S&P Global
Ratings

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Summary:
Little Elm, Texas; General Obligation

Primary Credit Analyst:
Melissa Banuelos, Farmers Branch + 1 (214) 871 1403; Melissa.Banuelos@spglobal.com

Secondary Contact:
Joshua Travis, Farmers Branch 972-367-3340; joshua.travis@spglobal.com

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Summary:

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Credit Profile		
US$4.275 mil comb tax and ltd pldg rev certs of oblig ser 2020 dtd 09/15/2020 due 08/01/2040		
Long Term Rating	AA/Stable	New
Little Elm comb tax and ltd pledge rev certs of oblig		
Long Term Rating	AA/Stable	Affirmed
Little Elm comb tax and ltd pledge rev certs of oblig		
Long Term Rating	AA/Stable	Affirmed
Little Elm GO		
Long Term Rating	AA/Stable	Affirmed
Little Elm GO (ASSURED GTY)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Town of Little Elm, Texas' anticipated $4.275 million series 2020 combination tax and limited pledge revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the town's GO bonds and certificates of obligation outstanding. The outlook is stable.

The certificates constitute direct obligations of the issuer payable from revenue from an annual ad valorem tax levied against all taxable property in the town, within the limits prescribed by law, and are further secured by and payable from a lien on and limited pledge (not to exceed $1,000) of the net revenue derived from the operation of the town's combined waterworks and sewer system. Given the de minimis revenue pledge, we rate the certificates based solely on the town's GO pledge. The maximum allowable ad valorem tax rate for Texas home rule cities 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 65 cents, 15 cents of which is dedicated to debt service. We do not differentiate between the city's limited-tax GO debt and its general creditworthiness given that the ad valorem tax is not derived from a measurably narrower tax base and that there are no limitations on the fungibility of the city's general resources. Proceeds from the certificates will fund public parking and street improvements.

Credit overview

Favorable location in the Dallas-Fort Worth metropolitan statistical area (MSA) and economic expansion of the region continue to drive population and tax base growth in Little Elm, translating into healthy revenue growth. These favorable conditions, combined with strong management practices, have allowed the town to post consecutive general fund surpluses and accumulate very strong reserves despite increased service demand and cash funding of capital projects. Although economic growth is leading to increased infrastructure needs and the town will issue additional debt in the next two years, we believe internal policies and fairly rapid amortization, combined with conservative forecasting, will allow Little Elm to maintain a manageable debt profile. Despite the abovementioned strengths, we believe the rating is constrained by below-average wealth and income levels compared with those of higher-rated peers. While uncertainty remains regarding the impact of COVID-19 and the economic recession (see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020 on RatingsDirect), we believe the city's reserves position it to cope with any revenue disruptions in the short-to-medium term.

The rating reflects our opinion of the city's:

- 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 methodology;
- Adequate budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 59% of operating expenditures;
- Very strong liquidity, with total government available cash at 87.7% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 15.9% of expenditures and net direct debt that is 89.8% of total governmental fund revenue, but rapid amortization, with 69.1% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance factors

We analyzed the city's 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. Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic, which, if sustained, could weaken the city's economy, liquidity, and budget performance.

Stable Outlook

Downside scenario

We could lower the rating if the city's financial performance deteriorates--potentially stemming from growing service demands or fixed cost pressure related to planned future debt issuances--leading to sustained and significant drawdowns in reserves.

Upside scenario

All else equal, we could raise the rating if the town continues to experience economic expansion and diversification, leading to improvements in wealth and income indicators to levels similar to those of higher-rated peers.

Credit Opinion

Strong economy

We consider Little Elm's economy strong. The city, with an estimated population of 42,639, is located in Denton County in the Dallas-Fort Worth-Arlington, TX MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 113% of the national level and per capita market value of $92,692. Overall, the city's market value grew by 13.3% over the past year to $4.0 billion in 2020. The county unemployment rate was 3.0% in 2019; however, this has increased to 12.8% in April, but has dropped to 7.8% in June 2020.

Spanning an area of roughly 22 square miles, the Town of Little Elm is located 33 miles northeast of downtown Dallas and 10 miles east of Denton on the northeast shore of Lewisville Lake.

As a developing suburban town with a population that has more than quadrupled over the past decade, Little Elm primarily remains a bedroom community with direct access to the MSA, but the local economy has also benefited from the robust growth of the Dallas-Fort Worth metroplex in recent years, with commercial development in the retail sector contributing to strong persisting growth.

Primary employers are the Little Elm Independent School District (with 853 employees), the town itself (294), Kroger (191), and Lowes Home Center (178). We consider the local tax base very diverse, as the top 10 taxpayers constituted only 11.7% of taxable AV in fiscal 2020.

Taxable AV itself has demonstrated steady year-over-year growth since fiscal 2011, with double-digit growth figures in each of the past five fiscal years. Management expects this trend to continue in line with robust residential development and increasing commercial activity, and is projecting that AV growth in the coming year will be similar to recent trends. Officials also expect that commercial growth will strengthen in coming years, particularly because expansion of Highway 380 will be completed in about five years.

Given the ongoing development, we expect Little Elm's tax base to continue to grow, despite the general reduction in economic activity caused by the COVID-19 pandemic. Upward rating pressure is possible, if the continued economic growth translates into wealth and income indicators improving to levels comparable with those of higher-rated peers, although it is not anticipated in the near future.

Very strong management

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

We revised the FMA to very strong from strong due to a change in our view of the city's financial management policy statement pertaining to debt.

Key practices include management's:

- Historical trend analysis when compiling the budget, along with the use of outside sources, where applicable;

- Quarterly budget-to-actual and investment reports to the town council;
- Formal investment policy that is compliant with the Texas Public Funds Investment Act;
- Long-term, five-year financial plan with built-in comprehensive assumptions that it updates annually;
- Capital plan that identifies various projects and funding sources;
- Formal policy of maintaining at least 25% of expenditures in reserve, which has been historically adhered to; and
- Comprehensive financial management policy statement to include guidelines for issuing debt.

Adequate budgetary performance

Little Elm's budgetary performance is adequate in our opinion. The city had slight surplus operating results in the general fund of 0.8% of expenditures, and surplus results across all governmental funds of 16.2% in fiscal 2019. In assessing the town's budgetary performance, we made adjustments for recurring transfers to the general fund and capital project fund from enterprise funds and for capital projects across total governmental funds funded with debt proceeds. In fiscal 2019, we also adjusted out one-time capital outlay, as it is nonrecurring.

General fund operating results of the city have been stable over the past three years, with a result of 16.2% in 2018 and a result of 16% in 2017. After expecting a drawdown relating to one-time capital expenditures in fiscal 2019, the town realized a $782,000 surplus, with both operating revenue and expenditures outperforming budget. Little Elm has conservative practices whereby year-end results often exceed budgeted expectations. Property taxes represented 50% of general fund revenue, followed by sales, use taxes (12%), licenses and permits (10%), all of which have grown in recent years, in line with the town's growth.

The global pandemic and threat of revenue loss led the city to develop a financial contingency plan in fiscal 2020 to ensure stability in fiscal performance, however, management reports it did not experience revenue shortfalls as a result of COVID-19. Sales tax collections year-to-date remain positive when compared to the previous year, despite stay-at-home measures associated with COVID-19.

We note that the town operates on a five-year financial plan that assumes draws on accumulated reserves to keep pace with growth-related needs in out years so that the general fund balance returns to the formal reserve policy level of 25% of expenditures at the end of year five. While management acknowledges the potential for future drawdowns, this practice gives the town substantial flexibility to address one-time or unexpected needs. Officials have not identified significant sources of budgetary pressures over the next few years and anticipate that long-term revenue growth will continue to be strong. Management has proposed a 39.9 million budget for fiscal 2021, which is a 7.6% increase compared to the prior year.

Given the potential revenue shortfalls in combination with the lingering recessionary pressures in the near term, we expect that financial results over the next two fiscal years could soften somewhat from historical performance. However, we expect revenue growth and conservative spending practices will continue to support at least adequate budgetary performance in both current and subsequent fiscal years.

Very strong budgetary flexibility

Little Elm's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 59% of operating expenditures, or $21.3 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 town has historically maintained very strong reserves well above 30% of operating expenditures. Over the past three years, the total available fund balance has remained above 55%, providing substantial flexibility over Little Elm's formal policy of 25%. As mentioned above, the town budgets on a five-year cycle, with the goal of overall balance at the end of five years. Consequently, we anticipate that the town could draw on its fund balance in the next few years. However, given historical results and no plans to draw on reserves to a level below the town's 25% policy level, we expect that available fund balance will remain very strong and in excess of 30% expenditures in the near term.

Very strong liquidity

In our opinion, Little Elm's liquidity is very strong, with total government available cash at 87.7% of total governmental fund expenditures and 5.5x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary demonstrated by its access to the market over the past two decades, which includes numerous GO- and revenue-backed bond issuances.

All of the town's investments comply with both Texas statutes and its own formal policy, and were held in mutual funds and cash equivalents--neither of which we view as aggressive--at the end of fiscal 2019.

The town has privately placed its series 2012A GO refunding bonds, series 2014 tax notes, and series 2020 GO refunding bonds, with a total par amount outstanding of $7.37 million, or 8% of total direct debt. The privately placed debt is fixed rate and does not include permissive covenants or provisions for acceleration. Additionally, we have identified no contingent liabilities that could pose a material risk to Little Elm's liquidity. Therefore, we do not expect the town's liquidity position to deteriorate from its very strong position in the near term.

Weak debt and contingent liability profile

In our view, Little Elm's debt and contingent liability profile is weak. Total governmental fund debt service is 15.9% of total governmental fund expenditures, and net direct debt is 89.8% of total governmental fund revenue. Approximately 69.1% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city's direct debt burden includes roughly $94.93 million of direct debt outstanding, of which about $46.235 million is fully self-supporting. The referenced calculations have been adjusted to account for the portion of tax-backed debt that is supported by the city's enterprise utility funds.

Following the issuance of the series 2020 bonds, the town has no authorized but unissued GO bonds outstanding, but officials are planning to issue additional debt for various projects in the near term, however, the amount has not yet been determined. Accordingly, the potential for future capital needs will likely keep the debt profile elevated in the near future.

Pension and other postemployment benefit (OPEB) liabilities

Little Elm's pension contributions totaled 5.6% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate credit risk for Little Elm. In our view, the pension plan is adequately funded, and annual costs remain relatively manageable despite our expectation that costs will increase. As a result, we do not anticipate the city's liabilities to threaten its fiscal stability in the medium term.

The city participates in the following plans as of Dec. 31, 2018 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 79.8% funded with a net pension liability equal to $7.8 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.

- 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 in 2019, benefit payments were $2,258.

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

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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