S&P Global
Ratings

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Summary:
Deer Park, Texas; General Obligation

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Credit Profile		
US$4.605 mil certs of oblig ser 2019 dtd 12/01/2019 due 03/15/2039		
Long Term Rating	AAA/Stable	New
US$4.435 mil ltd tax rfdg bnds ser 2019 dtd 12/01/2019 due 03/15/2030		
Long Term Rating	AAA/Stable	New
Deer Pk GO		
Long Term Rating	AAA/Stable	Affirmed
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

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Deer Park, Texas' series 2019 certificates of obligation and series 2019 limited-tax refunding bonds. At the same time, we affirmed our 'AAA' long-term rating on the city's general obligation (GO) debt outstanding. The outlook is stable.

Credit overview

The long-term rating reflects Deer Park's strong overall financial profile, which has historically yielded consistent and positive budgetary performance and enabled the city to cash fund a large portion of capital-related expenditures from excess revenue, while it maintained very strong reserves well above 75% of expenditures. Underlying the city's strong financial performance is a diverse and growing economy due to the city's location in the Houston metroplex and along a highly industrialized shipping channel. The city's economy also benefits from the presence of several industrial manufacturers and petrochemical refining plants within its industrial zone that have historically provided a stable revenue stream. Given that the taxable values associated with the Industrial District Agreements (IDAs) are not reflected in the city's ad valorem tax base, we acknowledge that the city's market value per capita is significantly understated. Considering a lack of material budget pressures, the city expects its budget to remain structurally balanced over the near term, supporting the stable outlook.

The rating reflects our assessment of the following credit characteristics:

- 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 2018;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2018 of 107% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.9x total governmental fund expenditures and 13.8x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 13.6% of expenditures and net direct debt that is 74.3% of total governmental fund revenue, as well as rapid amortization, with 70.8% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Security and use of proceeds

A limited-ad valorem tax, levied on all taxable property within the city, secures the 2019 certificates and 2019 limited-tax refunding bonds as well as the city's GO bonds and certificates outstanding. The certificates outstanding are additionally secured by a limited pledge of a subordinate lien on the net revenues of the city's waterworks and sanitary sewer system in an amount not to exceed $1,000. Given the limitation of the net utility system revenue pledge, the certificates are rated based on the city's ad valorem tax pledge.

State 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 Texas attorney general permits the allocation of $1.50 of the $2.50 maximum tax rate for ad valorem tax debt service. In fiscal 2019, Deer Park's total levy is well below the maximum at 72 cents per $100 of AV, 17.06 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. Proceeds from the series 2019 certificates will be used to finance sewer rehabilitation, water line replacement, improvements to the city's surface water treatment plant, ground storage tank rehabilitation, and painting of the elevated storage tank at the Coy Street Water Plant. Proceeds from the limited-tax refunding bonds will be used to refinance a portion of the city's debt outstanding for interest cost savings.

Strong economy

Deer Park, with an estimated population of 34,537, is strategically located in the center of a highly industrialized shipping channel and participates in the Houston-The Woodlands-Sugar Land MSA, which we consider to be broad and diverse. The local economy is based largely in manufacturing, petrochemicals, distribution, and retail, with one of the three major city areas--the industrial zone--occupied by many employers in the industrial sector. In fiscal 2018, the city's primary employers were Shell (with 3,100 employees), Deer Park ISD (1,868), Lubrizol Specialty Chemicals (1,360), and Universal Plant Services (1,342). In 2014, the city reached a contractual arrangement to remove 21 separate companies in the industrial zone from the tax roll in return for predictable payments-in-lieu-of-taxes (PILOTs), equal to roughly 64% of what the companies would have owed were they subject to full ad valorem taxation by the city. To date, the city currently has 27 industrial district agreements. The net fair value of industrial district properties was $2.63 billion in fiscal 2018.

The city's certified taxable value for fiscal 2020 is $3.004 billion, having increased 7.9% year-over-year. Over the last five years, taxable value has increased approximately 7.2% per year. The city has a projected per capita effective buying income of 103.9% of the national level and per capita market value of $105,524. We note that these figures do not include the IDA properties within the city's extraterritorial jurisdiction and recognize that assessed value per capita is understated because the IDA properties are not reflected on the tax rolls. 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.

Management reports that commercial growth continues to be strong, with a number of retail and light-industrial projects currently in development, including a mixed use retail complex projected to generate nearly $40 million in combined property and sales tax revenue over the next 15 years. City officials report that its 150-acre light industrial park has finally reached full build out with the last parcel currently under construction for a 300,000 square foot distribution warehouse by CAP Barbell. In addition, the city reports a number of large offices and warehouses that have recently came online or in varying stages of development Given ongoing development, access to the Houston MSA, and a robust industrial presence, we expect our view of the local economy to remain strong over the near term.

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 on a regular basis.

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. The city maintains a rolling 10-year capital improvement plan, which is linked to the operating budget and identifies funding sources for future capital projects. 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. The city does not currently perform formal long term financial planning.

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. Deer Park's budgetary performance remains strong after adjustments, which reflect operating surpluses of 3.7% of expenditures in the general fund and of 19.3% across all governmental funds in fiscal 2018. Deer Park has consistently adopted balanced budgets based on conservative revenue and expenditure assumptions that has allowed the city to historically maintain strong budgetary performance leading to an established track record of operating surpluses subsequently swelling available reserves over the years.

The strong fiscal 2018 performance stems from conservatively estimating revenues and strict expenditure controls, which resulted in positive final budget-to-actual variances. During fiscal 2018, actual general fund expenditures were $5.3 million less that the final budget, and revenues were $2.5 million over budget, leading to a positive variance of $7.1 million prior to other financing sources. Consistent positive performance at year-end has enabled the city to transfer excess revenue to self-finance various capital projects. After transfers, the net change in the city's fund balance totaled roughly $1.8 million. The underlying factors for the city's positive performance at year-end was due to higher-than-anticipated collections from sales taxes coupled with all expenditure line items performing below budget.

Deer Park's primary sources of general fund revenue in fiscal 2018 were property taxes (33%), "in lieu" payments under industrial district contracts (27%), and sales tax (16%). Both property and sales tax revenue streams have generally increased in line with the county's expanding economy and management believes this trend will continue in tandem with taxable value growth. In addition, PILOT payments will increase due to terms within the industrial district contracts requiring payments be based on 64% of taxable value for the next four years.

Deer Park's fiscal 2019 budget calls for break-even operations when incorporating other financing sources. However, year-to-date estimates indicate that the city will produce an operating surplus of roughly $8.4 million. Due to the large surplus, the city transferred out approximately $8.3 million for PAYGO capital expenditures, golf course lease fund, and chapter 380 agreement. The net change in the city's fund balance after transfers will total roughly $82,000. Lastly, the city proposed a balanced budget for fiscal 2020 with no significant budgetary pressures or issues identified that could adversely affect performance. Similar to prior years, the positive variances generated at year-end will allow the city to continue using excess revenue to fund PAYGO capital projects and add to its available fund balance. Based on recent history and no material source of near-term budget pressure, we anticipate that the city will continue to produce strong budgetary results in the near term as ongoing economic expansion drives operating revenue and the city maintains conservative budgeting practices.

Very strong budgetary flexibility

Deer Park's budgetary flexibility is very strong, in our view, with a high available fund balance in fiscal 2018 of 107% of operating expenditures, or $38.2 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. In addition, we assess that, in keeping with its traditionally conservative budgeting practices, the county 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, should reserve levels be pressured, we assess that Deer Park has the ability to reduce or eliminate its transfer of excess revenue to its capital projects fund, thereby maintaining reserves in accordance with policy.

Very strong liquidity

In our opinion, Deer Park's liquidity is very strong, with total government available cash at 1.9x total governmental fund expenditures and 13.8x governmental debt service in 2018. 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, and 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 both Texas statutes and its formal internal policy, and were held in certificates of deposit and local government investment pools at the end of fiscal 2018, none of which we consider aggressive.

We understand that the city has two series of debt that has been privately placed with principal outstanding of $7.625 million (9.9% 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

Revenue-backed debt supported through the city's enterprise fund has been adjusted in our direct debt-to-revenue calculations. Total governmental fund debt service is 13.6% of total governmental fund expenditures, and net direct debt is 74.3% of total governmental fund revenue. Approximately 70.8% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor. The city anticipates issuing debt to fund capital projects outlined in its 10-year capital improvement plan. Based on the current plan, approximately $5.6 million of water and sewer projects will be funded by that debt issuance. Given the utility-related purpose of the issuances, officials will more than likely continue the practice of supporting debt service for utility projects with utility revenues, while also being secured by the city's GO pledge.

Given the city's rapid amortization, we anticipate debt service costs will remain manageable as new debt is issued. Depending on the timing of the 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 would not expect it to have a near- or medium-term impact on the city's overall credit quality.

Pension and other post-employment benefits liabilities

We do not view pension liabilities as an immediate source of credit pressure for Deer Park, given our opinion of city's overall strong plan funding status and currently affordable contributions, although we do see a small risk of cost escalation.

Deer Park participates in the following plans as of Sept. 30, 2018:

- Texas Municipal Retirement System (TMRS) 94.87% funded with a net pension liability of $6.6 million;
- Texas Emergency Services Retirement System (TESRS) 81.4% funded with the city's proportionate share of TESRS net pension liability at $555,797; and
- Deferred Compensation Plan.

The city's combined required pension contributions to TMRS and TESRS totaled 6.8% of total governmental fund expenditures in 2018. TMRS made significant funding progress in the most recent year, with actuarially determined contributions in excess of static funding and very close to our minimum funding progress metric. The funding progress toward the systems liability is largely due to investment earnings exceeding the plans return assumption. Actuarial assumptions include a discount rate of 6.75% and a 28-year closed amortization period. The plan's assumed discount rate is not considered aggressive, in our opinion, though we consider the closed amortization period of 28 years 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.

TESRS also made significant funding progress in the most recent year, with actuarially determined contributions exceeded both static funding and minimum funding progress, indicating our view of timely progress on reducing pension liabilities. Actuarial assumptions include a discount rate of 7.75% reflecting a high level of market risk, and a 30-year open amortization period. We view open amortizations as more risky because they are not designed to fully pay off unfunded liability; however, timely progress on reducing liabilities is still being made. Lastly, the state is required to contribute an amount necessary to make the total system contributions actuarially sound.

The city's deferred compensation plan is available to all employees and allows them to defer a portion of their salary until future years. The plan is not available to employees until termination, retirement, death, or an unforeseen emergency.

Deer Park participates in the following OPEB plans:

- TMRS Supplemental Death Benefits Plan, and
- OPEB in the form of health care.

Health care is funded on a pay-as-you-go basis., which given claims volatility, as well as medical cost, and demographic trends, is likely to lead to escalating costs, although the city has some legal flexibility to modify these benefits, which could help reduce future costs. In regards to the supplemental death benefits plan, the city contributes to the plan at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. 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.

Deer Park's GO debt is eligible to be rated above the sovereign because we assess the town can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above the Sovereign--Corporate and Government Ratings: Methodology And Assumptions" (published Nov. 19, 2013), U.S. local governments are considered to have moderate sensitivity to country risk. The city's GO pledge is the primary source of security on the debt; this severely limits the possibility of negative sovereign intervention in the payment of the debt or in the town's operations. The institutional framework in the U.S. is predictable for local governments, allowing them significant autonomy, independent treasury management, and no history of government intervention. Deer Park has considerable financial flexibility, as demonstrated by its very strong general fund balance as a percentage of expenditures, as well as very strong liquidity.

Outlook

The stable outlook reflects our view of management's historical commitment to maintaining very strong reserves as evidenced by its overall strong financial profile and expect that the petrochemical industry will likely remain a strong local economic driver, despite fluctuations in commodity prices. In addition, the outlook reflects our opinion that Deer Park will continue to benefit from its access and participation in the broad and diverse Houston-The Woodlands-Sugar Land MSA, allowing for continued economic growth and subsequent tax revenue gains. As a result, we do not expect to change the rating over the next two years.

Downside scenario

While unlikely, we could lower the rating if Deer Park's available reserves were to materially weaken to levels below 75% of operating expenditures, either through large one-time expenditures or consistently weak budgetary performance.

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