

RatingsDirect®

Summary:

Hudson, Colorado; Sales Tax

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US\$3.59 mil ltd prop and sales tax rfdg bnds ser 2016 due 12/01/2036

Long Term Rating

A+/Stable

New

Rationale

S&P Global Ratings assigned its 'A+' long-term rating to Hudson, Colo.'s series 2016 limited property and sales tax refunding bonds. The outlook is stable.

The bonds represent limited-tax general obligations (GOs) of the town. An ad valorem property tax limited to 15.966 mills secures the bonds. This mill levy is separate from the town's general fund mill levy of 14.377 mills, which is not pledged to the bonds. The town is also pledging a 2% sales tax to the bonds, but we rate the bonds based on the limited property tax, which we view as the stronger pledge. Bond proceeds will be used to refund the town's series 2009 sales tax bonds and 2009 limited property tax GO bonds.

The rating reflects our view of the town's:

- Weak economy, with a concentrated local tax base, yet with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with "standard" financial policies and practices under our financial management assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2015, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2015 at 92% of operating expenditures;
- Very strong liquidity, with total government available cash at 112.7% of total governmental fund expenditures and 25.0x governmental debt service, as well as access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 4.5% of expenditures and net direct debt at 51.6% of total governmental fund revenue; and
- Strong institutional framework score.

Weak economy

We consider Hudson's economy weak. The town, with an estimated population of 1,570, encompasses approximately 5.7 square miles roughly 30 miles northeast of downtown Denver in Weld County. It is in the Greeley MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 90.2% of the national level and per capita market value of \$93,280. Overall, market value fell by 21.8% over the past year to \$146.5 million in 2017. Weakening Hudson's economy is a concentrated local tax base, with the 10 largest taxpayers accounting for 87.4% of the total tax base. The county unemployment rate was 3.8% in 2015.

We consider the town's participation in and access to the Greeley MSA positive factors. In 2014, the town's population

declined by roughly 39% from 2,580 due to its prison ceasing operations in 2013. The population is expected to remain fairly stable over the next few years compared to the current estimated figure.

The town's assessed value (AV) and actual value experienced significant growth in collection years 2015 and 2016 due to an increase in oil and gas production. In collection year 2015, AV grew 85.2% to \$63.5 million and actual value increased by 19.6% to \$138.3 million. After additional increases in both AV and actual value in collection year 2016 of 11.7% and 13.2%, respectively, values in the town dropped substantially in collection year 2017, according to preliminary figures. In collection year 2017, AV declined by 49.1% to \$36.1 million, which is 5.3% above the collection year 2014 value. Management noted that the steep increases in property values in 2015 and 2016 should be viewed as an anomaly and not representative of typical figures. As evidenced in recent years, we consider production and profit for oil and gas volatile and therefore consider the town's overall AV somewhat volatile as well. Looking ahead, management anticipates stable growth in AV over its 2017 figure due to recent and planned commercial and residential growth.

We consider the town's property tax base concentrated and the oil and gas industry represents a large portion of its AV. During the spike in oil and gas production, Kerr McGee (which includes Kerr McGee Gathering LLC and Kerr-McGee Oil and Gas Onshore L.P.), the town's largest taxpayer, represented 59.2% of total AV in 2016, followed by Inland PPD Hudson Associates, which accounted for 17.1%, and Encana Oil and Gas Inc. at 3.8%. We note that no other taxpayer made up more than 2% of AV. According to preliminary 2017 figures, oil and gas concentration declined and accounted for roughly 28.5% of AV.

Adequate management

We view the town's management as adequate, with "standard" financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

Key policies and practices include the town's:

- Revenue and expenditure assumptions based on several years of historical data and information from outside sources;
- Monthly review of budget-to-actual reports with council participation;
- Maintenance of an informal capital plan that does not meet our FMA criteria;
- Monthly disclosure of investment earnings to the governing body; and
- Formal reserve policy requiring a general fund reserve of one year's operating expenses, to which the town has adhered in the most recent audit fiscal year, inclusive of its taxpayer bill of rights (TABOR) reserve.

We note that the town lacks a formal debt management policy and long-term financial plan.

Adequate budgetary performance

Hudson's budgetary performance is adequate, in our opinion. It had operating surpluses at 37% of expenditures in the general fund and 12.7% across all governmental funds in fiscal 2015. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2015 results in the near term.

As a result of the increase in oil and gas production in collection years 2015 and 2016, the town experienced higher property and sales tax revenues in fiscal 2015 of 103% and 61%, respectively. The increase in revenues, coupled with

only modest expenditure growth, led to the strong operating surplus in fiscal 2015. According to preliminary estimates for fiscal 2016, management expects operating revenues to decline from the 2015 figures by about 29% due to the reduction in oil and gas production-related revenues. However, general fund expenditures are expected to grow by an estimated 53% in fiscal 2016 due to additional staff for new services, as well as several one-time expenses for capital outlay, resulting in a projected operating drawdown of about 12% of expenditures. In 2017, the town has budgeted for an additional general fund drawdown as it completes some of its one-time capital projects. It has budgeted for another decline in overall general fund revenues of 29% in 2017, after adjusting out other miscellaneous revenue, which has historically been significantly lower than budget. Management expects operating revenues to remain stable at this lower level from now on. As evidenced by recent fluctuations, we note that we consider revenues volatile and there is some uncertainty surrounding actual budgetary performance in future years due to the potential for large revenue swings.

Very strong budgetary flexibility

Hudson's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2015 at 92% of operating expenditures, or \$1.4 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 town's fund balances are supported by a formal policy to maintain reserves equal to one year of operating expenditures. We note that, when including the 3% TABOR reserve, fund balances have exceeded the policy target in fiscal 2015.

Very strong liquidity

In our opinion, Hudson's liquidity is very strong, with total government available cash at 112.7% of total governmental fund expenditures and 25.0x governmental debt service in 2015. In our view, the town has strong access to external liquidity if necessary.

In our view, Hudson's liquidity is reinforced by its strong access to external liquidity, with the town having issued sales tax, limited-tax GO, and wastewater revenue bonds within the past 20 years, and we have no reason to believe that its access to markets has diminished. We expect that liquidity levels will not materially change in the next few years. We believe the town does not have aggressive investments, as it currently invests in federal securities and the state investment pool.

Strong debt and contingent liability profile

In our view, Hudson's debt and contingent liability profile is strong. Total governmental fund debt service is 4.5% of total governmental fund expenditures, and net direct debt is 51.6% of total governmental fund revenue.

At this time, the town has no additional debt plans for the near-term. We have confirmed that it has no direct-purchase or variable-rate debt outstanding.

The town made its full annual required pension contribution in 2015.

The town established a deferred-compensation pension plan on behalf of all employees. The plan assets are held by Great-West Financial, the plan administrator.

Strong institutional framework

The institutional framework score for Colorado cities and towns with a budget greater than \$500,000 is strong.

Outlook

The stable outlook reflects our expectation that management will continue to make the adjustments necessary to maintain its very strong financial position, despite volatile revenues. We do not expect to change the rating within the two-year outlook horizon.

Upside scenario

We could raise the rating should the town's economy diversify and reduce concentration in the oil and gas industry. We could also do so if management were to demonstrate the ability to maintain very high reserves and stable budgetary performance through times of economic distress.

Downside scenario

Should the town experience sustained structural imbalance as a result of a significant decline in cyclical revenues, causing it to reduce its available fund balances to levels we no longer consider very strong, we could lower the rating.

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