S&P Global Ratings

RatingsDirect®

Summary:

East Aldine Management District, Texas; Sales Tax

Primary Credit Analyst:
Jennifer K Garza (Mann), Dallas (1) 214-871-1422; jennifer.garza@spglobal.com

Secondary Contact:
Kimberly Barrett, Centennial (1) 303-721-4446; Kimberly.Barrett@spglobal.com

Table Of Contents

Rationale

Outlook

Summary:

East Aldine Management District, Texas; Sales Tax

Credit Profile		
East Aldine Mgmt Dist sales tax (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
East Aldine Mgmt Dist sales tax		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating on East Aldine Management District, Texas' series 2009 and 2016 tax-increment contract revenue bonds to 'AA-' from 'A' due to its criteria application of the "Priority-Lien Tax Revenue Debt," published Oct. 23, 2018. The outlook is stable.

The bonds are a special obligation of the district, payable from, and secured by, a lien on and pledge of gross proceeds of a 1% sales-and-use tax levied within the district, plus an additional 1% special zone sales tax covering a portion of the district. A fully funded debt service reserve fund equal to the lesser of the maximum annual debt service (MADS) requirement or the maximum amount in a reasonably required reserve fund that management can invest without restriction as to yield further secure the bonds. We rate the bonds under our Priority Lien criteria, which factors in both the strength and stability of the pledged revenues, as well as the general credit quality of the municipality where taxes are distributed and/or collected (the obligor's creditworthiness or OC).

Key credit considerations include:

- Continued expansion and diversification of the district area;
- Very strong audited sales tax collections through 2017 and debt service coverage (DSC) at 3.5x MADS;
- Our view that nationwide sales tax revenue collections have exhibited relatively low volatility with no history of significant volatility at the local level;
- The district's general creditworthiness partially offsets the above credit strengths of the sales tax bond structure.

While the district has maintained a very strong reserve position compared to the overall budget, we believe the overall operational revenue stream is concentrated with sales tax revenue representing the majority of the operating revenues. While the operating revenues lack diversification, we believe the district's budgetary practices are conservative enough to allow for flexibility to adjust to unfavorable budget performance and maintain very strong reserves. Additional strengths include the district's good wealth and income levels and relatively low debt profile. Offsetting factors are the district area's adequate market value per capita levels and concentration in the operating revenue base that can be

susceptible to down cycles. The priority-lien rating on these bonds is limited by our view of the obligor's creditworthiness and is constrained from being raised unless there is improvement in the OC.

Economic fundamentals: Strong-to-very strong

The roughly 20.3-square-mile district is about 15 miles north of downtown Houston in an unincorporated part of Harris County. The district is home to approximately 55,000 residents in an older area of the county. Houston median household and per capita effective district buying incomes are, in our view, good at 104% and 103%, respectively, of national averages. Retail sales tax generators in the district include a Home Depot home improvement center, M.S. International Inc. (a distributor of flooring, wall, and countertop surfaces), and other retailers and manufacturing companies. The district also has significant business-to-business sales tax activity that officials estimate accounts for a significant amount of collections. Due to the size of the district and the relative size of its leading sales taxpayers, the district's sales tax base, while still concentrated, has moderated with the 10 leading sales tax remitters making up approximately 32% of 2018 collections compared to 40% of total sales tax collections in 2016. Management does not currently have any concerns with its leading taxpayers due to the support and strength of consumer retail and manufacturing operations in the district. We expect future commercial and retail growth will continue to provide for stable growth in sales tax revenue over the next two years.

Coverage and liquidity: Strong-to-very strong

Sales tax growth has been strong. Pledged revenue has grown 39% overall in the past five years with an average annual growth rate of 11% of which management attributes to significant growth and strong business-to-business activity within the district area. The district area collections grew more than 10% every year with the exception of 2016 when the revenue declined by 4% due in part to softening in the oil and gas market.

Management is currently projecting fiscal 2018 pledged revenue will provide approximately $10 million, or 4.14x MADS. The district conservatively budgets for revenues at $8.5 million, but we expect economic activity will continue to increase and provide very strong DSC.

MADS is scheduled to occur in fiscal 2018, but the district's combined debt service schedule is relatively level with payments of approximately $2.4 million each year through fiscal 2025 before annual payments decrease to about $1.2 million in fiscal 2030. The district ended fiscal 2017 with a $6.2 million unrestricted general fund balance, which equates to 139% of the operating budget. To issue additional parity bonds, the authorizing resolution requires the district to maintain not less than 1.5x average annual DSC. We understand management does not currently plan to issue additional sales tax bonds on parity with existing obligations within the next two years. In addition, we believe the district has a disincentive to bond down to the additional bonds test (ABT) since the district primarily uses excess revenue from the sales tax levy to support pay-as-you-go capital projects, public safety and recreational expenses, and staffing costs.

Liquidity is provided through a debt service reserve fund funded at the standard three-prong test, and was funded at MADS with bond proceeds. With strong coverage and a low volatility assessment based on our view of the dependability of sales taxes, there is no downward adjustment to the strong coverage score that would indicate potential liquidity pressures.

Volatility: Low

We assess the volatility of revenues in order to determine the likelihood of the availability of revenues during different economic cycles. We have two levels of volatility assessment: macro and micro.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, it is used to inform our opinion on expectations of future volatility. To determine our view of the volatility of sales taxes, we used total retail food and service sales data from the U.S. Census Bureau for the period 1993-2014.

The district's sales tax collections declined one year during the past 10 years predominately due to a softening in the oil and gas sector. While the district's base is not dependent on or concentrated directly in the oil and gas industry, the health of that sector indirectly influences the sales tax activity within the district. The district experienced a 3.7% decline in sales tax revenues in 2016, during the most recent oil and gas downturn, followed by several years of strong and steady sales tax revenue growth thereafter. Overall we expect volatility to remain low.

Obligor linkage: Close

We believe pledged revenues have exposure to operating risk because taxes are collected by the state at the point of sale and sent directly to the district for payment of debt service. In our view, the district does not benefit from limited scope of operations or extraordinary expenditure flexibility.

Rating linkage to East Aldine Management District

The Texas Legislature created the district in June 2001 to enhance the physical, social, and economic well-being of the Aldine community. It is a governmental entity administered by an appointed nine-member, all volunteer board of directors.

We assess the district's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax. The district's 2017 financial performance and reserve position remains very strong, with a 43% surplus in the general fund amounting to reserves at $6.24 million or 139% of expenditures for fiscal 2017. The district is estimating another strong surplus at 64% of the 2018 budget. Furthermore, the district has a goal to maintain at least $3 million in reserve in case of operational contingencies and at least one year of debt service (about $2.4 million). We view the district's debt profile as low; in particular, it does not provide pension or other postemployment benefits to its employees and the total debt is low at 1.3% of estimated market value. The district does not have any determined debt plans in the near term. The district's economy is good with median household effective buying income at 104% of the national level and market value per capita is adequate at an estimated $37,197 per capita. The district covers 20.3 square miles in unincorporated Harris County, just 15 miles north of downtown Houston. We believe the city's location with access to the broad and diverse Houston metropolitan statistical area and low unemployment supports both the OC, as well as the rating on the bonds.

Outlook

The stable outlook reflects our view of the district's strong ABT coupled with historically very strong DSC. We expect strong retail and business-to-business activity will continue to support strong sales tax collections during the next two years. We do not expect to change the rating during the two-year outlook horizon. However, under our criteria, there is a link between the attributes of the priority-lien pledge and the OC. Therefore, in some cases movement in the priority-lien rating could be dictated or limited by movement in the OC.

Upside scenario

We could raise the rating on the bonds if debt plans remain limited, coverage remains strong, and the district's general creditworthiness improves.

Downside senario

If coverage deteriorates to a level we no longer consider strong, or if the district's general creditworthiness deteriorates, including material draws on their very strong reserves, we could lower the rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.