MOODY'S
INVESTORS SERVICE

Ratings Report

Moody's affirms A1 on Titus County's TX unlimited tax and pass-through toll revenue bonds; negative outlook assigned

$63.8 million in rated debt affected

Opinion

Moody's Investors Service has affirmed the A1 rating on Titus County, TX's unlimited tax and pass-through toll revenue bonds and assigned a negative outlook. This action affects $63.8 million in Moody's rated debt. The rating also takes into consideration $82.5 million of debt not rated by Moody's. The bonds are secured by the county's unlimited ad valorem pledge and additionally secured by pass-through toll revenues received under an agreement with the Texas Department of Transportation (TXDOT).

SUMMARY RATING RATIONALE

The negative outlook assignment reflects a sharp decline in the assessed value (AV) of the county's largest taxpayer and considerably high debt service payments in the short-term. The affirmation is based on a history of positive financial operations resulting in a very healthy General Fund balance and cash reserves. The affirmation further takes into account to the elevated debt burden and slow principal payout. The county has no additional debt issuance plans in the immediate future. Long-term concerns with the highly concentrated tax base, tepid growth, and below average socioeconomic profile are also incorporated into the rating.

STRENGTHS

- High financial reserve and cash levels

- Conservative budgeting

CHALLENGES

- Elevated debt burden with slow principal amortization

- Significant assessed valuation decline from largest tax payer

DETAILED CREDIT DISCUSSION

MOODY'S
INVESTORS SERVICE

Ratings Report

OUTLOOK

Moody's assigned a negative outlook on the rating due to two main factors creating downward pressure on the rating in the short-term. First, a sharp decline in the most recent assessment of a power plant coupled with high taxpayer concentration exposes the county to further revenue losses if the current trend of tax base diversification slows. Concentration is still high at 37% of total AV but much lower than 2009 when it was closer to 60%. Second, large debt service payments will put a strain on the county's finances until state reimbursements begin in 2015.

TAX BASE GROWTH REMAINS FLAT DESPITE HIGH ECONOMIC CONCENTRATION

Titus County is located in northwest Texas approximately 64 miles west of Texarkana, TX (Aa3). The certified total assessed value (AV) in 2014 was $2.4 billion, although this figure will be slightly revised down in light of a recent settlement with Luminant Generation Co. LLC, the county's largest taxpayer. Luminant is a subsidiary of Energy Future Holdings Corporation (not rated) which filed for bankruptcy protection on April 29, 2014. Luminant owns and operates the coal-fired Monticello Power Plant (1,880 MW). The plant's AV peaked in 2008 above $1 billion but declined precipitously when it was valued at $429 million in 2014. Luminant protested the assessment, arguing that the value was closer to $202 million. They settled with the county in September on $350 million, still high at 15% of total AV but a difference of over $300,000 in tax levy. The plant's future remains an ongoing concern as bankruptcy proceedings continue through the first half of 2015 in addition to increasing stringency of environmental regulations. In spite of the protest, total AV remains relatively flat with a five-year average growth rate of -2.3%.

The second largest taxpayer, AEP Southwestern Electric Company (Baa2 stable) owns and operates the coal-fired Welsh Power Plant (1,584 MW) representing 11.3% of total assessed value. Although one of the three units will be retired by the end of this year, the company plans to invest approximately $400 million in retrofits at the other two units to comply with the EPA's Mercury Air Toxics Standard. The project is expected to add 200 - 300 temporary jobs.

The local labor market is mainly supported by agribusiness, trailer manufacturing, and lignite mining. The county is also among the leading producers of poultry due to Pilgrim's Pride Corporation (issuer long term B1 stable). The company's presence is reportedly stable, and they about 3,900 personnel which equates to more than 10% of the county's population. Socioeconomic indicators are slightly below average with median family income equal to 70% of the national median.

POSITIVE OPERATING HISTORY RESULTING IN HEALTHY RESERVE LEVELS

The county ended fiscal 2013 with a $6.4 million General Fund balance, or 68% of revenues, much higher than similarly rated peers. Even though tax revenues from Luminant were much lower than prior years, unaudited results for fiscal 2014 show that the county only had a slight draw on the General Fund balance, ending the year with a still sufficient $6.2 million. The county is budgeting for another draw on reserves in fiscal 2015 mainly to finance renovations at government offices.

Ratings Report

Management conservatively budgeted for fiscal 2015 based on Luminant's initial contention that the Monticello plant should be valued at $202 million. They proposed a tax rate increase of $4.39 per $1000 of AV, up from $4.15 in the prior year. However, shortly after the settlement, discussions with the public at a recent hearing resulted in the adoption of a very modest increase to $4.18.

LARGE DEBT SERVICE PARTIALLY OFFSET BY UPCOMING STATE REIMBURSEMENTS

In 2007 the county entered into an agreement with TXDOT under the Pass-Through Toll Program, designed to benefit local areas by accelerating highway safety and mobility improvements. Proceeds from the pass-through toll revenue bonds are funding a loop construction project on US 271, Farm-to-Market Road 2348, and Farm-to-Market 1000. The project is expected to be completed in mid-2015. Total debt outstanding is $142.3 million, of which $100 million is unlimited tax GO and $46 million is limited tax. This translates to a highly elevated 6.2% of AV in fiscal 2013. The slow payout schedule only has 39% of principal retired after ten years.

In 2015 the county will begin receiving reimbursements from TXDOT at a minimum of $4.2 million and a maximum of $8.4 million semiannually, although actual amounts will be based on toll revenues. These funds will be used to service the debt. The county expects the first payment to be received in March and approximately $3.5 million, which is smaller than the contractual minimum because the project is only about 80% complete at this time. Meanwhile, the total debt service requirements are $8.9 million and $10.9 million in fiscal years 2014 and 2015, respectively. This is more than double the average payment from 2008-2012. Moody's believes this will put pressure on financial operations in the near-term until TXDOT begins making the full reimbursements.

WHAT COULD MAKE THE RATING GO UP

- Significant tax base growth and diversification

- Improvement in socioeconomic measures

WHAT COULD MAKE THE RATING GO DOWN

- Major reduction in liquidity and reserve levels

- Prolonged declines in total assessed value

KEY STATISTICS

FY 2015 Full Value ($000): $2,417,879

FY 2015 Full Value Per Capita: $74,025

Median Family Income as % of US: 69.7%

MOODY'S
INVESTORS SERVICE

Ratings Report

FY 2013 Operating Fund Balance as % of Revenues: 31.86%

5-Year Dollar Change in Fund Balance as % of Revenues: 8.25%

FY 2013 Operating Cash Balance as % of Revenues: 33.63%

5-Year Dollar Change in Cash Balance as % of Revenues: 9.41%

Institutional Framework: Aaa

5-Year Average Operating Revenues / Operating Expenditures: 1.02x

Net Direct Debt as % of Full Value: 6.23%

Net Direct Debt / Operating Revenues: 7.30x

3-Year Average ANPL as % of Full Value: 0.42%

3-Year Average ANPL / Operating Revenues: 0.50x