

August 2, 2016

Mr. Stan Chambers  
McLennan (County Of) TX  
214 North 4th Street, Suite 100  
Waco, TX 76701

Dear Mr. Chambers :

We wish to inform you that on July 28, 2016, Moody's Investors Service reviewed and assigned a rating of

- Aa1 to MCLENNAN (COUNTY OF) TX, Combination Tax and Limited Pledge Revenue Certificates of Obligation Series 2016

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Should you have any questions regarding the above, please do not hesitate to contact me or the analyst assigned to this transaction, Brittini Smith at 415-274-1725.

Sincerely,

A handwritten signature in black ink that reads "Gera McGuire". The signature is written in a cursive, slightly slanted style.

Gera McGuire  
VP-Sr Credit Officer/Manager

cc: Mr. Mark McLiney  
SAMCO Capital Markets  
8700 Crownhill Blvd, Suite 601  
San Antonio, TX 78209

## CREDIT OPINION

28 July 2016

New Issue

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### Contacts

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## McLennan (County of) TX

New Issue - Moody's assigns Aa1 to McLennan Cnty, TX's Comb. Tax & Ltd Pledge Rev Certificates of Obligation, Ser. 2016

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 underlying rating to McLennan County's, TX, \$9.8 million Combination Tax and Limited Pledge Revenue Certificates of Obligation, Series 2016. Concurrently Moody's affirms the Aa1 rating on the county's \$3.9 million of outstanding general obligation limited tax debt. The county additionally has \$6.4 million in outstanding general obligation debt not rated by Moody's.

The Aa1 rating reflects the county's large, growing tax base anchored by the presence of Baylor University, diverse economy, strong financial position with robust reserves, and manageable debt and pension burden. The rating also reflects the county's below average resident wealth levels.

### Credit Strengths

- » Growing and diverse tax base with institutional presence
- » Robust reserve and liquidity position
- » Manageable debt and pension burden

### Credit Challenges

- » Below average resident wealth levels
- » Plans for additional borrowing, though expected to remain manageable

### Rating Outlook

Outlooks are usually not assigned to local governments with this amount of debt outstanding.

### Factors that Could Lead to an Upgrade

- » Material growth in the tax base
- » Improvement in resident wealth levels

### Factors that Could Lead to a Downgrade

- » Poor financial performance leading to a material decline in reserves

- » Trend of significant declines in taxable values
- » Significant increase in debt profile without corresponding tax base growth

## Key Indicators

Exhibit 1

McLennan (County of) TX	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 14,579,812	\$ 15,503,137	\$ 16,240,899	\$ 16,541,780	\$ 17,826,492
Full Value Per Capita	\$ 62,737	\$ 66,076	\$ 68,436	\$ 69,005	\$ 73,227
Median Family Income (% of US Median)	81.9%	82.6%	82.0%	81.9%	81.9%
Finances					
Operating Revenue (\$000)	\$ 75,236	\$ 76,311	\$ 82,096	\$ 91,939	\$ 96,941
Fund Balance as a % of Revenues	52.0%	41.0%	37.4%	40.8%	52.9%
Cash Balance as a % of Revenues	51.6%	42.2%	38.4%	41.9%	54.1%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 80,214	\$ 75,452	\$ 70,968	\$ 67,179	\$ 65,322
Net Direct Debt / Operating Revenues (x)	1.1x	1.0x	0.9x	0.7x	0.7x
Net Direct Debt / Full Value (%)	0.6%	0.5%	0.4%	0.4%	0.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.0x	1.2x	1.4x	1.3x	1.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.5%	0.6%	0.7%	0.7%	0.8%

Source: Moody's Investors Service

## Recent Developments

Recent developments are incorporated into the Detailed Rating Considerations.

## Detailed Rating Considerations

### Economy and Tax Base: Growing Tax Base Encompassing WACO Metropolitan Area; Stable Presence of Baylor University

The county is located in central Texas halfway between the cities of Dallas and Austin. The county encompasses the Waco MSA and its economy is primarily based on manufacturing, agriculture and higher education. The City of Waco is the county seat and center for manufacturing, tourism, conventions and agribusiness. Moody's Economy.com reported in March 2016, expansion in Waco will continue through 2016 due to investments in high-tech manufacturing and broad, consistent growth in service and long-term growth will benefit from Baylor and various tech industries. Resident wealth levels in the county are below average with median family income at 82% of the US, which is partially attributed to a large student population with Baylor University, Texas State Technical Institute, McLennan Community College. Baylor University has a population of nearly 16,000 students in the City of Waco. The unemployment rate in the county is very low at 3.6% in April 2016 compared to 4.2% for the state and 4.7% for the US.

The county has large tax base with 2016 assessed value of \$17.8 billion that has continued to grow year-over-year for the past decade. The county's five-year average annual growth rate is 5.1%. The growth in the tax base is attributed to a number of factors including growth in the commercial and industrial property values, economic development, expansion of some of the large employers. Based on preliminary results, taxable values increased 13% for 2016. The tax base exhibits very low levels of concentration with the largest taxpayers accounting for 2.3% of 2016 assessed value.

### Financial Operations and Reserves: Strong Financial Position; Robust Reserves

The county's financial position is strong with healthy levels of reserves that have increased the past two years. In 2014 and 2015, operating revenues outpaced expenditures by \$7.5 million and \$13.3 million, respectively. Moody's considers the county's operating funds to include the general, debt service and road and bridge fund. Prior to 2014, the county had experienced four years of consecutive deficits which reduced available reserves to \$30.1 million or a still healthy 39% of revenues. As a result of these declines,

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the county reduced expenditures and increased its tax rate resulting in much strong tax revenue. In fiscal 2015, available fund balance was \$51.3 million or 52.9% of revenues. This level of reserves is consistent with the median of similarly rated Aa1 counties in Texas.

For 2016, the county utilized \$7.3 million in reserves for a several purposes including retiring all short-term debt of \$2.8 million, called a \$2.5 million bond and increasing pension contribution by \$2 million. Even with the spend down of reserves, the county is still estimating general fund available reserves will total \$41.7 million at the end of fiscal 2015 compared to \$44 million in general fund reserves in fiscal 2015. Sales tax revenues are continuing to trend strong and are up \$550,000 compared to this time last year. The fiscal 2017 budget has not yet been proposed, however, if tax rates remain the same officials anticipate reserves will increase and they may add more to its pension contributions. Officials have stated they have no intention of dropping reserves below 25% of general fund expenditure policy.

#### LIQUIDITY

The county's liquidity position is strong with \$52.4 million in cash and investments or 54.1% of operating revenues. The general purpose debt service cash position totaled \$6.5 million which is restricted for debt service requirements

#### Debt and Pensions: Very Manageable Debt and Pension Burden

The county's debt burden will be very manageable with net direct debt of \$66.2 million or 0.7 times operating revenues and 0.4% of AV. Approximately \$20.1 million is limited tax general obligation debt and \$44.7 million in revenue bonds issued by the McLennan County Public Facility Corporation, not rated by Moody's. Moody's includes this on the debt statement because the Corporation is treated as a blended component unit of the county, while a legally separate entity, the corporation is part of the county's operations. The county anticipates issuing approximately \$20 million in general obligation debt for general county improvements within the next twelve months. This additional issuance would still be a very manageable debt burden.

#### DEBT STRUCTURE

All of the county's debt is fixed rate and payout is rapid with 75% of principal retired in ten years.

#### DEBT-RELATED DERIVATIVES

The county has no variable rate debt and is not party to any interest rate swaps or other derivative agreements.

#### PENSIONS AND OPEB

The county has an average pension burden with a Moody's three-year adjusted net pension liability (ANPL), under our methodology for adjusting reported pension data, of 1.4 times operating revenues and 0.7% of AV. The county participates in the Texas County and District Retirement System (TCDRS). Budgetary pressure due to the county's participation in TCDRS is expected to remain minimal in the near term. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported contribution information, or the reported liability information of the state-wide cost-sharing plans, but to improve comparability with other rated entities. For more information on Moody's insights on employee pensions and the related credit impact on companies, governments, and other entities across the globe please visit Moody's on Pensions at [www.moody.com/pensions](http://www.moody.com/pensions).

The county provides other post employment benefits (OPEB) to eligible retired employees in a single employer plan that is funded on a pay-go basis. In fiscal 2015, the county's annual OPEB contribution was \$580,058 and the unfunded actuarial accrued liability was \$37.3 million based on the most recent actuarial date of December 31, 2013. The County no longer offers OPEBs to new employees and therefore the unfunded liability in the future will begin to decrease.

The county's fixed costs were approximately \$9.2 million or a very manageable 6.6% of 2015 operating expenditures. Fixed costs refer to the district's debt service (net of PFC debt service), required pension contributions and retiree health care payments.

#### Management and Governance: Formalized Reserve Policy; Very Strong Institutional Framework

The county maintains a formal fund policy to maintain unassigned general fund reserves at 25% of general fund expenditures. We also notes management has utilized excess reserves to better the county's financial position including increasing pension contributions to offset its liabilities, which we view positively.

Texas counties have an institutional framework score of "Aaa," or very strong. Counties rely on highly predictable, property taxes for 70%-80% of their operating revenues, while 10%-20% comes from less predictable services charges. Counties maintain high

flexibility to raise property taxes, as most are well below the state mandated cap of \$8 per \$1,000 of AV, with no more than \$4 for debt. Expenditures primarily consist of personnel and judicial costs, which are highly predictable. Counties have high flexibility in reducing expenditures given a limited union presence. The commissioners court consists of five commissioners, one of which is the County Judge.

### Legal Security

The Certificates constitute direct obligations of the county payable from an annual ad valorem tax levied against all taxable property and additionally secured by a lien on the pledged revenues derived from the operation of the county's library system. The limited tax bonds are limited to a maximum of the \$4 per \$1,000 of assessed values from the \$8 per \$1,000 of assessed values allocated to counties. The current limited tax rate is \$2.42 per \$1,000.

### Use of Proceeds

Proceeds will be used to pay for improving and roads and bridges and various facilities and buildings and used on various capital projects.

### Obligor Profile

McLennan County is located in central Texas and comprises the Waco MSA and serves approximately 234,906 residents.

### Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

### Ratings

Exhibit 2

#### McLennan (County of) TX

Issue	Rating
Combination Tax and Limited Pledge Revenue Certificates of Obligation Series 2016	Aa1
Rating Type	Underlying LT
Sale Amount	\$9,800,000
Expected Sale Date	08/02/2016
Rating Description	General Obligation Limited Tax

Source: Moody's Investors Service

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