

RatingsDirect®

Summary:

Sherman, Texas; General Obligation

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Credit Profile

US\$3.31 mil ltd tax nts ser 2023 due 08/15/2028

Long Term Rating

AA/Stable

New

Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to Sherman, Texas' estimated \$3.31 million limited tax notes, series 2023.
- The outlook is stable.

Security

The notes will fund various equipment and vehicle purchases.

The notes constitute a direct obligation 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 47 cents, 20.1 cents of which is dedicated to debt service. We view the limited-tax GO debt pledge to be on par with 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.

Credit overview

Approximately 65 miles north of Dallas, close to the Oklahoma border, Sherman benefits from its participation in Sherman-Denison metropolitan statistical area (MSA), which serves as a regional trade center between Texas and Oklahoma. The city's financial position has strengthened with surpluses in fiscal years 2020 and 2021, bolstered by a growing tax base and increasing sales taxes. Continued development has also led to increased service and capital needs, which translates into high debt burden that we don't expect will moderate within the outlook horizon.

In addition, the rating reflects our assessment of the city's:

- Growing economy near the Texas-Oklahoma border;
- Very strong management and a strong institutional framework score;
- Solid budgetary performance, with very strong reserves and liquidity; and
- Very weak debt profile, with ongoing debt needs, but no immediate pension and other postemployment benefits (OPEB) pressures.

Environmental, social, and governance

The rating incorporates our view of environmental, social, and governance (ESG) risks relative to the city's economy, management, financial measures, and debt and liability profile, which we view as neutral in our credit analysis.

Outlook

The stable outlook reflects our expectation that very strong management will aid Sherman in maintaining balanced operations and very strong reserves through growth-related pressures and a potential recession. It also reflects our view that the city's elevated debt burden and below-average income indicators will remain constraining factors. We, therefore, do not expect to change the rating over the outlook period.

Downside scenario

If Sherman's budgetary performance deteriorates materially, leading to sustained decreases in reserves, or if the city's debt and pension obligations place financial pressure on the city, we could lower the rating.

Upside scenario

We could raise the rating if Sherman's economic base continues to expand and diversify, resulting in wealth and income levels comparable with those of higher-rated peers, coupled with an improvement of the city's debt profile.

Credit Opinion

Growing economy with large, impactful projects underway

Sherman is in north Texas, approximately 65 miles north of Dallas, near the Texas-Oklahoma border. The city is in Grayson County adjacent to Lake Texoma, a large recreational reservoir serving the region's residents, businesses and attracting visitors from throughout the country. Sherman is part of the Sherman-Denison MSA, which serves as a regional retail and medical center for northern Texas and southern Oklahoma and the city is the largest trade center between Dallas and Oklahoma City. In addition to the strong retail sector, electronics, manufacturing, and food-processing firms, such as Sunny-D, Tyson Foods, and Texas Instruments, along with a regional medical center, anchor the local economy.

AV, which grew consistently, consists primarily of residential, commercial, and industrial parcels. Management attributes the city's growth to appreciation of existing properties, coupled with the completion of various development projects being added to the tax roll. Officials expect this trend will continue given planned developments that include thousands of single and multi-family dwelling units as well as commercial and retail additions. Notably, year-to-date building permits increased about 40% over 2021, with an increase in value of more than 5,000%. In terms of single-family homes, median sales price is, according to officials, 20% above 2021 and new listings have increased 25%. Top employers include Tyson Fresh Meats, Sherman Independent School District, and Texas Instruments (TI).

TI recently announced plans for a new, nearly \$30 billion plant in Sherman that will replace its current facility, but the company also added a new production line of silicon wafers for use in electronics and other consumer products. The project is anticipated to create about 3,000-3,500 new jobs and management believes the plant will attract other companies within the industry. Officials also note that land values increased about 30% following the announcement of

the project. Even after abatements, the impact on the tax base is expected to be significant; officials expect the city's tax base will double by 2027. The tax abatements will commence once the plant becomes operational. Until then, the city will fully benefit from the tax base and revenue growth. Additional revenues generated during construction will help fund an expansion of the water and sewer facilities needed to accommodate the TI plant and ongoing growth.

Very strong management

Sherman looks back beyond five years of history when developing revenue and expenditure assumptions. The city performs ad hoc scenarios for a five-year period when developing the budget as well as using outside sources to inform its decision.

Management performs budget-to-actual financial reporting of the city's financial position to the governing body at minimum three times per year (April, June, and September), with procedures for budget adjustments in place if needed at any time.

The city has a formal five-year revenue and expenditure planning model, which is used as a budget planning tool to guide decision making and ensure that long-term implications of service level decisions are considered. The city has a comprehensive five-year capital improvement plan, with identified funding sources that it updates annually; the plan is linked to its operating budget.

Sherman's formal investment policy is in line with state statutes and city officials present quarterly investment reports that include holdings and earnings, to the city council. The city's formal debt management policy includes specific guidelines related to debt types the city issues, refunding targets, debt structure, and limits on the amount of debt that can be issued.

The city charter requires a minimum general fund balance of 5%, but officials have adopted a more stringent formal policy to maintain a minimum unrestricted general fund balance of not less than 60 days of expenditures on a cash basis. Informally, the city likes to maintain approximately 75 days of reserves, which it has done so historically.

The institutional framework score for Texas municipalities is strong.

Solid budgetary performance and very strong reserves and liquidity

Sherman's budgetary performance is strong, in our view, after adjusting for recurring transfers into the general fund from its enterprise funds and elimination of one-time capital expenditures funded with bond proceeds. Recent economic expansion required the city to balance growth-related capital needs with support for new and existing operational expenditures, which resulted in some mixed performance, tied mainly to capital expenditures. Otherwise, budgetary performance is fairly stable and positive, resulting from a combination of conservative budgeting and strong revenue growth. Management monitors the budget regularly throughout the year, and the city's final results are often better than budgeted.

The city's primary revenue sources include sales taxes (45% of general fund revenues), property taxes (26%), and charges for services (6%). Despite reliance on a more volatile revenue stream such as sales taxes, collections have remained strong even during the pandemic. In fact, officials report that Sherman is experiencing consecutive years of double-digit sales tax growth. To date, sales taxes are 15% higher compared with the same period last year.

The city expects a surplus in fiscal 2022 stemming from increased property and sales taxes. The fiscal 2023 budget is balanced and includes new positions reflecting the demand for services the city is experiencing, but the budget also contains contingencies for inflation. As a buffer for inflation and the potential recession, officials plan on maintaining reserves at higher-than-usual levels over the next few years. We anticipate that the city's operations will remain at least balanced as ongoing economic expansion drives operating revenue growth and the city maintains conservative budgeting practices.

We don't anticipate any changes to the city's very strong reserves and liquidity over the outlook horizon.

Very weak debt and contingent liability profile

The city will likely issue additional new money GO debt within the next couple of years, although an exact amount is unknown at this time. We expect its debt profile will remain very weak.

The city has one series of privately placed debt obligations, with principal outstanding totaling approximately \$240,000, or 0.2% of total direct as of fiscal 2022. The private placement is a fixed-rate obligation like the city's previously issued GO debt and bond provisions that do not contain events of default or acceleration clauses that could pressure the city's liquidity.

Pension and OPEB liabilities

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

The city participates in the following plans as of Dec. 31, 2020 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 92% funded with a net pension liability equal to \$12.9 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 a 25-year closed amortization period.
- Supplemental Death Benefits Fund (SDBF), which provides group-term life insurance benefits to active and retired members of the TMRS pension plan. The plan is funded on a pay-as-you-go basis, and the city's total OPEB liability for SDBF was \$1.9 million.
- Sherman also provides OPEB in the form of health care; contributions are made on a pay-as-you-go basis, and the liability was \$7.5 million.

Sherman, Texas--Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Adequate economy				
Projected per capita EBI % of U.S.	65.2			
Market value per capita (\$)	113,584			
Population		43,122	41,787	41,292
County unemployment rate(%)		4.6	5.9	
Market value (\$000)	4,987,963	4,257,895	3,481,853	

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

	Most recent	Historical information		
		2021	2020	2019
Ten largest taxpayers % of taxable value	10.2			
Strong budgetary performance				
Operating fund result % of expenditures		9.8	3.4	(0.5)
Total governmental fund result % of expenditures		8.7	(0.4)	(6.2)
Very strong budgetary flexibility				
Available reserves % of operating expenditures		39.9	31.6	29.9
Total available reserves (\$000)		16,893	12,744	11,355
Very strong liquidity				
Total government cash % of governmental fund expenditures		39.0	18.0	21.2
Total government cash % of governmental fund debt service		346.6	147.6	213.1
Very strong management				
Financial Management Assessment	Strong			
Very weak debt and long-term liabilities				
Debt service % of governmental fund expenditures		11.3	12.2	9.9
Net direct debt % of governmental fund revenue	184.9			
Overall net debt % of market value	6.1			
Direct debt 10-year amortization (%)	49.0			
Required pension contribution % of governmental fund expenditures		8.1		
OPEB actual contribution % of governmental fund expenditures		1.1		
Strong institutional framework				

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

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2022 Update Of Institutional Framework For U.S. Local Governments

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