S&P Global Ratings

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## Summary:

# Little Elm, Texas; General Obligation


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**Summary:**

# Little Elm, Texas; General Obligation

| Credit Profile | | |
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| US$25.7 mil comb tax & rev certs of oblig ser 2021 due 08/01/2041 | | |
| *Long Term Rating* | AA+/Stable | New |
| Little Elm comb tax and ltd pledge rev certs of oblig | | |
| *Long Term Rating* | AA+/Stable | Upgraded |
| Little Elm comb tax and ltd pledge rev certs of oblig | | |
| *Long Term Rating* | AA+/Stable | Upgraded |
| Little Elm GO | | |
| *Long Term Rating* | AA+/Stable | Upgraded |

## Rating Action

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) to 'AA+' from 'AA' on the Town of Little Elm, Texas' existing general obligation (GO) bonds and certificates of obligation. At the same time, S&P Global Ratings assigned its 'AA+' long-term rating to the town's anticipated $25.7 million series 2021 combination tax and revenue certificates of obligation. The outlook is stable.

The certificates constitute direct obligations of the issuer payable with revenue from an annual ad valorem tax levied against all taxable property in the town, within the limits prescribed by law, and are further secured by, and payable from, a lien on and limited pledge (not to exceed $1,000) of the net revenue derived from the operation of the town's combined waterworks and sewer system. Given the de minimis revenue pledge, we rate the certificates based solely on the town's GO pledge. The maximum allowable ad valorem tax rate for Texas home rule cities is $2.50 per $100 of assessed value (AV) for all purposes, with the portion dedicated to debt service limited to $1.50. The town's total tax rate is well below the maximum, at 65 cents, 13 cents of which is dedicated to debt service. We do not differentiate between the city's limited-tax GO debt and its general creditworthiness given that the ad valorem tax is not derived from a measurably narrower tax base and that there are no limitations on the fungibility of the city's general resources. Proceeds from the certificates will fund utility system improvements, as well as several park projects throughout the town.

### Credit overview

The upgrade reflects our view of the town's sustained strong budgetary performance and resultant very strong reserve position, supported by continued economic expansion and population growth. Available general fund reserves stand out when compared with those of peers and we have no expectations of material depletion going forward. Furthermore, despite ongoing capital needs to support the growth, the town's very strong management practices and policies have led to a manageable debt profile. While resident per capita effective buying incomes (EBIs) are, what we view as, good, they remain below those of peers. However, we expect that the town's favorable location within the broad and diverse Dallas-Fort Worth metropolitan statistical area (MSA) will support continued growth in both incomes and resident wealth levels. Therefore, we do not expect any changes to the rating over our two-year outlook horizon.

The rating reflects our opinion of the town's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results that we expect could weaken in the near term relative to fiscal 2020, which closed with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 66% of operating expenditures;
- Very strong liquidity, with total government available cash at 60.8% of total governmental fund expenditures and 3.8x governmental debt service, and access to external liquidity that we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 16.2% of expenditures and net direct debt that is 164.3% of total governmental fund revenue, but rapid amortization, with 65.3% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### Environmental, social, and governance (ESG) factors

We assessed the town's environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile and determined that all are in line with our view of the sector standard. We view the town's strong population growth over the past 20 years as a social opportunity, as it provides underlying economic strength to drive employment opportunities when compared with areas of the country experiencing population stagnation or loss.

## Stable Outlook

### Upside scenario

All else equal, we could consider a positive rating action if the town continues to experience economic expansion and diversification, leading to improvements in per capita EBIs to levels consistent with higher-rated peers.

### Downside scenario

Conversely, we could consider a negative rating action if the city's financial performance deteriorates--potentially stemming from growing service demands or fixed-cost pressure related to planned future debt issuances--leading to sustained and significant drawdowns in reserves.

## Credit Opinion

### Strong economy

We consider Little Elm's economy strong. The town, with an estimated population of 42,995, is in Denton County in the Dallas-Fort Worth-Arlington MSA, which we consider to be broad and diverse. The city has a projected per capita EBI of 109.2% of the national level and per capita market value of $118,853. Overall, the city's market value grew by 20.7% over the past year to $5.1 billion in 2022. The county unemployment rate was 6.5% in 2020.

Spanning approximately 22 square miles, Little Elm is 33 miles northeast of downtown Dallas and 10 miles east of Denton on the northeast shore of Lewisville Lake. As a developing suburban town with a population that has more than quadrupled over the past decade, Little Elm primarily remains a bedroom community with direct access to the MSA, but the local economy has also benefited from the robust growth of the Dallas-Fort Worth metroplex in recent years, with commercial development in the retail sector contributing to strong persisting growth.

Taxable AV itself has demonstrated steady year-over-year growth since fiscal 2011, with double-digit growth figures in most of the past eight years. While much of the growth has been attributable to the strong residential market, management reports that the commercial market has also been active. Current developments include an expansion by Retractable Technologies (a manufacturer of syringes used for COVID-19 vaccines), a new ASCO Equipment Company facility (construction and agricultural equipment rental and sales), as well as a sizable mixed-use facility that will feature a number of retail, restaurants, and entertainment venues. In addition, the town recently approved a 545-acre single-family development that will feature 2,200 new homes to be built over the coming years. Given the ongoing development, we expect Little Elm's tax base will continue to grow, with continued improvement in resident incomes likely.

### Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Key practices include management's:

- Historical trend analysis when compiling the budget, along with the use of outside sources, where applicable;
- Quarterly budget-to-actual and investment reports to the town council;
- Formal investment policy that is compliant with the Texas Public Funds Investment Act;
- Long-term, five-year financial plan with built-in comprehensive assumptions that it updates annually;
- Capital plan that identifies various projects and one-time expenses;
- Formal policy of maintaining at least 25% of expenditures in reserve, which has been historically adhered to; and
- Comprehensive financial management policy statement to include guidelines for issuing debt.

### Strong budgetary performance

Little Elm's budgetary performance is strong, in our opinion. The town had operating surpluses of 10.6% of expenditures in the general fund and 18.9% across all governmental funds in fiscal 2020. While we expect Little Elm to have at least balanced operating results, we do not expect results will be as favorable as they were in 2020.

In assessing the town's budgetary performance, we adjusted for recurring transfers as well as to account for capital expenditures made from debt proceeds or other non-recurring sources. Upon the onset of the global pandemic and threat of revenue losses, the town developed and implemented a financial contingency plan in fiscal 2020 to ensure stability in fiscal performance. The quick actions taken by the town, combined with no adverse effect on key revenues (property taxes are 49% of general fund resources, followed by sales taxes at 12%), contributed to a strong surplus. Notably, the city received more than $2 million in CARES Act funding that offset additional pandemic-related expenses, including public safety costs.

For fiscal 2021, the town's budget conservatively reflected a deficit. However, the town reports that revenues are exceeding budget, particularly sales taxes. After budgeting for 3% growth for the year, actual collections are up more than 13% compared with the same period in fiscal 2020. Building permit revenues are also up significantly, projected to more than double the amount included in the budget. Federal stimulus, through the American Rescue Plan Act, has also added to the city's coffers, with the first tranche of $2.2 million received this year and the remaining $2.2 million expected next year. While most of these funds will be used for capital improvements and economic support, the town has $1.2 million left unallocated. While the fiscal 2022 budget has not yet been adopted, the budget is conservatively forecast to reflect another deficit. However, given the strong revenue performance, combined with conservative expenditure assumptions, we expect budgetary performance will remain strong going forward.

### Very strong budgetary flexibility

Little Elm's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 66% of operating expenditures, or $25.5 million. We expect the available fund balance will remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The town has historically maintained very strong reserves well above 30% of operating expenditures. Over the past three years, the total available fund balance remained above 55%, providing substantial flexibility over Little Elm's formal policy of 25%. The town budgets on a five-year cycle, with the goal of overall balance at the end of five years. Consequently, we anticipate that the town could draw on its fund balance in the next few years, particularly in fiscal 2021 as officials designated $2 million of the prior year's surplus to be set aside for a public safety expansion. However, given historical results and no plans to draw on reserves to a level below the town's 25% policy level, we expect that available fund balance will remain very strong and above 30% expenditures in the near term.

### Very strong liquidity

In our opinion, Little Elm's liquidity is very strong, with total government available cash at 60.8% of total governmental fund expenditures and 3.8x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

The town has strong access to external liquidity if necessary, demonstrated by its access to the market over the past two decades, which includes numerous GO- and revenue-backed bond issuances. All of the town's investments comply with both Texas statutes and its own formal policy, and were held in mutual funds, investment pools, and certificates of deposit--none of which we view as aggressive--at the end of fiscal 2020.

The town has privately placed its series 2012A GO refunding bonds, series 2014 tax notes, and series 2020 GO refunding bonds, with a total par amount outstanding of $7.37 million, or 8% of total direct debt. The privately placed debt is fixed rate and it does not include permissive covenants or provisions for acceleration. In addition, we identified no contingent liabilities that could pose a material risk to Little Elm's liquidity. Therefore, we do not expect the town's liquidity position will deteriorate from its very strong position in the near term.

### Weak debt and contingent liability profile

In our view, Little Elm's debt and contingent liability profile is weak. Total governmental fund debt service is 16.2% of total governmental fund expenditures, and net direct debt is 164.3% of total governmental fund revenue. Approximately 65.3% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Following this issuance, the town will have approximately $113 million of direct debt outstanding. Town officials report that there are no near-term additional debt plans, therefore we do not anticipate our view of the town's debt profile changing over the next two years.

### Pension and other postemployment benefits liabilities

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate credit risk for Little Elm. In our view, the pension plan is adequately funded, and annual costs remain relatively manageable despite our expectation that costs will increase. As a result, we do not anticipate the town's liabilities will threaten its fiscal stability in the medium term.

The town participates in the following plans as of Dec. 31, 2018 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 86.8% funded with a net pension liability equal to $5.8 million.
- Supplemental Death Benefits Fund (SDBF), funded on a pay-as-you-go basis with a net OPEB liability of $418,000.

Little Elm's combined required pension and actual OPEB contributions totaled 5.6% of total governmental fund expenditures in 2020. The city made its full required pension contribution in 2020. TMRS' actuarially determined contributions fell slightly short of our minimum funding progress (MFP) metric, which assesses whether the most recent employer and employee contributions cover total service cost, plus unfunded interest cost, plus one-30th of the principal. When MFP is achieved, it indicates that an issuer has a strong funding discipline that aims to ensure timely progress on reducing its plans' liabilities. Given that this is an agent plan, assets are jointly managed. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, though there are offsetting factors. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020.

The SDBF plan provides group-term life insurance benefits to active and retired members of the TMRS pension plan. Although the town reports an OPEB liability for this plan, we note that participation in the plan can be terminated in any given year by council action. Therefore, we do not view the plan as a long-term liability of the town.

### Strong institutional framework

The institutional framework score for Texas municipalities is strong.

## Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments