

RatingsDirect®

Summary:

Town of Northlake, Texas; General Obligation

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Credit Profile

US\$6.8 mil comb tax & ltd surplus rev certs of oblig ser 2021 due 02/15/2041		
<i>Long Term Rating</i>	AA/Stable	New
Town of Northlake comb tax and assess rev certs of oblig ser 2014A due 08/15/2034		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
Town of Northlake comb tax and ltd surplus rev certs of oblig		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Town of Northlake GO rfdg bnds ser 2016 dtd 09/01/2016 due 08/15/2025		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Town of Northlake GO (BAM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
Twn of Northlake GO (MAC)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings raised its long-term rating to 'AA' from 'AA-' on the Town of Northlake, Texas' general obligation (GO) and certificates of obligation debt. At the same time, we assigned our 'AA' long-term rating to the town's series 2021 combination tax and limited surplus revenue certificates of obligation (\$6.8 million). The outlook is stable.

The upgrade is due to material economic growth combined with a decline in top 10 taxpayer concentration, as well as the improvement of our view of the town's financial management practices to good from standard.

The GO bonds are direct obligations of the town, payable from an annual ad valorem tax levied against all taxable property in the town, within the limits prescribed by law. The 2014B, 2016, and 2021 certificates are additionally secured by a pledge of the surplus revenues of the town's waterworks and sewer system not to exceed \$1,000. Given the limitation of the net utility system revenue pledge, the certificates are rated based on the town's ad valorem tax pledge. Given the size of the pledge, we rate these bonds to the town's ad valorem pledge. Northlake also has 2014A certificates of obligation outstanding that are additionally secured by special assessment levied on property within the Highlands Public Improvement District. We do not have sufficient information to rate the special assessment pledge, so we rate these bonds to the town's ad valorem pledge. Officials plan on using the proceeds for water and sewer improvements.

The maximum allowable ad valorem tax 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 town's total tax rate is well below the maximum, at 29.50 cents, 12.83 cents of which is dedicated to debt service. The ad valorem taxes are not levied on a narrower or

distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service. Therefore, we view the limited-tax pledge to be on par with the issuer credit rating, which reflects the town's general creditworthiness. Proceeds from the GO bonds will refund Northlake's series 2011 and 2012 certificates of obligations. The proceeds from the certificates of obligation will fund various street improvements.

Credit overview

Northlake has seen rapid growth, with AV increasing more than 600% in the past seven years. Despite this growth, management has reported strong surpluses in the past two years, increasing reserves to nearly 70% of expenditures. Although we believe the town will have to face continued capital pressure from rapid growth, we believe that management's conservative assumptions towards growth related revenues will allow Northlake to maintain reserves above their reserve target. The town's high debt burden likely precludes it from a higher rating for an extended period of time as Northlake continues to grow.

The rating reflects our view of the town's:

- Good financial management practices;
- Rapidly growing economy and property tax base in the Dallas-Fort Worth metroplex;
- Very weak debt burden; and
- Very strong reserves, with two strong surpluses in the past two years, and an expected surplus in fiscal 2021.

Environmental, social, and governance

We have analyzed the town's environmental and governance factors and we do not consider these risks outside of the sector standard. We consider the rapid population and property tax base growth as an opportunity, as the town has seen rapidly growing revenues due to housing expansion.

Stable Outlook

Upside scenario

We could take a positive rating action if the Northlake's economic metrics grow to levels commensurate with those of higher-rated peers, the town maintains current budgetary performance trends, and if it moderates its debt burden.

Downside scenario

We could lower the rating if the town materially spends down reserves.

Credit Opinion

Rapidly growing economy, with declining top 10 taxpayer concentration, expected to continue for at least five years

Northlake's local economy grew rapidly, with AV increasing to \$1.5 million in 2021 from \$241 million in 2014, with the property base growing 600% in seven years. This growth is driven mostly by single-family residential as housing demand grew in the Dallas-Fort Worth metroplex. The town is connecting more than two new water connections a day, and management estimates 900-1,000 new homes in 2021. Officials expect this build out will continue for at least

five years, as there is ample land for development. According to management, state roads currently hinder development, and as the state improves transportation infrastructure in the area, officials believe housing will continue to grow. This growth is evident in sales tax revenue growth in Northlake. Officials state that the pandemic did not have a significant effect on local economic revenues, and the Texas state comptroller reports that year-to-date sales tax revenues are 75% higher than at this time last year. Officials indicate that some of this growth is due to a Walgreens fulfillment center and pharmacy logistics, and management is treating this additional revenue as one time.

Northlake also serves as a logistics hub, with distribution warehouses and associated manufacturing leading the city's commercial properties. As residential properties have come to Northlake, concentration has declined. In addition, top 10 taxpayer concentration declined in the same period, with concentration dropping under 30% in 2021, from over 40% in 2017. This removed a negative economic factor adjustment, improving our local economy score in Northlake. Officials state that additional commercial development is also underway, with approximately seven million square feet of business park of projects under construction or in planning.

Strong management, with a comprehensive capital plan to assist with managing the town's rapid growth

We have changed our assessment of Northlake's Financial Management Assessment due to the town's capital planning and reserve policies.

The town uses extensive planning and analysis to devise revenue and expenditure assumptions based on historical trend analysis, and it reviews the growth trends of other fast-growing small cities and towns. Key financial management practices include quarterly reporting of the budget-to-actual results and investment performance to the governing body. Procedures for budget adjustments are in place if needed. Northlake's formal reserve goal is to maintain at least 120 days of operating expenditures in reserve. The town does not conduct long-term financial planning or have a debt management policy, but it is currently working on both documents. Since our previous review, Northlake instituted a comprehensive five-year capital plan, with sources for funding and single-page descriptions of each project. This plan is included in the budget and is updated annually.

Strong budgetary performance, adding to very strong reserves

In the past two years, Northlake has seen large surpluses, as management has taken a conservative approach to revenues from housing growth in the city. A significant portion of the city's revenues comes from building permits and associated fees (40%), and these revenues, along with sales taxes (15%) drove strong performance. However, given the cyclical nature of building permit revenues, we have adjusted our performance score. Management considers most of these as one-time revenues.

In 2019 Northlake posted a large surplus of \$1.3 million, due to an unexpected surge of development in the summer of 2019. Management took a conservative approach to these revenues ever since the financial crisis of 2008 and intends to conservatively budget these revenues given their exposure to market forces. In fiscal 2020, development activity again outpaced expectations leading to another surplus as the housing market made available properties scarce. Officials stated that they intend to treat these revenues as one time, and they have communicated to council their intention with development-related revenues.

For fiscal years 2021 and 2022, Northlake expects surplus revenues again, but it could spend some reserves on

one-time projects across the town such as a new town hall. There are no plans to reduce reserves below their reserve target of 120 days. In our view, management's approach to development-related fees is prudent, but we see potentially challenges in the future as the town continues to grow.

Northlake has historically maintained very strong reserves, well in excess of 30% of expenditures and recent performance has only increased the town's fund balance to 66%. The town has no plans to reduce its current fund balance below its formal target of 120 days of expenditures, but it could make various one-time transfers to support its debt service fund and to finance other capital needs from surplus revenues. As a result, we believe the town's fund balance will remain very strong, and in excess of 30% of its annual operating expenditures.

The town privately placed tax notes in 2020 for capital improvements. The bond resolution notes that in the event of a default, any additional payments after will be subject to a 4.4% rate—3.0% higher than the notes' 1.1% interest rate. The bond ordinance explicitly states that acceleration is not an available remedy. Although the higher interest rate is a slight concern, given Northlake's overall financial performance, and the lack of acceleration, we do not consider this obligation an immediate contingent liability.

Very weak debt profile, partially offset by minimal pension and other postemployment benefits (OPEB) liabilities

While Northlake faces significant growth, the town does not anticipate issuing debt until November 2023. The town plans to coordinate the issuance with Denton County and officials early estimates are \$15 million.

We do not consider the town's pension costs a current credit risk given the small size of the liabilities.

The town participates in the following plans:

- Texas Municipal Retirement System (TMRS), funded at 90.8% with a net proportional pension liability of \$365,000.
- TMRS OPEB, unfunded with a total liability of \$50,898.

Given that TMRS is an agent plan, assets are jointly managed. Currently, Northlake is making 100% of its required contribution, but it's not meeting our actual minimum funding or actual static funding calculations. With a closed, 27-year amortization period on a level-percent basis, we believe that the town will make progress towards funding its liabilities, but that contributions will likely increase, especially since the amortization is on a level-percent-of-payroll basis. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, although there are offsetting factors. For more information, see "Pension Spotlight: Texas" published on RatingsDirect Feb. 25, 2020.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Northlake, Texas--Key Credit Metrics				
	Most recent	Historical information		
		2020	2019	2018
Very strong economy				
Projected per capita EBI % of U.S.	134.5			

Northlake, Texas--Key Credit Metrics (cont.)

	<u>Most recent</u>	<u>Historical information</u>		
		2020	2019	2018
Market value per capita (\$)	158,537			
Population		4,930		
County unemployment rate(%)		6.5		
Market value (\$000)	1,506,098	860,584		
Ten largest taxpayers % of taxable value	29.7			
Strong budgetary performance				
Operating fund result % of expenditures		9.8	25.6	(0.7)
Total governmental fund result % of expenditures		33.3	48.1	32.0
Very strong budgetary flexibility				
Available reserves % of operating expenditures		66.7	64.0	46.8
Total available reserves (\$000)		3,595	3,075	1,831
Very strong liquidity				
Total government cash % of governmental fund expenditures		150.0	169.4	252.9
Total government cash % of governmental fund debt service		1,032.4	865.9	2,592.4
Strong management				
Financial Management Assessment	Good			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		14.5	19.6	9.8
Net direct debt % of governmental fund revenue	283			
Overall net debt % of market value	9.3			
Direct debt 10-year amortization (%)	61.0			
Required pension contribution % of governmental fund expenditures		3.1		
OPEB actual contribution % of governmental fund expenditures		0.1		
Strong institutional framework				

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

Related Research

- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed

Summary: Town of Northlake, Texas; General Obligation

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.

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