S&P Global
Ratings

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Summary:
The Colony, Texas; General Obligation

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Summary:

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Credit Profile		
US$9.25 mil combination tax and ltd surplus rev certs of oblig ser 2021 dtd 06/15/2021 due 08/15/2041		
Long Term Rating	AA+/Stable	New
The Colony GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to The Colony, Texas' anticipated $9.25 million series 2021 combination tax and limited surplus revenue certificates of obligation. At the same time, we affirmed our 'AA+' long-term rating on the city's previously issued general obligation (GO) bonds and certificates of obligation. The outlook is stable.

The Colony'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 certificates are additionally secured by a limited pledge of surplus revenues of the city's waterworks and sewer system in an amount not to exceed $1,000. Given the limitation of the net utility system revenue pledge, the certificates are rated based on the city's ad valorem tax pledge.

The city's maximum allowable ad valorem tax rate 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 allowable, at 65.5 cents, 16 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 Nov. 20, 2019), we view the limited-tax GO debt pledge as being on par with the city's general creditworthiness. The city does not levy ad valorem taxes 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.

The series 2021 proceeds will be used to fund various road, sidewalk, drainage and utility system improvements.

Credit overview

The Colony is a primarily residential community located in north Texas approximately 28 miles north of Dallas and 26 miles southeast of Denton. Given its location along major transportation corridors within the expanding Dallas metroplex, the city experienced a period of rapid tax base and population growth over the past decade. Despite increasing service demands and growth-related capital needs, it has consistently maintained budget balance tied to a combination of economy-fueled revenue growth and a strong framework of financial management. The Colony's revenues are largely derived from property taxes that are somewhat insulated from economic shocks and changes in consumer spending or activity, particularly given existing flexibility within the tax rate. Furthermore, the city's very strong reserve and liquidity positions provide additional cushion should there be short-term sales tax revenue interruptions. However, we understand the city's sales tax revenues did not contract during the pandemic and continue to grow. For S&P Global Ratings' most recent view of the U.S. economy, see the article titled "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect. Although we expect that The Colony will continue issuing debt to fund infrastructure needs, we believe that debt issuance will remain commensurate with overall economic growth, supporting stability in fixed costs and long-term budget balance.

In addition, the rating reflects our assessment of the following credit factors:

- 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;
- 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 52% of operating expenditures;
- Very strong liquidity, with total government available cash at 82.4% of total governmental fund expenditures and 5.4x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 15.3% of expenditures and net direct debt that is 149.4% of total governmental fund revenue, but rapid amortization, with 65.5% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We analyzed the city's environmental, social, 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.

Stable Outlook

Upside scenario

All else being equal, we could raise the rating if The Colony's continued economic expansion results in improved wealth and income metrics, relative to those of higher-rated peers, while the city maintains at least an adequate debt profile.

Downside scenario

Although unlikely, we could lower the rating if the city were to experience substantial economic deterioration, or budgetary performance weakens, resulting in sustained operating deficits and reductions in reserves below the city's formal policy.

Credit Opinion

Very strong economy

We consider The Colony's economy very strong. The city, with an estimated population of 46,497, is located in Denton 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 123% of the national level and per capita market value of $123,138. The city's market value grew by 9.9% over the past year to $5.7 billion in 2021.

Thanks to the city's location along a major transportation corridor including the Sam Rayburn Tollway, Interstate 35 East, and the Dallas North Tollway, residents are provided strong access to employment throughout the Dallas metroplex. The city is located approximately 28 miles north of Dallas and 26 miles southeast of Denton. In addition, the city's proximity to regional employment centers has spurred demand for new housing and contributed to modest population growth. Denton County's annual average unemployment rate was 6.5% for 2020, a significant recovery from a monthly peak of 12.4% for April 2020.

The taxable AV, which has grown by 57% in the past five years, consists predominantly of residential and commercial parcels, adding a degree of stability to its tax base. Single-family and multifamily residential development represents approximately 76% of the city's AV. Management attributes the growth to appreciation of existing residential and commercial properties, coupled with the completion of various development projects being added to the tax roll. Officials note that future development will be driven primarily by residential construction. The city's business park is about 90% built out, and there is limited additional commercial land scattered throughout the city available for development. The major housing development under construction will add about 250 houses a year, for the next four to five years, at a median price of about $440,000.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology. Highlights of the city's policies and practices include the following:

- The city has a formally adopted investment policy, and it reports holdings and earnings quarterly.
- Management makes monthly financial update reports to the city council that include year-to-date budget-to-actual figures. The city council can amend the budget at any time.
- The city's formal policy is to maintain at least 80 days of operational costs in the general and water and sewer funds to manage potential revenue shortfalls and to allow for uninterrupted cash flow.
- Revenue and expenditure assumptions are based on two years of historical data. Officials had previously used a five-year trend, but switched to two years given the current pace of growth.
- The city annually updates a five-year capital improvement plan with identified projects and revenue sources.
- A formal debt management policy is reviewed by the council annually. Some of the policy's provisions include limits on the amount of short-term obligations to no more than 5% of aggregate principal of debt outstanding. In addition, the policy limits the portion of property tax levied for debt service to 40% of total tax rate levied each year.
- The city lacks a formal long-term financial plan.

Strong budgetary performance

The Colony's budgetary performance is strong, in our opinion. The city had operating surpluses of 10.2% of expenditures in the general fund and 11.1% across all governmental funds in fiscal 2020. While we expect The Colony's operating results will be at least balanced, we do not expect them to be as favorable as they were in 2020.

Historically, the city has maintained very strong budgetary performance resulting from a combination of conservative budgeting and strong revenue growth. For fiscal 2021, the adopted general fund budget includes a $1.3 million planned spend down of fund balance. However, consistent with trends, management reports revenues are tracking better than budget and doesn't expect to fully spend the expenditure budget.

Although substantial residential and economic expansion over the past decade has required the city to balance growth-related capital needs with support for new and existing operational expenditures, we believe management is equipped with an embedded budgetary planning framework that supports its overall strong budgetary performance. In addition, the city derives general fund revenue from a diverse and historically reliable mix of revenue sources. For fiscal 2020, property taxes accounted for 59% of general fund revenue, followed by sales tax (16%) and franchise taxes (6%). Both property and sales tax revenues have demonstrated stable growth during the pandemic. Management reported that sales taxes are currently up 18% over last year. In addition, the city received $2.4 million of Coronavirus Aid, Relief, and Economic Security Act stimulus to cover COVID-related expenses.

Very strong budgetary flexibility

The Colony's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 52% of operating expenditures, or $18.7 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 Colony has historically maintained very strong reserve levels, in our view, exceeding 30% of operating expenditures in the past five fiscal years. Its formal policy requires reserve balances of at least 80 days of operating expenditures.

Very strong liquidity

In our opinion, The Colony's liquidity is very strong, with total government available cash at 82.4% of total governmental fund expenditures and 5.4x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

The Colony 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 worsen. All of the city's investments comply with Texas statutes and the city's internal investment policy. As of Sept. 30, 2020, investments consisted of highly rated local government investment pools, which we do not consider aggressive. The Colony's strong access to capital markets is demonstrated by its issuance of tax-backed GO bonds and sales tax bonds over the past 20 years. The city does not have any private placements or contingent liabilities that could materially affect its liquidity position in the near term.

Weak debt and contingent liability profile

In our view, The Colony's debt and contingent liability profile is weak. Total governmental fund debt service is 15.3% of total governmental fund expenditures, and net direct debt is 149.4% of total governmental fund revenue. Approximately 65.5% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Management plans to issue additional new-money debt in the amount of $10 million to $20 million annually, representing the city's regular annual issuance for street projects and infrastructure. Depending on the timing of the new debt relative to the current amortization schedule, our opinion of the city's debt and liability profile could change to very weak, although we would not expect it to have a near-term impact on the city's overall credit quality.

Pensions and other postemployment benefits (OPEB):

We do not view pension and OPEB liabilities as an immediate credit risk for the city. Despite a somewhat extended amortization, its pension plan is well funded, and annual OPEB costs remain relatively minimal. As a result, we do not expect a material increase in pension and OPEB contributions that could threaten the city's fiscal stability.

The city participates in the following plan as of Dec. 31, 2019 (latest measurement date):

Texas Municipal Retirement System (TMRS), 89.6% funded with a net pension liability equal to $10.97 million. Contributions are actuarially determined, and the city has historically fully funded its annual required costs. Actuarial assumptions include a 6.75% discount rate and 27-year closed amortization period.

For OPEB, it has no retirement health care benefit, just a supplemental Death Benefits Fund, which provides group-term life insurance benefits to active and retired members of the TMRS pension plan.

The Colony's combined required pension and actual OPEB contributions totaled 6.8% of total governmental fund expenditures in 2020. The city made its full required pension contribution in 2020.

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
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 27, 2021)		
The Colony GO		
Long Term Rating	AA+/Stable	Affirmed
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Long Term Rating	AA+/Stable	Affirmed
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Long Term Rating	AA+/Stable	Affirmed
The Colony GO bnds		
Long Term Rating	AA+/Stable	Affirmed

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.