

# RatingsDirect®

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## Summary:

# Lavon, Texas; General Obligation

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## Summary:

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### Credit Profile

US\$14.7 mil comb tax and ltd surplus rev certs of oblig ser 2020 dtd 06/01/2020 due 02/15/2040

*Long Term Rating* AA-/Stable New

US\$2.425 mil GO rfdg bnds ser 2020 dtd 06/01/2020 due 02/15/2030

*Long Term Rating* AA-/Stable New

## Rating Action

S&P Global Ratings assigned its 'AA-' rating to Lavon, Texas' \$2,425,000 general obligation (GO) refunding bonds and \$14.7 million combination tax and surplus revenue certificates of obligation, series 2020. Post-issuance, this will be the city's only debt. The outlook is stable.

The certificates and GO bonds are direct obligations of the city, payable from an ad valorem tax and levied within the limits prescribed by law, on all taxable property within the city. The certificates carry an additional pledge of surplus net revenue, limited to \$1,000, from the city's wastewater system. We base our ratings on these obligations on the city's limited-tax ad valorem pledge because legal provisions are insufficient to allow us to rate the revenue pledge.

The maximum allowable rate in Texas is \$2.50 per \$100 of assessed value (AV) for all purposes, with the portion dedicated to debt service limited to \$1.50. The city's levy is well below the maximum at 47.90 cents, 19.96 cents of which was levied for debt service for fiscal 2020. We rate the bonds and certificates on par with our view of the city's general creditworthiness, as the tax base supporting the obligations is coterminous with the city, and we see no unusual risks regarding the fungibility of resources or the city's willingness to support the debt.

The 2020 bonds will refund existing tax notes for savings and the 2020 certificate will fund various capital projects throughout the city, including roads, bridges, parks, and facility expansions.

### Credit overview

Located in the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), Lavon has experienced rapid tax base growth and there are several developments planned or already underway that will add a significant number of single-family homes to the city over the next few years. Officials stated that construction remains steady and there has not been a slowdown, although S&P Global Economics recognizes consumer spending and business investment in the U.S. have been particularly affected by restrictions on movement and stay-at-home orders (see "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect). Management has adopted several financial policies in recent years and built a very strong general fund reserve, which it intends to maintain. Should the recession deepen or begin to have broader impacts, particularly on property tax collections, we believe the city's very strong reserves and liquidity will provide the city time to adjust its budget. Although our outlook is generally two years, our view of the credit's stability focuses on the next six to 12 months, given the significant downside risks as

a result of the COVID-19 pandemic and developing recession.

The ratings also reflect our view of the city's:

- Strong economy, with access to a broad and diverse MSA;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with balanced operating results in the general fund and an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 49% of operating expenditures;
- Very strong liquidity, with total government available cash at 55.0% of total governmental fund expenditures and 8.7x governmental debt service;
- Very weak debt and contingent liability profile, with debt service carrying charges at 6.3% of expenditures and net direct debt that is 677.6% of total governmental fund revenue, as well as high overall net debt at greater than 10% of market value; and
- Strong institutional framework score.

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

The rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector. We analyzed its 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.

## **Stable Outlook**

### **Downside scenario**

We could lower the ratings if Lavon's budgetary performance weakens, resulting in sustained operating deficits leading to a reduction in reserves to a level below the city's policy-mandated level. Additionally, if the COVID-19 pandemic and the ensuing recession result in a material deterioration of key economic indices which translates to financial stress that we believe will persist, we could also consider a lower rating.

### **Upside scenario**

Conversely, we could consider a higher rating if the pandemic does not materially strain the city's financial position and its economy grows and diversifies, leading to an improvement in wealth and income to levels that are more in line with those of higher-rated peers.

## **Credit Opinion**

### **Strong economy**

We consider Lavon's economy strong. The city, with an estimated population of 4,200, is located in Collin County in the Dallas-Fort Worth-Arlington, TX MSA, which we consider to be broad and diverse. The city has a projected per

capita effective buying income of 113% of the national level and per capita market value of \$91,590. Overall, the city's market value grew by 17.0% over the past year, to \$384.7 million in 2020. The county unemployment rate was 3.1% in 2019.

The city of Lavon is located in southeastern Collin County, approximately 6 miles north of Rockwall and 35 miles northeast of Dallas. Over the last 10 years, the population has increased approximately 32%, reaching an estimated 4,210 in 2020. The city is primarily residential, which accounts for 84% of the tax base. Residents have access to a wide variety of employment centers in nearby cities, including Plano, McKinney, and Rockwall.

One of the city's largest single-family developers, Bloomfield Homes, has 658 lots under development with dirt moving, and they have indicated that there are no plans to stop or slow down plans. A second phase of the development has another 758 lots planned. Along with the activity in residential construction, recent commercial activity includes a number of gas stations, a 7-Eleven, an office building, a doctor's office, and a retail shopping center. Additional commercial development is expected once rooftops are established to support local businesses. However, with the scope of the COVID-19 economic challenges still unknown, a prolonged economic disruption, particularly protracted unemployment, would likely interrupt the robust demand for new construction the city had been experiencing.

### **Strong management**

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key factors include:

- When preparing annual budgets, management uses conservative assumptions, looks back at historical trends, and recently worked with a demographer on a new comprehensive plan;
- Monthly budget-to-actual reports are presented to the council;
- The formally adopted investment policy follows state guidelines and requires quarterly investment reports be provided to the council;
- The capital plan does not detail future capital needs and funding sources, but acts as a guide for evaluating capital needs and funding;
- Although there is not a long-term financial plan currently in place, the city recently passed a resolution to create a five-year financial forecast; and
- The city has a formal reserve policy of maintaining 25% of the annual general fund operating budget.

### **Adequate budgetary performance**

Lavon's budgetary performance is adequate, in our opinion. Our assessment considers our view that the pandemic and recession pose an event risk that could increase performance volatility for municipalities over the medium term. The city had balanced operating results in the general fund of negative 0.2% of expenditures and surplus results across all governmental funds of 33.1% in fiscal 2019.

In assessing Lavon's budgetary performance, we adjusted for capital lease proceeds expended toward one-time capital projects across governmental funds.

Conservative budgeting of both revenues and expenditures has supported year-end surpluses. Property taxes are generally a stable revenue source for the city, and represented 39% of general fund revenues in fiscal 2019. Because the city also receives revenues from sales tax (18%) and franchise and permit fees (17%), management expects these revenues streams will likely decrease as a result of the current COVID 19 stay-at-home orders and ensuing recession. The city is delaying certain capital expenses and cutting other items, which will reduce budgeted expenditures by approximately \$60,000. Additionally, Collin County is sharing funds received under the CARES Act, with \$224,178 going to Lavon. These measures are expected to help the city maintain structural balance for the fiscal year.

Property tax collections for the current fiscal year are already at 98% and recessionary effects on property values can take over a year, depending on the timing of valuation dates. Although the city does not seem to be affected in the short term by the sudden stop in the economy as a result of COVID-19 containment measures, prolonged unemployment could soften demand, and thus revenues, over the longer term.

### **Very strong budgetary flexibility**

Lavon's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 49% of operating expenditures, or \$1.3 million.

Management recently strengthened its general fund reserve policy from 10% to 25% in order to provide adequate financial flexibility. Management reports no plans to spend down reserves in the next two years. In light of this, and our view that management will adjust the budget as necessary if there is a downturn in revenue, we expect budgetary flexibility to remain very strong in the near future.

### **Very strong liquidity**

In our opinion, Lavon's liquidity is very strong, with total government available cash at 55.0% of total governmental fund expenditures and 8.7x governmental debt service in 2019. In our view, the city has satisfactory access to external liquidity, if necessary.

Lavon has historically maintained what we consider very strong cash balances, and given our expectation of balanced operations, we do not believe its cash position will materially weaken in the near term. All of the city's investments comply with both Texas statutes and its own formal policy, and were held in Texas local government investment pools at the end of fiscal 2019, none of which we view as aggressive. In addition, the city has no exposure to contingent liabilities that could pose a material risk to liquidity. Post current issuances, the city will have a minimal \$26,000 outstanding in a 2014 tax note that will pay off in fiscal 2021. Therefore, we do not expect the city's liquidity position to deteriorate from its very strong position in the near term.

### **Very weak debt and contingent liability profile**

In our view, Lavon's debt and contingent liability profile is very weak. Total governmental fund debt service is 6.3% of total governmental fund expenditures and net direct debt is 677.6% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 12.7% of market value.

The city does not have plans to issue debt for another five to 10 years, but timing will depend on the pace of

development. Although the certificates are expected to be paid from wastewater utility fees, we do not consider it self-supporting since this is new debt and there is not yet a historical trend of support.

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure, as required contributions currently represent an affordable share of total governmental expenditures. The combined pension and OPEB contributions totaled 2.2% of total governmental fund expenditures in 2018, with an adequate funded level on the pension plan. However, some aggressive actuarial assumptions could lead to future contribution volatility.

The city participates in the following plans as of Dec. 31, 2018:

- Texas Municipal Retirement System (TMRS): 88.6% funded with a net pension liability of \$107,253, as of Dec. 31, 2018.

TMRS actuarially determined contributions fell slightly short of 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-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. Actuarial assumptions include a discount rate of 6.75% and a 27-year closed amortization period. The plan's assumed discount rate is not considered aggressive, in our opinion, although we consider the closed amortization period of 27 years as extended, leaving greater potential for costs to grow based on actual performance. Lastly, contributions are likely to increase, given the level percent of payroll funding method, as opposed to level-dollar contributions, which would result in consistent payments.

### **Strong institutional framework**

The institutional framework score for Texas municipalities is strong.

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