S&P Global Ratings

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Summary:

Mesquite, Texas; General Obligation

Primary Credit Analyst:
Andy A Hobbs, Farmers Branch + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

Secondary Contact:
Stephen Doyle, Farmers Branch (1) 214-765-5886; stephen.doyle@spglobal.com

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Summary:

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Credit Profile		
US$14.955 mil GO bnds ser 2020 dtd 05/01/2020 due 02/15/2040		
Long Term Rating	AA/Stable	New
US$10.605 mil comb tax & ltd surplus rev certs of oblig ser 2020 dtd 05/01/2020 due 02/15/2040		
Long Term Rating	AA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA' rating to Mesquite, Texas' $14.9 million series 2020 general obligation (GO) bonds and $10.6 million series 2020 combination tax and limited surplus revenue certificates of obligation. At the same time, we affirmed our 'AA' GO rating on the city's existing parity limited-tax debt. The outlook is stable.

The obligations constitute direct obligations of the city, payable from the levy and collection of a direct and continuing ad valorem tax, within the limits prescribed by law, on all taxable property within the city. In addition, the certificates are secured by a limited pledge (not to exceed $10,000) of surplus net revenues of the city's waterworks and sewer system. Texas state law limits cities to a total property tax rate of $2.50 per $100 of assessed value (AV), $1.50 of which they can allocate for debt service. Mesquite's levy is well below the maximum at 73.4 cents, 23 cents of which it dedicates to debt service. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 19, 2019, we do not differentiate between the city's limited-tax GO debt and general creditworthiness.

Credit overview

The city has a history of maintaining strong-to-very strong financial metrics that are further supported by very strong fiscal management practices. Prudent fiscal practices coupled with solid key fiscal metrics have enabled Mesquite to pivot to managing any declines in revenues in the latter part of 2020. The advent of social distancing, restrictions in movement, and businesses stopping or modifying operations as a result of the spread of COVID-19 will have a negative impact on the local economy and the city's revenues, in particular sales tax revenues. S&P Global Economics recognizes consumer spending and business investment in the U.S. has been particularly affected by restrictions on movement and stay-at-home orders (see "An Already Historic U.S. Downturn Now Looks Even Worse," April 16, 2020). Future credit reviews will focus on what influence the current difficult situation has on the city, as well as the city's ability to respond in a timely and appropriate fashion to ensure maintenance of stable key credit metrics.

The rating reflects our assessment of Mesquite's:

- Adequate economy, with projected per capita effective buying income at 70.5% and market value per capita of $57,292, that is gaining advantage 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 (FMA) methodology;

- Adequate budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2018 results in the near term due to anticipated declines in sales taxes as a result of social distancing and disruptions in commerce;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 87.6% of total governmental fund expenditures and 6.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 13.5% of expenditures and net direct debt that is 135.3% of total governmental fund revenue; and
- Strong institutional framework score.

Stable One-Year Outlook

Downside scenario

We could lower the rating if Mesquite's financial performance deteriorates, affected by revenue decline, weak budget performance, rising fixed costs, or otherwise, leading to sustained and significant drawdowns in reserves.

Upside scenario

We could raise the rating if the city's economy were to expand and diversify, leading to improvements in wealth and income indicators similar to those of higher-rated peers. Moderation of the city's debt profile, while unlikely in the near term, could also lead us to raise the rating.

Credit Opinion

Adequate economy headed into environment of stress

We consider Mesquite's economy adequate. The city, with an estimated population of 153,129, is located in Dallas and Kaufman counties in the Dallas-Fort Worth-Arlington, TX MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 70.5% of the national level and per capita market value of $57,292. Overall, the city's market value grew by 8.9% over the past year to $8.8 billion in 2020. The weighted-average unemployment rate of the counties was 3.7% in 2018.

Despite the negative impacts of weak economic activity as a result of recent social distancing and efforts to combat the spread of COVID-19, we expect the local economy will remain relatively stable, given the trend of growth in market value, its favorable location in the Dallas MSA, and the trend of growing population in the north Texas region. Future credit reviews will evaluate any negative impacts to the local economy from the current unprecedented situation.

The city benefits from its favorable location 12 miles east of downtown Dallas along Interstate 30. The local economy--largely based in retail, manufacturing, and healthcare--has benefitted from the robust growth in the Dallas-Fort Worth metroplex in recent years, both geographically and economically. The city's market value, now over $8.7 billion, has experienced solid year-over-year growth averaging 8.2% annually since fiscal 2014. Primary employers include the local school district, a shopping mall, mailing services, a medical center, and a community college. We consider the local tax base very diverse, as the top 10 taxpayers make up a modest 5.3% of the total tax base. Despite the pandemic, we expect the city's market value will remain relatively stable.

Both residential and commercial development have contributed to the healthy market value growth in recent years. Although many new restaurants, hotels, and retail operators opening in the city have ultimately benefitted the local economy, the current situation has disrupted normal operations. Prolonged difficult conditions could significantly stress such businesses and dampen the local economy.

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 with historical trends. Budget-to-actual financial results are presented to the city council on a quarterly basis, and budget amendments--while typically done twice each year--can be made at any time if needed. The city uses a formal long-term financial plan that projects revenues and expenditure for a 10-year period, and attempts to forecast future large one-time expenditures. The plan is updated annually and includes conservative assumptions. Mesquite also maintains a formal five-year capital improvement plan, which is updated annually and identifies funding sources for projects. The plan is supported by a Capital Improvements Advisory Committee that serves in an advisory capacity to the city.

The city's formal investment policy is also reviewed annually, and investment earnings and holdings 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 policy includes provisions that total tax-supported debt shall not exceed 5% of total assessed value, debt service cost shall not exceed 25% of operating revenues, and the portion of the city's property tax rate levied for GO debt service shall not exceed 40% of the total tax rate. Mesquite has a recently updated formal reserve policy to maintain 60 days of general fund budgeted revenues with an initial goal of 70 days and a 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.

Adequate budgetary performance with anticipated decline in sales tax collections

Mesquite's budgetary performance is adequate in our opinion. The city had slight operating surpluses of 1.4% of expenditures in the general fund and of 0.8% across all governmental funds in fiscal 2019. General fund operating results of the city have been stable over the last three years, with a result of 0.9% in 2018 and 1.6% in 2017.

For fiscal 2019 the city's general fund revenues were primarily derived from property taxes (46%), sales taxes (28%), and charges for services (13%). We expect that sales tax collections will be directly affected by the restrictions in movement and disruption in operations of many retailers, hotels, and restaurants in the wake of the spread of COVID-19, but we believe a long history of stable and strong budgetary performance should allow the city to actively consider measured responses to any downturn in revenues. Throughout the beginning of fiscal 2020 through early March, the city reported solid sales tax collections approximately 8% higher than in the previous year. In recent years, Mesquite has experienced positive budget variances, which have benefitted stable revenue and expenditure expectations.

Officials anticipate a downturn in revenues for the latter part of 2020 and are identifying items in the budget they can make where reductions, in addition to thinking about the 2021 budget. The city has implemented a partial hiring freeze and property taxes, the vast majority of which have been collected for the year, are in line with budget. The city will examine what changes will be necessary throughout the end of the fiscal year (Sept. 30) and into fiscal 2021 to ensure adequate budgetary performance is maintained.

Very strong budgetary flexibility

Mesquite's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 17% of operating expenditures, or $20.8 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 16% of expenditures in 2018 and 17% in 2017.

The city has historically maintained very strong reserve levels supported by conservative budgeting and year-end surpluses. Surplus results in fiscal years 2017, 2018, and 2019 allowed Mesquite to increase both overall and unassigned fund balances. Despite the difficult conditions and expected decline in revenues, especially sales taxes in the latter part of 2020, the city intends to maintain very strong fiscal reserve levels. We believe it will take necessary steps to maintain at least strong reserves in the near term, which are supported by very strong fiscal management practices.

Very strong liquidity

In our opinion, Mesquite's liquidity is very strong, with total government available cash at 87.6% of total governmental fund expenditures and 6.5x governmental debt service in 2019. 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. The city has historically maintained what we consider very strong cash balances. All of its 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.

Weak debt and contingent liability profile

In our view, Mesquite's debt and contingent liability profile is weak. Total governmental fund debt service is 13.5% of total governmental fund expenditures, and net direct debt is 135.3% of total governmental fund revenue.

The city generally issues limited-tax debt on a routine basis. The last bond election for $125 million was approved in November 2015 for residential street construction, of which $66 million is authorized but unissued prior to the current sale. Mesquite will continue to follow its medium-term debt plans in line with its capital improvement plan and debt policy, although future debt issuance will likely be scrutinized based on the current conditions. We expect the debt burden will likely remain elevated in the near term. The city has no variable-rate debt nor is it party to any swap agreements. It will amortize approximately 57% of total direct debt over the next 10 years, which we consider average.

Pension and OPEB highlights

Mesquite's pension contributions totaled 7.3% 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 the city. 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 expect the city's liabilities to threaten its fiscal stability in the near term. The city participates in the Texas Municipal Retirement System (TMRS), which is 73.7% funded with a net pension liability of $147.9 million.

TMRS is 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. Although we do not expect short-term, fixed-cost pressure resulting from the city's TMRS obligations, the amortization period is above average 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 rise 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. Adding additional pressure to key pension metrics is the volatile market as a result of the pandemic and potential investment returns that fall well short of expectations.

The city provides OPEB in the form of post-employment health care, which it funds on a pay-as-you-go basis. For the year ended Sept. 30, 2019, it recognized an OPEB expense of $2 million.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Ratings Detail (As Of April 24, 2020)		
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 rfdg bnds		
Long Term Rating	AA/Stable	Affirmed
Mesquite GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.