

**Summary:**

# Sulphur Springs, Texas; General Obligation

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### Credit Profile

US\$4.24 mil GO rfdg bnds ser 2019 dtd 05/15/2019 due 09/01/2039

*Long Term Rating*

A+/Stable

New

## Rationale

S&P Global Ratings assigned its 'A+' rating to the city of Sulphur Springs, Texas' series 2019 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'A+' rating on the city's existing GO debt. The outlook is stable.

The certificates are payable from the city's ad valorem taxes, which are levied on all taxable property. Despite state statutory tax-rate limitations, we do not differentiate between the city's limited-tax debt rating and its general creditworthiness. That's because the ad valorem taxes are collected from a broad tax base and there are no restrictions on what the limited tax can be used for, which supports our view of the city's overall ability and willingness to pay debt service. State statutes limit the ad valorem tax rate for home-rule cities to \$2.00 per \$100 of taxable assessed valuation (AV) for all purposes. In addition, the Texas attorney general will permit the allocation of \$1.33 of the \$2.00 maximum tax rate for ad valorem tax debt service. For fiscal 2019, the city's levy is well below the maximum, at 44.0 cents per \$100 of AV, 5.68 cents of which is specifically dedicated to debt service. Proceeds of the 2019 bonds will refund existing debt for debt service savings.

The rating reflects our opinion of the following credit factors:

- Weak economy, with market value per capita of \$56,956 and projected per capita effective buying income at 77.5% of the national level;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 97.6% of total governmental fund expenditures and 7.8x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 12.5% of expenditures and net direct debt that is 131.7% of total governmental fund revenue; and
- Strong institutional framework score.

### **Weak economy**

We consider Sulphur Springs' economy weak. The city, with an estimated population of 16,143, is located in Hopkins County. The city has a projected per capita effective buying income of 77.5% of the national level and per capita market value of \$56,956. Overall, the city's market value grew by 0.8% over the past year to \$919.4 million in 2019. The county unemployment rate was 3.6% in 2017.

Sulphur Springs is located approximately 80 miles east of Dallas. Its economy is based on agriculture, dairy farming in particular, as well as food processing and distribution. The city's tax base is diverse, and its top ten taxpayers are made up primarily of food manufacturing and processing businesses as well as grocery supply and retail sales. The city's assessed value has grown 8.6% over the past five fiscal years, or about 1.7% annually on average. Management attributes the growth, in part, to the complete redevelopment of the city's downtown, which has seen very strong growth in values recently as retail and restaurant spaces have opened downtown. Also contributing to the growth is expansion of existing businesses throughout the city as well as some residential development. The increased retail activity in the city has resulted in sales tax revenue growth as well. The city's revenue base is relatively diverse, with 33.4% of general fund revenues coming from property taxes in fiscal 2018, and 38.7% from sales taxes.

In January 2019, the city annexed two industrial parks that will add to assessed value and property tax revenues starting in fiscal 2020. In addition, it is expected that Luminant Mining Co. will be donating 4,771 acres of land to the city, of which officials believe 1,200 acres is developable. Management believes this will be a great opportunity for industrial development to occur over the next 5 years. As the land is developed, it will be annexed into the city and added to assessed value. The city's ad valorem tax rate has been very stable for nearly twenty years, and with the growth expected to occur over the next few years, management does not anticipate the need to change the tax rate.

### **Adequate management**

We view the city's management as adequate, with standard financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

When developing budget assumptions, the city evaluates prior trends and incorporates conservative growth estimates. This typically leads to little budget-to-actual variance, with actual results outperforming budgeted estimates. The budget can be amended as needed throughout the fiscal year, but amendments are rare unless an unexpected cost or opportunity arises. The city provides monthly budget-to-actual reports to council. The city has a formal investment policy that outlines allowable investments and is published annually with the budget document. The city has an internal reserve policy to maintain available fund balance sufficient to cover two to three months of operating expenses. The city does not have a formal debt management policy, but does not plan to issue additional debt until at least fiscal 2023 once some existing debt has retired. The city has capital improvement plans for streets, drainage, and utility projects that identify the timing, cost, and funding source for the projects. The city does not have a long-term financial plan that includes multi-year projections of revenue and expenditures.

### **Strong budgetary performance**

Sulphur Springs' budgetary performance is strong in our opinion. The city had operating surpluses of 6.5% of expenditures in the general fund and of 4.7% across all governmental funds in fiscal 2018. After adjusting for recurring

transfers in to and out of the general fund, as well as one-time capital expenditures from bond proceeds, the city experienced positive operating results in fiscal years 2017 and 2018. The fiscal 2017 surplus was \$60,000 or 0.5% of expenditures, while the 2018 surplus was much stronger at \$757,000 or 6.5% of expenditures. This represents an improvement in budgetary performance compared to prior years where operating results were negative due to recurring transfers to capital projects funds to finance portions of downtown redevelopment and airport improvements. After making similar adjustments across all governmental funds, the city experienced positive results in each of the past three fiscal years of between \$309,000 and \$717,000 or 2.4% to 5.8% of total governmental fund expenditures.

The city initially adopted a 2019 budget with a \$146,000 or 1.9% general fund surplus. Based on performance fiscal-year-to-date, revenues are tracking above budget primarily due to sales taxes and interest earnings exceeding projections and expenditures are tracking close to budget. Management currently expects to outperform budget at fiscal-year-end with a slightly larger surplus than originally estimated.

### **Very strong budgetary flexibility**

Sulphur Springs' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 27% of operating expenditures, or \$3.1 million. The city has consistently maintained very strong fund balance over the past three fiscal years of between \$2.2 million and \$3.1 million, which equates to 19% to 27% of general fund expenditures. This is consistent with the city's internal reserve policy which requires a fund balance level that is sufficient to cover two to three months of operations, which would be equal to approximately 17% to 25% of expenditures. Management plans to maintain fund balance at similar levels in the future, with expectations to add to fund balance at fiscal 2019 year-end. Given that the city has maintained fund balance at targeted levels even with large capital expenditures and development occurring in recent years, we expect budgetary flexibility to remain very strong.

### **Very strong liquidity**

In our opinion, Sulphur Springs' liquidity is very strong, with total government available cash at 97.6% of total governmental fund expenditures and 7.8x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

The city's access to external liquidity is demonstrated through its issuance of GO bonds over the past 20 years. The city's investments comply with state and city guidelines, and we do not consider them to be aggressive. As of Sept. 30, 2018, the city's investments were held in US treasuries, local government investment pools, and certificates of deposit. The city has previously privately placed three series of GO debt, currently outstanding in the principal amount of \$19.5 million. In addition, the city plans to privately place its series 2019 tax notes (\$445,000) concurrently with the 2019 GO refunding bonds. Our review of the bond documents for the privately placed debt concluded that there are no permissive events of default, no cross-default provisions, and no default rate provisions; and acceleration of principal is not included as a potential remedy in an event of default. Therefore we do not consider this debt a contingent liability risk.

### **Weak debt and contingent liability profile**

In our view, Sulphur Springs' debt and contingent liability profile is weak. Total governmental fund debt service is 12.5% of total governmental fund expenditures, and net direct debt is 131.7% of total governmental fund revenue.

Proceeds of the 2019 bonds will refund existing debt for debt service savings. Subsequent to this issuance, the city has no plans to issue additional debt at this time. Sulphur Springs' combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.3% of total governmental fund expenditures in 2018.

The city provides pension benefits for all full-time employees through the statewide Texas Municipal Retirement System (TMRS), a multiemployer, public-employee retirement system. Under state law governing the TMRS, an actuary determines the contribution rate annually. The city has historically paid its actuarially determined contributions in full. The city's contribution in fiscal 2018 was \$576,057 or 4.2% of expenditures. The city's portion of the plan's net pension liability was \$1.3 million as of December 2017, and the funded ratio was 96.8%. The city also participates in the Supplemental Death Benefits Fund (SDBF), which is a defined benefit group life insurance plan administered by the state and is funded on a pay-as-you-go basis. The city contributed \$17,051 to SDBF in fiscal 2018.

### Strong institutional framework

The institutional framework score for Texas municipalities is strong.

## Outlook

The stable outlook reflects our opinion that Sulphur Springs will continue to maintain very strong budgetary flexibility, and strong budgetary performance while effectively managing capital needs and debt obligations. Therefore, we do not expect to change the rating within the two-year outlook period.

### Upside scenario

If the city's economic indicators improve to levels we consider comparable with those of higher-rated peers, coupled with moderation of the debt profile, we could raise the rating.

### Downside scenario

If the city's debt profile were to place financial pressure on the city, deteriorating budgetary performance or flexibility and resulting in sustained declines in reserves, we could lower the rating.

## Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Ratings Detail (As Of April 29, 2019)		
Sulphur Springs comb tax and rev certs of oblig		
<i>Long Term Rating</i>	A+/Stable	Affirmed
Sulphur Springs GO		
<i>Long Term Rating</i>	A+/Stable	Affirmed

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Ratings Detail (As Of April 29, 2019) (cont.)		
Sulphur Springs GO (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
<b>Sulphur Springs GO</b>		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
<b>Sulphur Springs GO comb tax</b>		
<i>Unenhanced Rating</i>	A+(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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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