

FITCH RATES SOUTHLAKE, TEXAS' \$17.69MM SER 2019 GO REFUNDING BONDS 'AAA'; OUTLOOK STABLE

Fitch Ratings-Austin-29 April 2019: Fitch Ratings has assigned a 'AAA' rating to the following Southlake, TX obligations:

--\$17.69 million general obligation (GO) refunding bonds, series 2019.

Fitch has also affirmed the 'AAA' Issuer Default Rating (IDR) and the 'AAA' limited tax rating on the roughly \$80 million in outstanding GO debt.

The Rating Outlook is Stable.

The bonds are scheduled for a competitive sale on or around May 7. GO bond proceeds will be used to refund outstanding debt for interest costs savings.

SECURITY

The GOs are payable from an ad valorem tax levied on all taxable property within the city, limited to \$2.50 per \$100 taxable assessed valuation (TAV).

ANALYTICAL CONCLUSION

Issuer Rating: The 'AAA' IDR and LT ratings reflect the city's exceptionally strong gap-closing capabilities, driven by strong revenue growth and sound expenditure flexibility.

Economic Resource Base

Southlake is part of the deep and diverse Dallas Fort Worth metropolitan statistical area (MSA) economy. As of 2017, the city's population was estimated at more than 30,000. The city covers approximately 23 square miles and its tax base is largely residential with some commercial and light manufacturing.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Southlake's general fund revenues have grown at a pace well above the rate of U.S. GDP, and Fitch expects this trend to continue. The city has significant independent ability to raise revenues based on ample tax rate capacity.

Expenditure Framework: 'aa'

Solid expenditure flexibility reflects strong control over work force spending. Carrying costs, comprised primarily of debt service, are moderately elevated due to heavily front-loaded principal payments. Fitch anticipates expenditures to grow in line with revenues.

Long-Term Liability Burden: 'aa'

Fitch expects the city's long-term liability burden in relation to personal income, currently at about 10% to remain modest to moderate, considering limited issuance plans and incorporating the potential for an increase in overlapping debt, which comprises the bulk of overall debt.

Operating Performance: 'aaa'

Fitch expects the city to demonstrate exceptional financial resilience during an economic downturn based on its strong gap-closing capacity and solid reserve levels.

RATING SENSITIVITIES

Strong Fiscal Health: The IDR and LT ratings are sensitive to shifts in fundamental credit characteristics, most notably the city's continued strong financial performance and growing economic base.

CREDIT PROFILE

Southlake lies on the southern shore of Grapevine Lake within close proximity to Dallas, Fort Worth and the Dallas Fort Worth (DFW) airport. The largely residential area is characterized by exceptionally high wealth. Southlake's high \$277,000 market value per capita and the average price for new homes are \$940,000. Residential properties comprise about 73% of the fiscal 2019 tax base, followed by commercial properties at 20%.

The city's tax base has experienced solid growth over the past several years. Fiscal 2019 taxable assessed value (TAV) at \$7.6 billion reflects an 8% increase over the prior year. New development underway or in the planning phases include residential properties, hotels, and office/industrial/warehouse projects. While the city calculates it is more than 80% built-out by population, commercial capacity remains in its zoned commercial corridors. Officials expect the city to reach build-out in 2030.

Despite only accounting for less than a quarter of the tax base, the commercial retail presence within the city is vibrant and draws visitors from throughout metro area. City management estimates the daytime population increases by more than 40% to roughly 46,000.

Revenue Framework

Taxes, including property and sales taxes, account for the bulk of the city's operating revenues. Based on fiscal 2018 audit results, property tax receipts accounted for 51% of general fund revenues, followed by sales tax at 30%.

Fitch believes that the city's revenue growth prospects are solid and consistent with regional trends as demonstrated by its general fund revenue compound annual growth rate (CAGR) of 4.1% for the 10 year period ending in fiscal 2018. The CAGR outpaces U.S. GDP and CPI for the same period.

Southlake's fiscal 2019 tax rate, \$0.447 per \$100 of TAV, provides ample capacity below the statutory cap of \$2.50. If a proposed tax rate results in an 8% year-over-year levy increase (based on the prior year's values), the rate increase may be subject to election if petitioned by voters.

Expenditure Framework

Similar to most municipalities, public safety accounts for a sizable portion of the general fund operating budget. In fiscal 2018, public safety accounted for 46% of general fund expenditures.

Fitch expects the city's pace of spending to remain generally in line with revenue growth. Fitch does not anticipate pressure on service levels given anticipated modest population growth.

The city of Southlake exercises full control over work force spending providing a sound level of expenditure flexibility. Fiscal 2018 carrying costs were moderately elevated at about 20% and reflect a front-loaded principal payment schedule. The city plans to amortize 73% of its principal debt within 10 years.

Long-Term Liability Burden

Southlake's long-term liabilities, including direct and overlapping debt plus the city's adjusted net pension liability, currently totals about 10% of personal income. Fitch expects the city's liability burden to remain low to moderate given limited debt issuance plans and well-funded pensions.

The expectation incorporates the potential issuance of overlapping debt, which currently comprises 76% of the overall long-term liability burden. Direct debt makes up about 23% and the Fitch adjusted net pension liability is the remaining 4.5%.

Southlake participates in the Texas Municipal Retirement System, an agent multiple-employer defined benefit plan. Under GASB Statement 68, the city reports a fiscal 2018 net pension liability (NPL) of \$7.2 million, with fiduciary assets covering 92% of total pension liabilities at the plan's 7% investment return assumption. Using a more conservative 6% investment return assumption, the estimated ratio of assets to liability declines to about 83%.

Operating Performance

Fitch expects Southlake to demonstrate exceptionally strong financial resilience during an economic downturn, consistent with past performance. The 'aaa' resilience assessment is informed by the city's revenue raising capabilities, solid expenditure flexibility and ample financial cushion.

The city closed fiscal 2018 with an unrestricted general fund reserve balance of about \$27 million, which equaled about 57% of operating expenditures. Officials adopted a budget with a general fund surplus of about \$8 million for fiscal 2019; and, with approximately five months remaining in the fiscal year, management expects to close the year with positive operating results.

Robust planning and prudent cost management support maintenance of a strong financial position, evidenced by high reserves in excess of policy targets. The city's fund balance policy targets a minimum 15% of general fund budgeted operating expenditures, with the stated optimum goal of 25% applicable to unassigned general fund reserves. Funds in excess of 25% are typically committed for strategic capital initiatives, helping to reduce growth in the city's indebtedness.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

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