S&P Global
Ratings

RatingsDirect®

Summary:

Addison, Texas; General Obligation

Primary Credit Analyst:
Rob M Marker, Centennial + 1 (303) 721 4264; Rob.Marker@spglobal.com

Secondary Contact:
Joshua Travis, Farmers Branch 972-367-3340; joshua.travis@spglobal.com

Table Of Contents

Summary:

Addison, Texas; General Obligation

Credit Profile		
US$14.195 mil GO bnds ser 2020 dtd 08/01/2020 due 02/15/2040		
Long Term Rating	AAA/Stable	New
US$13.275 mil GO rfdg bnds ser 2020 dtd 08/01/2020 due 02/15/2033		
Long Term Rating	AAA/Stable	New
Addison comb tax and rev certs of oblig		
Long Term Rating	AAA/Stable	Affirmed
Addison GO		
Long Term Rating	AAA/Stable	Affirmed
Addison GO		
Long Term Rating	AAA/Stable	Affirmed
Addison GO		
Long Term Rating	AAA/Stable	Affirmed
Addison GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to the town of Addison’s $14.2 million general obligation bonds, series 2020, and approximately $13.3 million general obligation (GO) refunding bonds, series 2020. At the same time, we affirmed our 'AAA' rating on the town's existing GO debt.

The series 2020 and GO bonds outstanding are direct obligations of the town, payable from a combination of the levy and collection of a continuing annual ad valorem tax, within limits prescribed by law, on all taxable property in the town. State statutes limit the ad valorem tax rate for home rule cities to $2.50 per $100 of taxable assessed valuation (AV) for all town purposes. The Texas attorney general permits the allocation of $1.50 of the $2.50 maximum tax rate for ad valorem tax debt service. In fiscal 2020, Addison's total levy is well below the maximum at 58.35 cents per $100 of AV, 14.94 cents of which is dedicated to debt service. Despite state statutory tax-rate limitations, we do not differentiate between the town's limited-tax debt and its general creditworthiness, since the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the town's overall ability and willingness to pay debt service.

Inclusive of the series 2020 issuance, the town will have approximately $87.3 million of net direct debt outstanding, a portion of which is considered self-supported. We understand proceeds from the bonds will fund various road construction projects and improvements to the Addison Athletic Club. The refunding bonds are being issued for interest savings.

Addison's GO bonds are eligible to be rated above the sovereign because we assess the town 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), U.S. local governments are considered to have moderate sensitivity to country risk. The town's GO pledge is the primary source of security on the debt; this severely limits the possibility of negative sovereign intervention in the payment of the debt or the town's operations. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy and independent treasury management, and has no history of government intervention. Addison has considerable financial flexibility, as demonstrated by its very strong general fund balance as a percentage of expenditures, as well as very strong liquidity.

Credit overview

Consistent operating surpluses, aided by strong management and prudent spending, has enabled Addison to transfer excess general fund revenues into its capital project fund in each of the last three fiscal years while maintaining its healthy reserve levels. The town's economy is primarily reliant on commercial properties, with many large corporate headquarters located in, and moving to the area. COVID-19 and resulting state-mandated business closures forced many of the town's taxpayers to close. Most will resume operations as lockdowns ease; however, some will have to close permanently due to the financial burden the recession has caused. (For more information, see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect.) Fortunately, the town of Addison has a diverse tax base spread across multiple sectors in a high demand MSA, all of which should help mitigate losses realized by some of the more affected industries. Combined with strong reserves, we view the credit as stable over our outlook horizon and believe management will prudently adjust operating budgets to maintain fiscal stability throughout the recession.

The rating reflects our view of the town's:

- Very 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 methodology;
- Weak budgetary performance, with an operating deficit in the general fund and a surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 56% of operating expenditures;
- Very strong liquidity, with total government available cash at 152% of total governmental fund expenditures and 11.7x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 13.0% of expenditures and net direct debt that is 154.6% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

Our analysis of these risks encompasses our review of environmental, social, and governance risks that currently exist. Most notably, the ongoing pandemic and the social risk arising from it have led to social distancing measures implemented and restricted traditional commerce, as suggested by state and local governments to limit the coronavirus' spread. As a consequence, certain key revenues, such as sales taxes, have fallen. We have also analyzed the environmental risks and have determined that they are in line with our view of the sector standard. We acknowledge the town's very strong management, with strong financial policies and practices as a positive factor as it relates to the town's overall creditworthiness.

Stable Outlook

Downside scenario

We could consider lowering the rating if the town experiences significant economic or financial stress that results in structural imbalance and declining reserves, or if the town's debt burden increases significantly, adding stress to its budgetary performance.

Credit Opinion

Very strong economy

We consider Addison's economy very strong. Located 15 miles north of downtown Dallas and positioned along several major thoroughfares, residents can easily access employment opportunities within the broad and diverse Dallas-Fort Worth-Arlington MSA. Its favorable location has stimulated residential and commercial growth and above-average wealth and income indicators. The town has a projected per capita effective buying income of 180% of the national level and per capita market value of $314,410. Overall, the town's market value grew by 2.0% over the past year to $4.8 billion in 2020

Unemployment has generally trended below national averages. In April 2020, unemployment rose to 12.8% within the MSA, highlighting the severity of the current recession. Preliminary data for May shows a slight decrease, to 12.3%, a possible indication that the economy is beginning to recover. However, with cases surging, particularly among southern states, the risk of additional business closures remains a possibility. (See "U.S. Biweekly Economic Roundup: Strong Job Gains May Slow As Virus Surges." Published July 02, 2020, on RatingsDirect.)

The local economy is diverse and anchored by key industries such as professional, scientific, and technical services, health care, and finance. Also, the town has a well-educated workforce, with roughly 58% of the population holding a bachelor's degree or higher, which provides employers access to a competitive, skilled labor pool. While residents of the town have convenient access to employment opportunities within the town of Dallas and throughout the Dallas-Ft. Worth metroplex, Addison itself has a multitude of employment opportunities. Given its abundance of commercial space, the town is home to several corporate headquarters, including Mary Kay Cosmetics, Bank of America, and Mattress Giant. Other key drivers of the local economy include the town's hotel and restaurant industries, in addition to the Addison Airport, one of the state's most used general aviation airports.

Real, commercial, and industrial properties account for 50% of total AV, followed by multi-family residential (17%) and single-family residential (16%). The town's economy is diverse, with the ten leading taxpayers representing 21% of total AV. Most are classified as office buildings with a few apartment properties and retail spaces. Mandated business closures beginning in March and many that are still in effect, required a significant portion of the town's businesses to close. Hotel occupancy rates reached a low of 13%; however, officials note that as of late June, occupancy is up near 30%. The industry still has a long way to go to recover, and one of its hotels, Crowne Plaza, has closed its doors. Expectations are that it will reopen; but, timing remains uncertain.

AV growth has generally been robust, increasing each year, looking back to 2015, a total of 27%, or on average, 5% per year. In 2019, a 240,000 sq foot office building opened, which is now headquarters to Occidental Chemical and Compass Data Centers. Other businesses have opened regional offices in the facility as well. Wingstop announced that they would be relocating its corporate headquarters to Addison in 2020, and many others have announced relocation plans and expansion plans within the town that should contribute to future AV growth.

Despite significant pressure on certain sectors of the town's economy, its diversity should provide a degree of stability. An additional 406 units within the town's Vitruvian Park mixed-use development will begin in the coming months. Moreover, Dallas Area Rapid Transit (DART) is constructing a commuter rail line called the Silver Line that will connect to the town's existing DART station. This $1.1 billion, 26-mile commuter rail line will traverse three counties and connect Addison to the Dallas-Fort Worth International Airport and numerous cities within the metroplex. Service is expected to commence in 2022.

Officials are estimating for a 3.5% increase in AV for 2021, with roughly $116 million of new properties added to the tax roll. However, they are conservatively projecting 0% growth in 2022 and 2023 as a result of the recession.

Very strong management

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

Management utilizes three to five years of historical financial trend analysis to formulate the subsequent year's budget assumptions. Additionally, quarterly budget-to-actual financial reports are provided to the town council and can amend the operating budget when needed. The council annually adopts a five-year rolling capital improvement plan that identifies potential projects and their respective funding sources. Management also prepares a five-year financial forecast that it presents to the town council annually.

The town council has a formalized and comprehensive investment management policy that is reviewed annually, and officials provide the council with quarterly investment holdings and performance reports. The town has a formalized debt management policy as well, in line with state requirements. The town's formalized fund balance policy requires general fund reserves above 25% of operating expenditures. The policy was adopted to prevent deterioration of reserves in the event of a drop in revenues or emergencies. The town has historically remained in compliance with this policy.

Weak budgetary performance

Addison's budgetary performance is weak, in our opinion. Our assessment considers our view that the pandemic and recession pose an event risk that could increase performance volatility for cities over the medium term. The town reported a deficit in the general fund of 1.1% of expenditures and a surplus across all governmental funds of 8.7% in fiscal 2019. In our calculations, we have adjusted the town's revenues and expenditures to treat recurring transfers as either revenues or expenditures, and eliminated significant one-time expenditures funded through cash-on-hand or debt proceeds.

Addison consistently adopts balanced operating budgets based on conservative assumptions, often leading to positive budget variances. The results have enabled the town to transfer excess revenue to its capital projects fund to self-fund various capital projects and alleviate some of its debt burdens. Consistent with that trend, the 2019 budget outperformed. The deficit result was exclusively attributable to the town's decision to transfer $4.5 million from the general fund to its capital projects fund. Although the budget was projecting a $4.7 million deficit, the net change in fund balance was a decrease in fund balance of approximately $374,000. Property taxes comprised the largest portion of 2019 revenues (43% of general fund revenues), followed by sales taxes (37%) and franchise taxes (6%).

Despite the severity of the recession, town officials are currently projecting a positive variance compared to the 2020 budget, which reflects a $4 million deficit and estimate they will end the year with an approximate deficit of $3 million, roughly 6% of projected expenditures. Again, consistent with past trends, the deficit result includes a $4 million transfer out of the general fund to the capital projects fund. COVID-19 and resulting business closures led to lower than expected sales tax collections through June; however, expenditure savings related to vacancies and energy savings will more than offset the declines in revenues.

In planning for the 2021 year, officials are projecting a 10% decline in sales tax collections but will continue to monitor events related to COVID-19 and make adjustments as needed. Provided the town's conservative budgeting history and strong management, we anticipate if revenue shortfalls are more severe than expected, management will prudently make offsetting adjustments to expenditures, ensuring maintenance of its healthy reserve levels. Financial projections through 2024 show balanced results with no remaining transfers scheduled out of the general fund. We expect that the town's budgetary performance will improve with the easing of lockdowns, and likewise, could face pressure if spikes in cases lead to further business closures or delays in reopenings.

Very strong budgetary flexibility

Addison's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 56% of operating expenditures, or $20.1 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The town has maintained very strong budgetary flexibility in each of the past three fiscal years. The available fund balance has remained more than 45% of general fund expenditures over the last three years and has consistently exceeded the town's formal reserve policy to maintain 25% of expenditures. Despite challenges from the pandemic, slowing of economic metrics, and lower-than-typical sales tax collections, expectations are to maintain very strong reserves for fiscal 2020. The town has a history of strong operating performance, and transfers of excess revenue from the general fund to the capital projects fund should limit the use of reserves.

Very strong liquidity

In our opinion, Addison's liquidity is very strong, with total government available cash at 151.5% of total governmental fund expenditures and 11.7x governmental debt service in 2019. In our view, the town has strong access to external liquidity if necessary.

Relatively consistent issuances of general obligation debt over the past two decades demonstrate the town's strong access to external liquidity. We do not view the town's investments as aggressive, provided that they are held in U.S. agency securities, state investment pools, commercial paper, and certificates of deposit. It is our understanding that the town does not have exposure to any variable rate debt obligations nor privately placed debt obligations that would cause contingent liability issues for the town.

Weak debt and contingent liability profile

In our view, Addison's debt and contingent liability profile is weak. Total governmental fund debt service is 13.0% of total governmental fund expenditures, and net direct debt is 154.6% of total governmental fund revenue. We have adjusted our calculations for debt supported through the town's enterprise fund.

Addison's adopted five-year capital improvement plan serves as a blueprint to address subsequent growth and development prudently. The plan projects roughly $47.1 million of additional debt issued through 2023, primarily attributable to continued road reconstruction. The town typically issues annually as part of its capital plan and generally amortizes a similar amount. We expect the town's debt burden to remain elevated, as Addison will likely issue additional debt to fund growth-related capital needs. However, we assess the town will prudently manage debt issuance relative to its rate of tax-base growth.

Pension and other postemployment benefits (OPEB)

Addison's combined required pension and actual OPEB contributions totaled 4.2% of total governmental fund expenditures in 2019, and the town made its full required pension contribution.

The town participates in:

- Texas Municipal Retirement System (TMRS): 91.0% funded with a net pension liability of $11.8 million 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. However, we consider the closed amortization period of 27 years as extended, leaving greater potential for costs to increase 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.

The town also provides certain health care benefits through a single-employer, defined-benefit OPEB plan known as the Supplemental Death Benefits Fund (SDBF) for all employees who retire from the town and receive benefits from a Town-sponsored retirement program. The town's contribution to the health plan consists of total premiums in excess of retiree contributions. In fiscal 2019, the town recognized OPEB expense of $282,226, or 0.2% of total governmental fund expenditures. As of the most recent actuarial valuation (Dec. 31, 2018), the town's total OPEB liability was $3.2 million.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.