

RatingsDirect®

Summary:

Red Oak, Texas; General Obligation

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Credit Profile

US\$4.33 mil comb tax & rev certs of oblig ser 2021 dtd 08/01/2021 due 02/15/2041

Long Term Rating AA/Stable New

US\$1.245 mil tax nts ser 2021A dtd 08/01/2021 due 02/15/2028

Long Term Rating AA/Stable New

Rating Action

S&P Global Ratings has raised its long-term rating on the City of Red Oak, Texas' limited-tax debt to 'AA' from 'AA-'. At the same time, we have assigned our 'AA' rating to the city's \$4.3 million combination tax and revenue certificates of obligation series 2021 and \$1.2 million tax notes series 2021A. The outlook is stable.

The certificates and tax notes are secured by the levy and collection of a direct and continuing annual ad valorem tax, within the limits prescribed by law, upon all taxable property within the city, as well as a pledge of the surplus revenue of the city's waterworks and sewer system. Proceeds from the sale of certificates and tax notes will fund various projects and equipment purchases throughout the city.

State statutes limit the ad valorem tax rate to \$2.50 per \$100 of taxable assessed valuation for all city purposes. Administratively, the Texas attorney general will permit the allocation of \$1.50 of the \$2.50 maximum tax rate for ad valorem tax 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. Given the limited nature of the additional pledged utility revenues, we base our ratings on these obligations on the city's limited-tax GO pledge.

Credit overview

The upgrade to 'AA' reflects the district's rapidly growing tax base, increase in available fund balance that is supported by strong fiscal management practices, and an expectation that future debt will be issued strategically and will not place a significant burden on the district's fiscal metrics nor its liquidity. Red Oak continues to benefit from its favorable location in the greater Dallas-Fort Worth metropolitan statistical area (MSA), as well as its strategic location along a major transportation artery. As a result, it has experienced solid market value growth and current development trends should result in further tax base expansion in the near term. The city has maintained stable fiscal performance and has added to fund balance in recent years despite a growing population and service demand, all of which contribute to the upgrade and stable outlook. Future credit reviews will focus on Red Oak's ability to maintain stable fiscal and other key credit metrics while expanding.

The rating reflects our view of the city's:

- Strong economy, with access to a broad and diverse 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 36% of operating expenditures;
- Very strong liquidity, with total government available cash at 120.5% of total governmental fund expenditures and 6.3x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 19.2% of expenditures and net direct debt that is 142.7% of total governmental fund revenue, but rapid amortization, with 69.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We have assessed the city's ESG risks relative to the economy, financial management, fiscal performance, as well as its debt and liability profile, and determined that all are in line with our view of the sector standard. When compared with areas in the country experiencing population loss, the city's substantial population growth exhibits a demographic trend that we believe is a social opportunity, as service costs are spread across a larger base and ongoing residential development contributes to tax base growth.

Stable Outlook

Upside scenario

We could raise the rating if key economic metrics and available fund balance continue to strengthen while the city's overall debt profile declines.

Downside scenario

We could lower the rating if weak budgetary performance were to cause a decline in available fund balance.

Credit Opinion

Strong economy

We consider Red Oak's economy strong. The city, with an estimated population of 14,532, is in Ellis County in the Dallas-Fort Worth-Arlington, TX MSA, which we consider broad and diverse. The city has projected per capita effective buying income of 93.1% of the national level and per capita market value of \$87,594. Overall, its market value grew by 10.5% over the past year to \$1.3 billion in 2021. The county unemployment rate was 6.0% in 2020.

The city benefits from a favorable location near the metro areas of Fort Worth and Dallas as well as the main transportation artery of Interstate 35. Annual market value growth and development have been solid in recent years.

Officials anticipate low-to-mid double-digit year-over-year percentage growth in market values. Several new single-family residential developments are underway in the city. Approximately 532 new single-family residences are planned for construction during fiscal years 2021-2022, and 1,569 new lots are planned for construction from 2022-2024. The average permitted valuation per single-family residence is \$362,760. During 2020, 337 residential building permits were issued, an increase of 120 from the previous year. Several new restaurants, as well as a large movie theater complex, are opening in Red Oak. The city is also home to Triumph Aerostructures, a manufacturer of civilian and military aircraft parts that opened in 2012. The manufacturer is the city's largest employer and continues to expand operations. The top 10 taxpayers are diverse, make up 10.8% of the total tax base, and include several apartment complexes, retail plazas, and a nursing home. Given the city's favorable location and ongoing developments, we expect key economic metrics will remain stable and strong over the near to medium term, which supports the upgrade and stable outlook.

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 monitor all of them on a regular basis.

Key fiscal management practices and policies include the use of three years of historical data and other data sources when developing revenue and expenditure assumptions. Management provides monthly reports on budget-to-actual results to the city council, which can amend the budget as needed. Red Oak has a rolling five-year capital improvement plan with identified funding sources for the upcoming year in the annual budget. In addition, it maintains a 10-year water capital improvement plan and a 10-year sewer plan. A list of projects is provided to council, but no years and funding sources are identified. The city has a formal investment policy, and staff and council members monitor policy investments and compliance monthly. It does not have a formal debt policy but adheres to processes to ensure bond proceeds are spent as required and accounted for properly. A formal reserve policy requires holding 45 days' expenditures in general fund reserves.

Strong budgetary performance

Red Oak's budgetary performance is strong in our opinion. The city had operating surpluses of 8.5% of expenditures in the general fund and 44.8% across all governmental funds in fiscal 2020. Although for fiscal 2021 we expect Red Oak to have at least balanced operating results, we do not expect they will be as favorable as they were in 2020.

Despite some economic disruptions associated with the pandemic, key revenue streams remain strong. For fiscal 2020, general fund revenue was primarily derived from property taxes (45.7% of total general fund revenue), sales taxes (21%), intergovernmental revenue (10.3%), and licenses and permits (8%). Similar to other cities, Red Oak's major general fund expenditure was for public safety. The city has a history of producing surplus operations in the general fund. Given concerns over the potential influence of the pandemic on revenue in 2020, capital expenses and raises for city personnel were postponed while performance was reviewed to ensure sufficient funding for these expenses remained. Fiscal year-end revenue for the general fund was \$1.3 million higher than the adopted budget. In addition, expenditures ended \$1.6 million below the adopted budget, which supported positive results.

Year-to-date projected revenue assumptions are exceeding the budget, and operating expenditures are estimated at

below budget. The city budgeted more conservatively than it traditionally does, due to remaining concerns over the pandemic. Its future fiscal interests target growth and increased service demands. The city anticipates American Rescue Plan Act funds will be used for near-term infrastructure projects, which should support general stability in fiscal metrics. Future credit reviews will focus on the city's ability to manage its budget and financial performance accordingly, with the understanding that budget growth is expected in the coming years.

Very strong budgetary flexibility

Red Oak's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 36% of operating expenditures, or \$4.6 million.

The available general fund reserve has increased in recent years. Although officials will continue to look for opportunities to cash fund some one-time capital projects, we do not expect Red Oak to draw reserves down below very strong levels or below its formal reserve target of 45 days of expenditures.

Very strong liquidity

In our opinion, Red Oak's liquidity is very strong, with total government available cash at 120.5% of total governmental fund expenditures and 6.3x governmental debt service in 2020. In our view, the city has strong access to external liquidity if necessary.

Red Oak demonstrates its strong access to external liquidity through its market access and issuance of tax-backed bonds during the past 20 years. It has historically held very high cash balances. Given current financial performance trends, we do not think cash will likely decrease in the near term. All city investments comply with Texas statutes and city investment policies, and we do not view them as aggressive. In addition, Red Oak has privately placed a portion of its debt. Bond terms are standard and do not contain any unusual provisions, such as acceleration, that could pressure liquidity.

Weak debt and contingent liability profile

In our view, Red Oak's debt and contingent liability profile is weak. Total governmental fund debt service is 19.2% of total governmental fund expenditures, and net direct debt is 142.7% of total governmental fund revenue.

Approximately 69.9% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Post-sale, the city will have approximately \$40.2 million in limited-tax general obligation parity debt outstanding. Payout of debt is rapid, with nearly 70% of principal retired in 10 years. Red Oak historically has issued tax notes to fund capital expenditures on an annual basis. Officials anticipate future debt issuance in the next two years, although we do not believe the city's debt profile will materially change or stress finances in the near term.

Red Oak's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.0% of total governmental fund expenditures in 2020. The city made its full required pension contribution in 2020.

Pension and OPEB liabilities:

We do not consider pension liabilities as a source of long-term credit pressure for Red Oak.

The city participates in the following plans:

- Texas Municipal Retirement System, funded at 89.7%; with a net pension liability of \$1.1 million; and
- Supplemental Death Benefits Fund (SBDF), with a net liability of \$214,339.

In general, we expect pension plan contributions to meet minimum funding progress. For the year ended Sept. 30, 2020, the city recognized OPEB expenses in governmental activities and business-type activities of \$20,010 and \$3,341, respectively.

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

Ratings Detail (As Of July 21, 2021)		
Red Oak GO		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Red Oak GO		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Red Oak GO (AGM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
Red Oak GO (BAM)		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

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