

# RatingsDirect®

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## Summary:

# Frisco, Texas; General Obligation

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## Summary:

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### Credit Profile

US\$108.27 mil GO rfdg & imp bnnds ser 2021 dtd 12/01/2020 due 02/15/2040		
<i>Long Term Rating</i>	AAA/Stable	New
US\$20.96 mil comb tax & surplus rev certs of oblig ser 2021 dtd 12/01/2020 due 02/15/2040		
<i>Long Term Rating</i>	AAA/Stable	New

## Rating Action

S&P Global Ratings assigned its 'AAA' rating to the City of Frisco, Texas' \$108 million general obligation refunding and improvement bonds, series 2021, and \$20.9 combination tax and surplus revenue certificates of obligation, series 2021. The outlook is stable.

The bonds constitute direct obligations of the city, payable from an annual ad valorem tax levied on all taxable property within the city, within the limits prescribed by law. The certificates are further secured by a pledge of the surplus net revenues of the city's waterworks and sewer system. Despite state statutory tax-rate limitations, we do not differentiate between the city's limited-tax debt and its general creditworthiness, because the ad valorem tax is not derived from a measurably narrower tax base and there are no limitations on the fungibility of resources, which supports our view of the city's overall ability and willingness to pay debt service.

Proceeds from the sale of the bonds will be used to finance various permanent improvement projects as well as to refund existing obligations for net present value savings. Proceeds from the sale of certificates will be used to finance improvements and extensions to the city's combined waterworks and sewer system and water re-use system consisting of transmission lines, pump stations and ground storage, as well as expanding, improving, and equipping the city's public works facilities.

### Credit overview

Frisco benefits from its favorable location in the Dallas-Fort Worth metroplex. Despite impacts from the pandemic, it maintains stable credit metrics. The city has established a long trend of stable fiscal performance, which is supported by continued economic development, subsequent growth in revenue, and well-established fiscal management practices. We believe Frisco should have the financial flexibility to withstand any revenue declines or budgetary stress in the near term. However, unemployment has spiked in the county, as it has across the nation. Long-term effects of the pandemic will depend on the severity of the impact. (For more information, see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect.) Future credit reviews will focus on what influence the current situation has on the city and its ability to maintain very strong fiscal reserves.

Key credit considerations include the city's:

- Very 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 (FMA) 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 an available fund balance in fiscal 2019 of 45% of operating expenditures;
- Very strong liquidity, with total government available cash at 33.1% of total governmental fund expenditures and 124.2% of governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 26.6% of expenditures and net direct debt that is 254.4% of total governmental fund revenue; and
- Strong institutional framework score.

#### Environmental, social, and governance factors

Our analysis of these risks encompasses our review of current environmental, social, and governance risks. We acknowledge the ongoing pandemic and potential negative effects it might have on various aspects of the city's creditworthiness. Absent COVID-19, we believe the social risks to be in line with the sector standard. We have also analyzed the environmental and governance risks and have determined that they are in line with our view of the sector standard.

## Stable Outlook

### Downside scenario

We could lower the rating if Frisco's budgetary performance weakens, resulting in deterioration of its budgetary flexibility to levels no longer comparable with those of peers. We could also lower the rating if the city's fixed cost burden weakens or stresses budgetary performance.

## Credit Opinion

### Very strong economy

We consider Frisco's economy very strong. The city, with an estimated population of nearly 200,000, is located in Collin and Denton counties in the Dallas-Fort Worth-Arlington, TX MSA, which we consider broad and diverse. The city has projected per capita effective buying income of 172% of the national level and per capita market value of \$180,506. Overall, its market value grew by 7.8% over the past year to \$31.7 billion in 2020.

Frisco is about 30 miles north of downtown Dallas and its market value has risen substantially over the past decade. The current certified value represents a 7.8% increase from the previous year and is composed predominately of single-family residential properties (62.7% of total tax base), commercial and industrial properties (16%), and multifamily residential properties (7.6%). The city's top 10 taxpayers are diverse, make up only 4.2% of the total tax base, and include a large mall, commercial real estate, apartments, and several hospitals. Despite some decline in commercial office space property values, officials note several large developments are in various phases of

construction or build-out, including the new headquarters of the Professional Golf Association. Residential growth is also strong and resident wealth levels have historically been above average. Based on ongoing development in the area, officials anticipate continued steady growth.

Officials recently reported that the city and the Frisco Community Development Corporation (CDC) have acquired ownership of the remaining 102 acres of the Exide property, which was the industrial facilities of the former battery recycling plant. As a result, the city and the CDC will take over cleanup of the site. On Oct. 6, the Frisco City Council unanimously voted to approve an agreement to take over remediation and ownership of the Exide property. The total estimated cost of the cleanup is \$29 million. Following the council decision, the city and CDC will pay \$3.5 million to Aspen American Insurance Co. Aspen held the \$25 million bond posted by Exide for cleanup. The \$3.5 million will cover the costs to resolve any claims Aspen has on the property. Aspen will pay the \$25 million to the Texas Commission on Environmental Quality. The money will be deposited into a trust, which will be in the CDC's name and dedicated to site cleanup. Frisco component units and the Environmental Services Fund will pay \$4 million into the same trust to cover additional, estimated costs to remediate the site. We do not foresee any near-term fiscal pressure associated with the city's ownership of the property or cleanup at this time.

### **Strong management**

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

Financial management practices include use of at least five years of historical trend analysis in developing revenue and expenditure assumptions for budgeting purposes. City officials provide monthly budget-to-actual reports to the city council and can amend the budget on an ad hoc basis. The city maintains a five-year capital improvement plan (CIP), which is updated annually. The CIP coincides with its bond program. Frisco uses a multiyear financial forecast in which future issues are identified, and revenue and expenditure decisions are made from a long-term perspective. The council has adopted a formal investment management policy that it reviews and approves annually. Management also provides the city council with quarterly investment holdings and returns. Although Frisco has a debt management policy, in our view the policy is not overly restrictive. It also adheres to a formal reserve policy of 25% of operating expenditures, which it exceeds.

### **Strong budgetary performance**

Frisco's budgetary performance is strong in our opinion. The city had operating surpluses of 7.3% of expenditures in the general fund and of 14.4% across all governmental funds in fiscal 2019.

Despite the onset of the COVID-19 pandemic, a surge in cases in Texas, and negative impacts to some revenue streams, we expect budgetary performance will remain stable, in large part due to the city's ability to make midyear adjustments as well as adherence to fiscal management practices. In fiscal 2019, general fund revenue of \$170.6 million outpaced expenditures by \$11.1 million prior to transfers. General fund revenue was primarily derived from property taxes (48%), sales taxes (26%), licenses and permits (7%), and franchise taxes (6%). Solid revenue collections over budget, close monitoring of expenditures, and other positive budget variances aided the strong budgetary performance for the year.

The pandemic and threat of revenue loss led the city to make several key changes in fiscal 2020 to ensure stability in fiscal performance. It established a hiring freeze, except for public safety positions, reduced discretionary spending and budgets throughout various departments, and closed some facilities such as the recreation and seniors center, among other traditional budget reduction measures. Sales tax collections year-to-date remain positive when compared with the previous year, mainly due to solid gains from the first half of the fiscal year. Officials expect hotel and motel tax revenue will remain weak throughout the fiscal year and are preparing for below-trend numbers in fiscal 2021. Despite the revenue pressure, they expect balanced operations for 2020. Given current year-to-date estimates and historical performance, we expect the city will sustain at least strong budgetary performance in the near term.

### **Very strong budgetary flexibility**

Frisco's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 45% of operating expenditures, or \$72.5 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

For fiscal 2019, the city added \$12.2 million to available fund balance. Given year-to-date trends and expectations, we expect that budgetary flexibility will remain very strong and above 30% of operating expenditures. Stable and strong budgetary performance will allow for maintenance of very strong reserves in the near to medium term.

### **Very strong liquidity**

In our opinion, Frisco's liquidity is very strong, with total government available cash at 33.1% of total governmental fund expenditures and 124.2% of governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

We expect the city's very strong cash position will continue in the next two years. Currently, all the city's investments comply with Texas statutes and the city's investment policy. Investments are predominantly held in federal agency notes and rated investment pools, which we don't consider aggressive. Our opinion that the city maintains exceptional access to external liquidity is based on its history of issuing GO debt as well as having issued revenue debt in the past. Frisco does not have any direct purchase agreements or privately placed debt that could pressure liquidity.

### **Very weak debt and contingent liability profile**

In our view, Frisco's debt and contingent liability profile is very weak. Total governmental fund debt service is 26.6% of total governmental fund expenditures, and net direct debt is 254.4% of total governmental fund revenue.

The city's historically high debt profile is in part due to managing a significant increase in service demand and population growth. We do not expect additional debt or the city's very high and weak debt profile will materially weaken overall credit quality. In the next two years, the city has plans for additional borrowing to finance various projects required to meet high growth and development demands. It has no variable-rate debt or swaps outstanding.

Frisco's pension contributions totaled 5.2% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

### **Pension and other postemployment benefits (OPEB) liabilities**

We do not anticipate any direct credit pressure from the city's involvement with its pension and OPEB obligations. The city participates in the following plans:

- The Texas Municipal Retirement System (TMRS), funded ratio of 80% and net pension liability of \$54.7 million.

The city contributes to a nontraditional, joint contributory, hybrid defined-benefit pension plan administered by the TMRS. Under state law governing the TMRS, an actuary determines the contribution rate annually. Frisco does not provide postretirement health or dental care benefits to retirees. Retired employees are entitled to elect continuation coverage under the city's health insurance plan. However, they are responsible for 100% of the premium costs and this plan is not part of the city's active employee plan but included in a separate risk pool. Therefore, the city has minimal direct or implicit cost for retirees' health care coverage and no measurable OPEB liability.

### **Strong institutional framework**

The institutional framework score for Texas municipalities is strong.

## **Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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