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Ratings

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## Summary:
# The Colony, Texas; General Obligation

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**Summary:**

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| Credit Profile | | |
|---|---|---|
| US$21.6 mil combination tax and ltd surplus rev certs of oblig ser 2022 dtd 05/15/2022 due 02/15/2042 | | |
| *Long Term Rating* | AA+/Stable | New |
| The Colony GO | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| The Colony GO | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| The Colony GO bnds | | |
| *Long Term Rating* | AA+/Stable | Affirmed |

## Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to The Colony, Texas' roughly $21.6 million series 2022 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 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 2022 proceeds will be used to fund various street, bridges, parks, drainage and erosion control improvements, and technology.

### Credit overview

The Colony is a primarily residential community 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 economy-fueled revenue growth. 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 stability. Though we view management as strong, the city does not do robust long-term comprehensive planning. Although we expect that The Colony will continue issuing debt to fund infrastructure needs to accommodate the growth in the city, we believe that debt issuance will remain commensurate with overall economic growth, supporting stability in fixed costs and long-term budget balance.

The rating reflects our opinion of the city's:

- Very strong economy, with access to a broad, diverse metropolitan statistical area (MSA) and ongoing residential development, leading to a strong tax base increase;
- Strong financial management, with good financial management policies and practices under our Financial Management Assessment (FMA) methodology, though lacking long-term financial planning and a strong institutional framework;
- Strong budgetary performance, with very strong reserves and liquidity; and
- Very weak debt and contingent liability profile, with annual issuances expected.

### Environmental, social, and governance

We analyzed the city's environmental, social, and governance (ESG) 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 note the city takes steps to mitigate cyber security risk.

## Stable Outlook

### Upside scenario

We could raise the rating if debt moderates so the carrying charges decrease materially, the city enhances their long-term planning, and continued economic expansion results in improved wealth and income metrics, relative to those of higher-rated peers.

### Downside scenario

We could lower the rating if financial performance weakens materially or if substantial debt issuances pressure the budget.

## Credit Opinion

### Stable, very diverse tax base in the Dallas MSA

The Colony, located in Denton County in the broad and diverse Dallas-Fort Worth-Arlington MSA, has been experiencing strong year-over-year AV growth, increasing 50% from $4.1 billion in fiscal 2018 to $6.1 billion in fiscal 2022. Officials attribute much of this growth to a strong housing market and multiple residential and commercial expansions. The city's location along a major transportation corridor, including the Sam Rayburn Tollway, Interstate 35 East, and the Dallas North Tollway, provides residents with strong access to employment throughout the Dallas metroplex.

The city's residential portion is approximately 85% built out and the commercial portion is also about 85% built out. The city's tax base is what we consider very diverse, though nine of the top 10 taxpayers are apartments. Top employers include multiple retail locations, education, the city itself, and a water park.

While the city's tax base is stable and has been experiencing consistent AV increases, we expect the level at which it grows to moderate in the next few years as the city approaches build-out.

### Strong management with good financial management policies, practices

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, and 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 60 days in the 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;
- The city annually updates a five-year capital improvement plan; and
- 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. Additionally, 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.

### Stable operating performance with very strong reserves

Budgetary performance has historically been strong, evidenced by general fund operating surpluses due to conservative budgeting and strong budget monitoring and oversight, equipping the city to balance growth-related capital needs with support for new and existing operational expenditures due to substantial residential and economic expansion. Our assessment of operating performance includes adjustments to account for recurring interfund transfers, as well as expenditure adjustments to reflect debt-funded capital expenditures.

The city derives general fund revenue from a diverse and historically reliable mix of revenue sources. For fiscal 2021, property taxes accounted for 59% of general fund revenue, followed by sales tax (21%) and franchise taxes (5%). Property taxes outperformed the budget by $1.4 million and sales taxes by $2.2 million. Fiscal 2022's budget was a 6.5% increase from fiscal 2021, taking into account higher property taxes and sales taxes, as well as increased personnel and capital expenditures, as well as increased debt service. The city typically adopts deficit budgets as a conservative budgeting tactic, then outperforms. At this point in the year, expenditures are well under budget, at only 42%, while revenues are at 83% of the budget.

The city received roughly $2.4 million in CARES Act funding in 2020, which it used for COVID-19-related expenses. In fiscal 2021, the county received $5.5 million in American Rescue Plan Act (ARPA) of 2021 funds and expects to receive an additional $5.5 million in 2022, which management will put toward sewer projects and broadband infrastructure.

Due to historical performance and a strong framework of active budget management, we do not expect operating results to weaken materially during the next few fiscal years.

The Colony has historically maintained very strong reserve levels, in our view, exceeding 30% of operating expenditures in the past five fiscal years. The city may spend down reserves in the next few years for various capital projects, including a possible purchase of a closed school, which would be $800,000 to $1 million a year for the next 10 years; however, the city is committed to maintaining its formal reserve policy of at least 80 days of general fund operating expenditures.

The city does not have any private placements or contingent liabilities that could materially affect its liquidity position in the near term.

### Elevated but manageable debt profile, with annual issuances expected

Post-issuance, the city will have approximately $136.5 million in direct debt outstanding. Management plans to issue additional new-money debt in the amount of $15-$20 million annually, representing the city's regular annual issuance for street projects and infrastructure, though we expect a portion of it to be self-supporting. The city also has a wastewater treatment plant project planned in the next several years that is estimated to cost $25 million. Despite an elevated debt profile, the city's fairly rapid amortization helps keep costs manageable.

Pensions and other postemployment benefits (OPEB):

As of Dec. 30, 2020, The Colony participates in:

- Texas Municipal Retirement System (TMRS), which is 90.5% funded, with a net pension liability of $10.9 million; and
- Supplemental Death Benefits Fund, administered through TMRS, with a total OPEB liability of $1.3 million.

TMRS' actuarially determined contributions exceeded our actual static funding calculation but fell slightly short of our minimum-funding progress metric, which assesses whether the most recent employer and employee contributions cover total service costs, plus unfunded interest costs, plus one-30th of principal. When achieved, this metric indicates an issuer has strong funding discipline that aims to ensure timely progress on reducing plan liabilities. Since TMRS is an agent plan, assets are jointly managed. TMRS uses certain assumptions that could increase contribution volatility, including a 6.75% discount, though there are offsetting factors. (For more information on TRS and Texas' pension landscape, see "Pension Spotlight: Texas," published Feb. 25, 2020.)

### Strong institutional framework

The institutional framework score for Texas municipalities is strong.

| The Colony--Key Credit Metrics | | | | |
|---|---|---|---|---|
| | **Most recent** | **Historical information** | | |
| | | **2021** | **2020** | **2019** |
| **Very strong economy** | | | | |
| Projected per capita EBI % of U.S. | 119 | | | |
| Market value per capita ($) | 126,216 | | | |
| Population | | | 48,285 | 46,497 |
| County unemployment rate(%) | | | 6.5 | |
| Market value ($000) | 6,094,344 | 5,725,559 | 5,207,639 | |
| Ten largest taxpayers % of taxable value | 14.5 | | | |
| **Strong budgetary performance** | | | | |
| Operating fund result % of expenditures | | 8.6 | 10.2 | 2.3 |
| Total governmental fund result % of expenditures | | 3.2 | 11.1 | (1.0) |
| **Very strong budgetary flexibility** | | | | |
| Available reserves % of operating expenditures | | 46.2 | 51.7 | 34.8 |
| Total available reserves ($000) | | 19,835 | 18,686 | 15,214 |
| **Very strong liquidity** | | | | |
| Total government cash % of governmental fund expenditures | | 97 | 82 | 62 |
| Total government cash % of governmental fund debt service | | 731 | 538 | 393 |
| **Strong management** | | | | |
| Financial Management Assessment | Good | | | |
| **Very weak debt & long-term liabilities** | | | | |
| Debt service % of governmental fund expenditures | | 13.2 | 15.3 | 15.7 |
| Net direct debt % of governmental fund revenue | 190 | | | |
| Overall net debt % of market value | 5.1 | | | |
| Direct debt 10-year amortization (%) | 61 | | | |
| Required pension contribution % of governmental fund expenditures | | 6.4 | | |
| OPEB actual contribution % of governmental fund expenditures | | 0.0 | | |
| **Strong institutional framework** | | | | |

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

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

| Ratings Detail (As Of May 2, 2022) | | |
|---|---|---|
| The Colony GO | | |
| *Long Term Rating* | AA+/Stable | Affirmed |

| Ratings Detail (As Of May 2, 2022) (cont.) | | |
|---|---|---|
| The Colony GO | | |
| *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.