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Ratings

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Summary:

Garland, Texas; General Obligation

Primary Credit Analyst:
Amahad K Brown, Farmers Branch + 1 (214) 765 5876; amahad.brown@spglobal.com

Secondary Contact:
Andy A Hobbs, Farmers Branch + 1 (972) 367 3345; Andy.Hobbs@spglobal.com

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Summary:

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Credit Profile		
US$22.605 mil GO rfdg bnds ser 2019 dtd 12/01/2019 due 02/15/2040		
Long Term Rating	AA+/Stable	New
Garland GO		
Long Term Rating	AA+/Stable	Affirmed
Garland GO		
Long Term Rating	AA+/Stable	Affirmed
Garland GO rfdg bnds ser 2018 dtd 12/01/2018 due 02/15/2029		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Garland, Texas' series 2019 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's previously issued GO bonds and certificates of obligation. The outlook is stable.

Security and use of proceeds

Garland's GO bonds and certificates of obligation constitute direct obligations of the city, payable from the proceeds of a continuing, direct annual ad valorem tax, within the limits prescribed by law, on all taxable property within its borders. The maximum allowable ad valorem tax rate in Texas is $2.50 per $100 of assessed value (AV) for all purposes, with the portion dedicated to debt service limited to $1.50. The city's total tax rate is well below the maximum, at 76.96 cents, 37.56 cents of which is dedicated to debt service. Based on the application of our criteria "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" (published Jan. 22, 2018), we view the limited-tax GO debt pledge on par with the issuer credit rating, which is based on the city's general creditworthiness. The city does not levy ad valorem taxes on a narrower or distinctly different tax base, and there are no limitations on the fungibility of resources available for the payment of debt service.

A pledge of net revenues of Garland's electric utility system or water and sewer system--in an amount not to exceed $1,000—also secures the city's outstanding certificates of obligation. Given the limited nature of the additional pledged revenues, our ratings on these obligations are based on the city's ad valorem tax pledge.

Proceeds of the GO refunding bonds will refund the series 2010 combination tax and revenue certificates of obligation maturing on or after Feb. 15, 2021, for debt service savings, and pay all of the city's GO commercial paper notes.

Credit overview

The 'AA+' rating reflects the city's maintenance of its very strong finances supported by a very strong financial management framework and growing economic base. Garland's position as a large employment center in combination with a housing stock that remains relatively affordable within the Dallas metroplex should contribute to future economic stability. Since the 2010 Census, Garland's estimated population has increased nearly 5%. In addition to increasing the demand for municipal services, this population growth has also heightened the need to improve and repair Garland's aging infrastructure. To meet this demand, the city proposed--and voters approved--a $423.7 million bond program on May 4, 2019, representing the city's first bond election in 15 years. The bond program consists of eight separate propositions on streets, public safety facilities, drainage improvements, parks and recreation, library, economic development, an animal shelter, and other municipal facilities. We do not expect additional debt associated with the 2019 bond program to materially weaken our view of Garland's credit quality, particularly given the city expects to issue the bonds gradually over a seven-to-10-year period, as well as the city's current debt service scheduled that is rapidly amortizing, which creates debt service capacity in future years. In addition, the city increased its debt service tax rate by 6.5 cents starting in fiscal year 2020 to generate the revenues sufficient to fund the bond program.

The 'AA+' rating reflects our opinion of the city's:

- Adequate economy, with projected per capita effective buying income (EBI) at 73.6% and market value per capita of $67,346, 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;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 19% of operating expenditures;
- Very strong liquidity, with total government available cash at 86.9% of total governmental fund expenditures and 6.2x governmental debt service, and access to external liquidity that we consider exceptional;
- Adequate debt and contingent liability profile, with debt service carrying charges at 14.1% of expenditures and net direct debt that is 138.1% 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 Garland's economy adequate. The city, with an estimated population of 242,504, is in Collin, Dallas, and Rockwall counties in the Dallas-Fort Worth-Arlington MSA, which we consider to be broad and diverse. The city has a projected per capita EBI of 73.6% of the national level and per capita market value of $67,346. Overall, the city's market value grew 8.2% over the past year to $16.3 billion in 2020. The counties' weight-averaged unemployment rate was 3.7% in 2018.

Garland is 14 miles northeast of Dallas. The city encompasses approximately 57 square miles, of which about 90% of the developable area is fully developed. We view the economy as stronger than what our metrics represent, because of the city's diverse commercial, retail, and industrial developments that stimulate the economy, despite lower-than-average wealth and income levels. As of July 2019, the city maintained a labor force of more than 128,000 with an unemployment rate of just 3.4%.

Garland has several industrial districts that have rail- and motor-freight transportation facilities. The top employers include Kraft Foods (796 employees), US Food Service (520), Atlas Copco (460), Silverline Window (425), and Hatco (390). The city has several commercial projects underway that are expected to bring new jobs as well as AV growth. These include the construction of two separate data center campuses--Digital Realty and RagingWire--that will each include approximately 1 million square feet. The Digital Realty facility was originally valued at $1 billion at full build out, however, the company presented an expansion plan in 2018 to increase its original site by 16 acres, which would bring the company's total planned investment to $1.4 billion. On the other hand, the RagingWire facility will be valued at $389 million at build out. In addition, Kraft Food is also planning to expand its footprint in the city, which is expected to add more than 200 jobs while also retaining 125 existing jobs. We expect these large-scale expansions and development to continue to support tax-base expansion and job growth over the next few years.

Garland's tax base is growing steadily, as the result of industrial, commercial, and residential development. Taxable AV has increased an average of 9.1% per year since tax year 2014. In aggregate, the tax base expanded by $5.6 billion or 54% between tax years 2014-2019. Although tax-base growth could moderate from the extremely strong levels recorded in recent years, city officials expect it to continue over the near term, particularly given the development pipeline. The tax base is very diverse, with the top 10 taxpayers comprising 3.8% of AV. Although we expect development activities in the city to continue, we do not expect to see a material change in the economic metrics over the next two years.

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.

Highlights include management's use of formal historical trend analysis to derive revenue and expenditure budget assumptions. The city can amend the budget, as necessary, throughout the year with city council approval. In addition to a comprehensive quarterly budget-to-actual review with the city council, management provides council with monthly dashboard reports on national and local economic indicators as well as key performance indicators for the general fund and utility fund. In addition, the city's formal five-year financial plan--publicly published and updated at least annually--includes projections for all major operating funds. Furthermore, the city maintains a five-year capital investment plan with identified cost estimates and funding sources that management updates annually.

The city's formal local investment management policy complies with the Texas Public Funds Investment Act, and the city provides quarterly reports to the council on holdings and earnings. The formal debt management policy includes basic policies such as an overall net debt limitation at 5% of AV. The formal reserve policy calls for the maintenance of 30 days' operating expenditures for the general fund and 45 days for water, sewer, and electric funds.

Strong budgetary performance

Garland's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 2.6% of expenditures, and slight surplus results across all governmental funds of 1.2% in fiscal 2018.

In our calculations, we have adjusted the city's revenues and expenditures to treat recurring transfers as either revenues or expenditures, and subtracted significant one-time expenditures funded through cash on-hand or debt proceeds. Garland's total governmental funds revenue base is diverse; leading sources include property taxes (42%), sales taxes (14%), charges for services (12.5%), and intergovernmental revenues (7%). Each of these revenue sources has demonstrated stable and steady growth in the past three fiscal years.

Garland has a history of conservative budgeting highlighted by better-than-budgeted year-end results. Despite budgeting to use fund balance to finance one-time expenditures in recent years, the city managed to increase fund balance as a result of expenditure savings and strong-than-expected revenue growth. In fiscal 2018, the city's audited general fund results reflect a relatively minor $265,000 use of fund balance, despite financing more than $7.3 million in one-time projects including a $4.6 million land purchase for economic development.

The fiscal 2019 budget projects a fund balance drawdown of approximately $2.1 million. However, as a result of higher-than-budgeted revenue collections and expenditures savings from project rollovers, the city is projecting near breakeven results for fiscal 2019. The fiscal 2020 budget includes a $2.4 million drawdown attributed to the continuation of the city's multi-year street improvement program. Given expectations of sustained revenue growth and a strong budget monitoring framework, we do not expect our view of the city's budgetary performance to weaken over the near term.

Future performance has the potential to be negatively affected by recent property tax reform legislation passed by the state. Specifically, the legislation, called the Texas Property Tax Reform and Transparency Act of 2019, limits the ability of certain local government units to increase maintenance and operations property tax revenues above 3.5% of the previous year without voter approval. The prior formal threshold for potential citizen intervention on the setting of property tax rates, known as the roll-back rate, was 8.0%. In an effort to offset the potential budgetary imbalance created by the new legislation, the city has taken steps to increase scheduled transfers into the general fund from its electric utility system while also funding a comprehensive fee study to ensure that current service fees and charges are sufficient to cover the cost of services. Given the city's proactive approach to addressing future budgetary challenges, we anticipate that Garland will continue to evaluate its options to maintain fiscal balance. For more information, see "Texas Local Governments Could Face Budget Headwinds--And Credit Quality Strain--From Property Tax Reform," published June 12, 2019, on RatingsDirect.

Very strong budgetary flexibility

Garland's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 19% of operating expenditures, or $32.3 million.

Although historically general fund reserves have been primarily classified as assigned or unassigned, the city reclassified approximately $11.4 million of previously unassigned reserves as committed in the fiscal 2018 audit. The fund balance commitment was approved via city ordinance to provide further transparency on the reserves that are available to finance various sub-funds within the general fund, namely for the infrastructure repair and replacement fund, the economic development fund, and the public health and immunization fund. Despite the designation, the committed balances have no legal restrictions and could be made available for emergencies or contingencies by the city council. Therefore, we include the committed reserves in our calculation of budgetary flexibility.

Garland's budgetary flexibility, as reflected in its available reserve balances relative to operating expenditures, remains very strong despite a growing budget. Since fiscal 2014, the city has added approximately $9.3 million to the total general fund balance through consistently strong budgetary performance. Given our expectation of continued strong budget results and no plans to materially reduce reserves in the near term, we expect the city's budgetary flexibility to remain strong. However, one-time spending that reduces total available reserves, including amounts committed to the infrastructure repair and replacement fund, to levels that we consider just strong or adequate could negatively affect the rating.

Very strong liquidity

In our opinion, Garland's liquidity is very strong, with total government available cash at 86.9% of total governmental fund expenditures and 6.2x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

The city's exceptional access to external liquidity is demonstrated through its market activity over the past 15 years. Garland has frequently issued bonds over the past two decades, including both fixed- and variable-rate GO bonds, commercial paper notes, and electric, water, and sewer revenue bonds.

It has historically had what we consider very strong cash balances and, given management's demonstrated ability to maintain balanced operations, we do not believe its cash position will worsen. All of Garland's investments comply with Texas statutes and the city's internal investment policy. As of March 31, 2019, the city held investments in U.S. treasury coupon securities, federal agency coupon securities, certificates of deposit, and investment pools, which we do not consider aggressive. The city has two series of tax notes outstanding that were privately placed. However, the obligations with a total par amount outstanding of $22.3 million (2.3% of total direct debt) do not contain any nonstandard events of default or permissive provisions that we view as a potential material liquidity risk.

Adequate debt and contingent liability profile

In our view, Garland's debt and contingent liability profile is adequate. Total governmental fund debt service is 14.1% of total governmental fund expenditures, and net direct debt is 138.1% 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.

Our ratios have been adjusted to reflect the portion of tax-backed GO bonds and certificates of obligation supported by the city's enterprise funds. In total, Garland has approximately $330.8 million of tax-backed debt obligations outstanding including the current issuance. In May 2019, the city's voters approved a $423.7 million bond referendum to finance various projects including streets and sidewalks, public safety facilities, drainage improvements, parks and recreation, library, economic development, an animal shelter, and other municipal buildings. The initial plan is to issue the bonds over a seven-to-10-year period. While the issuance of additional debt has the potential to weaken our assessment of the debt profile, we understand that the city will adjust tax rates at amounts sufficient to fund the bond program. For fiscal 2020, the city increased the debt service tax rate 6.5 cents.

Garland's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 8.8% of total governmental fund expenditures in 2018. Of that amount, 6.7% represented required contributions to pension obligations, and 2.0% represented OPEB payments. The city made its full annual required pension contribution in 2018.

We do not view pension and OPEB liabilities as an immediate credit risk for Garland. Despite a somewhat extended amortization, the city's pension plan is very well funded, and management continues to follow through on its adopted strategy for addressing the city's long-term OPEB liabilities. As a result, we do not anticipate a material increase in pension and OPEB contributions that could threaten the city's fiscal stability.

The city participates in the following plans as of Dec. 31, 2017 (latest measurement date):

- Texas Municipal Retirement System (TMRS), 100.16% funded with a net pension asset equal to $1.5 million. Contributions are actuarially determined, and the city has historically fully funded its annual required costs. Actuarial assumptions include a 6.75% discount rate and 28-year amortization period.
- Supplemental Death Benefits Fund (SDBF), which provides group-term life insurance benefits to active and retired members of the TMRS pension plan. The plan is funded on a pay-as-you-go basis, and the city's total OPEB liability for SDBF was $7.1 million.
- OPEB plan provides continuing health care benefits to eligible retirees. The plan is 7% funded, and the net OPEB liability is $72.8 million. While OPEB benefits have not historically been prefunded, Garland approved a long-term funding strategy for OPEB in budget year 2018 including annual transfers from the general fund and the utility funds to an OPEB trust fund. The annual utility fund transfer is approximately $750,000, and the initial contribution from the general fund was $500,000, which will be increased by $85,000 per year until the annual general fund contribution reaches $1.5 million. The budgeted contribution to the OPEB trust from the general fund is $670,000 for fiscal 2020.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our opinion of Garland's consistent financial performance and expanding local economy, supported by its very strong management. We do not expect to change the rating during the next two years, because we believe that Garland will likely maintain its very strong reserves and strong budgetary performance and continue to benefit from participation in the broad and diverse Dallas-Fort Worth MSA.

Downside scenario

If available reserves decline to levels that we consider just strong or adequate, triggered by weakened budgetary performance or significant one-time spending, we could lower the rating.

Upside scenario

Improvement in the city's debt profile and wealth and income indicators relative to those of higher-rated peers could result in a higher rating, all else equal.

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
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 29, 2019)		
Garland GO		
Long Term Rating	AA+/Stable	Affirmed
Garland GO		
Long Term Rating	AA+/Stable	Affirmed
Garland GO		
Unenhanced Rating	AA+(SPUR)/Stable	Current

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.