

# RatingsDirect®

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## Summary:

# Town Of Northlake, Texas; General Obligation

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### Credit Profile

US\$14.38 mil combination tax and ltd surplus rev certs of oblig ser 2022 due 02/15/2042

<i>Long Term Rating</i>	AA/Stable	New
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Town of Northlake comb tax and assess rev certs of oblig ser 2014A due 08/15/2034

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Town of Northlake comb tax and ltd surplus rev certs of oblig

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Town of Northlake GO rfdg bnds ser 2016 dtd 09/01/2016 due 08/15/2025

<i>Long Term Rating</i>	AA/Stable	Affirmed
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Town of Northlake GO (BAM)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Twn of Northlake GO (MAC)

<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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Many issues are enhanced by bond insurance.

### Credit Highlights

- S&P Global Ratings assigned its 'AA' long-term rating to the Town of Northlake, Texas' series 2022 combination tax and limited surplus revenue certificates of obligation (\$14.38 million).
- At the same time, we affirmed our 'AA' long-term rating on the town's existing general obligation (GO) debt and certificates of obligation.
- The outlook is stable.

### Security

A limited ad valorem tax, levied on all taxable property within the town, secures the GO bonds and certificates. The certificates are also secured by a limited pledge--not to exceed \$1,000--of the surplus net revenues of the town's waterworks and sewer system. Given the limited nature of the additional pledged revenues, we base our ratings on these obligations on the town's ad valorem tax pledge. Northlake also has series 2014A certificates of obligation outstanding that are additionally secured by special assessment levied on property within the Highlands Public Improvement District. We do not have sufficient information to rate the special assessment pledge, so we rate these bonds to the town's ad valorem pledge.

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. In fiscal 2023, the town is levying 29.50 cents, of which 11.74 cents is dedicated to debt service, and the remaining 17.76 cents for operations. Based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Nov. 20, 2019, we do not differentiate between the town's limited-tax debt and its general creditworthiness, since the ad

valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which support our view of the town's overall ability and willingness to pay debt service. Proceeds from the series 2022 certificates will fund various water and wastewater improvements within the town.

### **Credit overview**

Northlake has seen rapid growth, with AV increasing more than 600% in the past seven years. Despite this growth, management has reported strong surpluses in the past three years, maintaining reserves at approximately 60% of expenditures. Although we believe the town will have to face continued capital pressure from rapid growth, we believe that management's conservative assumptions towards growth related revenues will allow Northlake to maintain reserves above their reserve target. The town's high debt burden likely precludes it from a higher rating for an extended period of time as Northlake continues to grow.

The rating reflects our view of the town's:

- Rapidly growing economy and property tax base in the Dallas-Fort Worth metroplex;
- Good financial management practices under our Financial Management Assessment (FMA) methodology and a strong institutional framework score;
- Very strong reserves, with two strong surpluses in the past two years, and an expected surplus in fiscal 2023; and
- Very weak debt burden with additional debt plans.

### **Environmental, social, and governance**

The rating incorporates our view of the town's environmental, social, and governance (ESG) risks relative to its economy, management, financial measures, and debt and liability profile, which we view as neutral in our credit analysis. We consider the rapid population and property tax base growth as a social opportunity, as the town has seen rapidly increasing revenues due to housing expansion.

## **Outlook**

The stable outlook reflects our expectation that the town will continue to experience ongoing tax base growth while maintaining very strong reserves. We do not expect to change the rating during the two-year outlook.

### **Downside scenario**

We could lower the rating if the town's reserves materially weaken and fall below its formal reserve policy.

### **Upside scenario**

We could raise the rating if Northlake's debt profile declines and budgetary performance remains stable while the town's operating revenues transition over time.

## **Credit Opinion**

**Rapidly growing tax base, with declining top 10 taxpayer concentration, expected to continue for at least five years**

Northlake's local economy grew rapidly, with AV increasing to \$2.1 billion in 2022 from \$279 million in 2015, with the property base growing over 600% in seven years. This growth is fueled mostly by single-family residential as housing demand grew in the Dallas-Fort Worth metroplex. The town is connecting more than two new water connections a day, and management estimates 2,000 new homes in the next few years. Officials expect this build-out will continue for at least five years, as there is ample land for development. According to management, state roads currently hinder development, and as the state improves transportation infrastructure in the area, officials believe housing will continue to expand. Northlake also serves as a logistics hub, with distribution warehouses and associated manufacturing leading the town's commercial properties. Officials state that additional commercial development is also underway, with approximately seven million square feet of business park of projects under construction or in planning. Due to the ongoing and planned developments, we anticipate the town's tax base will continue to experience strong growth in the near term.

**Strong management, with a comprehensive capital plan to assist with managing the town's rapid growth**

The town uses extensive planning and analysis to devise revenue and expenditure assumptions based on historical trend analysis, and it reviews the growth trends of other fast-growing small cities and towns. Key financial management practices include quarterly reporting of budget-to-actual results and investment performance to the governing body. Procedures for budget adjustments are in place, if needed. Northlake's formal reserve goal is to maintain at least 120 days of operating expenditures in reserve. The town does not conduct long-term financial planning or have a debt management policy, but it is currently working on both documents. Northlake has a comprehensive five-year capital plan, with sources for funding and single-page descriptions of each project. This plan is included in the budget and is updated annually.

The institutional framework score for Texas municipalities is strong.

**Strong budgetary performance, adding to very strong reserves**

In the past two years, Northlake experienced large surpluses, as management took a conservative approach to revenues from housing growth in the town. A significant portion of the town's revenues comes from building permits and associated fees (45%), and these revenues, along with sales taxes (19%) fueled strong performance. However, given the cyclical nature of building permit revenues, we have adjusted our performance score. Permit revenues have shown steady growth, increasing to \$3.5 million in fiscal 2021 from \$1.5 million in fiscal 2018. Management considers most of these as one-time revenues and continues to budget conservatively, including only \$2.4 million in building permits for fiscal 2023.

The fiscal 2021 surplus is attributed to ongoing growth in building permits and strong sales tax collections. Officials intend to treat these revenues as one time, and they have communicated to council their intention with development-related revenues. For fiscal year 2022, Northlake expects a surplus once again. The fiscal 2023 adopted budget of approximately \$9.6 million is balanced and there are no plans to reduce reserves below their formal reserve policy. Lastly, the town was allocated a total of \$830,000 in COVID-related funds, which will mostly be used to fund one-time capital. In our view, management's approach to development-related fees is prudent, but we see potential

challenges in the future as the town continues to grow.

Northlake has historically maintained very strong reserves, well in excess of 30% of expenditures. The town has no plans to reduce its current fund balance below its formal target of 120 days of expenditures, but it could make various one-time transfers to support its debt service fund and to finance other capital needs from surplus revenues. As a result, we believe the town's fund balance will remain very strong, and in excess of 30% of its annual operating expenditures.

### **Very weak debt profile, partially offset by minimal pension and other postemployment benefits (OPEB) liabilities**

Including the current issuance, the town's total direct debt outstanding is approximately \$45.2 million of tax-backed debt, which consists of GO bonds and certificates of obligation. Northlake continues to experience significant growth, leading to additional capital needs. The town anticipates issuing approximately \$40 million in 2024 and an additional \$25 million in 2026. Due to the anticipated debt issuances, we expect the town's debt profile will remain very weak.

The town privately placed tax notes in 2020 for capital improvements. The bond resolution notes that in the event of a default, any additional payments after will be subject to a 4.4% rate--3.0% higher than the notes' 1.1% interest rate. The bond ordinance explicitly states that acceleration is not an available remedy. Although the higher interest rate is a slight concern, given Northlake's overall financial performance, and the lack of acceleration, we do not consider this obligation an immediate contingent liability.

#### **Pension and OPEB obligations**

We do not consider the town's pension costs a current credit risk given the small size of the liabilities.

The town participates in the following plans:

- Texas Municipal Retirement System (TMRS), funded at 90.4% with a net proportional pension liability of \$460,530.
- TMRS OPEB, unfunded with a total liability of \$50,898.

Given that TMRS is an agent plan, assets are jointly managed. Currently, Northlake is making 100% of its required contribution, but it's not meeting our actual minimum funding or actual static funding calculations. With a closed, 24-year amortization period on a level-percent basis, we believe that the town will make progress towards funding its liabilities, but that contributions will likely increase, especially since the amortization is on a level-percent-of-payroll basis. The plan uses certain assumptions that could increase contribution volatility, including a 6.75% discount rate, although there are offsetting factors. For more information, see "Pension Spotlight: Texas" published on RatingsDirect Feb. 25, 2020.

Northlake, Texas--Key Credit Metrics				
	Most recent	Historical information		
		2021	2020	2019
<b>Very strong economy</b>				
Projected per capita EBI % of U.S.	160			
Market value per capita (\$)	216,890			

Northlake, Texas--Key Credit Metrics (cont.)				
	Most recent	Historical information		
		2021	2020	2019
Population		3,583	3,317	
County unemployment rate(%)		4.4		
Market value (\$000)	2,060,452	1,243,427		
Ten largest taxpayers % of taxable value	25.1			
<b>Strong budgetary performance</b>				
Operating fund result % of expenditures		10.5	9.8	25.6
Total governmental fund result % of expenditures		21.4	33.3	48.1
<b>Very strong budgetary flexibility</b>				
Available reserves % of operating expenditures		59.3	66.7	64.0
Total available reserves (\$000)		4,372	3,595	3,075
<b>Very strong liquidity</b>				
Total government cash % of governmental fund expenditures		162.7	150.0	169.4
Total government cash % of governmental fund debt service		1,524.2	1,032.4	865.9
<b>Strong management</b>				
Financial Management Assessment	Good			
<b>Very weak debt and long-term liabilities</b>				
Debt service % of governmental fund expenditures		10.7	14.5	19.6
Net direct debt % of governmental fund revenue	286.6			
Overall net debt % of market value	10.4			
Direct debt 10-year amortization (%)	57.2			
Required pension contribution % of governmental fund expenditures		2.5		
OPEB actual contribution % of governmental fund expenditures		0.0		
<b>Strong institutional framework</b>				

Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2021 Update Of Institutional Framework For U.S. Local Governments

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