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Summary:

Cedar Hill, Texas; General Obligation

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US\$10.735 mil GO bnds ser 2020 due 02/15/2040

Long Term Rating AA/Stable New

US\$8.615 mil comb tax and rev certs of oblig ser 2020 due 02/15/2040

Long Term Rating AA/Stable New

Cedar Hill GO

Long Term Rating AA/Stable Affirmed

Cedar Hill GO

Long Term Rating AA/Stable Affirmed

Cedar Hill GO

Long Term Rating AA/Stable Affirmed

Rationale

S&P Global Ratings has assigned its 'AA' long-term rating to the city of Cedar Hill, Texas' series 2020 general obligation (GO) bonds and series 2020 combination tax and revenue certificates of obligation. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating on the city's GO debt outstanding. The outlook is stable.

Security and use of proceeds

The city's new and existing GO bonds and certificates are secured by a limited-ad valorem tax, levied on all taxable property within the city. The certificates are additionally secured from a limited pledge not to exceed \$1,000 of the surplus net revenues of the city's waterworks and sewer system. Given the limited nature of the additional pledged revenues, we base our ratings on these obligations on the city's ad valorem tax pledge.

Texas statutes limit the ad valorem tax rate for home rule cities to \$2.50 per \$100 of taxable assessed valuation (AV) for all city purposes. The state attorney general will permit the allocation of \$1.50 of the \$2.50 maximum tax rate for ad valorem tax debt service. In fiscal 2020, Cedar Hill's total tax rate was well below the state's and city's maximum thresholds at 69.7 cents per \$100 of AV, 17.3 cents of which is dedicated to debt service. Despite state statutory tax-rate limitations, we do not differentiate between the city'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 supports our view of the city's overall ability and willingness to pay debt service. The proceeds from the series 2020 bonds (par amount of \$10.735 million) will finance the construction, renovation, and improvement of various bridges, transportation corridors, and park and recreation facilities; and storm drainage improvements. The series 2020 certificates (par amount of \$8.615 million) will finance various infrastructure related projects for its downtown streets master plan. Following these issuances, total outstanding debt will be \$109.3 million of which we consider \$12.8 million self-supporting.

Credit overview

The long-term rating reflects our view of city's healthy financial position that is supported by a strong financial management framework that we assess will contribute to long-term credit stability. Strong revenue growth and conservative budgeting have contributed to a track record of positive budgetary performance, resulting in the maintenance of a very strong reserve and liquidity position that we expect to continue in the medium term. The city's location in the broad and diverse Dallas-Fort Worth-Arlington metropolitan statistical area (MSA) and along major transportation corridors should continue to foster ongoing economic growth that drives expansion of its revenue base to support fiscal stability. While the city's economic metrics continue to strengthen, they are not commensurate with those of higher rated peers. However, we acknowledge that the city's development pipeline could result in a material improvement in wealth levels in the medium-term. Beyond the outlook period, we assess the city's long-term credit stability will likely reflect its ability to address its capital pressures without over-leveraging itself, and the continuous maintenance of its healthy reserve position to sustain operations should a downturn in the economy affect the city's ability to generate sufficient operating revenue from its tax base.

The rating reflects our assessment of Cedar Hill's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with "strong" financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 37% of operating expenditures;
- Very strong liquidity, with total government available cash at 98.1% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 17.8% of expenditures and net direct debt that is 187.2% of total governmental fund revenue, but rapid amortization, with 69.2% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Two-Year Stable Outlook

Upside scenario

All else equal, we could raise the rating if Cedar Hill's economic base continues to expand and diversify during various stages of an economic cycle, resulting in wealth and income levels comparable with those of higher-rated peers.

Downside scenario

We could lower the rating if Cedar Hill's financial performance were to experience significant deterioration, leading to sustained and significant decreases in reserves, below levels we consider very strong.

Credit Opinion

Strong economy

Known as the "hill country" of the Dallas-Fort Worth metroplex, Cedar Hill is a predominantly residential community located roughly 15 miles southwest of downtown Dallas where it boasts the highest elevation between the Red River and the Gulf of Mexico. The city is intersected by U.S. Route 67 which provides residents strong access to jobs throughout the broad and diverse MSA for additional employment opportunities. The local economy is largely based in retail, with growing presences in the healthcare and manufacturing sectors.

After contracting in fiscal 2010 due to the national economic downturn, the city's property tax base has demonstrated healthy growth. Cedar Hill's strong tax base growth is attributed to appreciation from existing properties coupled with ongoing commercial and residential development that officials anticipate will continue due to an assortment of projects in varying stages of development. As a result of ongoing development and reappraisal, the city's tax base growth has averaged 7.1% over the past five years. In aggregate, the tax base increased approximately \$1.1 billion, or 41% since tax year 2014. The city's market value reached \$4.5 billion in fiscal 2020 resulting in per capita MV of \$86,742 and a projected per capita effective buying income of 88.8% of the national level. The weight-averaged unemployment rate of the counties was 3.7% in 2018.

Some highlighted developments noted by the city is the current construction of Preston Trail, a mixed-use multi-family project and phase II of the Bear Creek neighborhood which will plat 135 lots with 40 to 50 homes expected to become vertical by the end of 2019. The Cedar Hill Economic Development Corporation approved a development agreement for a mixed-use development project in historic downtown Cedar Hill. The 40,000 square foot mixed-used project will offer a retail, restaurant, and office space. Recently a Fairfield Inn came online and construction for Hampton Inn and A-loft hotel and conference center broke ground in 2019. Construction is expected to break ground in mid-2019. City officials report that the Texas Department of Transportation (TxDOT) recently completed a \$59 million construction project of U.S. 67, which started in May 2017 that provides infrastructure enhancements to meet local and regional travel demands by increasing capacity and provide congestion relief.

Additionally, TxDOT has proposed to construct a loop that connects U.S. 67 to IH 35E that will further increase mobility in the region. We assess these transportation endeavors will be a mechanism to stimulate additional development and commerce for Cedar Hill. Furthermore, the city is currently updating to further encourage development-redevelopment with targeted strategies that prioritize initiatives that allow for a unified effort to retain, expand, and attract new businesses and activity; enhance the live-work-recreate conditions; and preserve and enhance the community's diversity. We assess that the city's advantageous location, coupled with the various developments that have been completed or are in the pipeline, will support long-term economic strength and stability.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Management uses five years of historical information to generate the revenue and expenditure assumptions used in the budget process, including data at the individual-source level provided by the city appraiser for revenue projections. Management provides city council with quarterly financial reports of budget-to-actual comparisons and investment updates on performance and holdings. The budget can be amended as needed. The city also performs formal long-term financial planning, with comprehensive multi-year projections forecasting five years into the future, which are updated annually and reviewed by council during budget preparations.

Management's investment policy is in accordance with state guidelines. The city maintains a formal and comprehensive five-year capital improvement plan, with projects and funding sources identified. Cedar Hill has a formal debt management policy that is mostly qualitative in nature, but includes a quantitative target for refunding's requiring a minimum present value savings of 4%. Its formal reserve policy calls for an available general fund balance of 25% of operational expenditures, to which it has historically adhered.

Strong budgetary performance

In assessing the city's budgetary performance, we adjusted for annually recurring transfers into the general fund and eliminated expenditures toward capital outlay across all governmental funds that were funded from bond proceeds and excess revenues. Cedar Hill's budgetary performance remains strong after adjustments, which reflect operating surpluses of 1% of expenditures in the general fund and of 3.9% across all governmental funds in fiscal 2018. The city has historically maintained strong budgetary performance, resulting from a combination of conservative budgeting and strong revenue growth. The budget is monitored regularly throughout the year, and final results are frequently better than budgeted.

The strong fiscal 2018 performance stems from conservatively strict expenditure controls, which resulted in positive final budget-to-actual variances. During fiscal 2018, actual general fund expenditures were \$946,877 less than the final budget, which mitigated the negative variance in final budgeted revenues, leading to a total positive variance of \$326,193 prior to other financing sources. After transfers, the net change in the city's fund balance totaled approximately \$336,493. The underlying factors for the city's positive performance at year-end was due to expenditure line items performing below budget largely tied to personal related savings.

Recent residential and economic expansion has required the city to balance growth-related capital needs with support for new and existing operational expenditures however, we assess management is equipped with an embedded budgetary planning framework that supports its overall strong budgetary performance. In addition, the city derives general fund revenue from a diverse and historically reliable mix of revenue sources. For fiscal 2018, property taxes accounted for 53% of general fund revenue, followed by sales tax (21%), and franchise taxes (10%). Both property and sales tax revenue streams have generally increased in line with the city's expanding economy and management believes this trend will continue in tandem with taxable value growth.

The city's preliminary unaudited fiscal 2019 figures indicate it ended with a \$1.3 million surplus net of year-end

transfers due to positive variances in both revenues and expenditures, stemming from strong sales and property tax collections, coupled with personal savings across multiple departments. The city adopted the fiscal 2020 budget, which anticipates break-even results at year end after transfers and year-to-date figures indicate the budget is on target. Given management's conservative assumptions and the city's history of strong performance, we assess the city's operations will remain at least balanced as ongoing economic expansion drives operating revenue and the city maintains conservative budgeting practices.

Very strong budgetary flexibility

Cedar Hill's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 37% of operating expenditures, or \$12.6 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. The available fund balance includes \$8.8 million (26.1% of expenditures) in the general fund and \$3.8 million (11.4% of expenditures) that is outside the general fund but legally available for operations.

Our calculation of the city's available fund balance includes roughly \$3.8 million held in the city's street construction, economic development incentive, building maintenance, downtown city center, and drainage funds which can be accessed and used for general operating purposes at the council's discretion.

Cedar Hill has historically maintained very strong reserve levels, in our view, exceeding 33% of operating expenditures in the most recent three fiscal years. Fiscal 2019 preliminary unaudited results indicate a surplus of roughly \$1.3 million, further strengthening available reserves to roughly 41% of general fund expenditures when including non-general fund available balance. In addition, we assess that, in keeping with its traditionally conservative budgeting practices, the city will likely continue to make intrayear expenditure and revenue adjustments to outperform the budget at year end. Given our expectation of continued strong budgetary results and no plans to materially reduce reserves in the near term we expect budgetary flexibility to remain very strong

In 1975 the city executed a contract with the Trinity River Authority of Texas to purchase water conservatory rights from Joe Pool Lake (JPL). The city has been accruing funds since fiscal year 1995 to pay for this obligation and was able to early retire its long-term contract liability for water rights following the passage of the Federal Water Infrastructure Improvements for the Nation (WIIN) Act in December 2016. The early retirement allowed the city to experience an infusion of approximately \$18.5 million in available funds. Management has noted that city council recently adopted an ordinance that authorized the creation of the JPL nature corridor permanent fund. The funds primary purpose is to provide a perpetual revenue stream for preservation and development activities related to JPL. Furthermore, eligible revenue derived from the permanent fund may be distributed annually to the opportunity fund that's used for operation and maintenance expenditures related to JPL projects. While we do not incorporate the excess amount into our reserve analysis we acknowledge that it adds supplementary flexibility and help alleviate potential operating stress as the fund is self-funded and will use perpetual revenue to address capital and maintenance needs related to JPL.

Very strong liquidity

In our opinion, Cedar Hill's liquidity is very strong, with total government available cash at 98.1% of total governmental fund expenditures and 5.5x governmental debt service in 2018. In our view, the city has strong access to

external liquidity if necessary.

Cedar Hill has historically had what we consider very strong cash balances, and given management's demonstrated ability to maintain balanced operations, we do not believe the city's cash position will worsen. All of the city's investments comply with both Texas statutes and its formal internal policy, and were held in certificates of deposit, local government investment pools, municipal bonds, and agencies at the end of fiscal 2018, none of which we view as aggressive. Cedar Hill's strong access to external liquidity is demonstrated by its access to the market in the past three decades, hallmarked by numerous GO backed bond issuances. Lastly, the city has no exposure to contingent liabilities that could pose a material risk to liquidity. Therefore, we do not expect the city's liquidity position to deteriorate from its very strong position in the near term.

Weak debt and contingent liability profile

In our view, Cedar Hill's debt and contingent liability profile is weak. Total governmental fund debt service is 17.8% of total governmental fund expenditures, and net direct debt is 187.2% of total governmental fund revenue.

Approximately 69.2% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Cedar Hill does not have any swaps or variable-rate debt. The city's direct debt burden includes \$109.3 million of tax-backed debt, including GO bonds and certificates of obligation. Our ratios have been adjusted to reflect the portion of tax-backed debt supported by the city's water and sewer system fund leading to a net direct debt burden of \$96.5 million.

Cedar Hill's adopted CIP serves as a blueprint to address subsequent growth and development in a prudent manner. The plan for the general fund totals about \$38.9 million for fiscal years 2020-2024. All projects included in the CIP have identified funding sources that are determined with consideration of the city's financial capacity, potential effects on the tax rate, and operations and maintenance. We expect the city's debt burden to remain elevated, as Cedar Hill will likely issue additional debt as outlined in its five-year CIP.

Given the city's rapid amortization, we anticipate debt service costs will remain manageable as new debt is issued. However, if debt service carrying charges increase to levels we consider weak, we acknowledge that the city has the ability to adjust the I&S portion of its tax levy to mitigate any budgetary pressures. Depending on the timing of new debt relative to the current amortization schedule, our opinion of the city's debt and liability profile may change to very weak, although we do not expect it to have a near-term impact on the city's overall credit quality.

Pension and other postemployment benefits highlights

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate credit risk for the city largely as a result of the healthy funded status of the city's largest retirement plan that results in affordable contributions. The plan's strong funding status and generally sound funding assumptions result in a minimal annual contribution. Cedar Hill's combined required pension and actual OPEB contributions totaled 6% of total governmental fund expenditures in 2018. Of that amount, 5.9% represented required contributions to pension obligations, and 0.1% represented OPEB payments. The city made its full annual required pension contribution in 2018.

Cedar Hill participates in the following plans:

- Texas Municipal Retirement System (TMRS) 90.01% funded with a net pension liability of \$10.1 million.

TMRS made significant funding progress in the most recent year, with actuarially determined contributions in excess of static funding and close to our minimum funding progress metric. The MFP metric assesses whether the most recent employer and employee contributions cover total service cost, plus unfunded interest cost, plus one-thirtieth of the principal. When MFP is achieved it indicates that an issuer has a strong funding discipline that aims to ensure timely progress on reducing its plans' liabilities. The funding progress toward the systems liability in fiscal 2018 is largely due to investment earnings exceeding the plans return assumption. The plan uses a discount rate of 6.75%, which could lead to some contribution volatility. However, TMRS's asset valuation method helps stabilize contribution rates. Furthermore, the plan has a 26-year closed amortization period, which we view as extended, leaving greater potential for costs to grow based on actual performance. Lastly, contributions are likely to grow given the level percent of payroll funding method, as opposed to level-dollar contributions, which would result in consistent payments.

Cedar Hill participates in the following OPEB plans:

- TMRS Supplemental Death Benefits Plan (SDBF); and
- OPEB in the form of self-funded health care.

Cedar Hill has not established an irrevocable trust for its post-employment medical care so contributions to the plan are on a pay-as-you-go basis for claims in excess of retiree contributions. Given claims volatility, as well as medical cost, and demographic trends, cost to the plan are likely to escalate. Ho, although the city has some legal flexibility to modify these benefits, which could help reduce future costs.

SDBF 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 \$833,038. In 2018, benefit payments were \$32,339. Lastly, the city may terminate coverage under and discontinue participation in the Supplemental Death Benefits Fund by adopting an ordinance before Nov. 1 of each calendar year.

Strong institutional framework

The institutional framework score for Texas municipalities is strong.

Outlook

The stable outlook reflects our view of the city's growing economy within the broad and diverse Dallas-Fort Worth-Arlington MSA, as well as its very strong flexibility and liquidity. Although we believe the city will likely continue to issue debt to fund significant capital expenditure needs, the outlook reflects our expectation that management will likely issued debt relative to its tax base growth and debt management policy. For these reasons, we do not expect to change the rating over the two-year outlook period.

Upside scenario

All else equal, we could raise the rating if Cedar Hill's economic base continues to expand and diversify during various stages of an economic cycle, resulting in wealth and income levels comparable with those of higher-rated peers.

Downside scenario

We could lower the rating if Cedar Hill's financial performance were to experience significant deterioration, leading to sustained and significant decreases in reserves, below levels we consider very strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

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