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Ratings

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Summary:
Deer Park, Texas; General Obligation

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Summary:

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Credit Profile		
US$6.445 mil ltd tax rfdg bnds ser 2020 dtd 12/01/2020 due 03/15/2032		
Long Term Rating	AAA/Stable	New
US$5.555 mil certs of oblig ser 2020 dtd 12/01/2020 due 03/15/2040		
Long Term Rating	AAA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating to Deer Park, Texas' proposed $5.6 million, series 2020 certificates of obligation, and $6.4 million, series 2020 limited tax refunding bonds. S&P Global Ratings also affirmed its 'AAA' rating on the city's previously issued GO debt. The outlook is stable.

A direct annual ad valorem tax on all taxable property within the city secures the series 2020 certificates, the series 2020 bonds, and previously issued GO debt. A limited pledge of net revenues of the city's waterworks and sewer system in an amount not to exceed $1,000 further secures the certificates. Given the limited nature of the revenue pledge, we rate the certificates based on the city's ad valorem pledge alone.

Texas statutes provide for a maximum ad valorem tax rate of $2.50 per $100 of taxable assessed valuation (AV) for all purposes, including a maximum of $1.50 of the $2.50 for all ad valorem tax obligation debt service. Deer Park's total tax rate was well below the maximum at 72 cents per $100 of taxable AV, including 15.1 cents for debt service. We do not believe that the taxable base is measurably smaller, and we believe that resources are fungible. 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 GO debt and its general creditworthiness.

Inclusive of the series 2020 issuances, the city will have approximately $40.3 million of net direct debt outstanding. Proceeds from the series 2020 certificates will fund various water and sewer improvement projects, while the 2020 bonds' proceeds will refund existing debt for interest savings.

Credit overview

Consistently strong budgetary performance and maintenance of healthy reserves will enable Deer Park to mitigate disruptions from recessionary pressures related to Covid-19. Many local businesses are classified as essential, and therefore, they were permitted to remain open during temporary state-mandated business closures. Businesses are currently back open, and losses in sales tax collections are proving less severe than initially anticipated by officials. With a sizeable 2020 surplus expected and a balanced 2021 budget that will likely outperform, we expect the credit will remain stable. Our outlook focuses on a period of six-to-twelve months due to the uncertainty related to the COVID-19 pandemic.

For S&P Global Economics' latest forecast, see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect.

Deer Park's GO debt is eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, we consider U.S. local governments to have moderate sensitivity to national risk. The city's GO pledge is the primary source of debt security, which severely limits the possibility of negative sovereign intervention in the payment of the debt, or city operations. The nation's institutional framework for local governments is predictable, allowing the city significant autonomy and independent treasury management. Also, there is no history of government intervention.

The 'AAA' rating reflects our view of the cities:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good 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 2019;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2019 at 110% of operating expenditures;
- Very strong liquidity, with total government available cash at 156% of total governmental fund expenditures and 13.7x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 11.4% of expenditures and net direct debt that is 77.4% of total governmental fund revenue, as well as rapid amortization, and
- Strong institutional framework score.

Environmental, social, and governance factors

We have analyzed the city's environmental factors, including health and safety risks posed by COVID-19, coupled with social and governance risks relative to the economy, financial management, budgetary performance, and budgetary flexibility, as well as its debt and liability profile. We have determined that all are in line with our view of the sector standard. We view severe weather--primarily hurricanes and flooding--as the main environmental threat to Deer Park. However, we understand that officials have an emergency management plan in place, a full-time emergency management coordinator, and an emergency planning committee. The city could also leverage its very strong reserves to mitigate short-term disruptions while working with FEMA on possible reimbursements.

Stable Outlook

Downside scenario

Although not expected, if sustained budget deficits cause reserves to decline significantly or if key economic indicators deteriorate, we could consider a lower rating.

Credit Opinion

Strong economy

We consider Deer Park's economy strong. The city participates in the broad and diverse Houston-The Woodlands-Sugar Land MSA, covers 15 square miles, and serves a population of 34,718. A projected per capita effective buying income at 93% of national levels and a 2021 market value per capita of $93,446 have both declined over the last year. We believe market value per capita figures are likely understated because the city is engaged in multiple industrial development agreements with local businesses, reducing their tax obligations in exchange for payments-in-lieu-of-taxes (PILOTs). While Deer Park benefits from the institutional presence that is not captured in its market value, we note that the industrial properties, if captured, would likely result in significant taxpayer concentration. This concentration is evident in the city's reliance on PILOTs as the second-largest general fund revenue source.

Centrally located in the center of a highly industrialized shipping channel in Harris County, major oil, chemical, and manufacturing companies have strategically located operations in the city's industrial zone, set up in the northern region of the city's boundaries. Leading employers include Shell (3,200 employees), Deer Park Independent School District (2,660), Universal Plant Services, an industrial and energy industry service provider (1,360), and Dow Chemical Co. (1,330). These and other primary employers have remained relatively stable, despite the ongoing pandemic. While Shell has announced a global workforce reduction of approximately 10% over the next two years, they have not indicated how it will affect its Deer Park location. The majority of local businesses were determined essential and permitted to remain open throughout mandated business closures.

Assessed value growth has averaged 6.7% per year since 2015, and the most recent 2021 assessment reflects a 7.2% increase to $3.2 billion. Although primarily built-out, officials anticipate similar increases to the tax base over the next few years attributable to its desirable location, community amenities, and a strong housing market. The firm CAP Barbell is currently constructing a 300,000 sq. foot distribution warehouse, and Atlas Copco recently opened a 30,000 sq. foot administrative office building. Officials also anticipate that future redevelopment projects throughout many subdivisions in the city will further drive growth. We will continue to monitor how the pandemic affects the city's key economic indicators, including unemployment, which has fallen to 8.4% as of August 2020 after reaching a high of 14.6% in April.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them regularly.

Deer Park management uses five years of historical data and consults with outside sources to generate the revenue and expenditure assumptions used in the budget process. Budget-to-actual results are presented to the council monthly, and amendments to the budget are possible as needed, pending council approval. The city adheres to a formal policy for its investments and provides the council with quarterly updates on returns and holdings. Furthermore, it follows a formal reserve policy, requiring the maintenance of a fund balance at a minimum reserve level equal to 25% of expenditures. Deer Park has a formal debt management policy that is mostly qualitative in nature but includes soft quantitative targets related to debt types the city issues, refunding targets, and debt structure. Officials have not renewed a previously utilized capital improvement plan that went through fiscal 2020, and the city does not currently perform formal long-term financial planning.

Strong budgetary performance

Deer Park's budgetary performance is strong, in our opinion. Our assessment considers our view that the pandemic presents an event risk that could increase performance volatility. The city reported a surplus of 8.7% of the general fund's operating expenditures and a 19% surplus across all governmental funds in 2019. We have adjusted for what we view as recurring revenues and expenditures and for capital outlay funded with bond proceeds.

In four of the last five years, the city reported surplus results in the general fund, and officials have prudently built reserves while also making considerable transfers to its capital improvement fund. Officials budget conservatively, often exceeding initial projections. Although the 2019 final budget reflects a $4.1 million deficit, the city ended with a $3.4 million surplus aided by higher than budgeted property tax, sales tax, and investment revenue. Actual expenses came in approximately 11% under budget, also aiding the strong results. Property taxes are the city's predominant revenue source (33% of 2019 total revenue), followed by industrial district revenues (27%) and sales tax (16%). Both property and sales tax revenue streams have generally increased in line with the city's expanding economy

The city has contractual agreements extending through 2026 with 27 industrial companies. The agreements require each company to make a PILOT payment equal to 64% of what the companies would have owed if subject to full ad valorem taxation by the city. The approximate full taxable value of the industrial properties was $2.6 billion in 2019.

Through 11 months of fiscal 2020, sales tax collections are down approximately 1.6% compared to 2019, with the most significant declines reported in May, June, and July. Despite the modest fall in sales tax collections, officials project a surplus of approximately $3.6 million, or 8.7% of estimated expenditures. The city also incurred approximately $2.5 million of Covid-19 related expenses during the year, including overtime pay and protective equipment. Most of these costs are anticipated to get reimbursed in 2021. The 2021 budget reflects balanced operations. Officials conservatively assumed an 11% decline in sales taxes but still anticipate transferring $1.5 million of excess revenues to its capital improvement fund at year-end.

Very strong budgetary flexibility

In our view, Deer Park's budgetary flexibility is very strong, with a high available fund balance in fiscal 2019 at 110% of operating expenditures, or $41.5 million. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Over the past three years, Deer Park's available fund balance has exceeded 93% of expenditures and has surpassed the city's policy-mandated minimum of 25% of expenditures. Also, we assess that, in keeping with its traditionally conservative budgeting practices, the city will likely continue to make intra-year expenditure and revenue adjustments to outperform the budget at year-end. We note that the city often transfers out general fund excess revenues to cash fund one-time capital projects. Given our expectation of continued strong budget results and no plans to materially reduce reserves in the near term, we expect budgetary flexibility to remain very strong and above 75% of operating expenditures. While unlikely, if recessionary pressures increase, Deer Park could reduce or eliminate its transfers of excess revenue to its capital projects fund, thereby maintaining reserves

Very strong liquidity

In our opinion, Deer Park's liquidity is very strong, with total government available cash at 156% total governmental fund expenditures and 13.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Deer Park's strong access to external liquidity is demonstrated by its access to the market over the past four decades, hallmarked by numerous GO-backed bond issuances. It has historically maintained what we consider very strong cash balances. Given our expectation for balanced operations, we do not believe its cash position will materially weaken in the near term. All of the city's investments comply with Texas statutes and its formal internal policy and were held in certificates of deposit and local government investment pools at the end of fiscal 2019, none of which we consider aggressive.

The city has two series of privately placed debt, with principal outstanding of $6.1 million (8% of total direct debt). However, the obligations do not contain any provisions, such as acceleration or non-standard events of default that we view as a potential liquidity risk.

Adequate debt and contingent liability profile

We have adjusted for revenue-backed debt supported through the city's enterprise fund in our direct debt-to-revenue calculations. Total governmental fund debt service is 11.4% of total governmental fund expenditures, and net direct debt is 77.4% of total governmental fund revenue. Approximately 72% of the direct debt is scheduled to be repaid within 10 years, which we view as a positive credit factor.

The city has an additional $6.9 million of authorized but unissued bonds. However, there are no firm plans for issuance, and no additional debt is expected within the next 12 months. The city may approach voters in 2021 for capital projects, including two new fire stations, additional street and drainage projects, and a new activity center; however, provided rapid amortization, we anticipate debt service costs will remain manageable.

Pension and other post-employment benefits (OPEB) liabilities

Deer Park's required pension and actual OPEB contributions totaled 8% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution of $2.9 million. We do not believe the town's pension or OPEB obligations pose any near-term budgetary challenges.

Deer park participates in the following plans:

- Texas Municipal Retirement System (TMRS), an agent multiple-employer, public-employee retirement system administered by the state. The town's net pension liability was $16.6 million as of the fiscal 2019 audit, with a funded ratio of 88%.
- Texas Emergency Services Retirement System (TESRS) 80.3% funded with the city's proportionate share of TESRS net pension liability at $607,000

Under state law governing TMRS, an actuary determines the contribution rate annually. Actuarial assumptions include a 6.75% discount, which we view as aggressive, representing market risk and resulting in contribution volatility if TMRS fails to meet assumed investment targets. TESRS' monthly contribution requirement per active-emergency-services personnel is not actuarially determined. Rather, TESRS' board of trustees set minimum-contribution provisions; there is no maximum contribution.

Deer Park also participates in a single-employer, defined-benefit OPEB plan. These benefits are funded on a pay-as-you-go basis, and in fiscal 2019 payments for OPEB were 1.1% of expenditures. As of the most recent actuarial valuation (Dec. 31, 2019), the town's OPEB unfunded actuarial accrued liability was $24.2 million.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Ratings Detail (As Of November 6, 2020)		
Deer Pk GO		
Long Term Rating	AAA/Stable	Affirmed
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Long Term Rating	AAA/Stable	Affirmed
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Long Term Rating	AAA/Stable	Affirmed
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