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Ratings

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Summary:

McKinney, Texas; General Obligation

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Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

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Credit Profile		
US$38.43 mil taxable GO bnds ser 2021C dtd 06/01/2021 due 08/15/2041		
Long Term Rating	AAA/Stable	New
US$16.43 mil GO bnds ser 2021A dtd 06/01/2021 due 08/15/2041		
Long Term Rating	AAA/Stable	New
US$14.43 mil taxable GO rfdg bnds ser 2021B dtd 06/01/2021 due 08/15/2035		
Long Term Rating	AAA/Stable	New
McKinney GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to McKinney, Texas' $16.4 million series 2021A general obligation (GO) bonds, $14.4 million 2021B taxable GO refunding bonds, and $38.4 million 2021C taxable GO bonds. At the same time, we affirmed our 'AAA' long-term rating on the city's GO debt outstanding. The outlook is stable.

McKinney's 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. 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 city's total tax rate is well below the maximum, at 50.86 cents, 15.39 cents of which is dedicated to 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 view the limited-tax GO debt pledge to be on par with the issuer credit rating (ICR), which is based on the city's general creditworthiness. 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. Proceeds of the 2021A and 2021C bonds will be used to finance various capital improvements throughout the city; proceeds of the 2021B refunding bonds will finance a current refunding of the city's series 2013 bonds for interest cost savings.

The city's bonds and certificates are eligible to be rated above the sovereign because we assess the city 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" (Nov. 19, 2013), U.S. local governments are considered to have moderate sensitivity to country risk. The city'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 in the city'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. McKinney 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

McKinney has emerged from a difficult year in a strong position, even after initial expectations for local slowdown and potential financial pressures from the COVID-19 pandemic. AVs within the city have continued to rise, propelled by continual expansion of commercial entities and residential development. Continuing the trend of prior years, the city managed to post a surplus in the general fund, better than its revised expectation for operational balance in fiscal 2020. As a result, reserves remain very strong, totaling 54% of expenditures at year-end. The city's strong finances are supported by sophisticated policies and planning mechanisms that are forward-looking and conservative. While its debt profile is weak, it has been well-maintained, alongside a pension and other postemployment benefit (OPEB) obligation that we do not see as an immediate credit pressure. The stable rating outlook reflects our expectation that with operations remaining stable through the current budget year, McKinney's favorable reserve profile and thriving local economy will continue to provide additional near-term flexibility and lend stability to its overall credit profile.

The 'AAA' rating reflects our assessment of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating results that we expect could weaken in the near term relative to fiscal 2020, which closed with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 54% of operating expenditures;
- Very strong liquidity, with total government available cash at 99.6% of total governmental fund expenditures and 5.6x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 17.9% of expenditures and net direct debt that is 132.7% of total governmental fund revenue; and
- Strong institutional framework score.

Environmental, social, and governance factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Absent the implications of COVID-19, we consider the city's social risks to be in line with those of the sector. We also view environmental and governance risks as being in line with our view of the sector as a whole. We acknowledge the city's very strong management, with strong financial policies and practices as a positive factor as it relates to the city's overall creditworthiness.

Stable Outlook

Downside scenario

We could lower the rating if the city experiences financial stress that leads to structural budget imbalance or substantial declines in reserves to levels no longer comparable with those of similarly rated peers. In addition, if key economic metrics were to deteriorate materially, we could also lower the rating.

Credit Opinion

Very strong economy

We consider McKinney's economy very strong. The city, with a population of 185,616, is the Collin County seat, about 30 miles north of downtown Dallas. It is in the Dallas-Fort Worth-Arlington MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 130% of the national level and per capita market value of $126,102. Overall, market value grew by 5.4% over the past year to $23.4 billion in 2021.

McKinney benefits from its favorable location within the greater Dallas Fort-Worth Metroplex. The city's primarily residential tax base has experienced tremendous growth over the past decade, despite temporary slowdowns in the economy due to the spread of COVID-19. Development and expansion, specifically on the commercial side, continued during the pandemic, as highlighted by preliminary valuation estimates for fiscal 2022 showing a nearly 6% increase over 2021. The demand for housing remained strong as well.

While the city did experience a slight slowdown at the height of the pandemic, mainly in its sales tax revenues, as well as its tourism department and at the municipal airport, recovery has been ongoing in recent months. Fiscal 2020 sales taxes came in higher than the prior year, and activity at the airport, hotels, and convention centers has begun to slowly rise. Unemployment at the county level peaked in April 2020 at 11.7%, but has since fallen to 5.6% (in March). (For more information on COVID-19's effect on the U.S. public finance sector, please see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," March 24, 2021.) Given the city's continued growth and development, even throughout the pandemic, coupled with its proximity to the greater Dallas-Fort Worth area, we believe that our view of the local economy will remain very strong.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

McKinney has a formal general fund balance policy to maintain 25% of operations in reserve. The policy affords the city the financial flexibility to fund capital projects from cash on hand while effectively managing potential shortfalls in major revenue sources. Management provides monthly budget-to-actual reporting of the city's financial position to the governing body, with procedures for budget adjustments in place if needed. The city has a comprehensive five-year capital improvement plan (CIP), with identified funding sources, that it updates annually; the plan is linked to its operating budget. In addition, it has a formal five-year financial management plan for both operations and the water and sewer fund that detail budgetary projections. These plans are updated annually. McKinney's formal ongoing debt management practices include specific guidelines related to debt types the city issues, refunding targets, debt structure, and acceptable tax rate implications. The formal investment policy is in line with state statutes, and officials review quarterly investment reports that include holdings and earnings, to monitor compliance and results.

Strong budgetary performance

McKinney's budgetary performance is strong, in our opinion, posting operating surpluses of 6.8% of expenditures in the general fund and 6.7% across all governmental funds in fiscal 2020. While we expect McKinney to have at least balanced operating results, we do not expect results to be as favorable as they had been in 2020. In our analysis of budgetary performance, we adjusted for recurring transfers in and out of the general fund, as well as recurring transfers into all governmental funds from the city's enterprise funds. We additionally removed one-time capital spending funded with bond proceeds from its total governmental expenditures.

McKinney's budgetary performance reflects consistent operating surpluses over the past six fiscal years, which has allowed the city to build and maintain a reserve position that is in line with its growing budget. Even throughout the pandemic, robust economic growth and development, which has generated additional local tax revenues through tax-base expansion and increased retail activity, continues to support the city's strong budgetary performance.

Despite revised budgetary estimates for fiscal 2020 that conservatively projected break-even results in the general fund, the city was able to post a healthy surplus, due to increases in property tax collections reflecting higher valuations, higher-than-budgeted sales taxes, and decreased public works spending. Initial projections for decreased revenues due to the COVID-19 pandemic were not realized, and a sizable increase to fund balance was achieved, also brought about by a reduction in general expenditures made during midyear cuts. The result additionally accounts for certain CARES Act and other COVID-19-related relief funding that was received and spent in fiscal 2020.

The city adopted a $159.4 million balanced budget for fiscal 2021, which includes a reduction to its ad valorem tax rate. The budget also accounts for a 15% increase in sales taxes, which have continued to rise due to both population and commercial growth. Management expects that the general fund will end in line with prior years, posting a surplus, that could potentially be used to purchase capital equipment. Based on actual results for fiscal 2020, as well as current tracking for fiscal 2021, management has established a strong ability to respond to potential financial pressures and manage the city's expenditures in a way that has helped it maintain structural balance, even in an uncertain economic and financial environment. McKinney has maintained its key fiscal metrics, and we expect that it will continue to do so; therefore, we expect our view of budgetary performance to remain steady over the near term.

The revenue base is diverse, with property tax collections making up about 52% of general fund revenue, followed by sales taxes (19%) and franchise fees (10%) in fiscal 2020. The largest general fund expenditure categories were police and fire, which account for 46% of general fund expenditures; expenditures also included over $6 million in capital expenditures.

Very strong budgetary flexibility

McKinney's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 54% of operating expenditures, or $84.2 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.

The city has historically maintained very strong reserve levels, with available fund balance remaining above 30% of general fund expenditures in each of the last three fiscal years, which exceeds its formal reserve policy of 25%. Given its positive results for fiscal 2020, the city was able to continue adding to its fund balance, showing an $11 million increase over 2019 (or 6.8%). Management indicated that in coming years, a portion of these increased reserves could be used to assist with funding for its city hall project, although we expect that reserves will remain very strong and above 30% of operating expenditures.

Very strong liquidity

In our opinion, McKinney's liquidity is very strong, with total government available cash at 99.6% of total governmental fund expenditures and 5.6x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary. It has demonstrated this through its issuance of GO, revenue, and sales tax bonds over the past 20 years. Its $236 million in available cash and investments comply with Texas statutes and the city's internal investment policy. McKinney 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 near term. The series 2019 tax and limited pledge waterworks and sewer system revenue certificates of obligation were privately placed with BOK Financial. The bonds do not contain any permissive covenants, including nonstandard events of default or acceleration, that we view as a potential material liquidity risk.

Very weak debt and contingent liability profile

In our view, McKinney's debt and contingent liability profile is very weak. Total governmental fund debt service is 17.9% of total governmental fund expenditures, and net direct debt is 132.7% of total governmental fund revenue.

We calculate total direct debt at about $502 million. When excluding self-supporting debt paid from the city's enterprise funds, net direct debt amounts to approximately $328 million. The city's direct debt burden includes GO bonds, certificates of obligation, sales tax bonds, and utility revenue bonds. Based on its CIP and expected growth in service demand, we expect future debt issuance in 2021 and 2022, with the CIP including debt-funded projects through 2025. Given expectations for future debt, coupled with fairly rapid amortization of debt (60% being repaid within 10 years), we expect the city's debt profile to remain unchanged over the near term. McKinney does not have any swaps or variable-rate debt.

Pensions and other postemployment benefits:

We do not believe that pension and OPEBs present a material risk to McKinney's finances at this time, particularly given the city's strong financial position, which supports its ability to consistently fund its annual required contributions. In addition, the TMRS pension plan is relatively well-funded and funding strategies for OPEBs should alleviate any near-term budget pressure associated with modest increases in contributions. Fiscal 2020 contributions exceeded static funding, indicating some progress toward paying down unfunded liabilities, but it fell short of our minimum funding progress metric. For more information pension funding in Texas, see "Pension Spotlight: Texas", Feb. 25, 2020.

The city participates in the following pension and OPEB plans:

- Texas Municipal Retirement System (TMRS), which is a nontraditional, joint contributory, hybrid, defined-benefit, agent multiple-employer pension plan administered by the state. The city consistently makes its actuarially determined pension contribution. It reported a net pension liability of $39.5 million. The plan was funded at 80.0%, as measured by the ratio of the fiduciary net position as a percentage of the total pension liability. Actuarial assumptions include a 6.75% assumed rate of return.
- McKinney also participates in a single-employer defined-benefit group-term life insurance coverage operated by TMRS known as the Supplemental Death Benefits Fund (SDBF). The city has historically contributed 100% of the contractually required rate as determined by an annual actuarial valuation. At Sept. 30, 2020, the city reported an

SDBF liability of $2.2 million.

- The city provides OPEB health care for employees through a single-employer defined-benefit health insurance plan. The plan provides medical benefits for eligible retirees, their spouses, and dependents through the city's group health insurance plans, which cover both active and retired members. Management and the city council approve the benefit levels and contribution rates annually as part of the budget process. The plan is funded on a pay-as-you-go basis. At Sept. 30, 2020, the city reported a total OPEB liability of $21.9 million.

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
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of May 25, 2021)		
McKinney GO		
Long Term Rating	AAA/Stable	Affirmed
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