MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Pilot Knob Municipal Utility District 3, TX

Update following upgrade to Baa2

Summary

Pilot Knob Municipal Utility District No. 3's (Baa2 stable) credit profile benefits from rapid tax base growth and limited operations because of its utility agreements with the City of Austin (Aa1 stable). General fund reserves continue to improve annually, and another surplus is budgeted in fiscal 2022. Debt service fund reserves are currently sound, but an increase in the debt service rate is expected in 2023 because of rising debt service. The credit profile is constrained by a small tax base and a high debt profile with plans for additional debt given the significant amount still owed to developers.

On September 21, we upgraded the district's general obligation unlimited tax debt to Baa2 from Baa3.

Credit strengths

» Rapidly growing tax base

» Healthy general fund reserves

» No pension or OPEB liabilities

Credit challenges

» High debt profile with slow payout and ascending debt service schedule

» Significant amount owed to the developer

Rating outlook

The stable outlook reflects the expectation that construction of single-family homes will drive assessed value (AV) growth over the next several years and that general and debt service fund reserves will remain sound. In addition, the district will only issue new debt in conjunction with AV growth, which will keep the debt burden stable but high.

Factors that could lead to an upgrade

» Continued tax base growth

» Material improvement in fund balance and liquidity

» Material decline in the debt burden

Factors that could lead to a downgrade

» Tax base contraction

» Decline in fund balance or liquidity

» Increase in the debt burden

Key indicators

Exhibit 1

Pilot Knob Municipal Utility District 3, TX

	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value ($000)	$6,854	$13,797	$54,142	$86,964	$113,696
Population	-	144	1,089	1,211	2,124
Full Value Per Capita	-	$95,815	$49,717	$71,812	$53,529
Median Family Income (% of US Median)	68.7%	73.2%	73.2%	77.9%	77.9%
Finances					
Operating Revenue ($000)	$67	$163	$1,029	$870	$1,977
Fund Balance ($000)	$25	$84	$1,019	$1,606	$2,921
Cash Balance ($000)	$35	$371	$1,282	$1,826	$3,073
Fund Balance as a % of Revenues	37.9%	51.8%	99.1%	184.5%	147.8%
Cash Balance as a % of Revenues	51.9%	227.9%	124.7%	209.8%	155.4%
Debt/Pensions					
Net Direct Debt ($000)	$0	$3,250	$7,450	$10,040	$11,860
3-Year Average of Moody's ANPL ($000)	$0	$0	$0	$0	$0
Net Direct Debt / Full Value (%)	0.0%	23.6%	13.8%	11.5%	10.4%
Net Direct Debt / Operating Revenues (x)	0.0x	20.0x	7.2x	11.5x	6.0x
Moody's - ANPL (3-yr average) to Full Value (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Moody's - ANPL (3-yr average) to Revenues (x)	0.0x	0.0x	0.0x	0.0x	0.0x

Finances include the general and debt service funds; the MFI of Del Valle ISD is used as a proxy for that of the district
Sources: US Census Bureau, Pilot Knob Municipal Utility District 3, TX's financial statements and Moody's Investors Service

Profile

Pilot Knob MUD 3 contains 678 acres and is located eight miles southeast of downtown Austin in Travis County (Aaa stable). The estimated population is 3,120. Utility operations are provided by Austin.

Detailed credit considerations

Economy and tax base

Tax base growth will continue as more single-family homes are constructed. Assessed value (AV) has increased significantly since development commenced in 2015. Certified fiscal 2022 AV grew 82.4% to $304.9 million, which is larger than the Baa2 median.

Approximately 82% of the developable land has been developed with utilities and another 13% is being developed now. The district is entirely single-family residential and near-term new growth will come from continued construction of single-family homes (197 homes are under construction and there are 246 vacant lots). The remaining 29 acres of undeveloped land is expected to eventually contain more single-family homes and some commercial improvements.

As AV has grown, taxpayer concentration has declined and the top 10 taxpayers now account for a modest 7.6% of fiscal 2022 AV. Most of the top taxpayers are the developer and homebuilders.

Financial operations and reserves

General fund balance as a percentage of revenue will remain healthy given conservative budgeting. Fiscal 2020 (September 31 year-end) audited results show the fourth consecutive general fund surplus. Available fund balance grew by $991,000 to $1.9 million, which equals 153.3% of revenue and 784% of expenditures. Fiscal 2021 outperformed the budget and expected results show a $648,000 surplus, which would bring fund balance to about 280% of 2021 revenue. The proposed fiscal 2022 budget includes a $566,000 surplus. The district receives its revenue from property taxes and drainage fees, which is a one-time fee collected when a developer sells a lot to a homebuilder. When the district is fully built out, property taxes will be the sole revenue source.

Available operating fund balance (which includes the general and debt service funds) totaled 147.8% of combined revenue at fiscal 2020 year-end. Projections indicate that at calendar year-end, the district will maintain around 50-60% of the subsequent year's debt service cost in reserve for the next few years. These projections assume no AV growth, debt service from two new issuances planned for later this year, and an increase in the debt service tax rate in 2023.

Liquidity

Cash will remain healthy and in line with fund balance. In fiscal 2020, operating fund cash totaled $3.1 million or 155.4% of revenue. Of this, $1.9 million was in the general fund, which is equal to 158.5% of general fund revenue.

Debt and pensions

The debt profile will remain elevated given slow principal payout and plans for additional debt to reimburse developers. Including the Series 2021 bonds, the direct debt burden is 8.8% of fiscal 2022 AV. Developers are owed a significant $25.2 million post-sale of the 2021 bonds. The district plans to issue two more bond issues later this year (totaling $11.5 million), and subsequent issues to reimburse the developer will be issued in conjunction with tax base growth. The district aims to keep the debt burden under 12%.

Legal security

The bonds are secured by an annual ad valorem tax levied, without legal limit as to rate or amount, against all taxable property located within the district.

Pensions and OPEB

The district does not have any employees and therefore does not have pension or OPEB obligations.

ESG considerations

Environmental

The local government sector generally has low exposure to environmental risks. According to data from Moody's affiliate Four Twenty Seven, the district has high exposure to water stress and medium exposure to heat stress, extreme rainfall and hurricanes. Favorably, federal and state governments help mitigate these exposures. The US government continues to provide substantial assistance via its Federal Emergency Management Agency (FEMA) in the wake of large storms. The state has taken action to help mitigate water stress risk within its borders by issuing general obligation debt through the Texas Water Development Board (TWDB) since the 1950s to finance a variety of water conservation and supply projects.

Social

Population will continue to grow since the district is not yet built out. Income levels in the area, using the Del Valle ISD (Aa3) as a proxy, are below average with a median family income equal to 77.9% of the US (2019 American Community Survey). New home prices in the district range from $192,000 to $524,000.

Governance

The district is governed by a board of directors, consisting of five directors serving four-year staggered terms. Although the district does not have any employees, which is typical for MUDs, the district contracts out for critical needs including bookkeeping and other financial services. The district is subject to oversight by the Texas Commission of Environmental Quality.

Texas MUDs have an Institutional Framework score of Aa, which is strong compared to the nation. Property taxes, one of the sector's major revenue sources, are not subject to any caps for debt service. MUDs that are considered over 95% developed are subject to a property tax cap of 3.5% for maintenance and operations. Unpredictable revenue fluctuations tend to be minor, or under 5% annually.

Across the sector, fixed and mandated costs specifically for debt service are generally greater than 25% of expenditures. MUDs have no full-time employees. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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