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Ratings

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Summary:
Royse City, Texas; General Obligation

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Summary:

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Credit Profile		
US$8.375 mil comb tax and rev certs of oblig ser 2020 due 08/15/2045		
Long Term Rating	AA-/Stable	New
US$4.12 mil GO rfdg bnds ser 2020 dtd 09/15/2020 due 08/15/2033		
Long Term Rating	AA-/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Royse City, Texas' approximately $4.1 million series 2020 general obligation (GO) refunding bonds and $8.4 million series 2020 combination tax and revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the city's previously issued GO debt. The outlook is stable.

Revenue from Royse City's ad valorem tax, levied within the limits prescribed by law on all taxable property within the city, secures the city's GO bonds and certificates.

The certificates are additionally payable from surplus revenue of the city's water and sewer system, limited to $1,000. Given the limit on the revenue pledge, we rate the certificates based on the limited-tax GO pledge.

Texas statutes limit the maximum ad valorem tax rate to $2.50 per $100 of taxable assessed valuation (AV) for all city purposes. Administratively, the state attorney general will permit the allocation of $1.50 of the $2.50 maximum tax rate for ad valorem tax debt service. In fiscal 2020, the city levied well under the maximum at 62.15 cents per $100 of AV, with 44.35 cents for operations and 17.80 cents for debt service. Based on the application of our criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Jan. 22, 2018 on RatingsDirect, we do not differentiate between the city's limited-tax GO debt and its general creditworthiness, given that the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources.

Bond proceeds will refund a portion of debt outstanding for savings. The city will use proceeds from the certificates to replace fire, police, and public works vehicles, and to fund sewer and utility improvements.

Credit overview

Located northeast of the Dallas metropolitan area, Royse City benefits from the regional growth experienced over the past decade. This has increased property values and sales tax revenue, the city's primary revenue sources. Revenue growth combined with conservative budgeting led to strong growth of the city's reserves over the past three years.

While the scope of economic and financial challenges posed by COVID-19 remains to be seen, to date the city has not seen negative impact to its revenue or tax base, and we believe the city will continue to achieve balanced operations and maintain reserves at levels we consider very strong. Alternatively, should the city's revenues fall during an economic downturn, without offsetting expenditure reductions, we could lower the rating.

The rating reflects our view of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area;
- Adequate management, with standard financial policies and practices under our financial management assessment methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 54% of operating expenditures;
- Very strong liquidity, with total government available cash at 143.1% of total governmental fund expenditures and 9.8x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 14.7% of expenditures and net direct debt that is 196.7% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance factors

We analyzed the city's 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. We view the risks posed by the COVID-19 pandemic to public health and safety as a social risk that, if sustained, could weaken the local economy through higher unemployment and disruptions in consumer spending. Absent the implications of COVID-19, we consider the city's social risks in line with those of the sector.

Stable Outlook

Downside scenario

We will likely lower the rating if the city's financial performance or budgetary flexibility deteriorates, whether as a result of operating deficits or one-time expenditures.

Upside scenario

We could raise the rating with continued economic growth, combined with maintenance of current reserve levels. This would be more likely if supported by more robust policies and practices.

Credit Opinion

Strong economy

We consider Royse City's economy strong. The city, with an estimated population of 13,811, is located in Collin, Hunt, and Rockwall counties in the Dallas-Fort Worth-Arlington metropolitan statistical area, which we consider broad and diverse. The city has a projected per capita effective buying income of 95.9% of the national level and per capita market value of $80,072. Overall, the city's market value grew by 8.5% over the past year to $1.1 billion in 2021. The weight-averaged unemployment rate of the counties was 3.1% in 2019.

Royse City benefits from a major overpass along Interstate 30, which has helped spur commercial and retail growth in recent years. The city still has substantial room to grow. We note that Royse City recently annexed three residential developments through development agreements, consisting of approximately 2,500 lots at buildout. Residential growth supports continued retail and commercial development, including numerous projects along the historic main street area, including new restaurants. Buc-ee's, a 50,000-square-foot combination gas and convenience store, opened in June 2019 and generates significant new sales tax revenue for the city.

Officials do not report negative impact from the COVID-19 pandemic and the ensuing recession. While early speculation was that AV may see declines in the coming year, demand does not appear to have waned. Since March, two new subdivisions have begun construction and others continue phased development.

Businesses that closed temporarily during the stay-at-home orders have reopened and the city's sales tax revenue has grown 20% to 30% each month during the pandemic, which management attributes to continued expansion of the largest sales tax generators.

As a result, we expect that the city's tax and revenue base will remain at least stable in the near term. While sales taxes could experience some losses in a downturn, continued development will broaden the collection base, potentially mitigating some of this risk.

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our financial management assessment methodology, indicating our view that the finance department maintains adequate policies in some but not all key areas.

When developing the budget, officials use historical data from the past three to five fiscal years to forecast revenue and expenditures, in addition to working closely with the tax assessor and leading sales taxpayers. Management provides monthly budget-to-actual financial updates to the city council and can amend the budget when needed. The city does not maintain a formal long-term financial plan or a debt management policy. The city has a capital improvement plan, adopted in 2013, for water and sewer projects, but the plan is not rolling and goes out to only 2023. In addition, the city has a roadway capital improvement plan, with projects to be funded with impact fees, but no timelines are associated with the plan.

Royse City does have a formal investment policy that closely follows state investment guidelines, and investment holdings and earnings are reported monthly to city council. The city's formal reserve policy requires a minimum unassigned general fund balance equal to 90 days of operations, or 25% of general fund expenditures. The city remains in compliance with its policies.

Adequate budgetary performance

Royse City's budgetary performance is adequate, in our opinion. The city had operating surpluses of 14.5% of expenditures in the general fund and of 17.9% across all governmental funds in fiscal 2019. Potential volatility as a result of COVID-19 and the ensuing recession moderates our initial assessment of budgetary performance.

Officials attribute the surplus results of the past three years to conservative budgeting, particularly in revenue forecasts. Despite significant growth, management continues to budget sales tax growth at a conservative 3% to 5% year over year. Combined with an estimate for property tax collections below historical rates, this means that Royse

City typically exceeds its revenue projections each year, while expenditures remain in line with budgets.

General fund revenue consists mainly of ad valorem and sales taxes, which accounted for 42% and 27% of total revenue in fiscal 2019, respectively.

Despite the pandemic, fiscal 2020 revenue is once again trending above budget, with year-to-date sales tax revenue up 25%. Early in the pandemic, the city made the decision to freeze open positions, defer several capital projects, and maintain only necessary operational spending. As time progressed and the impact of the pandemic proved less severe than expected, Royse City reopened the majority of the frozen positions. Based on these positive trends, the city will likely end the fiscal year with another surplus.

Officials approached the 2021 budget with caution. Sales tax was budgeted flat. While three new positions were approved, start dates were phased in over the year, providing the opportunity for adjustments should the economic conditions deteriorate. Outside of the new positions, the budget included little operational growth. Deferred capital will be considered incrementally as the year progresses.

As the city grows, management could use some of its surplus results to cash-fund capital needs, in particular for street repairs and vehicle purchases, reducing the need to borrow for these costs. Given the demonstrated conservative budgeting practices of the city as well as the expectation of continued revenue growth, we expect Royse City will be able to manage its growing needs while maintaining balanced operations.

Very strong budgetary flexibility

Royse City's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 54% of operating expenditures, or $4.4 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.

Given our expectation of stable budgetary results, we anticipate that the city's available fund balance will remain above 30% of expenditures over the outlook horizon, which we view as a positive credit factor. We believe such levels of reserves will allow the city substantial budgetary flexibility to manage any unforeseen challenges, including a decline in sales tax revenue or growth pressures. Although the city expects to use some of its surpluses to fund capital needs, we do not expect this to result in materially weakened reserves. Therefore, we expect budgetary flexibility to remain very strong.

Very strong liquidity

In our opinion, Royse City's liquidity is very strong, with total government available cash at 143.1% of total governmental fund expenditures and 9.8x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

The city's investments are in highly rated state pools that are highly liquid with maturities of one year or less. The city has two privately placed debt obligations (one of which is variable-rate) totaling $1.2 million, or 3% of total direct debt. The variable-rate series 2011 certificates of obligation will be refunded with the series 2020 bond proceeds. The bond documents do not include any nonstandard events of default, cross-default, or acceleration provisions. Therefore, we do not believe the obligations would put any additional or extraordinary stress on the city's liquidity position. With our expectation that both budgetary performance and flexibility will remain stable, we expect no material changes to the city's liquidity position.

Very weak debt and contingent liability profile

In our view, Royse City's debt and contingent liability profile is very weak. Total governmental fund debt service is 14.7% of total governmental fund expenditures, and net direct debt is 196.7% of total governmental fund revenue.

While the city has no immediate plans for new debt issuances, it is looking to fund a police station within approximately five years, and ongoing growth will require ongoing investment in roads and water and sewer infrastructure. New debt issuances will depend on AV growth, as management aims to maintain stable tax rates. Given growing needs, we expect the city's debt burden to remain elevated.

Pension and other postemployment benefit (OPEB) liabilities

Royse City's required pension and actual OPEB contributions totaled 6.9% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution.

We do not view pension and OPEB liabilities as an immediate credit risk. While contributions are manageable, we anticipate that these costs will increase given amortization and payroll growth assumptions. However, we believe Royse City has sufficient budgetary flexibility and liquidity to address these costs.

The city participates in the following plans:

- Texas Municipal Retirement System, a nontraditional, joint contributory, hybrid defined benefit pension plan administered by the state. An actuary determines the contribution rate annually. The city's net pension liability was $2.5 million as of Dec. 31, 2018 and the plan's funded ratio was 75%, assuming a 6.75% discount rate. Fiscal 2019 actual contributions fell slightly short of minimum funding progress (94%), but met our static funding metric. In general, we expect progress toward full funding to be slower given the plan's amortization basis of level percent using a payroll growth assumption of 3.5%, though it is over a closed period of 25 years.
- Royse City offers limited OPEB benefits, participating in the cost-sharing, multiple-employer, defined benefit group term life insurance plan operated by TMRS known as the supplemental death benefits fund. It contributes at a contractually required rate. Total OPEB liability was $105,000 as of Dec. 31, 2018.

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 September 10, 2020)		
Royse City comb tax and rev certs of oblig		
Long Term Rating	AA-/Stable	Affirmed
Royse City GO		
Long Term Rating	AA-/Stable	Affirmed

Ratings Detail (As Of September 10, 2020) (cont.)		
Royse City GO (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Royse City GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Royse City GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Royse City GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.