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## Summary:

# Ferris, Texas; Appropriations; General Obligation

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**Summary:**

# Ferris, Texas; Appropriations; General Obligation

| Credit Profile | | |
|---|---|---|
| US$7.25 mil comb tax and wtrwks and swr sys rev cets of oblig ser 2021 due 03/01/2041 | | |
| *Long Term Rating* | AA-/Stable | New |
| Ferris GO | | |
| *Long Term Rating* | AA-/Stable | Affirmed |

## Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Ferris, Texas' anticipated $7.25 million series 2021 combination tax and waterworks and sewer system revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating on the city's general obligation (GO) debt outstanding. The outlook is stable.

The certificates and the city's GO bonds outstanding are both secured by revenue from a limited ad valorem tax levied on all taxable property within the city. The certificates are additionally secured by net surplus revenue from the city's waterworks and sewer system in an amount not to exceed $1,000. However, we rate the certificates based solely on the city's ad valorem pledge, as the limited net revenue pledge is insufficient to provide for full payment of debt service on the certificates. Certificate proceeds will be used for various improvements to the city's waterworks and sewer system.

For Type A general law municipalities, state statutes provide for a maximum ad valorem tax rate of $1.50 per $100 of taxable assessed value (AV) for all city purposes. However, the Texas attorney general permits the allocation of $1.00 of the $1.50 maximum tax rate for ad valorem tax debt service. For fiscal 2021, the city's total tax rate is well below the maximum at 60 cents per $100 of taxable AV, including 10.8 cents for debt service. Despite state statutory tax rate limitations, we do not differentiate between the city's limited-tax debt and its general creditworthiness, because the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the city's overall ability and willingness to pay debt service.

### Credit overview

Located just south of Dallas, along Interstate 45, the city has experienced recent strong growth, with taxable values increasing 67% in three years. With additional development planned, the city is poised to see rapid population growth, likely leading to improved resident income and wealth levels. Along with the growth, the city will face challenges in the form of increased capital and infrastructure needs. However, the city is well positioned, with very strong general fund reserves, and it monitors budget-to-actual financial performance monthly with the city council. Management of rapid growth would be helped by a multiyear financial forecast, which the city currently lacks. As yet, the city has not been affected by the COVID-19 pandemic as most of its revenues come from property taxes and landfill dumping fees, which have not experienced a decline. For S&P Global Economics' 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.

The rating reflects our opinion of the city's:

- Weak economy, with projected per capita effective buying income at 63.2% and market value per capita of $61,985, offset by its 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;
- Very strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong liquidity, with total government available cash at 57.2% of total governmental fund expenditures and 5.4x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 10.7% of expenditures and net direct debt that is 255.3% of total governmental fund revenue, as well as high overall net debt at greater than 10% of market value; and
- Strong institutional framework score.

### Environmental, social, and governance (ESG) 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 also incorporates our view of the risks posed by the COVID-19 pandemic to public health and safety as a social risk. Absent the implications of COVID-19, we consider the city's social risks to be in line with those of the sector.

## Stable Outlook

### Downside scenario

We could consider a lower rating if the city's financial profile weakens and the city is unable to balance growth-driven needs and one-time spending while maintaining balanced operations .

### Upside scenario

Although not expected, we could consider a higher rating if the city were to develop long-term financial planning and resident wealth and income levels were to improve markedly, all other factors remaining consistent.

## Credit Opinion

### Weak economy

We consider Ferris' economy weak. The city, with an estimated population of 2,930, is located in Dallas and Ellis counties 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 63.2% of the national level and per capita market value of $61,985. The city's market value was stable over the past year at $181.6 million in 2021. The weighted-average unemployment rate of the counties was 3.1% in 2019.

The city, located approximately 20 miles south of Dallas on Interstate 45, is primarily a residential suburb along the southern border of the Dallas-Arlington-Fort Worth MSA. Residents have access to employment centers throughout the MSA, as well as to several major employers within the city, including Waste Management and Atco products, a manufacturer of automotive air conditioning components. While the city historically has been somewhat rural with limited growth, its AV has improved significantly to $181.6 million from $108.8 million in fiscal 2017 (a 67% increase). This growth has been attributable largely to single-family residential construction, which accounts for 56% of the city's total appraised value.

Favorably, the city reports significant single-family growth, with 500 homes already permitted this year, compared with 73 total permits issued last year. We note that the Woodstone development may annex into the city. The development consists of 5,800 acres, and home prices will range from $350,000 to $1 million. However, the first phase consists of approximately 100 acres and will feature 82 homes and some commercial development. Officials also report a smattering of new small retailers such as coffee shops. A large glass manufacturer is expected to open within the next 18 months. Given the planned single-family developments, we believe that the city will continue experiencing rapid AV and population growth, which will likely materialize in improved wealth and income metrics.

### Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or regularly monitor all of them.

We revised the city's FMA to good from standard based on management's adoption of a new comprehensive debt management policy and a return to the practice of monthly budget-to-actual financial performance reports submitted to city council.

Current practices include:

- The city uses historical trends and outside sources to make informed revenue and expenditure assumptions. The city also Implemented a zero-based budget this year and requires justifying budgets at the department level.
- The city has a formal investment management policy that is reviewed annually and complies with state law. Quarterly investment reports are provided to the city council.
- The city has also adopted a formal general fund reserve policy, which requires it to maintain a minimum balance of 25% of expenditures (excluding capital outlay). The policy allows for the city to deal with large swings in revenue or cope with natural or fiscal emergencies, and includes a replenishment provision if reserves fall to less than 25%.
- Long-term planning includes an annually updated strategic plan outlining a five-year plan for major initiatives, but lacks a detailed multiyear operating financial forecast.
- We understand that as part of the five-year strategic plan, the city plans to include a multiyear capital plan that would be updated every three years.
- The city adopted a debt management policy in March 2021. The policy is comprehensive and provides parameters

and measurable benchmarks and limitations for its debt, including minimum amortization rate 25% over 10 years, principal portion of general fund debt not to exceed 6% of AV, and debt service carrying charges not tied to a specific revenue source restricted to a maximum of 40% of general fund revenue.

### Very strong budgetary performance

Ferris' budgetary performance is very strong, in our opinion. The city had operating surpluses of 14.8% of expenditures in the general fund and of 12.2% across all governmental funds in fiscal 2019. Our assessment accounts for our expectation that budgetary results could improve from 2019 results in the near term.

Our opinion of the city's budgetary performance includes adjustments to account for recurring transfers into the general fund from the city's water and wastewater fund. While the city outperforms budgets, it has posted deficits in two of the past three audited years (2016 and 2018). While the deficits appear to be attributable to largely capital and construction, we have made no adjustments to the reported figures. In fiscal 2018, these purchases of land, equipment, and infrastructure improvements led to a $248,000 reduction in the general fund balance.

The city's primary sources of revenue (in fiscal 2019) were host fees paid by Waste Management and other regional collectors for dumping (accounting for 45% of general fund revenue), followed by property taxes (at 20%), and fines and forfeitures (accounting for 10%). The current agreement with Waste Management expires in 2045, and the landfill has an estimated 25- to 30-year life remaining. Management reports that there is no competition and the majority of the county uses the landfill. The city also collects sales taxes, which made up only 8% of revenue, generated from essential retailers such as gas stations and grocery stores.

Officials report the fiscal 2019 positive general fund results were largely due to an increase in host fees and a few vacant positions. Fiscal 2020 unaudited actual results include a return to general fund deficits, although very minor, as a result of the purchase of a $791,000 fire truck. The general fund budget for fiscal 2021 includes a surplus, which management attributes to new construction and better tracking and development of development-related fee schedules. They have also added several positions in specializations to support their growth, such as code compliance and city planners. These positions are offset by new property tax revenue.

### Very strong budgetary flexibility

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 budgetary flexibility with reserves exceeding 30% of expenditures in each of the past three fiscal years, despite reductions in available fund balance for capital outlay. With no plans to spend down, combined with the balanced budget for 2021, we believe the city will maintain its very strong budgetary flexibility in excess of 30% of expenditures.

### Very strong liquidity

In our opinion, Ferris' liquidity is very strong, with total government available cash at 57.2% of total governmental fund expenditures and 5.4x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

In our view, the city has strong access to external liquidity if necessary given its relatively frequent history of

GO-supported debt issuance over the past 20 years. All of the city's funds are held in collateralized deposit accounts. While we note that the city has privately placed its series 2006 certificates of obligation, there are no nonstandard events of default or acceleration risks that we believe would stress the city's liquidity position. Based on the city's historical maintenance of very strong liquidity, we do not expect this score to change over the next few years.

### Very weak debt and contingent liability profile

In our view, Ferris' debt and contingent liability profile is very weak. Total governmental fund debt service is 10.7% of total governmental fund expenditures, and net direct debt is 255.3% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 12.4% of market value.

To support growth, the city is planning a GO bond election in May to request voter authorization for about $3.5 million for public safety infrastructure and $6 million fiber network. The public safety project would include construction of larger and additional facilities for police and fire departments. The additional debt would likely weaken the city's already-heavy debt burden. However, we understand that the city has passed a water and sewer rate increase that will help support pay existing bond debt service. In addition, a portion of the debt is designated for police and fire infrastructure to support the proposed annex of the 5,800-acre development, which would significantly bolster AV as it comes online.

Ferris' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 2.9% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

Pension and OPEB liabilities

We don't believe that postemployment benefit costs will pressure the city's financial or liability profile, largely as a result of the strong funding status of the city's largest retirement plan that results in affordable contributions.

The city participates in the following defined benefit plans:

- Texas Municipal Retirement System (TMRS), an agent multiple-employer plan: 92.2% funded as of Dec. 31, 2018, with a net pension liability of about $301,000;
- Texas Emergency Services Retirement System (TESRS), a cost-sharing multiple-employer plan: 80.3% funded, with a net pension liability of about $27,000; and
- For OPEB, it has no retirement health care benefit, only a supplemental death benefit.

For TMRS, given that it is an agent plan, assets are jointly managed. The plan uses a discount rate of 6.75%, which could lead to some contribution volatility. However, TMRS' asset valuation method helps stabilize contribution rates. The plan's strong funding status and generally sound funding assumptions result in a minimal annual contribution. TESRS provides pension benefits for volunteer firefighters and the city is considered a nonemployer contributing entity. Contributions to the plan are statutorily based, and the state of Texas is required to contribute to make the fund actuarially sound. In fiscal 2018, contributions to the fund exceeding our minimum funding progress metric, though the plan discount rate is elevated at 7.75%, which could subject the plan to market volatility in the future.

### 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 March 31, 2021) | | |
|---|---|---|
| Ferris tax & wtrwks & swr sys (ltd pledge) rev certs of oblig ser 2020 dtd 01/15/2020 due 03/01/2040 | | |
| *Long Term Rating* | AA-/Stable | Affirmed |