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Ratings

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Addison, Texas; General Obligation

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Credit Profile		
US$8.755 mil GO rfdg bnds ser 2022 dtd 01/01/2022 due 02/15/2037		
Long Term Rating	AAA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to the Town of Addison, Texas' anticipated $8.8 million general obligation (GO) refunding bonds, series 2022. The outlook is stable.

The GO bonds are direct obligations of the town, payable from the levy and collection of a continuing annual ad valorem tax, within limits prescribed by law, on all taxable property in the town. Proceeds from the series 2022 GO bonds will be used to refund series 2012 combination tax and revenue certificates of obligation.

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 61.46 cents per $100 of AV, 17.35 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.

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, on RatingsDirect, 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, have 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. Fortunately, the town of Addison has a diverse tax base spread across multiple sectors in a high-demand metropolitan statistical area, all of which should help mitigate losses realized by portions of the hotel industry, which has yet to recover its business travel-related weekday activity. This, combined with strong reserves, leads us to view the town's creditworthiness as stable over our outlook horizon and believe management will prudently adjust operating budgets to maintain fiscal stability throughout the pandemic.

The rating reflects our view of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Strong financial policies and practices under our financial management assessment (FMA) methodology, and strong institutional framework score;
- Strong budgetary performance with very strong reserves and regular transfers to the capital projects fund;
- Very weak debt and contingent liability profile, with additional debt plans.

Environmental, social, and governance

Our analysis of these risks encompasses our review of environmental and social risks that currently exist, and all are in line with sector standards. We acknowledge the town's very strong management, with strong financial policies and practices, as a positive governance 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

Steady assessed value growth despite some contraction in the commercial sector

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 have convenient access to employment opportunities within Dallas and throughout the Dallas-Ft. Worth metroplex, Addison itself has a multitude of employment opportunities.

AV growth has generally been steady, including 3% for 2022 to $5.1 billion. Commercial and industrial values are up for 2022, but still below 2020 levels, primarily as a result of a decline in hotel values. Residential values are expected to be strong, based on new construction. Real, commercial, and industrial properties account for 46% of total AV, followed by multifamily residential (22%) and single-family residential (16%). Mandated business closures during the onset of the pandemic required a significant portion of the town's businesses to close. Hotel occupancy rates have rebounded to around 50% from a low of 13% during 2020, according to management. Before the pandemic, occupancy rates averaged around 60%. Officials also report that hotel room rates are up. However, the hotel tax does not support the general fund and is used to promote the arts, tourism, and hotel industry. The hotel tax performed better than budgeted and reserves exceed the town's 25% policy.

Given its abundance of commercial space, the town is home to several corporate headquarters, including Mary Kay Cosmetics, Bank of America, and Mattress Giant. Wingstop recently moved its corporate headquarters to the town, employing about 200 full-time jobs. 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. Galaxy Fixed Base Operator is anticipated to complete construction in 2022 of a 20,000-square-foot terminal, two 38,000-square-foot hangars, and a 30,000-square-foot hangar.

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 were completed in 2020, and Urban InTown Homes completed a 116,000-square-foot luxury townhome phase in February 2021 at Addison Grove, with additional homes under construction. Moreover, Dallas Area Rapid Transit (DART) is constructing a commuter rail line called the Silver Line that be the town's first DART rail 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.

History of strong performance and transfers to capital projects fund

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 budget for the fiscal year ended Sept. 30, 2020, outperformed. The deficit result was exclusively attributable to the town's decision to transfer from the general fund to capital projects. Property taxes constituted the largest portion of 2020 revenues (47% of general fund revenues), followed by sales and mixed beverage taxes (38%) and combined franchise fees (6%).

In planning for the 2021 year, officials were projecting a 10% decline in sales and mixed beverage tax collections but produced an increase over budget due to the full reopening of the economy since March. With several adjustments to the expenditure budget and outperforming revenue, the town estimates a modest general fund surplus. The general fund budget for fiscal 2022 also includes a modest surplus.

The town received about $900,000 in CARES Act funds and has been allocated $4 million from American Rescue Plan Act funds.

It is our understanding that the town does not have exposure to any variable-rate debt obligations or privately placed debt obligations that would cause contingent liability issues for the town.

Very weak debt with additional debt plans

Addison's adopted five-year capital improvement plan serves as a blueprint to address subsequent growth and development prudently. According to the capital projects summary in the fiscal 2021 budget book, roughly $48.9 million of additional debt could be 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.

Retiree benefits not an immediate source of budget pressure

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure, as required contributions currently made up an affordable share of total governmental expenditures.

As of Dec. 31, 2019, the town participates in:

- Texas Municipal Retirement System (TMRS): 97.8% funded with a net pension liability of $3 million.
- For OPEB, has retirement health care benefit and a Supplemental Death Benefits Fund 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 2020, the town contribution was $6,342 with a liability of $1.1 million.

The combined pension and OPEB contributions totaled 4.9% of total governmental fund expenditures in 2020. The town made its full required pension contribution in 2020. 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 plan's assumed discount rate of 6.75% is not aggressive, in our opinion.

Strong financial policies and practices under our FMA methodology

Highlights of the town's policies and practices under our FMA include the following:

- Management utilizes three to five years of historical financial trend analysis to formulate the subsequent year's budget assumptions.
- Quarterly budget-to-actual financial reports are provided to the town council, and officials 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.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Addison Key Credit Metrics

	Most recent	Historical information		
		2020	2019	2018
Economy				
Projected per capita EBI as % of U.S.	163			
Market value per capita ($)	320,336			
Population		15,844	15,632	15,330
County unemployment rate (%)		7.7		
Market value ($000s)	5,075,396	4,819,907	4,725,759	
Ten largest taxpayers as % of taxable value	21.3			
Budgetary performance				
Operating fund result as % of expenditures		(1.3)	(1.1)	13.2
Total governmental funds result as % of expenditures		8.4	8.7	12.4
Budgetary flexibility				
Available reserves as % of operating expenditures		54.7	55.5	59.3
Total available reserves ($000s)		20,053	20,084	20,465
Liquidity				
Total government cash as % of governmental funds expenditures		147	152	134
Total government cash as % of governmental funds debt service		1,026	1,166	900
Management				
Financial management assessment	Strong			
Debt and long-term liabilities				
Debt service as % of governmental funds expenditures		14.3	13.0	14.9
Net direct debt as % of governmental funds revenue		180		
Overall net debt as % of market value	4.3			
Direct debt 10-year amortization (%)	65			
Required pension contribution as % of governmental funds expenditures		4.6		
OPEB actual contribution as % of governmental funds expenditures		0.3		
Institutional framework				

Note: Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2021 Update Of Institutional Framework For U.S. Local Governments