S&P Global
Ratings

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Summary:
Mesquite, Texas; General Obligation

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Summary:

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Credit Profile		
US$35.02 mil GO rfdg and imp bnds ser 2018 due 02/15/2038		
Long Term Rating	AA/Stable	New
US$17.67 mil comb tax and ltd surplus rev certs of oblig ser 2018 due 02/15/2038		
Long Term Rating	AA/Stable	New
Mesquite GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating to the city of Mesquite, Texas' series 2018 general obligation (GO) refunding and improvement bonds, and to the city's series 2018 combination tax and limited-surplus revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating on the city's GO debt outstanding. The outlook is stable.

The series 2018 bonds are payable from the levy and collection of a direct and continuing ad valorem tax levied, within the limits prescribed by law, on all taxable property within the city. The series 2018 certificates of obligation are secured by a direct and continuing ad valorem tax, as well as a surplus net revenue pledge of the city's waterworks and sewer system, not to exceed $1,000. Despite the additional de minimis revenue pledge, we rate the debt based on the city's GO pledge, which we view as the stronger pledge. Texas state law limits cities to a total property tax rate of $2.50 per $100 of assessed value (AV)--$1.50 of which can be allocated for debt service. Mesquite's levy is well below the maximum at 68.7 cents, of which 23.7 cents is dedicated to debt service. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Jan. 22, 2018, on RatingsDirect), we do not differentiate between the city's limited-tax GO debt and its general creditworthiness. Bond proceeds will partially refund the city's series 2008 certificates of obligation and series 2008 GO refunding bonds outstanding, and will finance improvements related to city streets, sidewalks, and drainage infrastructure. Certificate proceeds will finance street, sidewalk, and drainage infrastructure, as well as the purchase of new information technology infrastructure, new public vehicles, and fund an assortment of improvements to existing city facilities.

The rating reflects our opinion of the city's:

- Weak economy, with projected per capita effective buying income at 77.4% and market value per capita of $49,600, though that is advantageously gaining from 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;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2017;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 61.0% of total governmental fund expenditures and 5.2x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 11.8% of expenditures and net direct debt that is 133.6% of total governmental fund revenue; and
- Strong institutional framework score.

Weak economy

We consider Mesquite's economy weak. The city, with an estimated population of 143,060, is located in Dallas and Kaufman counties in the Dallas-Fort Worth-Arlington MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 77.4% of the national level and per capita market value of $49,600. Overall, the city's market value grew by 5.6% over the past year to $7.1 billion in 2018. The weight-averaged unemployment rate of the counties was 4% in 2016.

Spanning an area of roughly 46 square miles, the city of Mesquite is located 12 miles east of downtown Dallas along Interstate 30 and US Highway 80. The local economy--largely based in retail, manufacturing, and health care--has benefitted from the robust growth within the Dallas-Fort Worth metroplex in recent years, both geographically and economically. Primary employers in fiscal 2017 were represented by Mesquite Independent School District (with 4,000 employees), Town East Mall (2,750), the United Parcel Service Inc. (2,300), and Dallas Regional Medical Center (1,500). We consider the local tax base very diverse, as the top 10 taxpayers constituted only 7.6% of taxable AV in fiscal 2017. Taxable AV itself has demonstrated steady year-over-year growth since fiscal 2014, and management expects this trend to continue in line with ongoing development.

Both residential and commercial development have contributed to measured, healthy AV growth in recent years. Following a year of strong commercial development in fiscal 2017 in which multiple retail enterprises opened or began construction, city officials anticipate that commercial development will reach record levels in the near term, with an assortment of new retail, hotel, and restaurant employers coming online. Most notably, Ashley Furniture is expected to open its new 877,000 square foot manufacturing and distribution facility by year-end 2018, which will further strengthen the city's taxable value and employment base. Residential development likewise continues to represent a reliable source of taxable value growth for Mesquite, and multiple new subdivisions are poised to begin or continue selling homes in calendar year 2018.

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.

Mesquite utilizes five years of historical data and consults with outside sources when developing revenue and expenditure assumptions for its annual budget. Conservative positions are typically used when compared to historical trends. Budget-to-actual financial results are presented to the city council on a monthly basis, and budget amendments--while typically done once each year--can be made at any time if needed. The city utilizes a formal long-term financial plan that projects revenues and expenditure for a 10-year period, and attempts to forecast large, one-time expenditures. The plan is updated annually and includes conservative assumptions. Mesquite additionally maintains a formal five-year capital improvement plan, which is updated annually and identifies funding sources for projects. The city's formal investment policy is also reviewed annually, and investment earnings and holding are presented to council on a quarterly basis. Management adheres to a formal debt management policy that is frequently reviewed and sets comprehensive limitations on debt issuances. The city has a formal reserve policy of maintaining 15% of operating expenditures in reserve, which is based on working capital needs.

Strong budgetary performance

Mesquite's budgetary performance is strong in our opinion. The city had surplus operating results in the general fund of 1.6% of expenditures, and slight surplus results across all governmental funds of 0.6% in fiscal 2017. General fund operating results of the city have been stable over the last three years, with a result of 1.5% in 2016 and a result of negative 0.4% in 2015.

In assessing the city's budgetary performance, we made adjustments for recurring transfers into and out of the general fund, and for expenditures toward one-time capital projects across total governmental funds with the use of debt proceeds.

After initially budgeting for balanced operations in fiscal 2017, the city's general fund surplus of $1. million after transfers resulted from the outperformance of revenues by $1.5 million, which eclipsed a $379,000 negative variance in expenditures from budget. Management attributes revenue growth to strengthening ad valorem taxes in tandem with increased AV, as well as increases in sales tax collections corresponding with a growing local economy. Adversely influencing general fund results were police service expenditures, which finished $1.2 million over budget stemming from increased overtime pay and training time expenses for the implementation of new software systems. Ad valorem taxes accounted for 42% of general fund revenues in fiscal 2017, with sales taxes (31%) and charges for services (13%) constituting the next two largest sources--all of which have remained stable in recent years.

The city once again budgeted for break-even general fund operations in fiscal 2018, and management reports that revenues and expenditures are trending ahead of expectations thus far. Therefore, the city may finish with a surplus as large as $500,000. While a $1.1 million negative position held in the city's group health insurance fund has been identified by management as a potential contributing factor to future budgetary performance, given the size and strength of the city's budgetary position, we believe performance will remain strong in the near term.

Very strong budgetary flexibility

Mesquite's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 17% of operating expenditures, or $18.4 million.

The city has historically maintained very strong reserve levels, exceeding its formal policy of 15% operating expenditures. Surplus results in fiscal 2017 allowed the city to grow both overall and unassigned fund balance by an additional $1.9 million and 1.3 million, respectively, and despite budgeting for balanced operations in fiscal 2018, management anticipates once more adding to fund balance. Furthermore, management reports no intention to draw below its formal target in the future. Therefore, we expect budgetary flexibility to remain very strong in the near future.

Very strong liquidity

In our opinion, Mesquite's liquidity is very strong, with total government available cash at 61% of total governmental fund expenditures and 5.2x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

Mesquite's strong access to external liquidity is demonstrated by its access to the market over the past two decades, which includes numerous GO-and utility-supported bond issuances. It has historically maintained what we consider very strong cash balances, and given our expectation for balanced operations in fiscal 2018, we do not believe its cash position will materially weaken in the near term. All of the city's investments comply with both Texas statutes and its own formal policy, and were held in certificates of deposit, agency notes, money markets, and local government investment pools at the end of fiscal 2017--none of which we consider aggressive. Additionally, we have not identified contingent liabilities that could pose a material risk to liquidity. Therefore, we do not expect the city's liquidity position to deteriorate from its very strong position in the near term.

Weak debt and contingent liability profile

In our view, Mesquite's debt and contingent liability profile is weak. Total governmental fund debt service is 11.8% of total governmental fund expenditures, and net direct debt is 133.6% of total governmental fund revenue.

In November of 2015, voters authorized $125 million in GO bonds for residential street construction. Following the issuance of the series 2018 bonds and certificates, the city plans to issue roughly $58 million of additional debt over the next two years. Given these medium term debt plans, we anticipate the city's debt burden will likely remain elevated in the near term. However, we expect the city will continue to issue debt once sufficient tax base growth has occurred to support it, as not to significantly elevate the debt profile. The city has no variable rate debt, nor is it party to any swap agreements. It will amortize roughly 62.9% of total direct debt over the next 10 years, which we consider above-average.

Mesquite's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 7.2% of total governmental fund expenditures in 2017. Of that amount, 5.6% represented required contributions to pension obligations, and 1.6% represented OPEB payments. The city made its full annual required pension contribution in 2017.

Mesquite provides pension benefits for all full-time employees through the statewide Texas Municipal Retirement System (TMRS), an agent multiemployer, public-employee retirement system. Under state law governing TMRS, an actuary determines the contribution rate annually, and the city contributes to the TMRS plan at the actuarially determined rate. The city recorded a net pension liability of $125.8 million as of Sept. 30, 2017. The reported funding ratio for the plan was 76.1%, calculated as plan fiduciary net position over total pension liability, compared to 76.5% following fiscal 2016. While we do not anticipate short-term, fixed-cost pressure resulting from the city's TMRS obligations, the amortization period is long in our view (29 years as of Dec. 31, 2016), and the level percentage of payroll amortization method (assuming 3.5% annual payroll growth) creates negative amortization where the net pension liability is expected to grow each year until contributions become large enough to reduce the unfunded liability. Therefore, we acknowledge the potential for the city's pension-related costs to increase in the longer-term, though we anticipate that any near-term increases should be manageable given the city's strong financial position and budgetary performance.

The city provides other postemployment benefits in the form of post-retirement healthcare, which it funds on a pay-as-you-go basis. It contributed $2.3 million toward OPEB in fiscal 2017, representing 86.5% of its annual OPEB cost, and reported an unfunded actuarial accrued liability of $38.9 million at fiscal year-end.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our view of the city's stable and improving economy within the broad and diverse Dallas-Fort Worth metroplex, its very strong flexibility and liquidity, and very strong management, which has contributed to strong budgetary performance and surplus operations in recent years. It also reflects our expectation that the city's debt profile will remain elevated, corresponding with anticipated growth and planned future debt issuances. Therefore, we do not expect to change the rating during the two-year outlook horizon.

Upside scenario

All else held equal, we could raise the rating if the city were to experience economic expansion and diversification, leading to improvements in wealth and income indicators similar to those of higher-rated peers. Continuing improvement of the city's debt profile could also lead us to raise the rating.

Downside scenario

We could lower the rating if the city's financial performance deteriorates--potentially stemming from fixed cost pressure resulting from growing pension-related liabilities--leading to sustained and significant draw downs in reserves.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

Ratings Detail (As Of April 25, 2018)		
Mesquite GO		
Long Term Rating	AA/Stable	Affirmed
Mesquite GO		
Long Term Rating	AA/Stable	Affirmed
Mesquite GO		
Long Term Rating	AA/Stable	Affirmed
Mesquite GO		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of April 25, 2018) (cont.)		
Mesquite GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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