Fitch Rates Texas $7.8B Series 2010 TRANS 'F1+' Ratings

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Fitch Ratings-New York-12 August 2010: Fitch Ratings assigns an 'F1+' rating to:

--$7.8 billion State of Texas (the state) tax and revenue anticipation notes (TRANs), series 2010.

The TRANs, dated Aug. 31, 2010 and due Aug. 31, 2011, are for bid on Aug. 24, 2010 and are not callable.

RATING RATIONALE:
--Conservative economic and revenue assumptions. Ample coverage for each set aside, including from borrowable resources.
--Sound legal protections.
--Financial operations are conservative, although the current downturn has eroded cash balances.
--Finances dependent on consumption-based (primarily sales) taxes; other pressures due to property tax relief and capital needs.

KEY RATING DRIVER:
--Continued maintenance of ample cash cushion in the form of borrowable resources and ability to maintain adequate coverage of set aside payments.

SECURITY:
--Limited obligations of the state payable from an irrevocable pledge of, and lien on, deposits in the proceeds account, the payment account and sinking account of the note fund.

CREDIT SUMMARY:
The 'F1+' rating reflects sound legal protections from set-asides, good coverage for each set-aside payment, substantial borrowable resources and a history of conservative economic and revenue assumptions. These factors offset cash flow strain in the general revenue fund (GRF) due to recessionary weakness as well as longer term risks associated with a sales tax dependent revenue structure and pressure tied to the state's expanded responsibility for education funding.

The TRANs are not general obligations of the state, but are payable from deposits in the payment and sinking accounts of the note fund. TRANs are issued annually for cash management, with the series 2010 notes selling under a $7.8 billion fiscal 2011 authorization, a higher level than borrowings over the last decade due to the recession's impact on forecast cash receipts. The state has issued TRANs annually for more than two decades, with much of the annual cash flow mismatch tied to school aid disbursed early in the fiscal year. The series 2010 TRANs represent 11.7% of forecast fiscal 2011 cash receipts.

Repayment is derived from investment earnings and transfers from the GRF to the sinking and payment accounts, with six scheduled payment dates. The final payment date is Aug. 24, 2011, and the fiscal year ends on Aug. 31, 2011. The GRF has access to substantial borrowable resources to cover cash flow needs including transfers for note repayment, averaging $12.4 billion through fiscal 2011. Coverage from GRF and borrowable resources on each set-aside date is good, ranging from 33.7 times (x) on March 30, 2011 to 3.9x on Aug. 24, 2011. The cash flow safety margin, measuring how far receipts could fall while still providing 1x coverage, is forecast at 5.5% as of Aug. 24, 2011, including borrowable resources.

Borrowable resources include the Economic Stabilization Fund (ESF), currently funded at $7.8 billion and expected to rise to $8.2 billion by the end of fiscal 2011. There are no planned draws on the ESF balance during this biennium, and any draw requires a three-fifths vote of the state legislature. The ESF balance is not legally available on the final day of the biennium; consequently the state forecasts a negative cash balance on Aug. 31, 2011 at $236 million following depletion of all other borrowable resources.

Excluding the use of any borrowable resources, the fiscal year 2011 GRF cash balance is forecast to begin at negative $2.2 billion and end at negative $4.5 billion, after final TRAN repayment. The state has customarily forecast cash flows conservatively; the fiscal 2011 forecast reflects slow economic improvement and includes $1.2 billion in savings from 5% spending cuts announced in January 2010, but excludes use of any additional federal stimulus. The legislature will reconvene in January 2011 to address the state's near-term fiscal challenges, including the forecast negative cash balance on Aug. 31, 2011.

Fitch rates the state's long-term GO debt 'AAA', reflecting its low debt, conservative financial operations and an economy that has expanded and diversified, despite recent recessionary conditions. Financial pressures arise from the demand that rapid growth places on the state's consumption-based tax system, as well as from longer-term transportation needs and an increased state commitment to education. Recessionary weakness appears to be moderating, although the downturn has weighed on collections of sales and natural resource taxes. The state maintains a sizable budget reserve. The enacted fiscal 2010-2011 budget achieved balance by lowering planned spending from the prior biennium and relying on federal stimulus. Following weaker than forecast tax collections and the comptroller's downward revenue forecast revision in November 2009, spending cuts of 5% have been implemented to ensure balance through the fiscal 2010-2011 biennium; a GRF structural gap of up to $18 billion is forecast in the next biennium.

For further information on the State of Texas, see Fitch's rating action commentary "Fitch Rates Texas Public Finance Authority's $450M GO CP 'F1+'," dated Aug. 12, 2010, on Fitch's website, 'www.fitchratings.com'.

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