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**Summary:**

# Mesquite, Texas; General Obligation

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## Table Of Contents

**Summary:**

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| Credit Profile | | |
|---|---|---|
| US$10.165 mil comb tax & ltd surplus rev certs of oblig ser 2019 dtd 05/01/2019 due 02/15/2039 | | |
| *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 2019 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 general obligation (GO) debt outstanding. The outlook is stable.

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. Mesquite's GO bonds outstanding 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. 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 73.4 cents, of which 24.6 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 Mesquite's general creditworthiness.

Certificate proceeds will finance street, sidewalk, and drainage infrastructure, the purchase of new information technology infrastructure, and new public vehicles, as well as fund an assortment of improvements to existing city facilities.

Located in the Dallas-Fort Worth (DFW) metroplex, the city benefits from a broad and diverse tax base. Although Mesquite generally has lower income and wealth indicators than similarly rated cities, we believe the economic expansion under way represents a healthy local economy that is consistent with the current rating. Ongoing residential and commercial development is expected to continue with several significant projects planned or under way. The city also demonstrates strong management, very strong reserves, and manageable debt.

The rating further reflects our opinion of Mesquite's:

- Adequate economy, with projected per capita effective buying income at 73.7% and market value per capita of $56,185;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and break-even operating results

at the total governmental fund level in fiscal 2018;

- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 16% of operating expenditures;
- Very strong liquidity, with total government available cash at 130.3% of total governmental fund expenditures and 10.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 12.1% of expenditures and net direct debt that is 126.8% of total governmental fund revenue, as well as rapid amortization, with 66.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

### Adequate economy

We consider Mesquite's economy adequate, an improvement from our view that the economy was weak about a year ago. The improvement is primarily driven by an increase in the per capita market value to $56,185. The city, with an estimated population of 143,350, is located in Dallas and Kaufman counties in the Dallas-Fort Worth-Arlington metropolitan statistical area, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 73.7% of the national level. Overall, the city's market value grew by 13.5% over the past year to $8.1 billion in 2019. The weight-averaged unemployment rate of the counties was 3.8% in 2017.

Mesquite benefits from its location 12 miles east of downtown Dallas along Interstate 30 and U.S. Highway 80. The local economy--largely based in retail, manufacturing, and health care--has benefitted from the robust growth within the DFW metroplex in recent years, both geographically and economically. Primary employers are 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 5.45% of taxable AV in fiscal 2019. Taxable AV has demonstrated steady year-over-year growth averaging approximately 9% annually since fiscal 2014.

Both residential and commercial development have contributed to healthy AV growth in recent years. Many new restaurants, hotels, and retail operators are locating within the city limits. Most notably, Ashley Furniture will open its new 877,000-square-foot manufacturing and distribution facility in the first half of 2019. The facility exceeds a capital investment of $65 million and is expected to bring in approximately 350 jobs. Residential development remains strong with several large subdivisions under way or breaking ground and some that are within a public improvement district with mixed-use development including retail, restaurants, and park space. Officials believe that improvement at the airport will likely open some additional opportunities now that the runway can accommodate larger company jets. We believe the city will continue to experience strong economic growth at rates that are at least similar to the historical trend.

### Very strong management

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

Mesquite uses 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. Mesquite uses a formal long-term financial plan that projects revenues and expenditure for a 10-year period, and the city attempts to forecast future large one-time expenditures. The plan is updated annually and includes conservative assumptions. In addition, Mesquite 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 recently updated formal reserve policy to "maintain 60 days of general fund budgeted revenues with an initial goal of 70 days and long-term goal of 90 days, which is based on working capital needs. Although the general fund may not initially meet the minimum requirements in the policy, the general fund shall be in compliance with the policy as long as the financial position shows continuous improvement each year."

### Strong budgetary performance

Mesquite's budgetary performance is strong in our opinion. The city had slight surplus operating results in the general fund of 0.9% of expenditures, and balanced results across all governmental funds of negative 0.1% in fiscal 2018. General fund operating results of the city have been stable over the last three years, with a result of 1.6% in 2017 and a result of 1.5% in 2016.

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.

Mesquite generally adopts balanced budgets and conservative budgeting supports year-end surpluses. For example, fiscal 2017 resulted in a $1 million surplus due to strong revenue performance in sales tax collections.

The city once again budgeted for break-even general fund operations in fiscal 2018 although the year ended with another $1 million surplus. Mesquite's general fund revenues are derived 44% from property taxes, 30% from sales taxes, 13% from charges for service, and 13% from other sources. All of the main revenues sources were over budget, which offset over spending in fire, police, and park services.

The 2019 budget is balanced for revenues and expenditures, and ongoing growth in property and sales tax revenues has allowed the city to address priorities such as public safety and road maintenance. Sales tax revenues as of March 2019 are up 1.81% over the previous year, which is approximately $195,000. In addition, property tax collections have been strong and are expected to provide an additional $4.1 million over the previous year. The city also continues to implement salary adjustments, which are estimated to total $3.7 million for the general fund in fiscal 2019. Given historical results and Mesquite's demonstrated trend of conservative budgeting, we believe budgetary performance will remain strong.

Management is focused on addressing the deficit position of the city's group health insurance fund. The fund ended fiscal 2018 with a $558,708 surplus, which reduced the negative fund balance to $4.6 million. Plan changes in 2019 include a 10% increase for the city and for employees and the renewed contract with the insurance carrier is expected to produce larger network discounts with a positive effect overall claims. Although it will take time, improvements toward balancing the fund indicate that it will not be a growing risk to the city's overall fiscal health.

### Very strong budgetary flexibility

Mesquite's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 16% of operating expenditures, or $19 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 17% of expenditures in 2017 and in 2016.

The city has historically maintained very strong reserve levels supported by conservative budgeting and year-end surpluses. Surplus results in fiscal years 2017 and 2018 allowed Mesquite to grow both the overall and unassigned fund balances by an additional $1.3 million and $577,000, respectively. Management intends to use the next few years of economic expansion to continue increasing the general fund balance so that Mesquite is financially secure for any economic slowdown that might occur. We believe the city will maintain its very strong general fund balance given that it has no plans to draw down on it and its historical practice of allowing operating surpluses to increase the amount in reserves.

### Very strong liquidity

In our opinion, Mesquite's liquidity is very strong, with total government available cash at 130.3% of total governmental fund expenditures and 10.8x governmental debt service in 2018. 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 2019, 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--none of which we consider aggressive. In addition, 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.

### Adequate debt and contingent liability profile

In our view, Mesquite's debt and contingent liability profile is adequate. Total governmental fund debt service is 12.1% of total governmental fund expenditures, and net direct debt is 126.8% of total governmental fund revenue. Approximately 66.9% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city generally issues certificates of obligation each year to supplement a larger bond election. The last bond election for $125 million was approved in November of 2015 for residential street construction. The authorized but unissued amount from this authorization totals $66.35 million, and $33 million of that is expected to be issued in 2020. Given these medium-term debt plans, we anticipate Mesquite'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 66.9% of total direct debt over the next 10 years, which we consider above average.

Mesquite provides pension benefits for all full-time employees through the statewide Texas Municipal Retirement System (TMRS), an agent multiple-employer, 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. Mesquite made its annual contribution of $9.7 million and had a net pension liability of $103.9 million as of Sept. 30, 2018. The reported funding ratio for the plan was 81%, calculated as plan fiduciary net position over total pension liability. 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 and the level percentage of payroll amortization method (assuming 3% 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 long term, though we anticipate that any near-term increases should be manageable given Mesquite's strong financial position and budgetary performance.

The city provides other postemployment benefits (OPEB) in the form of postretirement health care, 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 DFW metroplex, Mesquite's very strong flexibility and liquidity, and the city's demonstrated ability to maintain balanced operations. It also reflects our expectation that Mesquite'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 moderation of Mesquite's debt profile could also lead us to raise the rating.

### Downside scenario

We could lower the rating if the city's financial performance deteriorate leading to a sustained and significant drawdown in reserves.

## Related Research

- 2018 Update Of Institutional Framework For U.S. Local Governments

| Ratings Detail (As Of April 11, 2019) |
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| Ratings Detail (As Of April 11, 2019) (cont.) | | |
|---|---|---|
| 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 |
| **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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.