

Fitch Upgrades Texas Unemployment Obligation Bonds to 'AAA'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has assigned an 'AAA' rating to the following Texas Public Finance Authority (TPFA) unemployment compensation obligation assessment revenue refunding bonds:

-- \$419,245,000, series 2014A;

-- \$274,000,000, series 2014B.

The bonds are scheduled to sell the week of April 21.

In addition, Fitch upgrades to 'AAA' from 'AA+' the ratings on \$1.1 billion in outstanding TPFA unemployment compensation obligation assessment revenue bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are special obligations of the Texas Public Finance Authority and Texas Workforce Commission payable from a first and exclusive lien on pledged revenues, including revenues derived from the levy of the unemployment obligation assessment, amounts deposited to the obligation trust fund and program fund, and any other revenues deposited to the obligation trust fund that are legally available to pay the obligations.

KEY RATING DRIVERS

UPGRADE BASED ON STRONG PERFORMANCE: The upgrade, to 'AAA,' reflects the

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strength of pledged revenues since original issuance of parity bonds in 2010, which combined with structural mechanisms to accelerate repayment is rapidly reducing outstanding par.

UNLIMITED ASSESSMENT: The obligation assessment is a broad tax applied to employers in the state, the rate for which is established annually while bonds are outstanding in order to provide a minimum of 1.5x coverage of debt service in the following year, as well as administrative costs; there is no limit on the obligation assessment rate. Bonds are not secured by other assessments that make up the state's unemployment assessment.

HOLDBACK TO ENSURE SUFFICIENT COVERAGE: The structure provides that excess collections after debt service payment be used for early bond redemption. If projected receipts are expected to lag, the resolution provides for the holdback of excess receipts collected in the spring months, but not needed for immediate debt service, to ensure sufficiency of funds for debt service.

STRONG COLLECTIONS: The state's unemployment assessment collection mechanisms are strong and well-established, with a collection rate approaching 100%. Payments by employers, including the obligation assessment levied for bondholders, are highly seasonal, with the bulk of collections in the spring.

ADDITIONAL RESOURCES FOR EARLY REPAYMENT: Any balance in the state's unemployment compensation fund above a maximum threshold is legally available to repay outstanding bonds, although such funds are not specifically pledged.

ESTABLISHED PROGRAM: The bond program was established during the 2002-2003 downturn and has since been strengthened by the addition of the holdback provision and by statutory powers to allow transfer of excess unemployment compensation fund balances to bondholders.

STRONG ECONOMIC GROWTH: The state's economy has expanded rapidly and diversified over the last two decades, and recent economic growth has been strong. However, natural resources remain important.

RATING SENSITIVITIES

The rating is sensitive to any challenges to the smooth functioning of the unemployment compensation rate-setting and collection process as well as any fundamental changes in the state's economy that could materially affect collections of assessments.

CREDIT PROFILE

The upgrade to 'AAA' reflects the strength of pledged revenues and the bonds' strong bondholder protections and structural features which are resulting in rapid repayment since parity bonds were first issued in 2010. The obligation assessment is a legislatively authorized component of Texas' unemployment tax that by covenant must be levied while bonds are outstanding. The assessment is collected with the state's other unemployment taxes on its broad and diverse economic base; collection experience is very strong.

The rate is determined annually by the Texas Workforce Commission at a level sufficient to provide 1.5x coverage of debt service in the next calendar year, with excess collections available for accelerated bond repayment. Since issuance, early redemptions from excess pledged revenues have totaled \$423 million. Under current forecast assumptions, the bonds are projected to be fully repaid in 2017 by scheduled debt service and early redemptions.

Proceeds were used to repay in late 2010 approximately \$1.7 billion in advances made by the federal government to cover a deficit in the state's unemployment compensation trust fund (the trust fund) and to provide \$400 million to replenish the trust fund.

Obligation assessment bonds were first issued in 2003 and fully redeemed in 2007 well ahead of original planned maturity. In addition to the excess coverage by the obligation assessment, repayment was accelerated by a 2007 statutory change allowing balances in the trust fund in excess of its statutory ceiling (2% of the state's taxable wage base, or

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about \$1.9 billion in 2013 and forecast at about \$2 billion in 2014) to be used for early bond repayment. Excess trust fund balances are legally available, but not pledged.

The state's trust fund balance was nearly \$1.4 billion as of December 2013, and thus none of these balances have been used for early redemptions to date. Under the state's current forecast, the trust fund balance will reach about \$1.9 billion by the end of 2014, just below the expected 2014 statutory ceiling of \$2 billion. In Fitch's view, the availability of future trust fund balances will likely further accelerate rapid repayment of the bonds.

The resolution includes a holdback provision in effect during the second half of the year, when fewer assessments are received, by which pledged receipts can be directed toward early redemption only if the 1.5x coverage threshold is met for the period through the next debt service payment date and a minimum of \$25 million is retained in the debt service account. There is no debt service reserve.

The state's unemployment taxes currently include the general rate, a replenishment tax, and the obligation assessment, among other components. The average combined tax rate in 2014 is 1.66%; the average obligation assessment tax yield for the bonds is 0.33%. Collections are historically very strong, exceeding 99% per quarter. Only the revenues from the obligation assessment are pledged to bondholders.

The obligation assessment rate is reset annually in November by the commission for payment by employers in the following calendar year at a level sufficient to cover debt service by 1.5x and bond expenses. The rate is not capped, nor is legislative approval necessary for the commission to adjust the rate. Texas statute establishes a trust fund balance ceiling of 2% of taxable wages and a floor of either \$400 million or 1% of taxable wages as of June 30 for use by the commission in establishing the following year's rates.

The commission deposits collections to the obligation assessment trust fund; payments from the fund do not require appropriation. After transfer of funds for principal, interest and administrative expenses, funds may be used for interest payments on any outstanding federal advances, prior to determining funds available for early redemption.

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In Texas, aggregate unemployment taxes are payable quarterly on the first \$9,000 of taxable wages. As a result of the limited taxable wage base, collections are highly seasonal, with nearly two-thirds of unemployment tax revenues paid in the first quarter based on first-quarter taxable wages; about 20% of collections are paid in the second half of the year prior to the Jan. 1 debt service payment.

Receipts are deposited to the trust fund, from which unemployment benefits are drawn. Obligation assessments are deposited to a separate obligation assessment trust fund, available only for bondholders.

State economic performance has been solid since the last downturn, with growth rates well in excess of national averages. Unemployment as of February 2014 was 5.7%, compared to 6.7% nationally. Employment growth in February 2014 was 2.7% year-over-year, compared to 1.5% nationally. The state's economy has expanded rapidly and diversified over the last two decades, although natural resource sectors remain a key part of the state's strong economic performance. Population growth is very rapid, rising nearly 27% since 2000 (compared to 12.3% nationally). Personal income has shown strong growth in recent quarters, rising 3.3% in the fourth quarter of 2013, compared to 1.4% nationally. Personal income per capita measured 98% of the nation's in 2013, ranking 25th among the states.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:

-- 'Tax-Supported Rating Criteria' (Aug. 14, 2012);

-- 'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. State Government Tax-Supported Rating Criteria http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

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