

# RatingsDirect®

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## Summary:

# Southlake, Texas; General Obligation

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Credit Profile		
US\$8.69 mil tax and wtrwks and swr sys (ltd pledge) rev certs of oblig ser 2022 dtd 06/01/2022 due 02/15/2037		
<i>Long Term Rating</i>	AAA/Stable	New
Southlake GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southlake GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southlake GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Southlake GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed

## Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Southlake, Texas' anticipated \$8.69 million series 2022 tax and waterworks and sewer system (limited pledge) revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating and underlying rating (SPUR) on the city's previously issued general obligation (GO) bonds and certificates of obligation. The outlook is stable.

The bonds and the city's parity debt are payable from a direct and continuing ad valorem tax levied, within the limits prescribed by law, on all taxable property within the city. The certificates are further secured by surplus revenue of the city's waterworks and sewer system not to exceed \$1,000. Given the limited revenue pledge, we rate the certificates based on Southlake's ad valorem tax pledge. Texas statutes provide for a maximum ad valorem tax rate of \$2.50 per \$100 of taxable assessed valuation (AV) for all purposes, including a maximum of \$1.50 of the \$2.50 for all ad valorem tax obligation debt service. In fiscal 2022, the city's levy is well below the maximum at 39 cents per \$100 of AV, 6.5 cents of which is dedicated to debt service. The ad valorem taxes are not levied on a narrower or distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service. Based on the application of our Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness criteria (published Nov. 20, 2019 on RatingsDirect), we view the limited-tax GO debt pledge to be on par with the issuer credit rating, which reflects the city's general creditworthiness. The bond proceeds will fund various city improvements.

Southlake's 'AAA' rated bonds are eligible to be rated above the sovereign, because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions (published Nov. 19, 2013, on RatingsDirect) U.S. local governments are considered to have moderate sensitivity to country risk. The city's locally derived property taxes secure the bonds and the institutional framework in the U.S. is predictable, with significant U.S. local government

autonomy. In a potential sovereign default scenario, U.S. local governments should maintain financial flexibility through the ability to continue collecting locally derived revenues and U.S. local governments have independent treasury management.

### **Credit overview**

Southlake is an extremely wealthy, primarily residential, community that benefits from its location within and access to the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA). The city continues to experience economic growth in line with much of the Dallas Metroplex, and which is likely to continue due to ongoing commercial and residential development. The city's strong financial performance allows it to use excess revenues to cash fund capital projects, thereby assisting with expenditures associated with economic growth. While the city anticipates additional debt issuances, we do not anticipate that it will affect its budgetary performance and expect that financial operations will remain sound.

The rating reflects our view of the city's:

- Very robust and strong economy, with access to the Dallas-Fort Worth MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology and a strong institutional framework score;
- Historical trend of operating surpluses in the general fund and maintenance of reserves over 65% during the past three fiscals; and
- Manageable debt profile, despite the potential for additional debt plans.

### **Environmental, social, and governance**

We have assessed Southlake's environmental, social, and governance risks relative to its economy, financial management, fiscal performance, and debt-and-liability profile, and consider them neutral within our credit rating analysis.

## **Stable Outlook**

### **Downside scenario**

Although it is unlikely, we could lower the rating if the city's budgetary performance significantly weakens to levels that we consider structurally imbalanced, causing the city to draw down its reserves to levels that we no longer consider very strong. In addition, we could lower the rating if Southlake's debt profile notably increases, causing material budgetary pressures.

## **Credit Opinion**

### **Primarily residential economic base with assessed valuation growth**

Southlake spans approximately 23 square miles and is located just over 25 miles northwest of downtown Dallas and 10 miles from Dallas-Fort Worth (DFW) International Airport. In our view, the city continues to benefit from its favorable location in the DFW Metroplex and its close proximity to the airport. The city is primarily residential and is

characterized by extremely high income levels, with many residents commuting to Dallas for employment opportunities. In addition, property values have historically been very strong and continue to improve, as demonstrated by an 18% increase over the past five years, since fiscal 2018. Management continues to project conservative annual growth in AV but expects to exceed this rate based on trends and ongoing economic development.

While residential property taxes compose the majority (nearly 71%) of Southlake's AV, the city also has a large commercial presence. Most of the city's commercial properties are retail and office space, with a total of 3,678 businesses within the city. The city has several mixed-use developments recently completed or under construction, including a variety of high-end shopping, class A office space, a movie theatre, and a Westin hotel. In addition to ongoing commercial development, the city has several residential developments that it expects to come online over the next few years. Therefore, we anticipate that the city will continue to experience economic expansion over at least the next few fiscal years.

### **Very strong management with strong financial policies and practices**

When drafting the budget, management uses historical trends and statistical information to forecast revenue and expenditures, and works closely with department heads during the budget process to identify departmental needs. Officials monitor the budget monthly and adjustments are typically made at midyear, although management has the flexibility to make amendments throughout the fiscal year. The city has a comprehensive formal long-term financial plan and a formal long-term capital improvement plan (CIP), with identified funding sources. It also has a written, in-depth, and conservative investment policy, and gives monthly updates regarding holdings and earnings to the governing body. It also has a formal debt management policy that it has historically adhered to, identifying targets for refunding parameters and the types of debt that are acceptable for issuance. Finally, the city has a formal reserve policy that targets reserves of at least 25% of operating expenditures for emergencies, which it has historically maintained above this target.

### **Very strong operating performance despite one-time capital projects**

Southlake has a strong history of balanced and positive budgetary performance, partially due to its conservative assumptions. Because of its maintenance of very strong reserves, well above levels required by its policy despite transfers of excess revenues and reserves in excess of its fund balance policy to its strategic initiatives fund, we do not anticipate that the city's reserve position will deteriorate over the next two years. Furthermore, we do not believe that the city has any contingent liabilities that we view as a risk to its liquidity profile. Therefore, we expect that the city's liquidity position will remain very strong over the next two years.

When assessing the city's budgetary performance, we have adjusted for recurring operating transfers and one-time capital expenditures.

City officials attribute fiscal 2021's strong operating surplus primarily to growth in sales tax revenues, coupled with conservative spending. Municipal sales and mixed beverage taxes grew by roughly 18% in fiscal 2021 compared to fiscal 2020. Overall, we believe the city's operating revenue streams are diverse, with property tax revenues accounting for half of general fund revenues and sales tax revenues for approximately 36%.

The city has budgeted for another operating surplus for fiscal 2022. Management notes that the budget is tracking well,

and the city anticipates another operating surplus. The city will be allocated a total of \$8 million in American Rescue Plan (ARP) funds, which it intends to use for one-time capital expenditures. Therefore, we believe the city's financial performance will remain very strong over the next few years.

### Weak debt and contingent liability profile with additional debt likely

We note that the city's high overall net debt is driven in large part by the significant overlapping debt of Carroll Independent School District. After the issuance of the 2022 bonds, the city will have approximately \$96.2 million in GO debt outstanding, much of which is considered self-supporting. In line with Southlake's CIP, ongoing capital projects will require additional debt issuances. Therefore, we believe the city will continue to have an elevated debt burden. In addition, if the city's 10-year amortization schedule were to fall below 65% due to future debt issuances, we would have a weakened view of the city's debt profile; however, we do not expect this to negatively affect the city's overall credit quality.

### Pension and other postemployment benefits

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit risk for the city, as required contributions currently represent an affordable share of total governmental expenditures.

The city participates in:

- Texas Municipal Retirement System (TMRS): 92.9% funded with a net pension liability of \$8.5 million as of Dec. 31, 2020;
- Subsidized health care, including medical, vision, dental, and life insurance coverage costs incurred by retirees and their dependents. Contributions are made on a pay-as-you-go basis and totaled \$332,082 in fiscal 2021; and
- Supplemental Death Benefits Fund (SDBF). The plan is funded on a pay-as-you-go basis, and the city's total OPEB liability for SDBF is \$1.1 million. For the fiscal year-end 2021, benefit payments were \$10,272.

TMRS' actuarially determined contributions exceed our minimum funding progress (MFP) metric. The MFP metric assesses whether the most recent employer and employee contributions cover total service cost, plus unfunded interest cost, plus one-thirtieth 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. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, which we view as aggressive, though there are other offsetting factors. For more information, see Pension Spotlight: Texas (published Feb. 25, 2020, on RatingsDirect). Despite the potential for contribution volatility, we expect that prudent budgeting practices and strong reserves will allow the city to absorb the increases with minimal disruption to financial performance in the near term.

### Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Southlake, TX: Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
<b>Very strong economy</b>				
Projected per capita EBI % of U.S.	242.9			

## Southlake, TX: Key Credit Metrics (cont.)

	Most recent	Historical information		
		2021	2020	2019
Market value per capita (\$)	271,662			
Population		31,199	30,954	30,514
County unemployment rate (%)			7.3	
Market value (\$000)	8,475,584	8,429,817	8,345,315	
Ten largest taxpayers % of taxable value	9.2			
<b>Very strong budgetary performance</b>				
Operating fund result % of expenditures		20.5	22.0	18.7
Total governmental fund result % of expenditures		23.5	19.6	11.7
<b>Very strong budgetary flexibility</b>				
Available reserves % of operating expenditures		96.5	89.4	68.5
Total available reserves (\$000)		43,656	37,604	30,605
<b>Very strong liquidity</b>				
Total government cash % of governmental fund expenditures		191.2	156.5	126.4
Total government cash % of governmental fund debt service		1132.6	932.5	902.9
<b>Very strong management</b>				
Financial Management Assessment	Strong			
<b>Weak debt &amp; long-term liabilities</b>				
Debt service % of governmental fund expenditures		16.9	16.8	14.0
Net direct debt % of governmental fund revenue	74.1			
Overall net debt % of market value	4.7			
Direct debt 10-year amortization (%)	84.5			
Required pension contribution % of governmental fund expenditures		4.2		
OPEB actual contribution % of governmental fund expenditures		0.4		
<b>Strong institutional framework</b>				
<b>EBI--Effective buying income. OPEB--Other postemployment benefits.</b>				

Data points and ratios may reflect analytical adjustments.

## Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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