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$9.0 mil comb tax and ltd pledge rev certs of oblig ser 2019 dtd 08/01/2019 due 02/01/2039		
Long Term Rating	AA+/Stable	New
Lucas GO		
Long Term Rating	AA+/Stable	Affirmed
Lucas GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Lucas, Texas' series 2019 combination tax and limited pledge revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's general obligation (GO) debt outstanding. The outlook is stable.

Lucas' rapid economic expansion and parallel evolution of the management policies and practices support the rating. The city is bolstering its robust reserve position and spending down in a controlled manner to accommodate the local growth, which we expect to continue. The rating is constrained by the high debt levels and lack of long-term financial planning.

The 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, and 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.

Lucas' GO bonds and certificates of obligation constitute direct obligations of the city, payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within its borders. Many of the city's certificates of obligation are further payable from a limited amount of the net revenue derived from the operation of the utility system. We view Lucas' GO pledge as the stronger security and our rating reflects this. Furthermore, 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 fiscal 2019 is well below the maximum, at 30.32 cents, 10.08 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. Proceeds from the certificates will fund several infrastructure improvements, including road expansions and waterline looping.

The rating reflects our opinion of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);

- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Very strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2018 of 123% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 10.8x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 17.2% of expenditures and net direct debt that is 231.5% of total governmental fund revenue; and
- Strong institutional framework score.

Very strong economy

We consider Lucas' economy very strong. The city, with an estimated population of 8,080, is a developing suburban city in southeast in Collin County, seven miles east of Allen, 12 miles southeast of McKinney, and about 25 miles north of Dallas. It is in the Dallas-Fort Worth-Arlington MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 187% of the national level and per capita market value of $205,063. Overall, market value grew by 16.4% over the past year to $1.3 billion in 2019. The county unemployment rate was 3.3% in 2018.

The city's tax base is mostly residential and most residents commute throughout the MSA for employment, with leading area employers including high-technology, electronic, and telecommunication companies. The top-10 taxpayers account for just 3.7% of market value.

The city continues to see strong demand for housing, with approximately 101 homes to be developed by 2020. Average home prices in Lucas are among the highest in the county, averaging over $600,000. Ongoing residential and commercial growth in surrounding communities also increased the need for improved transportation. The Texas Department of Transportation recently completed a major roadway expansion, opening the possibility for commercial growth on a 200-acre tract of land in the city, which will help to diversify its economy and generate additional revenues, and four major commercial projects are already underway. Given the ongoing and anticipated development, we expect the city's market value to continue to grow over the next two years and its economic metrics to remain very strong.

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.

Highlights of the city's other management practices include its use of 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, as well as a debt management policy. The fund balance policy also states that an action plan is to be taken if reserves fall to less than 25% of expenditures. The city adopted a five-year rolling capital improvement plan in November 2018, 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.

Very strong budgetary performance

Lucas' budgetary performance is very strong, in our opinion. The city had operating surpluses of 9.7% of expenditures in the general fund and 12.6% across all governmental funds in fiscal 2018.

We adjusted general fund revenue for recurring transfers in from the utility and fire district funds. The very strong general fund performance in fiscal 2018 resulted partly from stronger-than-anticipated impact fees, property tax collections, building permits and inspection fees, and sales and franchise taxes. The city's primary general fund revenue sources were property taxes (44%), sales tax (21%), and licenses and permits (12%). Public safety remains the largest expenditure category, accounting for 42% of general fund expenditures in fiscal 2018, of which approximately $2 million is for fire department services.

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 adopted a balanced budget for fiscal 2019. Year-to-date general fund revenue and expenditures are trending positively and the city anticipates a modest surplus in fiscal 2019. The fiscal 2020 budget proposal is balanced, with conservative estimates applied to growing revenue streams, and we anticipate its budgetary performance will remain very strong over the next two years given its historically positive variances.

Very strong budgetary flexibility

Lucas' budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2018 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 spend some of its reserves above its informal reserve goal of 100% of general fund expenditures to fund nonrecurring capital expenditures. Despite the planned draws, we anticipate that its budgetary flexibility will remain very strong and in excess of 75% of operating expenditures over the next two years.

Very strong liquidity

In our opinion, Lucas' liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 10.8x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

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. 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.

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 $1.765 million and $1.025 million 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 17.2% of total governmental fund expenditures, and net direct debt is 231.5% of total governmental fund revenue.

The city has approximately $25.5 million of total direct debt outstanding. It has set up a Technology Committee to assess local internet connectivity needs, which could prompt additional borrowing over the next two years.

Lucas' pension contributions totaled 4.3% of total governmental fund expenditures in 2018. The city made 106% of its annual required pension contribution in 2018.

The city contributes to a nontraditional, joint contributory, hybrid defined-benefit pension plan administered by the Texas Municipal Retirement System (TMRS). Under state law governing the TMRS, an actuary determines the contribution rate annually. Using updated reporting standards in accordance with Governmental Accounting Standards Board (GASB) Statement Nos. 67 and 68, the city recorded a net pension liability of $585,300 as of Dec. 31, 2017, the most recent actuarial valuation date, and the plan reported a funded ratio of 84.6%.

The city also contributes to the Texas Emergency Services Retirement System (TESRS), a cost-sharing, multiple-employer defined-benefit pension system established and administered by the State of Texas to provide pension benefits for emergency services personnel who serve without significant monetary remuneration. Using updated reporting standards in accordance with GASB 67 and 68, the city recorded a net pension liability of $50,665 as of Dec. 31, 2017, the most recent actuarial valuation date, and the plan reported a funded ratio of 76.9%.

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 has historically fulfilled the contractually required rate as determined by an annual actuarial valuation.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our expectation that Lucas will continue to benefit from its participation in the Dallas-Fort Worth-Arlington MSA, further supporting its very strong economic metrics. Additionally, we anticipate that it will maintain its very strong financial profile in line with management's ability to adapt to the city's growth needs. Consequently, we do not anticipate changing the rating within the two-year outlook horizon.

Upside scenario

We could raise the rating if the city's debt profile moderates to a level in line with that of its higher-rated peers and if it internalizes more formal management policies and practices that will enable it to sustain its growth needs while maintaining its financial strength.

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.

Related Research

2018 Update Of Institutional Framework For U.S. Local Governments