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>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>$100</td>
<td>$2,500</td>
</tr>
<tr>
<td>2021</td>
<td>$200</td>
<td>$2,000</td>
</tr>
<tr>
<td>2022</td>
<td>$300</td>
<td>$1,500</td>
</tr>
<tr>
<td>2023</td>
<td>$400</td>
<td>$1,000</td>
</tr>
<tr>
<td>2024</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td>2025</td>
<td>$600</td>
<td>$0</td>
</tr>
<tr>
<td>2026</td>
<td>$700</td>
<td>$-</td>
</tr>
<tr>
<td>2027</td>
<td>$800</td>
<td>$-</td>
</tr>
<tr>
<td>2028</td>
<td>$900</td>
<td>$-</td>
</tr>
<tr>
<td>2029</td>
<td>$1,000</td>
<td>$-</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service

**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

MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES (“MIS”) ARE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY’S PUBLICATIONS MAY INCLUDE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY’S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE MOODY’S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY’S RATING RANGES. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY’S OPINIONS INCLUDED IN MOODY’S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY’S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY’S ANALYTICS, INC. CREDIT RATINGS AND MOODY’S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY’S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY’S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY’S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

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. for ratings opinions and services rendered by it fees ranging from $1,000 to approximately $2,700,000. MCO and MIS also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

Risk of entities, credit commitments, or debt or debt-like securities, and Moody’s publications may include Moody’s current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. Moody’s defines credit risk as the risk that an entity may not meet its contractual financial obligations as they come due and any estimated financial loss in the event of default or impairment. Moody’s rating symbols and definitions publication for information on the types of contractual financial obligations addressed by Moody’s ratings. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings and Moody’s opinions included in Moody’s publications are not statements of current or historical fact. Moody’s publications may also include quantitative model-based estimates of credit risk and related opinions or commentary published by Moody’s Analytics, Inc. Credit ratings and Moody’s publications do not constitute or provide investment or financial advice, and credit ratings and Moody’s publications are not and do not provide recommendations to purchase, sell, or hold particular securities. Neither credit ratings nor Moody’s publications comment on the suitability of an investment for any particular investor. Moody’s issues its credit ratings and publishes Moody’s publications with the expectation and understanding that each investor will, with due care, make its own study and evaluation of each security that is under consideration for purchase, holding, or sale.

MOODY’S INVESTORS SERVICE

© 2019 Moody’s Corporation, Moody’s Investors Service, Inc., Moody’s Analytics, Inc. and/or their licensors and affiliates (collectively, “MOODY’S”). All rights reserved.

For information on the types of contractual financial obligations addressed by Moody’s ratings, see Moody’s rating symbols and definitions publication for information on the types of contractual financial obligations addressed by Moody’s ratings. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings and Moody’s opinions included in Moody’s publications are not statements of current or historical fact. Moody’s publications may also include quantitative model-based estimates of credit risk and related opinions or commentary published by Moody’s Analytics, Inc. Credit ratings and Moody’s publications do not constitute or provide investment or financial advice, and credit ratings and Moody’s publications are not and do not provide recommendations to purchase, sell, or hold particular securities. Neither credit ratings nor Moody’s publications comment on the suitability of an investment for any particular investor. Moody’s issues its credit ratings and publishes Moody’s publications with the expectation and understanding that each investor will, with due care, make its own study and evaluation of each security that is under consideration for purchase, holding, or sale.

Additional terms for Japan only: Moody’s Japan K.K. (“MJKK”) is a wholly-owned credit rating agency subsidiary of Moody’s Group Japan G.K., which is wholly-owned by Moody’s Corporation. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

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 657AFSL 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.

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. MOODY’S represents, to the extent permitted by law, that all information and sources of information used in assigning any credit rating are 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.

Additional terms for Japan only: Moody’s Japan K.K. (“MJKK”) is a wholly-owned credit rating agency subsidiary of Moody’s Group Japan G.K., which is wholly-owned by Moody’s Corporation. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

MOODY’S INVESTORS SERVICE

U.S. PUBLIC FINANCE

Additional terms for Japan only: Moody’s Japan K.K. (“MJKK”) is a wholly-owned credit rating agency subsidiary of Moody’s Group Japan G.K., which is wholly-owned by Moody’s Corporation. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

MOODY’S INVESTORS SERVICE

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. for ratings opinions and services rendered by it fees ranging from $1,000 to approximately $2,700,000. MCO and MIS also maintain policies and procedures to address Japanese regulatory requirements. Ranging from JPY125,000 to approximately JPY250,000,000.

MOODY’S INVESTORS SERVICE