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Summary:

Stephens County, Texas; General Obligation

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Credit Profile

Stephens Cnty GO (BAM)

Unenhanced Rating

A+(SPUR)/Stable

Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has raised its long-term rating and underlying rating on Stephens County, Texas' series 2014 general obligation (GO) refunding bonds to 'A+' from 'A'. The outlook is stable.

The upgrade reflects our views that despite recent declines in taxable values, increases in the tax rate coupled with cuts in expenditures have aided stable financial performance.

The GO bonds are secured a limited ad valorem property tax pledge on all taxable property in the county. Given the county's rating level and available liquidity, we rate the series 2014 obligations under our GO limited tax criteria and on par with our GO criteria. The maximum allowable rate in Texas is 80 cents per \$100 of assessed value for all purposes with the portion dedicated to debt service limited to 40 cents. The county's levy is at the maximum at 80 cents, 13.7 cents of which is dedicated to debt service. However, we believe the county possesses the financial stability and flexibility to sustain identical ratings on its unlimited- and limited-tax GO bonds.

The rating reflects our assessment of the following factors for the county:

- Weak economy, with projected per capita effective buying income at 82.8% of the national level and market value per capita of \$57,471;
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund but break-even operating results at the total governmental fund level in fiscal 2015;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 of 33% of operating expenditures;
- Very strong liquidity, with total government available cash at 39.3% of total governmental fund expenditures and 3.3x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 12.0% of expenditures and net direct debt that is 72.8% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with all debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Weak economy

We consider Stephens County's economy weak. The county has an estimated population of 9,422. The county has a projected per capita effective buying income of 82.8% of the national level and per capita market value of \$57,471. Overall, the county's market value fell by 12.7% over the past year to \$541.5 million in 2017. The county

unemployment rate was 4.2% in 2015.

Stephens County is located in north central Texas approximately 73 miles northeast of Abilene and 150 miles west of Dallas. The county's economy is centered on mineral production, making the area more susceptible to economic volatility directly related to the oil and gas sectors. Given prolonged low oil prices and a generally weak energy sector, the county's total taxable values have experienced year-over-year declines since their peak in fiscal 2011. The county's total taxable value in fiscal 2017 of \$541.4 million represents a significant 42% decline since 2011. The top 10 taxpayers represent a relatively small 11.6% of the total tax base, yet of those, the vast majority are involved with operations related to mineral extraction or transportation.

Despite the declines in the taxable value, officials are hopeful total taxable value will remain more stable in the future. Officials note that several small commercial developments should help stabilize the local economy including a new Tractor Supply store, Walmart, and other smaller retailers.

Adequate management

We view the county's management as adequate, with "standard" financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

We have revised the county's management score to adequate from weak based on improvement in general fund performance--the result of an increase in taxes as well as reduction in expenditures.

The county utilizes actual and historical data going back three years to formulate revenue and expenditure assumptions. While no formal analysis is done, officials work with the appraisal district as well as additional sources for help with budget assumptions. Officials provide monthly budget to actual revenue and expenditure reports to council. Budget amendments are made on an as-needed basis and typically occur at the end of each year, yet can be done at any time. The county lacks a formal long-term financial and capital improvement plan. It also does not maintain a formal debt management or reserves and liquidity policy. Stephens County does have a long-standing formal investment policy that is reviewed annually and investment reports are shared with the council monthly.

Adequate budgetary performance

Stephens County's budgetary performance is adequate in our opinion. The county had slight deficit operating results in the general fund of 1.2% of expenditures, but a balanced result across all governmental funds of negative 0.5% in fiscal 2015.

A history of weak operating performance has been driven by declines in property tax collections, the county's largest revenue stream. In fiscal 2015 property taxes in the general fund totaled \$4.82 million, which accounted for 86.3% of total general fund revenues. Total collections in 2015 were down \$374,610 or 7.2%. Fiscal 2015 general fund operations resulted in a modest operating deficit of \$67,262 (following a modest \$10,000 transfer out of the fund). Despite the decline in revenues, relatively stable operating performance in 2015 was supported by a reduction in expenditures as well as an increase in the overall property tax.

Further reductions in expenditures in 2016 aided stable fiscal year-end anticipated results. Officials anticipate a modest operating surplus in fiscal 2016 of several hundred thousand dollars. Management reports cuts in spending across all

departments, including the sheriff's office and jail, aided operating performance in the year. Balanced operations are expected for fiscal 2017.

Very strong budgetary flexibility

Stephens County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 of 33% of operating expenditures, or \$1.9 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The county has historically maintained a very strong financial position, with reserves over 30% in the past three years. Fiscal 2015 year-end available general fund balance totaled \$1.88 million, which we consider solid. Despite challenges of declining property tax revenues as a result of declines in total taxable value, budgetary flexibility and available reserves are expected to remain healthy in the near term.

Very strong liquidity

In our opinion, Stephens County's liquidity is very strong, with total government available cash at 39.3% of total governmental fund expenditures and 3.3x governmental debt service in 2015. In our view, the county has strong access to external liquidity if necessary.

We do not anticipate the liquidity position to change significantly in the near term. We consider the county's investments nonaggressive and liquid in nature. The county has demonstrated the ability to access the capital markets by frequently issuing GO bonds in the last 15 years.

Strong debt and contingent liability profile

In our view, Stephens County's debt and contingent liability profile is strong. Total governmental fund debt service is 12.0% of total governmental fund expenditures, and net direct debt is 72.8% of total governmental fund revenue. Overall net debt is low at 2.0% of market value, and all of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

The county has a strong debt profile. It has one series of debt outstanding: the GO refunding bonds series 2014, which fully mature in 2023. Stephens County's debt profile is not expected to change in the near term as it has no plans for additional borrowing in the next two years. The county does not have variable-rate debt or swaps in its debt portfolio.

Stephens County's pension contributions totaled 4.1% of total governmental fund expenditures in 2015. The county made its full annual required pension contribution in 2015.

The county participates in the Texas County and District Retirement System, a multiple-employer defined benefit pension plan. It has consistently made its annual required contribution to the plan. As of Dec.31, 2015, the plan's fiduciary net position as a percent of liability was 103.5%.

Strong institutional framework

The institutional framework score for Texas counties is strong.

Outlook

The stable outlook reflects the county's stable reserve and liquidity positions, which we expect will continue. Despite recent declines in the tax base, Stephens County has managed expenditures to ensure stable financial performance. We do not expect to change the rating during the next two years.

Upside scenario

Diversification and growth in the local economy leading to improved wealth and income levels could lead us to raise the rating. Improvement in the county's financial management score driven by formalization of financial and debt management policies, as well as long-term financial and capital plans, could also warrant a positive rating action.

Downside scenario

Further declines in the tax base that lead to deterioration in the county's financial position could warrant downward rating pressure, yet we do not anticipate this in our two-year time horizon.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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February 21, 2017

Stephens County
200 West Walker
Breckenridge, TX 76424
Attention: Ms. Sharon Trigg, County Treasurer

Re: *Stephens County, Texas, General Obligation Bonds*

Dear Ms. Trigg:

S&P Global Ratings has reviewed the rating on the above-listed obligations. Based on our review, we have raised the underlying rating (SPUR) from "A" to "A+" while affirming the stable outlook. A copy of the rationale supporting the rating and outlook is enclosed.

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