

Research Update:

San Marcos, TX Series 2026A Waterworks And Wastewater System Revenue Bonds Assigned 'AA' Rating; Outlook Stable

April 3, 2026

Overview

- S&P Global Ratings assigned its 'AA' long-term rating to the city of San Marcos, Texas' anticipated \$93.1 million series 2026A waterworks and wastewater system revenue bonds.
- At the same time, S&P Global Ratings affirmed its 'AA' rating on the city's existing waterworks and wastewater system revenue bonds.
- The outlook is stable.

Rationale

Security

The San Marcos waterworks and sewer system's first-lien net revenue pledge secures the bonds. The 2026A bond proceeds will be used to fund the construction of a second water reclamation facility within the city to address growth, as well as to fund improvements of certain existing system facilities. We view the bond provisions as credit-neutral. The city will fund a debt service reserve fund if debt service coverage (DSC) falls below 1.3x the average annual debt service requirements on the bonds. Post-issuance, the San Marcos water and sewer system will maintain approximately \$260 million in all-in combined debt outstanding (including system-supported general obligation [GO] debt). We have equalized the ratings on all existing liens, including an approximately \$3.6 million Texas water development board prior obligation, given the de minimis amount of debt on the Texas water development board closed prior lien and the healthy financial metrics on an all-in basis.

Credit highlights

The rating reflects our view of the water and sewer system's general creditworthiness driven by an expanding economy and by a stable financial profile supported by comprehensive management policies. San Marcos benefits from its location between Austin and San Antonio, which has fueled demand for local housing and commercial development. Supporting the rating is the city's willingness to adjust rates, including annual rate increases and growth-related impact

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fee adjustments. S&P Global Ratings' all-in DSC calculation, which treats the city's payments to the Alliance Regional Water Authority as a fixed charge that is debt-like in nature, averaged 1.9x, which we view as extremely strong, during the three audited years through fiscal year 2025. In our view, the key risks to the utility system's credit quality involve managing customer growth and executing infrastructure-upgrade objectives for planned capital projects.

While the current \$239 million 10-year capital improvement plan (CIP) and the new water reclamation facility will be debt-financed with a portion of the 2026A bonds, management's conservative financial practices and substantial reserves mitigate risks associated with rapid growth and infrastructure demands. We view the utility's cash levels as credit-supportive in light of an event of an unexpected capital need or cost escalation. Based on the utility's financing plan, capital spending is gradually moderating from the peak years of its CIP and is transitioning to focus on asset management and system optimization. We believe management will continue to adjust rates to align with rising debt service costs, while maintaining healthy all-in DSC metrics and liquidity.

The rating further reflects our assessment of the utility system's:

- Growing economy with access to large regional employment centers. The city is home to Texas State University, which has over 38,000 enrolled students and in our view provides a stabilizing institutional presence. While city income levels are below average, reflecting the relatively young population, this is somewhat offset by an expanding economy and population.
- History of stable operating performance and solid reserves that we anticipate could moderate somewhat from current levels given the city's plans to spend excess reserves for identified priorities such as one-time capital, but ultimately supported by the city's commitment to a 150-days' cash reserve policy. We anticipate liquidity will remain well above two years' cash on hand in the medium term, maintaining the exceptionally strong, favorable adjustment seen historically.
- Operational management and financial management assessments of good, which, in our view, indicates a favorable alignment of operations with management's strategic goals, even if some risks exist. The city is in the process of constructing a wastewater treatment plant with a capacity of two million gallons per day (mgd), expandable to 8 mgd.
- Large CIP with moderate leverage that we expect will increase in the future.

Environmental, social, and governance

We view the city utility system's environmental and social risks as somewhat above average and its governance risk as mostly credit-neutral. The city has reported no recent regulatory fines, penalties, or major water quality issues in the past three years. However, we view the city's water system as facing challenges from acute and chronic environmental physical risks from potential prolonged drought, leading to long-term asset adequacy (water shortage) risks. The city sources its water supply from a dual supply of existing wells tapping the Edwards Aquifer and a pipeline from the Guadalupe River; in addition, recent partnerships with other agencies are designed to firm additional raw water resources, enough to satisfy average and peak day demand. The city maintains a drought-management plan that includes mandatory conservation measures, and management believes the city will have water supply until 2050, based on current growth levels.

While income levels are well below national averages, we view social capital risks as somewhat above average, given that rates represent 3.4% of median household effective buying income. We view San Marcos' pace of development as a positive social capital factor, expanding the revenue base, though this may require debt issuance to fund infrastructure growth. In addition, we view

governance risks as credit-neutral. The city possesses autonomy for rate increases, maintains established cyber security protocols, and manages operational staff through active succession planning.

Outlook

The stable outlook reflects our expectation that San Marcos is addressing its most pressing growth- and maintenance-related capital needs, allowing for continued financial stability. The outlook also reflects our expectation that the city will maintain healthy financial performance and manage capital needs through proactive funding while maintaining ample capacity to absorb CIP costs in the medium term.

Downside scenario

We believe strengths in the San Marcos utility system's financial profile partly offset some of the weaknesses in the economic profile, including below-average income levels and potential rate affordability pressures. However, if liquidity levels fall below expectations, or if the CIP funding mechanism shifts to require a significantly greater amount of additional leverage than anticipated, which could alter related financial metrics, we could lower the rating.

Upside scenario

Given the city utility system's various debt obligations and subsequent above-average rate affordability, we do not expect to raise the rating during the two-year outlook period. Also limiting the upside are the city's income levels. However, we could raise the rating in the long term if the system's local economy were to expand and diversify, leading to improved income metrics and increased rate-raising flexibility, while the city progresses on its CIP.

San Marcos, Texas--Economic and financial data

	Most recent	Fiscal year-end			
		2025	2024	2023	Median (AA)
Economic data					
MHHEBI of the service area as % of the U.S.	65.6				110.0
Unemployment rate (%)	3.2				3.6
Poverty rate (%)	10.4				10.0
Water rate (6,000 gallons or actual) (\$)	59.3				36.5
Sewer rate (6,000 gallons or actual) (\$)	66.14				41.0
Annual utility bill as % of MHHEBI	3.4				1.1
Operational management assessment	Good				Good
Financial data					
Total operating revenues (\$000s)		74,969	65,817	62,075	24,286
Total operating expenses less depreciation (\$000s)		43,906	39,417	36,002	17,090
Net revenues available for debt service (\$000s)		39,009	34,802	31,336	--
Debt service (\$000s)		14,888	14,322	14,442	--
S&P Global Ratings-adjusted all-in DSC (x)		2.0	1.9	1.9	2.2
Unrestricted cash (\$000s)		183,809	149,529	143,005	24,667
Days' cash of operating expenses		1,528	1,385	1,450	631
Total on-balance-sheet debt (\$000s)	262,536	169,476	178,383	151,405	39,844

San Marcos, Texas--Economic and financial data

	Most recent	Fiscal year-end			Median (AA)
		2025	2024	2023	
Debt-to-capitalization ratio (%)	53.7	42.7	46.7	45.2	27.0
Financial management assessment	Good	--	--	--	Good

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

Ratings List

New Issue Ratings

US\$93,060,000 City of San Marcos, (A political subdivision of the State of Texas located in Hays, Caldwell and Guadalupe Counties), Texas, Waterworks and Wastewater System Revenue Bonds, Series 2026A, dated: May 13, 2026, due: August 15, 2046

Long Term Rating AA/Stable

Ratings Affirmed

Water & Sewer

San Marcos, TX Water and Sewer System AA/Stable

The ratings appearing below the new issues represent an aggregation of debt issues (ASID) associated with related maturities. The maturities similarly reflect our opinion about the creditworthiness of the U.S. Public Finance obligor's legal pledge for payment of the financial obligation. Nevertheless, these maturities may have different credit ratings than the rating presented next to the ASID depending on whether or not additional legal pledge(s) support the specific maturity's payment obligation, such as credit enhancement, as a result of defeasance, or other factors.

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