Memo

9 July 2020
To: Mayor and City
Council members
As part of our long-term financing of necessary important public investments, two credit agencies look at our credit risk level as a service to investors. Both agencies, with a national/global perspective and frame of reference, have **affirmed** the City of Pearland's high grade rating.
Moreover, Moody's had a credit watch outlook as we had purposeful draw down of our GF fund balance in excess of minimums. However, with your leadership, Moody's has **removed** that note and returned our outlook to **Stable.**
Ratings separately given for general obligation (property tax-backed) and enterprise fund (water and sewer rate revenue backed).
Clay

To: Clay Pearson, City Manager

From: Carla Campbell, Management Assis[tant]

CC: Jon Branson, Deputy City Manager
Trent Epperson, Assistant City Manager
John McCarter, Interim Director of Finance

Date: July 9, 2020

Re: 2020 Public Capital Project Debt Financing Sale Credit Ratings

As a standard part of the annual debt issuance process, the City receives ratings from two agencies: Fitch Ratings and Moody's Investors Service. Both Fitch and Moody's affirmed the City's high credit ratings for this latest issuance, with Moody's revising the "negative" outlook to "stable". The high ratings affirmed by these two rating agencies allow the City to secure low interest rates when issuing bonds to fund our capital improvement plan. Attached, for your review, are the recent rating reports from Fitch Ratings and Moody's Investors Service in relation to the City's issuer rating and Series 2020 bond issuances scheduled to sell on July 13, 2020 with closing on August 11, 2020. The results of the sale will be presented to City Council at the regular City Council meeting on July 13, 2020.

Fitch Ratings

On July 6, 2020, Fitch Ratings reaffirmed the 'AA-' rating for Water and Sewer System and its outstanding revenue debt and assigned the same rating for its Series 2020 revenue bonds. On July 7, 2020, Fitch Ratings reaffirmed the City's 'AA' rating for its outstanding General Obligation and Certificates of Obligation debts and assigned the same rating to its Series 2020 bonds.

According to Fitch, the 'AA' rating for GO and CO bonds reflects the City's superior financial elasticity related to projected revenue growth and expenditure flexibility in the COVID-19 environment. The 'AA-' rating for the Water and Sewer revenue bonds reflects the City's sustainable revenue structure, strengthen by its service area, and manageable debt.

Moody's Investors Service

On July 7, 2020, Moody's Investors Service affirmed the City's 'Aa2' high grade rating with a stable outlook for its outstanding General Obligation (GO) and Certificates of Obligation (CO) debts and assigned the same rating for its Series 2020 bonds. Moody's also affirmed an 'Aa3' high grade rating to the City's Water and Sewer System and its outstanding revenue debt and assigned the same rating for its Series 2020 revenue bonds.

Last year, Moody's reaffirmed the City's Aa2 rating, but with a negative outlook. The negative outlook did not change the assigned Aa2 rating. However, the negative outlook placed the City on the rating agency's radar to monitor over the next 18-24 months. According to Moody's the negative outlook reflected three years of draws in the General Fund (fiscal 2016-2018). Over the last several years the City has taken steps to improve their credit rating, such as revising its Comprehensive Financial Management Policy to increase the fund balance policy minimum from 2 months to an equivalent of 2-3 months and taking necessary action to increase the fund balance in the General Fund.

The rating outlook this year changed from negative to stable because of the City's improved fund balance position and recent Budget Amendment #2 to include expense reductions to offset lower than expected revenue performance due to the economic impact of COVID-19. Budget Amendment #2 will provide enough financial cushion to increase existing fund balance reserves, as well as mitigate the impact of COVID-19 heading into FY21.

The following table shows the comparable investment grade ratings of the three major rating agencies:

Moody's	Fitch	Credit Worthiness
Aaa	AAA	Prime
Aa1 Aa2 Aa3	AA+ AA AA-	High grade
A1 A2 A3	A+ A A-	Upper medium grade
Baa1 Baa2 Baa3	BBB+ BBB BBB-	Lower medium grade
Ba1 Ba2 Ba3	BB+ BB BB-	Non-investment grade/Speculative
B1 B2 B3	B+ B B-	Highly speculative
Caa1 Caa2 Caa3	CCC	Substantial risks / Extremely speculative / Default imminent with little prospect for recovery

The Permanent Improvement Bonds Series 2020 for $16.4 million, Certificates of Obligation, Series 2020A for $9.2 million and Series 2020B for $10.1 million were all assigned a rating of 'Aa2' by Moody's and 'AA' by Fitch. The Water and Sewer System Revenue Bonds, Series 2020B for $8.5 million were assigned 'Aa3' by Moody's and 'AA-' by Fitch. These ratings demonstrate very strong creditworthiness relative to other U.S. municipal or tax-exempt issuers or issues.

Please feel free to contact me if you have any questions, and/or need additional information.

Attachments: Fitch Rating Reports (2)
Moody's Rating Reports (2)

FOR IMMEDIATE RELEASE

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Pearland Receives Improved Credit Rating

PEARLAND, TEXAS – July 11– Reviews from Moody's Investor Services and Fitch Ratings, Inc., two nationally recognized credit rating agencies, recently affirmed the City of Pearland as having high-grade credit worthiness for the City's 2020 bond issuances. The ratings demonstrate very strong credit worthiness relative to other U.S. municipal or tax-exempt issuers or issues.

Moody's and Fitch measured the City's General Obligation issuances and scored the city's credit highly, with an AA2 rating and AA rating, respectively. The credit report from Moody's said, "The rating reflects a large and growing tax base with above average income levels and an improving financial position." Similarly, the Fitch report said the 'AA' indicates the City's superior financial flexibility, supported by strong revenue growth prospects and adequate expenditure flexibility.

The City issues bond financing to fund long-term Capital Improvement projects essential to safety and quality of life in Pearland. As part of that process, the debt receives ratings for credit risk from independent credit rating agencies that affect the City's interest rate. Generally, abetter the rating brings lower a interest rate that the City pays, relative to similar issues on the market at the time. .Projects include City facilities, parks, and roads, all of which are planned and detailed in a multi-year capital improvement program available for review on pearlandtx.gov.

Rating Outlook and Potential Economic Impacts of COVID-19

Fitch and Moody each reported the City's rating outlook as stable, with Moody revising upward to stable from negative.

Moody's outlook revision cites the city's improved reserve position due to management's budget management and expense control practices, and reductions to offset expected weaker revenue performance.

Despite economic disruptions due to the COVID-19 pandemic, the City's affirmed credit rating puts the City in a good financial position going forward.

Moody's report said, "The city has also been proactive in careful expense management in response to the coronavirus pandemic allowing for a structurally balanced budget to persist during the year."

Water/Sewer Revenue Bonds Receive Aa3 and AA- Ratings

Both credit rating agencies also rated the City's Water and Sewer System Revenue Bonds highly. Moody's assigned an Aa3 rating while Fitch assigned an AA- to the City.

Both ratings reflect the City's large and growing water/sewer customer base with above average income levels, while considering the system's high debt load due to an active Capital Improvement Plan to continue to improve the water and sewer system. Water and sewer revenue bonds are repaid exclusively from the water and sewer business that the City operates through rates.

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FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Pearland, Texas' Limited Tax Bonds 'AA'; Outlook Stable'

Tue 07 Jul, 2020 - 10:04 AM ET

Fitch Ratings - Austin - 07 Jul 2020: Fitch Ratings has assigned a 'AA' rating to the following City of Pearland, Texas bonds:

--$16,420,000 permanent improvement bonds, series 2020;

--9,160,000 certificates of obligation (COs), series 2020A;

--$10,090,000 COs, series 2020B.

Fitch has also affirmed the following Pearland, Texas ratings at 'AA':

--Long-Term Issuer Default Rating (IDR);

--Approximately $310 million limited tax bonds and COs.

The Rating Outlook is Stable.

The bonds and COs are scheduled to sell via negotiation the week of July 13th. Proceeds will be used to fund various city-wide capital improvements and to pay related issuance costs.

SECURITY

Permanent improvement bonds are voted general obligations of the city. The bonds and COs are payable from a property tax levy that is limited to $2.50 per $100 of taxable assessed valuation (TAV). The 2019 COs are additionally payable from a nominal (not to exceed $10,000) subordinate pledge of net revenues from the city's waterworks and sewer system.

ANALYTICAL CONCLUSION

The 'AA' rating reflects the city's superior financial flexibility, supported by strong revenue growth prospects and adequate expenditure flexibility. Long-term liabilities are likely to remain elevated but moderate over the medium term given the debt plans of the city and overlapping entities.

ECONOMIC RESOURCE BASE

Pearland is located just south of Houston's outer loop, mostly in Brazoria County, with easy access to major corridors. The city has been experiencing rapid population growth, rising to approximately 122,500 in 2019, about a 34% increase since 2010. The population growth is supporting residential development and more recently strong growth in commercial properties.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Post-pandemic revenue growth prospects remain strong given both recent economic expansion and near-term prospects. Pearland's general fund revenues are expected to continue on a trajectory of solid growth due to ongoing residential and commercial development. The city's independent legal ability to raise operating revenues is substantial even with the recent passage of state legislation limiting tax-raising flexibility.

Expenditure Framework: 'aa'

Fitch expects spending growth will be in line with or marginally above the pace of strong revenue growth as the city continues to expand. Expenditure flexibility is adequate given moderate carrying costs, very flexible workforce environment and regular cash funding of some capital projects.

Long-Term Liability Burden: 'a'

Fitch expects the city's long-term liability burden to remain elevated but still moderate given the city's current debt plans, rapid principal amortization and expectations for debt issuance by overlapping taxing entities. The city's pension liability comprises a small proportion of the overall liability burden.

Operating Performance: 'aaa'

The city's strong reserve levels, high budget flexibility and modest historical revenue volatility leave it well positioned to address typical cyclical downturns. The current economic contraction and revenue loss will challenge these strengths over the coming months. However, conservative budget practices support the city's plans to preserve financial flexibility, and Fitch believes the city has the capacity to handle this stressed scenario while maintaining operational balance and a strong financial cushion.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Managing growth pressures while maintaining solid financial flexibility.

--A decrease in fixed costs, including annual debt service and the actuarially determined contributions for pension plans, equating to less than 20% of the total governmental expenditures.

--Continued healthy resource base growth that brings the long-term liability assessment solidly below 20% of personal income.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material and sustained change to the city's currently solid revenue profile and expenditure flexibility that diminishes the city's high level of financial resilience.

--An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deeper than expected tax revenue losses and materially erodes the district's gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector-wide Coronavirus Implications

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the city's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report titled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published on April 29, 2020 on www.fitchratings.com.

As is the case with other cities, Pearland has experienced the effects of coronavirus mitigation and the related economic shutdown. The governor directed a gradual reopening of the state's economy in late April, but the subsequent pace of economic traction remains conditioned on the still-evolving nature of the pandemic in Texas. Recently rising levels of coronavirus cases in Texas has prompted the governor to mandate a return to certain social distancing measures, such as the reduction of maximum service capacity at restaurants and the closure of bars.

Coronavirus - City Budgetary Update

The city activated a response and early financial assumptions in March, at the first signs the virus could have an impact. Currently, the projected drop in revenue is $2.6 million (3.0%) for fiscal 2020, offset by a reduction to expenditures of $4.2 million (4.7%). Some savings include a freeze on ancillary spending and a partial hiring freeze, while other savings happened as a result of shutting down, such as expenses related to parks and recreation. Management reports new single family development is still occurring. Early assessed values suggest 13% growth for fiscal 2021, but the city is only budgeting for about 8% in order to develop a conservative budget. Over the last few months, the number of permits has been down but the amount of revenue generated by permits is reportedly steady; 294 new single-family houses were permitted over the first half of 2020, a 4% decrease from the prior year. However, large commercial projects came online from prior years planning efforts, causing a yoy increase in permit revenues. According to management, the main effect that COVID-19 has had on development in the city is uncertainty in regards to the future economy. A 9.28% decline in permit revenue is projected for fiscal 2020, as the city has expected to see the bulk of effects on the current fiscal year between June and August. Additionally, the city is modeling for a 10% to 15% drop in sales tax revenues, relative to the fiscal 2020 budget, for the remaining months of the fiscal year. Management is anticipating a sharp, short-term drop in elastic revenue sources (such as sales tax revenue) due to the economic effects of the virus and related shutdowns, depressing revenues for the remainder of the fiscal year and into fiscal 2021. As such, spending on things like office furniture and non-uniform wearing apparel has been suspended. The projected general fund ending fund balance of $18.9 million (22% of expenditures) in fiscal 2020 exceeds policy minimum by $4.8 million. The city's goal is to provide a cash cushion going into the fiscal 2021 budget. The city's response team is currently developing local rental assistance and small business assistance programs to help the community.

CREDIT PROFILE

Pearland benefits from its location in proximity to the strong Houston economy, with easy access to major transportation corridors. The city continues to shift from a bedroom community to an active participant in the robust Houston MSA economy with a focus on industry sectors such as healthcare and energy.

Various economic development projects in the city have recently been completed or are under way. Lonza opened the largest dedicated cell-and-gene-therapy manufacturing facility in the world in 2018. In 2019, it completed multiple expansions including a new 10,000 sf laboratory, and acquired a 19 acre parcel of land for potential future growth. Endress+Hauser, a Swiss-based company that manufactures instrumentation and devices for customer solutions worldwide, broke ground on its 100,000 sf facility in March of 2019. Keystone Engineering Group, a multi-disciplined engineering consulting firm, announced that it will construct its headquarters and manufacturing facility in the city. Other developments that started during the 2020 fiscal year include healthcare, retail, and engineering related projects. Additionally, as noted above, the housing market continues to grow.

The city's tax base has experienced a CAGR of 6% over the last 10 years ending in 2020 and is expected to grow another 8% in 2021. Per capita personal income levels are above average, and unemployment remains low relative to state and national averages.

REVENUE FRAMEWORK

Pearland receives approximately 30% of its general fund revenues from property taxes, followed by sales taxes at 29%. Charges for services and licenses and permits are the next largest revenue sources, contributing 22% and 15%, respectively, in fiscal 2019. Property tax revenues continue to become a larger portion of the city's overall revenue base and slightly outpaced sales tax revenues in the general fund for the first time in recent history.

Pearland's average annual revenue gains have been strong at 4.6% when adjusting for tax rate changes over the past 10 years, exceeding inflation and U.S GDP. Fitch expects that, despite the potential for near-term decline in general fund revenues, over the longer term, the resumption of normal business activity should produce a return to economic, population and tax base gains in line with pre-pandemic trends.

The city's tax rate of $0.74 per $100 TAV in fiscal 2020 ($0.31 of which is for operations) provides ample rate capacity below the legal limit of $2.50 per $100 of TAV. However, the Texas legislature recently approved and the governor signed into law Senate Bill 2 (SB2), which limits local governments' property tax rate flexibility. Most notably, SB2 reduces the allowable unvoted operating levy increase produced by the rollback tax rate (now the 'voter approval tax rate') from 8.0% to 3.5% for most local taxing units and requires a ratification election (replacing the current petition process) if any local taxing unit exceeds its voter approval rate.

The tax rate limitation in SB2 excludes new additions to tax rolls and allows for banking of unused margin for up to three years. SB2 also retains some flexibility for local governments in the event of an applicable emergency/disaster declaration by the governor. Up to an 8% operating tax rate levy increase is then permitted in the two fiscal years following that declaration.

Remaining control over other local revenues such as fines, fees, and charges for services is sufficient to still generate substantial revenue-raising flexibility for the city relative to Fitch's assessment of expected modest revenue volatility in a typical downturn. The revenue cap does not apply to debt service tax levies.

EXPENDITURE FRAMEWORK

General fund operational spending is led by public safety, which comprised about 56% of the total in fiscal 2019.

Despite the city's strong population growth trend, up roughly 34% since 2010, Fitch does not anticipate undue pressure on service levels. Expenditures are expected to grow in line with or slightly above revenue growth over the near to medium term.

Pearland's spending flexibility is adequate based on carrying costs for debt service, pension, and other post-employment benefits at about 21% of fiscal 2019 spending. Carrying costs are almost entirely for debt service and principal amortization is rapid with 66% paid out in 10 years. $12.5 million (6% of total spending) of the roughly $38.0 million debt service payment was due to a payment to an escrow agent related to refunding bonds. Regular capital outlay through transfers to the capital projects fund and a flexible workforce environment with no labor contracts support expenditure flexibility. While yearly debt service payments will substantially increase with this issuance and other direct debt plans over the medium term, Fitch expects carrying costs to remain moderate, but slightly elevated.

LONG-TERM LIABILITY BURDEN

Inclusive of the current issuances, Pearland's long-term liability burden is nearly 20% of estimated personal income and is made up predominantly of overlapping debt. The net pension liability (NPL) contributes only modestly to the town's long-term liability burden. The city plans to issue an additional $80 million in GO bonds over the next four years. Fitch also expects overlapping debt issuers, particularly the school districts, may need to issue additional debt to accommodate the rapid population growth. The 'a' long-term liability burden assessment assumes that personal income and population will continue to grow as direct and regional debt needs grow.

Pensions are provided through the Texas Municipal Retirement System (TMRS), an agent multiple-employer defined benefit plan. Under GASB 67 and 68 reporting, the city reported a fiscal 2019 net pension liability (NPL) of about $30 million, with fiduciary assets covering roughly 81% of total pension liabilities, which falls to a Fitch-estimated 72% using a more conservative 6% return assumption. The city historically contributes to its pension at actuarially determined levels. The Fitch adjusted net pension liability makes up about 3% of the total liability burden.

OPERATING PERFORMANCE

Fitch expects the city to maintain the highest level of gap-closing capacity through both the current economic crisis and future economic cycles. A moderate degree of revenue volatility is attributable to the economic sensitivity of rapidly growing revenues. Even with revenue volatility accounted for, the city has always maintained a fund balance above Fitch's 'aaa' assessment threshold. The prior three fiscal years ended with a drawdown in reserves due to planned use for one time capital expenses. However, a $3.2 million surplus in fiscal 2019 brought the general fund balance to a healthy $17.2 million or about 21.5% of spending. Management reports plans to continue to grow the fund balance over the coming fiscal years, and unaudited fiscal 2020 results account for about a $1.6 million addition to fund balance. The city's strong financial performance has benefited from ongoing growth in its ad valorem and sales tax bases, contributing to healthy reserves in excess of policy targets and providing the city with a high degree of financial flexibility.

Management has been proactive in maintaining operational balance, typically outperforming conservative budget assumptions. Pearland's conservative budget practices have historically supported healthy operations, including spending reductions in response to slower sales tax collections. The city typically uses reserves (or the year's developing surplus) for pay-go funding of smaller capital items. Capital projects are deferred when necessary to stay above its reserve policy target and maintain a strong financial position. Fitch expects reserves to grow, as management and council have implemented a plan to increase the minimum fund balance over the coming years, further strengthening the city's financial cushion.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Pearland (TX) [General Government]	LT IDR	AA Rating Outlook Stable	Affirmed
• Pearland (TX) /General Obligation - Limited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Pearland (TX)	EU Endorsed

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SOLICITATION STATUS

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.

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.

US Public Finance Infrastructure and Project Finance North America United States

FitchRatings

Fitch Rates Pearland, Texas' Water & Sewer Revs 'AA-'; Outlook Stable

06 JUL 2020 1:08 PM

Fitch Ratings - New York - [publication date will be automatically inserted] Fitch Ratings has assigned an 'AA-' rating to the following city of Pearland, Texas bonds:
--Approximately $8.5 million water and sewer system revenue bonds series 2020B.

The bonds are scheduled to sell via negotiation the week of July 13th. Proceeds will be used to pay for waterworks and sanitary sewer system improvements and to pay the costs of issuance.

Further, Fitch has assessed the system's Stand Alone Credit Profile (SCP) at 'aa-' and affirms the 'AA-' rating on the city's following outstanding water and system bonds:
-- $0.6 million waterworks and sewer system adjustable rate revenue bonds; Series 1999;
-- $125.5 million water and sewer system revenue bonds, Series 2014, 2016A, 2017C, 2018B and 2019B

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The SCP of 'aa-' and 'AA-' rating reflect the city's strong revenue defensibility, bolstered by its service area, and manageable operating risks. Leverage, though projected to become elevated for the rating category, is expected to remain manageable as the city continues to refine the funding requirements associated with its capital improvement plan (CIP). Fitch expects the city will continue to adjust rates to manage cost pressures associated with the CIP as well as continued, though moderating growth.

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for the Water and Sewer sector. While the Pearland system's performance through most recently available data has not indicated impairment, material changes in revenue and cost profile are occurring across the sector. Fitch's ratings are forward-looking in nature. Fitch will monitor developments in the sector as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks as appropriate.

CREDIT PROFILE

The city of Pearland (the city, IDR AA/Outlook Stable) is a primarily residential community located approximately 15 miles from downtown Houston. The city's water and sewer system (the system) provides retail service to an expanding population approaching 123,000, representing almost 39,000 water and 37,000 sewer connections (fiscal

2019). The city has undergone a period of rapid growth which, while still robust with a five year CAGR in excess of 2.5%, has begun to moderate. There is continued focus on ensuring adequate water supplies and treatment are available to meet the current population and projected demands.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Strong Rate Flexibility Supported by Favorable Affordability Metrics

Revenues are wholly derived from monopolistic services to an area that exhibits favorable demographics and customer growth trends. Rates are considered affordable for more than 90% of customers.

Operating Risks 'aa'

Low Operating Cost Burden; Significant Capital Improvement Plan Underway

The system's operating risks profile is strong with a low cost burden per million gallons of water treated. The system is in the midst of a significant capital improvement plan which will improve supply and treatment, supporting a low life cycle ratio.

Financial Profile 'aa'

Strong Financial Profile Challenged by Increasing Leverage

The system's financial profile is expected to reflect increased leverage associated with its large capital plan. The current liquidity position combined with regular and potentially notable rate increases, should keep leverage consistent with the assessment, although at a potentially elevated level.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained improvement in the district's financial performance and a sustained net adjusted leverage below 7.0x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:
--Net adjusted debt that exceeds and remains above 10x.
--Greater than anticipated cost increases that result in an operating cost burden in excess of $6,500/mg, pressuring the Operating Risk assessment.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from ‘AAA’ to ‘D’. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

SECURITY

The bonds are payable from net revenues of Pearland's water and sewer system. Impact fees are available for but not pledged to payment of debt service.

Revenue Defensibility

Revenues are wholly derived from monopolistic services to an area that exhibits favorable demographics and customer growth trends. The city has the legal ability to raise rates without further regulatory oversight. Rates are considered affordable for more than 90% of the population. In light of current affordability and the still growing service area, the city is well positioned to implement a series of potentially notable rate increases as the CIP is implemented.

Operating Risks

Operating costs for the system as measured by cost per million gallons produced are low but increasing. This figure approximated $4,900/mg in fiscal 2019 and fluctuates with production, but costs are on an upward trend. The city purchases it water from the city of Houston and the Gulf Coast Water Authority. Purchased water costs, along with costs associated with treatment will continue to place pressure on operating costs.

Financial Profile

The current financial profile of the system is strong, reflective of increasing but still moderate leverage and strong coverage of debt service and full obligations. Net Adjusted Debt to Adjusted Funds Available for Debt Service (FADS) was just over 8.0x in fiscal 2019, with 1.6x Coverage of Full Obligations (COFO). The system's liquidity position is considered neutral to the rating.

Leverage is anticipated to increase as the city implements its large capital plan. The timing and amount of debt continues to be refined, but based on preliminary projections, leverage will remain above 8.0x and may reach 10x. The actual timing and amount of debt and rate increases, combined with the availability of impact fees will drive the ultimate leverage ratio. The city has indicated that should impact fees be lower than currently projected, it would seek to scale back growth related capital and/or implement additional rate increases to manage leverage. The majority of the approximately $470 million CIP (fiscal 2020 - 2025) is expected to be funded by fiscal 2022, after which leverage should begin to moderate.

Under the FAST base case, net leverage rises to 9.6x in 2022. Under the FAST rating case, which applies a 10% increase to planned capital expenditures, net leverage increases to 10.3x in 2022. Both cases reflect the debt issued in 2020, the potential for an additional $315 million of debt through 2024, but a more modest realization of impact fees than currently projected by the issuer. Should these fees materialize as projected, net leverage should remain under 9.0x for the base case and 9.3 for the rating case and begin decline in the latter years of the forecast period.

Fitch also applied additional stresses to revenue in its forward look to incorporate the potential impact of the coronavirus; the result produced only a modest change to stress scenario outlined above. Fitch considered the projected 9.7x leverage in 2021 in its assessment. While elevated for the rating category, Fitch expects leverage to remain manageable. Again, impact fees in amounts larger than those currently incorporated would reduce this ratio.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Applicable Criteria
Public Sector, Revenue-Supported Entities Rating Criteria (pub.27-Mar-2020)(includes rating assumption sensitivity)
U.S. Water and Sewer Rating Criteria (pub.03-Apr-2020)(includes rating assumption sensitivity)

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ENDORSEMENT POLICY

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MOODY'S INVESTORS SERVICE

CREDIT OPINION
8 July 2020

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Pearland (City of) TX

Update following affirmation of Aa2 on GOLT; outlook revised to stable

Summary

The City of Pearland, TX's (Aa2 stable) benefits from a large and growing tax base with above average income levels and an improving financial position. Reserve levels should continue to grow in the next fiscal year guided by budget practices that include expense reduction to offset expected weaker revenue performance. These strengths are balanced against higher debt levels compared with peers. The city's pension burden is manageable and will not be a drag on credit quality over the next several years.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for City of Pearland, TX because the city has solid liquidity to ward off any short term pressures. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the city changes, we will update our opinion at that time.

On July 7, 2020, we affirmed the city's Aa2 issuer rating and general obligation limited tax rating and revised the outlook to stable from negative.

Credit strengths

» Sizable tax base with continued robust assessed valuation growth

» Above average resident income levels

» Pension burden is below the national cities' median

Credit challenges

» Reserves remain below the median for Aa2 national peers

» Reliance on economically sensitive sales tax revenue for general fund operations

» Elevated debt levels contributes to high fixed costs

Rating outlook

The outlook revision to stable from negative incorporates the city's improved reserve position that is projected to continue through fiscal 2020. This projection reflects management's budget management and expense controls with reductions to more than offset expected weaker revenue performance. The city's projected surplus will still persist even under our stressed base case revenue scenario with sales taxes reducing by 30% in the third quarter of 2020, a key consideration in the outlook revision.

Factors that could lead to an upgrade

- Surplus operations that drives increases in reserves
- Significant decline in the debt burden

Factors that could lead to a downgrade

- Weak operating performance driving additional draws on reserves
- Tax base contraction
- Increase in debt levels absent corresponding tax base growth

Key indicators

Exhibit 1

Pearland (City of) TX	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$7,583,086	$8,464,775	$9,771,728	$10,630,111	$10,975,612
Population	101,725	106,238	113,693	117,867	117,867
Full Value Per Capita	$74,545	$79,677	$85,948	$90,187	$93,119
Median Family Income (% of US Median)	161.5%	158.3%	158.2%	156.1%	156.1%
Finances					
Operating Revenue ($000)	$94,222	$102,215	$106,041	$112,886	$116,379
Fund Balance ($000)	$26,094	$29,045	$20,174	$20,649	$22,613
Cash Balance ($000)	$24,922	$28,615	$22,224	$20,272	$26,776
Fund Balance as a % of Revenues	27.7%	28.4%	19.0%	18.3%	19.4%
Cash Balance as a % of Revenues	26.5%	28.0%	21.0%	18.0%	23.0%
Debt/Pensions					
Net Direct Debt ($000)	$376,484	$408,534	$419,698	$419,232	$406,966
3-Year Average of Moody's ANPL ($000)	$62,756	$72,243	$87,796	$97,235	$107,178
Net Direct Debt / Full Value (%)	5.0%	4.8%	4.3%	3.9%	3.7%
Net Direct Debt / Operating Revenues (x)	4.0x	4.0x	4.0x	3.7x	3.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.8%	0.9%	0.9%	0.9%	1.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.7x	0.7x	0.8x	0.9x	0.9x

Financial information includes general and debt service funds
Source: City of Pearland, TX Comprehensive Annual Financial Reports

Profile

The City of Pearland is about 15 miles south of Houston (Aa3 stable) along State Highway 88, in Brazoria County (Aa1). The city is largely residential with a population estimate of 118,000.

Detailed credit considerations

Economy and tax base: large tax base with stable economy

Pearland's sizable and diverse tax base, will continue to benefit from its participation in the larger Houston metropolitan area even though the pace of growth may slow over the next few years in response to weakened demand from the coronavirus pandemic. The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, retail and oil and gas could suffer particularly severe impacts.

The City of Pearland is largely residential with single and multifamily property accounting for above 66% of the tax base. In the past five years, assessed values have grown an annual average of 8.6% with a 4.5% increase in fiscal 2020 to reach $11.5 billion. Preliminary values for fiscal 2021 reflect an increase of 13.9% and capture values in the ground as of January 1, 2020. City officials report a currently stable local environment with several ongoing developments. Developments projects include companies in technology, gene and cell therapy and office/business expansions. Two other companies are also constructing headquarter facilities in the area. Residential construction is also reportedly stable. Thus far, city official report no major business interruption or project delays although the solid pace of growth will likely weaken in response to the pandemic.

The city's demographic levels is stable. Population growth has been explosive with triple digit increases in three of the past four census cycles. With a relatively young population (median age of 35 per the 2018 American Community Survey (ACS)), the laborforce participation has steadily increased in the last decade. Although the April unemployment rate of 10.8% was lower than the state's 13% and the nation's 14.4%, it is likely to increase because of weakened economic conditions. The median family income was above national averages at 156.1%, also as of the ACS's 2018 data. Positively, the median home value is 109.6% of the nation, signifying relative home affordability.

Financial operations and reserves: improving reserves expected to continue in fiscal 2020

The city's improved financial position will continue to benefit from budget management as the city manages through weaker revenue performance, a direct result of the pandemic. However, year to date revenue performance though weaker than the prior year's, has been better than originally expected and is likely to drive surplus operations at fiscal year end.

For fiscal 2020 (September 30 year-end), city officials expect a $2.6 million reduction in general fund revenue for the entire year. Sales tax performance, which accounts for about 19% of total operations including debt service revenue is down 5%, and is projected to be down another 8% through the end of the year. The city's largest sectors that contribute to sales tax collections for the city include general retail, construction and manufacturing, utilities and restaurants and entertainment. Although some of the sectors have been impacted by the pandemic, other sectors such as manufacturing and utilities have been largely unaffected and have allowed the city's total sales tax collections to perform better than its original expectations. Property tax collections, at 50% of operating revenue, were up 4% compared with the budget and were largely received by January. Charges for services, another major revenue source at about 15%, is also down 8% compared with the budget through May and projected to be down through the end of the year.

In response to weaker revenue performance, city officials reduced the budget by about $4.2 million with the largest savings from personnel related costs and miscellaneous services. With the change, the city is currently projecting to end fiscal 2020 with a surplus of $1.6 million in the general fund. This surplus will persist even under our baseline scenario of a 30% reduction in sales tax collections. In this scenario, the city's projected surplus will be $300 thousand.

In addition to the projected surplus for the year, the city has received $6.4 million from the Coronavirus Aid, Relief, and Economic Security Act. City officials are currently working through how to allocate the funds with initial recommendations for about a third to be used for continuity of operations, public safety and incident management.

The expected fiscal 2020 surplus will allow the city to continue to improve its reserve position. In fiscal 2019, the general fund reported a $3.2 million surplus, allowing the available fund balance to reach $17.2 million, a favorable 20.6% of revenue. Including the debt service fund, the city's total operations reported an almost $2 million surplus, growing available operating reserves to $22.6 million, 19.4% of revenue.

Preliminary planning for fiscal 2020 is underway. Although numbers are not available, city officials expect that several of the expense controls implemented in fiscal 2020 will be carried over into the budget prepared for the year.

LIQUIDITY

The city's cash position is favorable with $24.6 million in the general fund and $11.6 million in the debt service fund, as of May 31st. The city's liquidity position is projected to be sufficient for it operating needs.

At fiscal year end 2019, general fund cash was $21.2 million or 35.5% of revenue with operating cash at $28.8 million or 23% of operating revenue.

Debt and pensions: elevated debt but manageable pensions

The city's high debt burden compared with peers will remain affordable supported by a large tax base but will likely remain over the next several years because of expected debt issuance. Including the July sale, the city will have $341.8 million in general obligation limited tax debt and $83.3 million in tax increment revenue bonds which are secured by a separate stream of revenue that do not compete with general fund operations. Total debt net of $4.5 million secured by the utility system results in a direct debt burden of 3.7%, and increases to 12.4% overall when considering debt by overlapping entities.

Following the July sale, the city will have $80 million in authorized unissued debt which will be issued annually until it is exhausted within the next five years. The city's five year capital improvement plan (CIP) calls for a total of $223.3 million in drainage, streets, facilities and park needs over the next five years. A majority of the needs will be funded with debt and a portion of the debt will receive support from the utility system, while a modes amount will be funded with cash. This plan will keep debt levels elevated over the next several years.

DEBT STRUCTURE

All of the city's debt is fixed rate. The debt service schedule is largely descending with the exception of the fiscal 2030 where debt increases by $13 million compared with the prior year. Following that, the debt levels decrease until final maturity in fiscal 2040.

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

Budgetary pressures because of the city's participation in the Texas Municipal Retirement System (TMRS) for all employees, is likely to be affordable. For fiscal 2019, the city contributed $6.2 million, which was just shy of the $6.5 million actuarial costs.

The city's fiscal 2019 contribution rate was 106% of the Moody's calculated tread water level of $5.9 million. The “tread water” indicator measures the annual government contribution required to prevent the reported net pension liability from growing, under reported assumptions. Contributions above this level cover all net pension liability interest plus pay down some principal; this is stronger from a credit perspective compared with contributions below this level.

As reported, the city's net pension liability for the pension plan was $30.3 million using a 6.75% discount rate for TMRS. Moody's adjusted net pension liability (ANPL) for the city, using a 4.2% discount rate, was $110.8 million in fiscal year 2019, net of enterprise support. The three year average ANPL is a manageable 0.9 times of operating revenue or 1% of full value.

The city provides other post-employment benefits (OPEB) to its employees with funding on a pay as you go basis. In fiscal 2019, the city contributed $71 thousand. The city's adjusted net OPEB liability based using our methodology for adjusting liabilities was $5.9 million or 5% of operating revenue.

Fixed costs including debt service of $31.6 million, pension contributions of $6.2 million and OPEB contributions of $71 thousand totaled $37.9 million and consumed 32.6% of operating revenue, slightly higher than the 32.3% using the tread water figure.

ESG considerations

ENVIRONMENTAL

The city has high risk to natural and man made hazards with susceptibility to extreme rainfall and hurricane and typhoons. Positively, the city will benefit from significant and targeted infrastructure development in the area by multiple levels of government. Additionally, the city has historically received federal aid through the Federal Emergency Management Agency and also has enough cash to manage through any unforeseen challenges as a result of a major environmental event.

SOCIAL

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for City of Pearland, TX because the city has enough liquidity to ward off any financial challenges. Please see the summary and economy and tax base sections for more detailed information.

GOVERNANCE

The city is governed by a mayor and a seven member city council who serve three year staggered terms. The city demonstrates good governance by historically adhering to a formal reserve policy, which has recently been amended to three months of total expenditures. The city expects its reserves will improve to meet that policy in the next few years. The city also conducts long range economic forecasting and capital planning. The city has also been proactive in careful expense management in response to the coronavirus pandemic allowing for a structurally balanced budget to persist during the year.

Texas Cities have an Institutional Framework score of “Aa”, which is strong. The sector's major revenue sources (property taxes and sales taxes) account for about a third of revenue each and are subject to a cap; the remaining third is derived from other fees and is not subject to a cap. Property taxes, are subject to a statutory cap of $25 per $1,000 of assessed values, with no more than $15 allocated for debt. Most cities are well under the cap, and on an annual basis can increase their property tax revenue by 3.5% on existing property without voter approval. Most cities are at the sales tax cap for operating purposes. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures and are primarily debt service expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit levels based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Pearland (City of) TX

Scorecard Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$11,467,873	Aa
Full Value Per Capita	$97,295	Aa
Median Family Income (% of US Median)	156.1%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	19.4%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	-1.0%	Baa
Cash Balance as a % of Revenues	23.0%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	2.6%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	3.7%	A
Net Direct Debt / Operating Revenues (x)	3.6x	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.9%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.9x	A
Notching Factors:[2]		
Unusually Strong or Weak Security Features; Debt secured by statute		Up
	Scorecard-Indicated Outcome	Aa2
	Assigned Rating	Aa2

[1] Economy measures are based on data from the most recent year available
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication
Source: City of Pearland, TX Comprehensive Annual Financial Reports, Moody's Investors Service, US Census

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Pearland (City of) TX Wtr. & Sew. Ent.

Update to credit analysis

Summary

The City of Pearland, TX's Water and Sewer System's (Aa3) benefits form a large and growing customer base in a favorable location in proximity to the City of Houston, TX (Aa3 stable). The system's operating performance is solid with favorable debt service coverage ratios supported by annual rate increases and ample reserve. The system's debt levels are elevated and the leverage will remain high over the next several years driven by an active capital plan stemming from high demand from a growing customer base, that will require debt issuance in the next few years.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any immediate credit risks for City of Pearland, TX Water and Sewer system given solid liquidity to ward off any short term pressures. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the city changes, we will update our opinion at that time.

Credit strengths

» Solid operating performance; favorable debt service coverage

» Growing service area

Credit challenges

» High debt load

» Robust capital plan will drive additional debt issuance and maintain leverage

Rating outlook

Moody's does not generally assign outlooks to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

» Improved financial position that continues to support strong debt service coverage

» Decline in the system's debt

Factors that could lead to a downgrade

» Weakened financial position that results in reduction in debt service coverage

» Inability to maintain debt service coverage levels consistent with peers as additional debt is added

» Violation of legal covenants

Key indicators

Exhibit 1

Pearland (City of) TX Wtr. & Sew. Ent.					
System Characteristics					
Asset Condition (Net Fixed Assets / Annual Depreciation)	33 years				
System Size - O&M (in $000s)	$21,971				
Service Area Wealth: MFI % of US median	156.09%				
Legal Provisions					
Rate Covenant (x)	1.40				
Debt Service Reserve Requirement	DSRF funded at less than 3-prong test OR springing DSRF (A)				
Management					
Rate Management	A				
Regulatory Compliance and Capital Planning	Aa				
Financial Strength					
	2015	2016	2017	2018	2019
Operating Revenue ($000)	$30,201	$43,677	$51,544	$55,593	$55,696
System Size - O&M ($000)	$18,807	$20,992	$23,848	$23,813	$21,971
Net Revenues ($000)	$14,449	$23,170	$28,157	$33,148	$39,030
Net Funded Debt ($000)	$116,556	$180,445	$200,020	$214,883	$230,617
Annual Debt Service ($000)	$10,760	$10,646	$15,059	$16,949	$16,031
Annual Debt Service Coverage (x)	1.3x	2.2x	1.9x	2.0x	2.4x
Cash on Hand	230 days	240 days	256 days	336 days	377 days
Debt to Operating Revenues (x)	3.9x	4.1x	3.9x	3.9x	4.1x

Source: City of Pearland TX Audited Financial Statements, Moody's Investors Service

Profile

The system provides water and sewer services to the City of Pearland (Aa2 stable), which is 15 miles south of Houston along State Highway 288. Water and sewer customers totaled about 39,000 and 38,000 respectively as of May 1, 2020.

Detailed credit considerations

Service area and system characteristics: growing residential service area

The system's large customer base will remain stable supported by sustained residential demand. Although the pace of growth may be tempered in the next one to two years, if the coronavirus pandemic continues to weaken global demand and consumer activity and sentiment. The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, retail and oil and gas could suffer particularly severe impacts. However, our outlook for the US municipal water and sewer utility sector remains stable in spite of the coronavirus outbreak and resulting economic downturn. The system like the rest of the sector benefits from strong liquidity and its role as a provider of essential services.

The City of Pearland is largely residential with single and multifamily property accounting for above 66% of the tax base. Strong demand have allowed assessed value to grow an annual average of 8.6% with a 4.5% increase in fiscal 2020 to reach $11.5 billion.

Preliminary values for fiscal 2021 reflect an increase of 13.9% and capture values in the ground as of January 1, 2020. The demographic profile is stable. Population growth has been explosive with triple digit increases in three of the past four census cycles. Although the April unemployment rate of 10.8% was lower than the state's 13% and the nation's 14.4%, it is likely to increase because of weakened economic conditions. Positively, the laborforce participation has steadily increased in the last decade supported by a relatively young population (median age of 35 per the 2018 American Community Survey (ACS). The median family income was above national averages at 156.1%, also as of the ACS's 2018 data. Positively, the median home value is 109.6% of the nation, signifying relative home affordability.

Customer accounts have improved over the last three years with an average annual increase of 2.3% and 1.6% for water and sewer customers, respectively. As of May 2020, system officials report that customer accounts were relatively flat for water accounts and up 2.4% for sewer accounts compared with the prior year.

The system's useful life is a strong 33 years and will remain solid supported by ongoing infrastructure development. Water and sewer usage remain well under the permitted capacity with no reports of regulatory issues. Water supply is provided by 10 water wells and two surface water take points from the City of Houston. The system will eventually transition to use more surface water in accordance with the conversion mandate for the larger area.

Debt service coverage and liquidity: solid operating performance and reserves guided by rate increases

The system's solid operating performance will continue to be guided by prudent practices and supported by rate increases, both of which have allowed the financial profile to remain consistent with peers despite debt issuance.

For fiscal year 2020 (September 30 year end), system officials report that revenue are down and projected to remain $4 million below the amended budget by fiscal year end. Lower than expected revenue performance is due in part to a rework of the system's billing system. Officials also report reduced usage and a slight increase in delinquent accounts. Positively, system officials also report reduced expenses and project costs will be $4.4 million lower by the end of the year. Debt service coverage is projected to be a still favorable 1.98 times even though this number is lower than the coverage reported in the prior year. The system is also expected to record a $1.2 million increase in cash by the end of the year.

The fiscal 2020 projection is solid compared with the system's historical past performance. In the past five years debt service coverage was over 2.00 times annually, with the exception of fiscal 2015, when the system reported coverage of 1.65 times. Fiscal 2019 performance ended with coverage of 2.52 times senior lien revenue bonds and 2.43 times total debt service including debt supported by the general government. The maximum annual debt service is scheduled for fiscal 2023 and based on fiscal 2019 net revenue would provide coverage of 1.66 times.

The system's forecast through fiscal 2022 calls for rate increases to support increased operations, cash funding of capital and increased debt service payments from expected issuance. Debt service coverage is projected to be slightly under 1.50 times with a draw down of cash to meet operating needs. The system has a long history of outperforming budget expectations and will likely out perform the projections in the forecast. The ability to maintain a solid financial profile even as the system pursues its capital plan will be key to maintaining the credit profile.

LIQUIDITY

The system's current liquidity is solid with $38.6 million or about 641 days cash on hand, outside of the $10.3 million restricted for the debt service reserve requirement and customer deposits.

In fiscal 2019, the unrestricted cash was $22.7 million or an ample 377 days cash on hand at fiscal year end.

Debt and legal covenants: debt ratio will increase given robust capital improvement plan

The system's elevated debt levels will remain over the next several years because of a robust capital plan to meet increased demand. Including the July sale, the system's total outstanding debt is $351.5 million yielding a high debt to operating revenue of 4.14 times in fiscal 2019. This ratio is elevated compared with the median for the rating category.

The capital improvement plan through fiscal 2025 calls for roughly $288.1 million in water and sewer needs that is expected to be funded with debt. A huge portion of the debt will support a new water plant that should be online in 2022 and expansion of two water reclamation facilities.

The debt issuance will require rate increases to allow the system maintain solid operating performance and the rate increases will be subject to City Council approval. The ability to maintain solid financial metrics while pursuing the capital plan will be key to maintaining the credit profile.

Bondholder security is enhanced with adequate legal protections including a debt service reserve equal to the average annual debt service. The July sale's debt service reserve fund will be funded with cash over a 60 month period. Previously issued revenue bond debt service reserve funds have been met with a combination of cash and surety policies. As of July 1, 2020, the debt service reserve fund had $8.5 million in cash, with the balance in sureties. Other satisfactory legal provisions include a 1.15 times annual debt service rate covenant and a 1.40 times average annual debt service additional bonds test.

DEBT STRUCTURE
All of the system's debt is fixed rate. The debt service schedule is descending with a final maturity slated for fiscal 2050. Payout is below peers with 49.9% of principal retired in 10 years.

DEBT-RELATED DERIVATIVES
The system is not party to any derivative agreements.

PENSIONS AND OPEB
All of the system's employees are employees of the City of Pearland, TX and participate in the city's pension plan with the Texas Municipal Retirement System. The system pays its share of the required contribution under administrative reimbursements to the general fund. Please see Moody's Credit Opinion on the city's general obligation bonds released on July 7, 2020.

ESG considerations
ENVIRONMENTAL

The City of Pearland has high risk to natural and man made hazards with susceptibility to extreme rainfall and hurricane and typhoons. Positively, the city will benefit from significant and targeted infrastructure development in the area by multiple levels of government. Additionally, the city has historically received federal aid through the Federal Emergency Management Agency and also has enough cash to manage through any unforeseen challenges as a result of a major environmental event.

SOCIAL

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for City of Pearland, TX because the city has enough liquidity to ward off any financial challenges. Please see the service area and system characteristics section for more detailed information.

The city's demographic profile is stable and will continue to support the system's customer base. Population growth has been explosive with triple digit increases in three of the past four census cycles. With a relatively young population (median age of 35 per the 2018 American Community Survey (ACS)), the laborforce participation has steadily increased in the last decade. Although the April unemployment rate of 10.8% was lower than the state's 13% and the nation's 14.4%, it is likely to increase because of weakened economic conditions. The median family income was above national averages at 156.1%, also as of the ACS's 2018 data. Positively, the median home value is 109.6% of the nation, signifying relative home affordability. These factors have allowed for customer account growth.

GOVERNANCE

The City of Pearland, TX is governed by a mayor and seven council members who serve three year staggered terms. Administrative duties are conducted under the city manager and administrative staff. The system also maintains a reserve policy of 25% of expenditures (net of debt service). Regulatory compliance and capital planning is viewed as strong given no current regulatory issues and multiyear budget forecasting and capital planning to serve a large and growing population. The rate management is moderate.

Rate increases were effective for fiscal 2020, the first since fiscal 2018 and system officials include rate increases in the plan for the next three years to manage operating and capital needs.

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CLIENT SERVICES

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Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
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