S&P Global Ratings

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Summary:

Lucas, Texas; General Obligation

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Summary:

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Credit Profile		
US$2.98 mil GO rfdg bnds ser 2020 dtd 11/01/2020 due 02/01/2031		
Long Term Rating	AA+/Stable	New
Lucas GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Lucas, Texas' anticipated $3 million series 2020 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's GO and certificates of obligation debt outstanding. The outlook is stable.

The GO bonds and certificates are payable from revenue from a direct and continuing ad valorem tax levied, within the limits prescribed by law, on all taxable property within the city. 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 total levy in 2020 is well below the maximum, at 29.98 cents, 10.89 cents of which is dedicated to debt service and the remainder to funding operations. We do not make a rating distinction between Lucas' unlimited- and limited-tax pledge because we factor these limitations and fungibility of resources into our overall assessment of the city's general creditworthiness, and the levy is not on a narrower tax base.

Many of the city's certificates are further payable from surplus net revenue of its combined utility system, not to exceed $1,000. Given the limited nature of the revenue pledge, we rate the certificates based on the city's GO pledge.

Credit overview

Lucas' rapid economic expansion and parallel evolution of the management policies and practices support the rating. The city has bolstered its robust reserve position with consistent surpluses while spending on capital projects to accommodate the local growth. The rating is constrained by the high debt levels and lack of long-term financial planning. Although the longer-term recessionary pressures on the local economy are uncertain, we expect that Lucas will continue to benefit from its participation in the rapidly expanding Dallas-Fort Worth-Arlington metropolitan statistical area (MSA), further supporting its very strong economic metrics. Additionally, we anticipate that it will maintain its very strong financial profile consistent with its informal target of 100%. For these reasons, the (two-year) outlook is stable. For S&P Global Economics' most recent view of the U.S. economy, see the article titled "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect.

The rating also reflects our opinion of the city's:

- Very 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;

- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2019 of 123% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 11.7x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 16.5% of expenditures and net direct debt that is 216.4% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's ESG 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. Our rating also incorporates our view of the risks posed by the COVID-19 pandemic to public health and safety as a social risk, which, if sustained, could weaken the local economy through higher unemployment and disruptions in consumer spending, directly affecting the economically sensitive revenue. Absent the implications of COVID-19, we consider the city's social risks to be in line with those of the sector. To prepare for environment risk in the form of severe weather events, the city participates in the Collin County Hazard Mitigation Plan, which includes a vulnerability assessment.

Stable Outlook

Downside scenario

We could lower the rating if the city's budgetary performance weakens, resulting in deterioration of its flexibility to levels no longer comparable with those of peers.

Upside scenario

Although not expected during the current outlook period, we could raise the rating if the city's debt profile moderates to a level in line with that of its higher-rated peers.

Credit Opinion

Very strong economy

We consider Lucas' economy very strong. The city, with an estimated population of 8,338, is located in Collin County in the Dallas-Fort Worth-Arlington, Texas, MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 189% of the national level and per capita market value of $181,485. The city's market value grew by 5.3% over the past year to $1.5 billion in 2021. The county unemployment rate was 3.1% in 2019.

The city's tax base is dominated by large estate-type residential development, and most residents commute throughout the MSA for employment, with leading area employers including high technology, electronic, and telecommunication companies.

Officials report limited effects of the COVID-19 pandemic on economic activity, as demonstrated by a 17% increase in sales tax revenues for fiscal 2020, generated from Walmart and a gas station. The city continues to see strong demand for housing, with approximately 100 new homes expected for fiscal 2021 at an average price of nearly $1 million, according to officials. The city also has two commercial developments in progress, an auto parts store and a seven-acre strip mall. The city also has about 200 acres of commercial zoned land available for development on its southern boundary.

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 regularly monitor all of them.

Highlights of the city's management practices include the following:

- The city uses historical trend analysis in developing its revenue and expenditures assumptions for budgeting purposes.
- Officials provide monthly budget-to-actual reports to the city council and can amend the budget on an ad hoc basis.
- The council has adopted a formal investment management policy that it reviews and approves annually. Management also provides the city council with quarterly investment holdings and returns.
- The city has a formal general fund balance policy that calls for an unassigned general fund balance equal to 50% of its general fund expenditures. The fund balance policy also states that an action plan is to be implemented if reserves fall to less than 25% of expenditures.
- The city also has a formal debt management policy.
- The city maintains a five-year rolling capital improvement plan, which is linked to the current budget and includes adaptation strategies for weather-related events.
- It does not have a forward-looking, long-term financial plan beyond its annual budget.

Strong budgetary performance

Lucas' budgetary performance is strong, in our opinion. The city had operating surpluses of 10.7% of expenditures in the general fund and of 9.0% across all governmental funds in fiscal 2019. We adjusted general fund revenue for recurring transfers in from the utility and fire district funds. After adjusting the city's total governmental expenditures for the use of bond proceeds, the city's total governmental performance was also very strong. The city's primary general fund revenue sources were property taxes (44%), sales tax (20%), and licenses and permits (8%).

The fiscal 2019 general fund performance is the result of better-than-budgeted revenue performance, particularly from property taxes and sales taxes and expenditure savings across multiple departments. Fiscal 2020 is also projected to close better than budgeted with a positive result equal to 3% ($210,201) of projected general fund expenditures. Midyear expenditure reductions were redirected to purchase one-time items, according to management. The budget for fiscal 2021 was adopted with a general fund surplus of $555,525, before a potential general fund transfer to a proposed fiber-optic internet service utility of $711,839, which is still pending voter approval and city council approval.

We understand that the city is proposing a GO bond in the Nov. 3, 2020, election to fund the implementation of a fiber-optic cable service. The city would contract out project management for the implementation of the fiber network and expects the utility to eventually be self-supporting with an estimated total subsidy from the general fund through a loan of $4.73 million, to be drawn over 10 years, with a 15-year repayment term. According to officials, the city's feasibility study assumes a 55% take rate; in comparison, a similar project in a neighboring city exceeded an originally estimated take rate of 60%.

Very strong budgetary flexibility

Lucas' budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2019 of 123% of operating expenditures, or $7.4 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor. Officials report that the city plans to maintain its informal reserve goal of 100% of general fund expenditures. Although the city is projecting interfund loans totaling $4.73 million from the general fund to the new cable utility, we do not expect the projected subsidy to materially weaken budget flexibility. The city has a history of generating consistent general fund surpluses and the interfund loan is to be made over 10 years, with the largest projected loan in any one year of just $1.2 million, which would not materially reduce its fund balance to levels we no longer consider very strong.

Very strong liquidity

In our opinion, Lucas' liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 11.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Our opinion that the city maintains strong access to external liquidity is based on its history of issuing GO debt over the past 20 years.

Lucas has historically had what we consider very strong cash balances, and given management's demonstrated ability to maintain balanced operations, we do not believe its cash position will materially weaken over the next two years. All of the city's investments comply with Texas statutes and the city's investment policy. Its investments are predominantly held in bank deposits and state investment pools, which we don't consider aggressive.

The city has two privately placed transactions from 2007, which are both with Bank of America N.A.: a $5 million certificate maturing in 2027 and a $3.245 million GO bond maturing in 2022, of which $1.6 million and $690,000 remain outstanding, respectively. In our opinion, the liability is small compared with the city's budget. Furthermore, terms are standard with no noncredit events of default or acceleration provisions. Therefore, we do not believe this results in additional risk to the city's debt or financial ratios.

There is currently litigation against the city related to unpermitted commercial structures in a residential zone, but no material settlement is expected.

Very weak debt and contingent liability profile

In our view, Lucas' debt and contingent liability profile is very weak. Total governmental fund debt service is 16.5% of total governmental fund expenditures, and net direct debt is 216.4% of total governmental fund revenue.

Future debt plans include a $19.2 million GO bond election proposed for the Nov. 3, 2020, ballot would double the amount of the city's outstanding tax-backed debt from about $17 million currently. Pending voter approval and city council direction, officials plan to issue the full amount of the proposed GO bonds during fiscal 2021 to fund installation of fiber-optic cables within the city to provide internet service for residents and businesses. The cost estimate is based on an outside consultant's feasibility study. According to officials, due to the large size of the residential lots, resulting in low housing density, commercial service providers have not invested in upgraded infrastructure.

Pensions and other postemployment benefits (OPEBs):

- Pension costs are not a source of credit pressure, given that they represent just 4.3% of the city's total governmental funds expenditures in fiscal 2019.
- Recent volatility in the markets and the amortization and payroll growth assumptions will likely lead to increased costs in the future. However, we believe the city has sufficient budgetary flexibility and liquidity to address these costs.
- For OPEBs, the city does not offer a retirement health care benefit, only a supplemental death benefit.

The city provides pension benefits for all of its full-time employees through the Texas Municipal Retirement System (TMRS), a multiple employer, defined-benefit pension plan. As of Dec. 31, 2018, the city's proportionate share of the plan is 80.3% funded with a net pension liability of $851,000. Actuarially determined contributions was roughly on target with our minimum funding progress metric (MFP) at 98.4%, and our static funding calculation at 102.5%. 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. Actuarial assumptions include a discount rate of 6.75% and a 25-year closed amortization period. The plan's assumed discount rate is not aggressive, in our opinion, although we consider the closed amortization period of 25 years as slightly 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. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020.

The city also participates in the cost sharing, multiple-employer defined-benefit group-term life insurance coverage operated by TMRS, known as the Supplemental Death Benefits Fund. It may terminate coverage and discontinue participation by adopting an ordinance before Nov. 1 of any year to be effective the following Jan. 1. The city contributes to the plan at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 20, 2020)		
Lucas comb tax and ltd pledge rev certs of oblig ser 2019 dtd 08/01/2019 due 02/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Lucas GO		
Long Term Rating	AA+/Stable	Affirmed