fund balances.

Strong budgetary performance

San Antonio's budgetary performance is strong in our opinion. The city had operating surpluses of 2.6% of expenditures in the general fund and of 2.2% across all governmental funds in fiscal 2017. General fund operating results of the city have been stable over the past three years, with a result of 1.1% in 2016 and a result of 2.4% in 2015.

We have adjusted the city's total governmental revenue and expenditures for recurring transfers and one-time items such as spending-down of previously deposited bond proceeds.

Depending on the level of capital spending from year to year, the budgetary flexibility tends to fluctuate. The adopted fiscal 2018 budget projected a small 1.2% general fund deficit as a result of increased spending on streets and other priorities per city council direction, but preliminary figures indicate a 1.4% surplus.

The adopted fiscal 2019 budget shows a slight drawdown of 2.5%, incorporating the council's priorities, such as increased spending for streets and affordable housing. However, given historically favorable budget-to-actual variances and no plans for significant drawdown across total governmental funds (net of bond proceed spending), we expect the city's budgetary performance to remain strong.

The city budgets on a two-year basis and maintains a five-year financial forecast; it has no plans to significantly draw down its reserves or materially alter its budget practices. It is common practice for the city to project budget gaps and work throughout the year to close them and maintain its historically strong financial position.

The forecast fiscal 2020 general fund budget is structurally balanced.

According to the city's fiscal 2019-2023 financial forecast, general fund revenue is expected to grow annually at rates ranging from 2.6% to 3.3%, including 3.3% in fiscal 2019.

On the expenditure side, the general fund forecast reflects the annual projected expenditures required to sustain the current levels of service. The growth in expenditures over the forecast period is primarily due to increases in contractual requirements such as the police collective bargaining agreement, mandated operational costs associated with the completion of capital projects, inflationary increases, health care costs, and the continuation of the civilian pay plan.

The city council recently identified street maintenance and affordable housing as priorities for the next few years. The five-year financial forecast identifies funds potentially available for such policy issues. Hence, the city could utilize a portion of available fund balance. However, any draws would occur only after satisfying the policy to maintain a 15% available fund balance. Given San Antonio's strong fiscal discipline, we don't expect the planned draws to have a material impact on its finances.

The general fund continues to rely on contributions from the city's electric provider, City Public Service Energy; this utility revenue is the largest source of general fund revenue and accounted for about one-third of total general fund revenue in fiscal 2017, followed by property taxes (29%) and sales taxes (24%). Although the utility operates in a deregulated environment, we believe that its favorable and competitive position mitigates the risks with the city's dependence on these payments.

Very strong budgetary flexibility

San Antonio's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 19% of operating expenditures, or $212.9 million.

The city has a history of conservative budgeting practices, demonstrating a broad and well-embedded culture of fiscal discipline, and has historically exceeded budgeted projections.

Actual operating results for fiscal 2017 reflected an increase in the nominal level of reserve, but after adjustments for recurring transfers and one-time capital expenditures, reserve levels have remained at about 20% of expenditures per the audited results.

Given the estimated fiscal 2018 results, coupled with a formal 10% reserve policy and a target of at least 15%, as well as historically conservative budgeting, we expect the city's flexibility to remain very strong.

However, we note that the city could face potential financial pressures in the future stemming from public safety costs and recent events as described in more detail below.

In November, the city dropped a lawsuit against its firefighters' association after the Texas Supreme Court refused to hear the case in the summer. The city sought to overturn the "evergreen clause" included in the expired collective bargaining agreement (CBA). The evergreen clause effectively keeps in place the CBA's terms, including compensation provisions, for a period of 10 years following its expiration in 2014. The city filed the lawsuit after the association declined to negotiate a new CBA that would include changes to benefits, such as requiring firefighters to pay health care premiums for themselves or their dependents. The firefighters currently do not contribute toward these costs.

The city was successful in mediating a CBA with its police force in 2016, and this resulted in cost savings for the city, including an estimated $87.5 million in health care cost avoidance. This enabled the city to keep public safety spending under 66% of general fund expenditures. However, the city is fairly close to this self-imposed limit at about 64.3% in fiscal 2018. This is significantly higher than that of peers across the nation, and a major contributing factor is the historically generous public safety benefits. While we believe that the city will be able to manage these expenditures in the near term, escalating benefit costs could begin to crowd out other essential services and result in budgetary pressure.

Another potential source of budgetary pressure stems from recent charter amendments championed by the firefighters' association and approved by voters in the November election.

The first amendment limits the city manager's office term to eight years and compensation to 10x the salary of the lowest-paid city employee.

The second amendment allows the firefighters' association to unilaterally declare an impasse in negotiations and requires San Antonio to enter into binding arbitration. We believe that any potential arbitration outcome that imposes additional costs on the city could have significant ramifications for its budget and its financial position.

At this time, however, there is no indication of any immediate pressures as no new negotiations between the city and the firefighters' association have taken place. However, we will monitor the outcome of any negotiations and will assess the impact on the city's finances as needed.

Very strong liquidity

In our opinion, San Antonio's liquidity is very strong, with total government available cash at 21.3% of total governmental fund expenditures and 1.5x governmental debt service in 2017. In our view, the city has exceptional access to external liquidity if necessary.

Our calculations include liquid investments with maturities of less than one year.

In our view, the city has exceptional access to external liquidity if necessary, supported by its regular annual issuances of tax-supported debt and utility revenue debt. All of its investments comply with Texas statutes and the city's internal investment policy. The city's investments are not aggressive, in our view, and are available and liquid within a year. San Antonio investments include obligations of the U.S., money market funds, and state-pooled investments, which we do not consider aggressive, given the portfolio diversification. We expect the city's liquidity to remain very strong given management's demonstrated ability to maintain balanced operations.

The city has several series of privately placed debt that is fixed, with no acceleration or events of default that could pressure its liquidity. In December 2016, the city entered into a variable-rate transaction that has a 30-year amortization. The certificates have a three-year fixed rate at 2.64% and a one-year call option as well as multimodal conversion flexibility at the end of the initial three-year interest rate period.

San Antonio has no contingent liabilities that could lead to unexpected deterioration in its liquidity.

We note that our view of the city's liquidity could weaken if a new contract with the fire union requires the city to make any large one-time payments, such as retroactive pay to account for lost cost-of-living adjustments. However, the timing of any negotiations and the potential impact are unknown.

Weak debt and contingent liability profile

In our view, San Antonio's debt and contingent liability profile is weak. Total governmental fund debt service is 14.0% of total governmental fund expenditures, and net direct debt is 131.9% of total governmental fund revenue.

After this issuance, the city will have roughly $580 million of authorized but unissued debt from its 2017 bond election. Over 67% of voters approved a total of $850 million in bonds, with no expected tax rate impact. Officials plan to issue a total of about $670 million in additional debt in fiscal years 2019 and 2020. We do not anticipate that this planned issuance will have a material impact on San Antonio's debt profile, as it is roughly equal to debt amortizing over the same period.

San Antonio's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.7% of total governmental fund expenditures in 2017. Of that amount, 6.0% represented required contributions to pension obligations, and 1.7% represented OPEB payments. The city made its full annual required pension contribution in 2017.

San Antonio provides two pension benefit plans to its employees: the Texas Municipal Retirement System (TMRS) and the Fire and Police Pension Fund.

The TMRS is a nontraditional, joint contributory, hybrid defined benefit pension plan. Under state law governing the TMRS, an actuary determines the contribution rate annually. The city has historically made its full required contributions. The plan recorded a net pension liability of $494.6 million as of Dec. 31, 2016, the most recent actuarial valuation date. The plan reported a funded ratio of 72.8%, assuming a 6.75% discount rate, which is a slight decline from the funded ratio of 72.9% at Dec. 31, 2015. The plan's fiscal 2017 audit, which will be reflected in the city's fiscal 2018 financial statements, shows a decline in net pension liability to $422.4 million and a funded ratio of 77.9%.

The Fire and Police Pension Fund is a single-employer defined benefit retirement plan administered by the San Antonio Fire and Police Pension Fund. The plan is funded in accordance with state statutes and contributions are not actuarially determined. The plan recorded a net pension liability of $577.2 million as of Dec. 31, 2016, the most recent actuarial valuation date. The plan reported a funded ratio of 83.1%, assuming a 7.25% discount rate, which is a slight increase from the funded ratio of 79.7% at Dec. 31, 2015. The plan's fiscal 2017 audit, which will be reflected in the city's fiscal 2018 financial statements, shows a decline in net pension liability to $349.3 million and a funded ratio of 90.2%.

Plan provisions include a backwards deferred retirement option plan (BackDROP), which provides a lump-sum benefit. On retirement, retirees who choose the BackDROP will receive a lump-sum payment for a number of full months of service elected by the member that does not exceed the lesser of (1) the number of months of service credit the member had in excess of 20 years, or (2) 60 months and a reduced annuity payment.

The city also provides other postemployment health benefits to most retired employees through two plans, which it funds on a pay-as-you-go basis.

The Retiree Health Benefits Fund covers civilian employees and uniform employees retiring prior to Sept. 30, 1989. The unfunded liability for the plan was $288.9 million as of Oct. 1, 2016, the most recent actuarial valuation date, and the plan was unfunded.

Fire and police personnel retiring after Sept. 30, 1989 are covered under the Fire and Police Retiree Health Care Fund. The unfunded liability for the plan was $595.1 million as of Jan. 1, 2017, the most recent actuarial valuation date, and the plan was 37% funded.

Given the current funded status of the city's pension plans and strategies to manage future costs, we do not believe pension and OPEB liabilities present material risk to its debt and contingent liability profile.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our view of San Antonio's very strong budgetary flexibility and liquidity, which is supported by very strong management. The stable outlook is further supported by San Antonio's broad and diverse economy and strong budgetary performance, which will likely allow management to continue to meet its capital and growing service delivery needs.

We do not expect to change the rating during the two-year outlook period because we believe the city will maintain a very strong financial profile and that its economy will continue to prosper. However, a material deterioration of its budgetary performance resulting in a reduction of available fund balance to levels no longer comparable with those of peers, or a weakening of its key economic indicators could place pressure on the ratings.

The rating could also come under pressure if the renegotiated terms of the city's collective bargaining agreement with the firefighters' association significantly increase the city's public safety expenditures or require large lump-sum payments. These potential pressures are a source of uncertainty and will not necessarily emerge within the outlook horizon, but could affect the city's budgetary flexibility and liquidity, and thus we will assess any potential credit impact as more information emerges.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of December 17, 2018)		
San Antonio		
Long Term Rating	AAA/Stable	Affirmed
San Antonio		
Long Term Rating	AAA/Stable	Affirmed
San Antonio note		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of December 17, 2018) (cont.)		
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO		
Long Term Rating	AAA/Stable	Affirmed
San Antonio GO nts		
Long Term Rating	AAA/Stable	Affirmed
San Antonio Mun Facs Corp, Texas		
San Antonio, Texas		
San Antonio Mun Facs Corp (San Antonio) (Pub Safety Answering Point Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Antonio (Mun Facs Corp) (Dev and Bus Svcs Ctr Proj)		
Long Term Rating	AA+/Stable	Affirmed
San Antonio Pub Facs Corp, Texas		
San Antonio, Texas		
San Antonio Pub Facs Corp (San Antonio) (convention ctr refinancing and expansion proj)		
Long Term Rating	AA+/Stable	Affirmed
Starbright Indl Dev Corp, Texas		
San Antonio, Texas		
Starbright Indl Dev Corp (San Antonio)		
Long Term Rating	AA+/Stable	Affirmed

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MOODY'S INVESTORS SERVICE

Rating Action: Moody's assigns Aaa to City of San Antonio, TX's Series 2019 GOLT; stable outlook

10 Dec 2018

New York, December 10, 2018 -- Moody's Investors Service has assigned a Aaa to the City of San Antonio, TX's $24.5 million General Improvement Refunding Bonds, Series 2019. We have also maintained the Aaa issuer rating and Aaa rating on the city's previously issued general obligation limited tax (GOLT) debt. Post sale, the city will have $1.9 billion in GOLT debt.

RATINGS RATIONALE

The Aaa issuer and GOLT rating is supported by a growing and vibrant economy, anchored by dynamic sectors that have spurred stable employment trends. The city also benefits from a solid financial profile that benefits from steady operating performance and significant revenue raising flexibility. Wealth and residential income levels in the city are low, reflective of its expansive size and also consistent with areas that demonstrate high institutional presence. The credit profile is constrained by the city's high debt load, driven by increasing demand for goods and services, a byproduct of strong population growth. The elevated debt profile is a large contributor to high fixed costs. Favorably, the pension burden is affordable and not expected to be a source of negative pressure within the next three to five years.

The Aaa GOLT rating is the same as the Moody's issuer 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.

RATING OUTLOOK

The stable outlook reflects the expectation that strong financial management practices, stabilized operating performance, and a growing local economy will continue to support stable credit fundamentals and keep long term liabilities manageable.

FACTORS THAT COULD LEAD TO AN UPGRADE

-Not applicable

FACTORS THAT COULD LEAD TO A DOWNGRADE

-Weakened financial performance

-Weakened economic profile, contraction in assessed valuation

-Growth in unfunded pension liability resulting in budgetary pressure

-Increasing debt levels absent corresponding taxable value growth

LEGAL SECURITY

The bonds are secured by an annual ad valorem tax levied against all taxable property within the limits prescribed by law.

USE OF PROCEEDS

The bond will refund the Series 2006 HUD loan for an expected net present value saving of 2.7% and no extension of final maturity.

PROFILE

San Antonio, the county seat of Bexar County (Aaa stable), is the seventh largest city in the nation, and the second most populous metropolitan area in Texas (Aaa stable). The local economy is anchored by three primary sectors: military, financial services and tourism. The city estimates the current population at 1.5 million.

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.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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MOODY'S INVESTORS SERVICE

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MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

San Antonio, Texas

New Issue Report

Ratings

Long-Term Issuer Default Rating[a]	AA+
New Issue	
General Improvement Refunding Bonds, Series 2019	AA+
Outstanding Debt	
Limited Tax Bonds[a]	AA+
Municipal Facilities Corporation Lease Revenue Bonds[b]	AA
Public Facilities Corporation Lease Revenue Bonds[b]	AA
Starbright Industrial Development Corporation (Starbright Project) Contract Revenue Bonds[b]	AA

[a]Downgraded from 'AAA' on Dec. 19, 2018.
[b]Downgraded from 'AA+' on Dec. 19, 2018.

Rating Outlook

Stable

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New Issue Summary

Sale Date: Negotiated sale on Jan. 8, 2019

Series: $24,500,000 General Improvement Refunding Bonds, Series 2019

Purpose: Proceeds to be used to refund outstanding debt for interest cost savings.

Security: Bonds are payable from an annual property tax levy limited to $2.50 per $100 assessed valuation.

Analytical Conclusion

The downgrade of the Issuer Default Rating (IDR) to 'AA+' from 'AAA' and the one-notch downgrade of other city debt reflect the city's diminished expenditure flexibility triggered by a voter-approved city charter amendment that permits firefighters to call for binding arbitration during future collective bargaining agreement (CBA) negotiations that result in an impasse. Firefighters and police comprise the city's largest expenditures, which have been expanding rapidly due to costly benefits. The city may opt to remain in the current firefighter CBA through 2024, during which time salaries remain flat, but Fitch Ratings believes longer term workforce controls are materially weaker under a binding arbitration framework. The 'AA+' also reflects strong revenue flexibility and growth prospects, minimal revenue volatility and superior financial resilience. A moderate long-term liability burden is expected to remain in this category despite large recent and planned voter authorizations.

Economic Resource Base: San Antonio is the second largest city in the state and the seventh largest in the U.S. Prominent sectors include military and government, domestic and international trade, convention and tourism, medical and healthcare, and telecommunications. Steady population growth is fueled by a favorable employment environment and ample developable land.

Key Rating Drivers

Revenue Framework: 'aaa'
Diverse resources include utility revenues, property taxes and sales taxes that support the city and are expected to yield continued strong gains due to rapid population growth and economic expansion. The city's independent legal ability to raise property tax revenues provides ample flexibility.

Expenditure Framework: 'a'
The city's adequate expenditure flexibility is derived from management's prudent budgeting practices and moderate but rising carrying costs, balanced against diminished flexibility in future firefighter CBA negotiations to control rapidly growing public safety spending driven by costly benefits. Firefighters' unilateral ability to require binding arbitration upon a CBA impasse represents a material degree of uncertainty in budgeting one of the city's largest expenditures.

Long-Term Liability Burden: 'aa'
Addressing the city's sizable deferred capital needs and needs related to overlapping issuers' growth are expected to be accompanied by commensurate growth in the area's resource base, allowing the liability burden to remain moderate. The city consistently funds its pensions at actuarially determined levels.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Downgraded	Stable	12/19/18
AAA	Affirmed	Stable	7/26/18
AAA	Revised	Stable	4/30/10
AA+	Affirmed	Stable	6/16/03
AA+	Upgraded	—	10/26/99
AA	Assigned	—	10/13/92

Related Research

Fitch Rates San Antonio, TX Limited Tax Bonds 'AA+'; Downgrades IDR to 'AA+'; Outlook Stable (December 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Operating Performance: 'aaa'

The combination of the city's ample revenue flexibility, minimal expected revenue volatility, moderate carrying costs and large reserves leaves it well positioned to address cyclical downturns. The city has demonstrated a commitment to prudent fiscal practices.

Rating Sensitivities

Shift in Fundamentals: The IDR and bond ratings are sensitive to material change in the city's strong revenue flexibility and growth prospects, moderate liability burden and superior operating performance. Fitch expects city financial practices to remain strong throughout economic cycles.

Credit Profile

The local economy continues to expand rapidly with continued sector development in high technology, medical and healthcare, higher education and financial services, providing diversity beyond the military presence, which remains a major economic factor. Lackland Air Force Base, Randolph Air Force Base and Fort Sam Houston account for over 80,000 military and civilian personnel. These facilities benefited from very large investments and additions to troop strength in past base realignments. They also include high-value missions such as the sole medical school for all military medical personnel.

Large corporations that are headquartered within the city include United Services Automobile Association (over 17,000 employees), Valero (IDR of 'BBB') and Rackspace. The expansive employment base remained resilient during the 2015–2016 downturn in drilling activity in the nearby Eagle Ford Shale, during which drilling activity settled to a level of about one-third of previous peaks. The unemployment rate remains below state and national averages.

Located 150 miles from the U.S.-Mexico border, the city's economic base has some exposure to the uncertainty related to the Trump administration's renegotiation of the North American Free Trade Agreement (NAFTA). A new trade agreement, the United States Mexico Canada Agreement (USMCA) has been signed by the respective leaders but must still be ratified by each country's legislative branch. In its current form, the USMCA should reduce key uncertainties for trade among the three countries. However, failure to ratify the USMCA or ratification of a materially different revised USMCA could have major economic implications for local economies along the U.S.-Mexico border. For additional details, see Fitch's press release, "Fitch Ratings: NAFTA Replacement USMCA Settles Key Trade Uncertainties," dated October 2018, and "NAFTA Termination Could Hit Upper Midwest, Border State Economies Hard," dated April 2018. However, Fitch expects the impact on San Antonio to be mitigated by the diversity of its expansive economy.

The city's population expanded by nearly 14% from 2010–2017, exceeding both state and national averages. Building permit values have exceeded $3 billion (2.7% of fiscal 2018 market value) annually since 2014. Property value appreciation and new construction have resulted in steady AV gains, averaging nearly 5% over the past 10 years, including a nearly 9% increase in fiscal 2019. Per capita personal income levels remain below average due to both an elevated poverty level and the prevalence of large institutions in the higher education and military sectors.

Revenue Framework

The city relies on a combination of utility revenues (33% of fiscal 2017 general fund revenues), property taxes (29%) and sales taxes (25%). Utility revenues are primarily from City Public

Service (CPS; senior lien bonds rated 'AA+'), the electric utility, plus a modest amount from the San Antonio Water System (SAWS; senior lien bonds rated 'AA+').

Historical revenue growth has been above the level of inflation and U.S. GDP growth. The city's revenues are projected to continue this trend given the rapidly expanding employment base and strong demographic trends.

With a current total tax rate of $0.558 in fiscal 2019, ample taxing margin remains under the $2.50 per $100 AV property tax cap for operations and debt service. If a proposed tax rate results in an 8% year-over-year levy increase (based on the prior year's values), the rate increase may be subject to election if petitioned by voters.

Utility revenue raising flexibility is limited as CPS payments are capped at 14% of CPS's gross revenues per city ordinance and CPS's master indenture. City council does, however, approve rate increases. Under the flow of funds for CPS utility revenue bonds, distribution of the 14% of gross revenues to the general fund is the fifth priority, preceded by operations and maintenance expenses, payment of parity bonds and reserves, payment of inferior lien obligations and a distribution to the repair and replacement account.

Expenditure Framework

Typical of municipalities, public safety leads as the city's largest expenditure. It is the city's goal and practice to cap public safety spending at 66% of expenditures and transfers out in order to avoid the crowd-out of other services. In the fiscal 2019 budget, police and fire spending account for approximately 38% and 25% of general fund appropriations, respectively, for a total of about 63%.

The pace of spending growth absent policy actions is likely to be in line with or marginally above the natural pace of revenue growth as the city expands its service levels to accommodate a rapidly growing population and costly public safety health insurance benefits. The longer-term trajectory of spending is dependent on the results of future labor agreements.

The city's fixed cost burden is moderate, with carrying costs for debt, pensions and OPEB equal to about 19% of fiscal 2017 governmental expenditures. Fitch expects the growth in debt service to cause overall carrying costs to increase over time but remain manageable given the city's goal and practice to maintain a level tax rate to fund its capital plans.

City Charter Amendment Impacts Structure of Fire Collective Bargaining Agreement

In November 2018, city voters approved two city charter amendments affecting employee compensation that were placed on the ballot via voter initiative. Proposition C provides the local firefighter union the authority to require the city to participate in binding arbitration on all issues in the event of an impasse during future CBA negotiations. Fitch believes this proposition further constrains the city's spending flexibility over what Fitch already considered to be limited due to long evergreen clauses. Unlike non-public safety compensation, management cannot control pay hikes and benefit levels for police officers and firefighters, which must be established through a CBA.

CBA negotiations with the police and fire associations stalled in 2014 as the city attempted to realign the costly benefits for police and fire employees and their dependents. As a result, the CBAs for police and fire expired in September 2014, causing both groups to operate under an evergreen clause whereby the terms of the expired agreements (excluding pay hikes) are automatically renewed through September 2024. Subsequently, the city filed a lawsuit claiming the expired CBA's 10-year evergreen clause is unconstitutional due to the length of the term.

In 2016, the city and police negotiated a five-year CBA that includes employee contributions for healthcare, a reduction in the evergreen clause to eight years from 10 years, and a 17% pay increase over fiscal years 2017–2021. Additionally, employee health premiums are allowed to escalate during evergreen periods.

Because the previous firefighter CBA is still in effect during the evergreen clause, the provisions of Proposition C will not impact the city until the evergreen period expires in 2024 or a new firefighter CBA is negotiated at the request of the city. Remaining in the evergreen period precludes awarding pay hikes to firefighters, mitigating salary cost pressures, although they are offset by continued costly benefits.

Although the firefighters' compensation levels and benefits are far more generous than the state's other large urban cities, which would argue for a favorable outcome for the city in the event that binding arbitration is called for, the new CBA framework for firefighters represents a source of uncertainty in determining one of the city's largest expenditures. Additionally, the provisions of Proposition C allow the arbitration board to consider the financial impact of a CBA during negotiations, but once approved, there is no provision for annual reopeners in the event of economic declines. More recently, after the voter approval of the city charter amendments, the city dropped its lawsuit against the firefighter union and invited the union to renew negotiations utilizing a mediator which the union rejected.

The city's expenditure flexibility is also narrowly impacted by Proposition B, which eliminates the city council's authority to determine the city manager's compensation. The city charter amendment also limits the city manager's term to eight years and requires a supermajority (eight votes out of 11) to select the city manager. Specifically, the city charter amendment will limit the city manager's pay to 10 times the amount of the lowest paid city employee. The amendment does not affect the current city manager (who has announced plans to retire by June 30, 2019 at the latest).

Long-Term Liability Burden

The long-term liability burden, including overall debt and unfunded pension liabilities, is moderate at about 17% of personal income and is comprised primarily of overlapping debt (about 60% of total). It's the city's goal to maintain a flat debt service tax rate as the city addresses its large deferred capital needs with measured debt issuance. Voters approved an $850 million GO authorization in 2017 of which over $580 million will remains unissued. The city expects to issue the remaining authorization by 2021, along with additional COs and tax notes, assuming reasonable AV growth assumptions. The city's debt model includes $925 million in GO bond authorizations in 2022 and 2027, which Fitch considers modest relative to almost $8 billion in aggregate direct and overlapping debt. Fitch expects increases in overall debt levels will be accompanied by continued gains in the resource base, keeping the overall liability burden moderate.

Civilian and certain public safety employees participate in an agent multiple employer defined benefit pension plan administered by the Texas Municipal Retirement System (TMRS). Fire fighters and police participate in a single-employer defined benefit pension plan administered by a separate board. The aggregate ratio of assets to liabilities equals nearly 80% and declines to less than 69% based on Fitch's adjustment for a 6% return assumption on investments. At $1.9 billion, the Fitch-adjusted net pension liability equals approximately 3% of personal income. Annual pension payments consistently meet the actuarially determined contribution.

Operating Performance

The city's financial resilience is derived from a combination of ample revenue flexibility, conservative budgeting, minimal general fund revenue volatility, and large reserves. For details, see Scenario Analysis, page 6.

In the wake of the last downturn, the city gradually increased its formal general fund balance policy from 9% of spending to 10% of spending and increased its two-year budget reserve from 3% to 5% of spending. The city annually appropriates its two-year budget reserve but annual operating surpluses have resulted in no utilization of the reserve since fiscal 2013. The adopted fiscal 2019 budget continues this pattern which Fitch expects will lead to balanced or surplus operations for the general fund. The city's five-year financial forecast projects continued maintenance of an aggregate 15% fund balance based on assumptions of moderate growth in AV, utility revenues, and sales taxes plus continuation of current fire fighter compensation and benefits per the expired CBA under the evergreen clause.

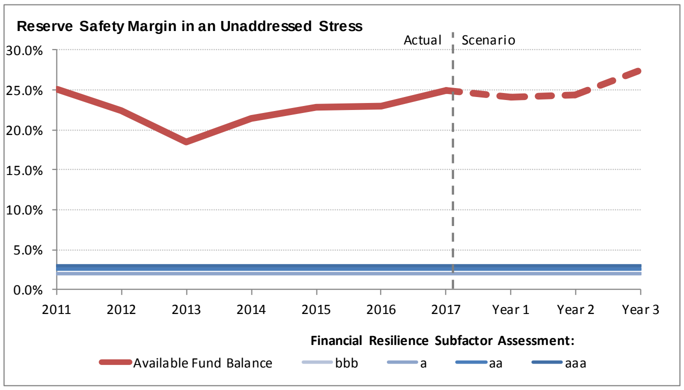
Appropriation Debt

The payment of debt service on the PFC and MFC lease revenue bonds and the Starbright IDC contract revenue bonds requires an annual appropriation by the city. The contract revenue bonds, unlike other appropriation debt, are payable solely from CPS's payments to the city's general fund. Coverage from pledged revenues on contract revenue bond debt service is very high.

Pursuant to an economic development contract between the city and the IDC, the city is unconditionally obligated to pay debt service on the contract revenue bonds. The payments are not subject to reduction, and the corporation covenants it will maintain the contract in full force as long as bonds are outstanding. Although no additional leveraging is planned, Fitch notes that additional bonds are allowed under the indenture.

San Antonio (TX)

Scenario Analysis



Analyst Interpretation of Scenario Results:

The city's financial resilience is derived from a combination of ample revenue flexibility, conservative budgeting, minimal general fund revenue volatility, and large reserves. These credit strengths are expected to keep the issuer's reserve levels well above the amount needed for a 'aaa' financial resilience assessment during an economic downturn. CPS revenues have trended upward but are subject to some volatility due to swings in weather and natural gas prices. The relative stability of AV during downturns has provided steady property tax revenues. Sales tax revenues perform in line with the overall economy.

The fiscal 2017 audit posted a $29 million (2.6% of spending) operating surplus, increasing its unrestricted fund balance to $278 million or 25% of spending. Management projects another net general fund surplus for fiscal 2018.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	3.2%	4.8%
Inherent Budget Flexibility		High	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	890,262	898,162	917,522	994,636	1,031,383	1,063,682	1,115,332	1,104,179	1,139,435	1,194,151
% Change in Revenues	-	0.9%	2.2%	8.4%	3.7%	3.1%	4.9%	(1.0%)	3.2%	4.8%
Total Expenditures	863,882	885,578	923,543	958,703	1,005,388	1,029,042	1,064,133	1,085,416	1,107,124	1,129,266
% Change in Expenditures	-	2.5%	4.3%	3.8%	4.9%	2.4%	3.4%	2.0%	2.0%	2.0%
Transfers In and Other Sources	14,603	18,877	17,341	27,699	27,773	24,344	24,448	24,204	24,976	26,176
Transfers Out and Other Uses	39,113	47,640	42,669	30,201	28,895	47,342	46,608	47,540	48,491	49,461
Net Transfers	(24,510)	(28,763)	(25,328)	(2,502)	(1,122)	(22,998)	(22,160)	(23,337)	(23,515)	(23,285)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	1,870	(16,179)	(31,349)	33,431	24,873	11,642	29,039	(4,574)	8,797	41,599
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	0.2%	(1.7%)	(3.2%)	3.4%	2.4%	1.1%	2.6%	(0.4%)	0.8%	3.5%
Unrestricted/Unreserved Fund Balance (General Fund)	226,646	209,710	178,208	212,059	235,905	247,959	277,534	272,960	281,757	323,356
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	226,646	209,710	178,208	212,059	235,905	247,959	277,534	272,960	281,757	323,356
Combined Available Fund Bal. (% of Expend. and Transfers Out)	25.1%	22.5%	18.4%	21.4%	22.8%	23.0%	25.0%	24.1%	24.4%	27.4%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.