

Rating Update: Moody's affirms A1 on the City of Kennedale's, TX GOLT

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KENNEDALE (CITY OF) TX
Cities (including Towns, Villages and Townships)
TX

Opinion

NEW YORK, December 11, 2014 --Moody's Investors Service has affirmed the A1 rating on the City of Kennedale's, TX \$565 thousand in outstanding certificates of obligation. The certificates are direct obligations of the city and are secured by the ad valorem tax levy within the limits prescribed by law as well as a subordinate lien on surplus revenues of the city's Waterworks and Sewer System. Kennedale has approximately \$16.5 million in debt including long-term obligations not rated by Moody's.

SUMMARY RATING RATIONALE

The A1 affirmation is based primarily on improvements to the local economy evidenced by residential and commercial development activity as well as expected growth in total full value. The rating action also takes into account the multi-year draws on reserves to levels below similarly rated peers, and moderate debt burden with average principal payout.

STRENGTHS

- Expanding and diversifying tax base
- Improving socioeconomic profile

CHALLENGES

- Narrowing reserve levels below similarly rated peers
- Persistent structural imbalance
- Moderate debt burden

DETAILED CREDIT DISCUSSION

TREND OF NARROWING RESERVES

The city's financial history has been marked with consistent operating deficits due to declining sales taxes. While near term projections reflect surplus operations in fiscal 2014, medium term projections reflect fiscal challenges persist. Over the past six years, the General Fund reported operating deficits in all but one year (2009). Fiscal 2013 ended with a \$198 thousand operating deficit, the fourth consecutive year of moderate draws on reserves. The General Fund balance fell to \$984 thousand, or 15.7% of General Fund revenues, about half of the median for similarly rated peers. Declining sales tax revenues is a significant factor in the structural imbalance; General Fund revenues typically are comprised of approximately 15% revenues from sales taxes. For fiscal 2014, the city adopted an amended budget which reflected a further fund balance decline to \$883 thousand. According to unaudited fiscal 2014 results the General Fund balance increased by \$447 thousand to \$1.4 million, or 18% of revenues. The favorable performance is partly due to a tax rate increase and improved sales tax revenues. During the fiscal year, the city increased the total tax rate to \$7.48 per \$1,000 in assessed value, compared to the previous \$7.23 total tax rate; the total tax rate remained flat in 2015. Of the total, \$5.51 was allocated to the General Fund, and \$1.96 to the Debt Service Fund. Despite the increase, the tax rate remained well below the statutory cap of \$25 per \$1,000 of assessed values. Sales tax revenues increased due to the opening of two new fast food restaurants during the fiscal year. The city budgeted for a \$426 thousand deficit in fiscal 2015. Officials report that expenditures are being carefully monitored, and a lower deficit is expected. Over the next four years, city officials plan to improve the General Fund balance to the goal of 25% of expenditures within the next four years. However, outside of expected gains in the local economy, no formalized plan exists to close the budget

gap, which remains a weakness for the credit.

EXPECTED GROWTH IN MODERATELY-SIZED TAX BASE FOLLOWING YEARS OF MODEST DECLINES

The City of Kennedale is conveniently located between the Cities of Fort Worth (Aa1/STA) and Arlington (Aa1/STA) with easy access to major highways including Interstate Highway 20, Loop 820, and US Highway 287. The \$564 million tax base is mainly residential with some light industry. After a few years of modest declines in full value, the fiscal 2015 certified assessment grew 6% due to residential and business development gains in a recovering economy. The city expects similar growth levels in subsequent years. Four residential subdivisions are currently under construction, adding 201 new homes with values ranging from \$265 thousand to \$350 thousand. Development on another 183 home subdivision in the southwest part of town will begin in late 2015 or early 2016. A planned closure of three race tracks to open the area for further residential development is expected to generate approximately 450 additional home sites. The northern part of town near the major thoroughfares is a planned employment center. This is the location of Fort Worth Tower (FWT), Inc., a radio/telephone tower manufacturing firm and the City's largest employer with about 480 employees. The company recently purchased 35 acres for expansion and is expected to surpass 500 personnel over the next year. Furthermore, retail and fast food establishments are opening in this area, and negotiations are currently underway for the construction of a hotel. The developments are expected to continue driving taxable value growth in the next few years.

The tax base is moderately concentrated. The ten largest taxpayers compose a 13.3% share of total full value, a marked decrease from 17.5% in the previous year. Moody's views the simultaneous full value growth and declining concentration as a credit positive. The combined AV among principal tax payers fell 20% in the last year primarily because of a lower valuation of FWT, Inc. City officials report that the drop in taxable value for FWT, Inc was anomalous and mainly due to a temporary reduction in inventory.

MODERATE DEBT BURDEN WITH ADDITIONAL DEBT ISSUANCE PLANS

The city's direct debt position is above average for the rating category at 2.96% of total full value on a fiscal year 2015 valuation. Net of self supporting debt, the burden reduces to 2.36%. The payout schedule is satisfactory with 72% of principal retired in ten years. Debt service payments were 18% of fiscal 2013 operating expenditures. The city is planning for another debt issuance of approximately \$796,000 in early 2016. Expectations are the debt will initially be supported by the Water and Wastewater Fund and eventually paid from Tax Increment Reinvestment Zone (TIRZ) funds. Proceeds will finance the extension of a wastewater interceptor for the planned 183 home subdivision in the southwest part of town. The Water and Wastewater Fund supports \$3.4 million in debt with an adequate 1.17x net revenue to debt service coverage ratio in fiscal 2013.

Kennedale participates in the state-wide Texas Municipal Retirement System, an agent multiple-employer public employee retirement system. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is \$6.7 million. The three-year average ANPL equates to a manageable 1% of fiscal 2015 full value and 0.78x operating revenues.

WHAT COULD CHANGE THE RATING UP

- Significantly improved reserve levels
- Large tax base expansion

WHAT COULD CHANGE THE RATING DOWN

- Failure to return to structural balance and replenish reserves
- Increased debt burden without offsetting increases in full value

KEY STATISTICS

FY 2015 Full Value (\$000): \$563,645

FY 2015 Full Value Per Capita: \$77,895

Median Family Income as % of US: 101.3%

FY 2013 Operating Fund Balance as % of Revenues: 13.18%

5-Year Dollar Change in Fund Balance as % of Revenues: - 6.02%

FY 2013 Operating Cash Balance as % of Revenues: 15.57%

5-Year Dollar Change in Cash Balance as % of Revenues: - 5.45%

Institutional Framework: Aa

5-Year Average Operating Revenues / Operating Expenditures: 0.98x

Net Direct Debt as % of Full Value: 2.36%

Net Direct Debt / Operating Revenues: 1.78x

3-Year Average ANPL as % of Full Value: 1.03%

3-Year Average ANPL / Operating Revenues: 0.78x

RATING METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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