Fitch Ratings

Fitch Rates Louisville-Jefferson County Metro Government's (KY) $31MM GO Bonds 'AAA'; Outlook Stable

Fitch Ratings-New York-19 October 2018: Fitch Ratings has assigned a 'AAA' rating to the following Louisville-Jefferson County Metro Government, KY bonds:

--$15.8 million tax-exempt general obligation (GO) bonds, series 2018A;
--$14.8 million taxable GO bonds, series 2018B.

The bonds are being issued to repay the series 2017A notes, which were issued for the purpose of initially funding the acquisition and redevelopment of brownfields and adjacent properties in the Butchertown Stadium District Development Area. The bonds are scheduled to sell competitively the week of Oct. 29.

In addition, Fitch has affirmed the following ratings:

--The metro government's Issuer Default Rating (IDR) at 'AAA';
--Approximately $455 million unlimited tax GO bonds at 'AAA';
--Approximately $35 million lease revenue refunding bonds, series 2007A, issued by the Jefferson County Capital Projects Corp., KY, at 'AA+';
--$25 million GO bond anticipation notes (BANs) at 'F1+'.

The Rating Outlook is Stable.

SECURITY
The bonds and notes are general obligations of the metro government, payable from an ad valorem tax on all taxable property within the metro government without limitation as to rate or amount. The lease revenue bonds are special obligations of the Jefferson County, Kentucky, Capital Projects Corporation, payable from appropriated lease rental payments received from the metro government.

ANALYTICAL CONCLUSION

The 'AAA' ratings reflect the metro government's low long-term liabilities, strong revenue and expenditure frameworks, and Fitch's expectation that the metro government will maintain a high level of financial flexibility throughout economic cycles. The one-notch distinction between the 'AAA' IDR and the 'AA+' special obligation rating reflects the slightly higher degree of optionality associated with the appropriation for debt service. The 'F1+' short-term rating corresponds to the metro government's 'AAA' IDR, supporting strong market access for the long-term debt that will take out the BANs.

Economic Resource Base
The city of Louisville and Jefferson County merged in January 2003 to form the combined metro government, replacing the former city and county governments. The metro government area, with a combined population of over 770,000, is the largest local government in the state.

KEY RATING DRIVERS

Revenue Framework: 'aa'
Fitch projects solid revenue growth below U.S. economic performance, but above the level of inflation. The metro government has an ample degree of control to independently raise revenues.

Expenditure Framework: 'aa'
Growth in expenditures should continue to be in line with to marginally above revenue growth, while the metro government has solid flexibility to control its main expenditure items.

Long-Term Liability Burden: 'aaa'
The metro government's long-term liability burden, including overall debt and pension liability, is low.

Operating Performance: 'aaa'
The metro government has the highest level of gap-closing capacity and is expected to manage through economic downturns while maintaining a strong level of fundamental financial flexibility.

RATING SENSITIVITIES
Financial Management: The 'AAA' rating is sensitive to ongoing budget management that maintains financial flexibility sufficient to address periods of economic downturn.

CREDIT PROFILE

Population gains and a relatively stable economic picture contributed to steady growth in property values over the past decade. While taxable assessed value was flat during the downturn, it returned to growth over the past several years, increasing over 22% from 2008 through 2017.

UPS is the area's leading employer, with over 20,000 employees. The healthcare, higher education and government sectors account for most of the remaining top employers in the diverse local economy. The manufacturing sector is also prominent, accounting for a greater percentage of total employment than the national average, which contributed to an elevated unemployment rate during the great recession. Unemployment has generally been in line with the national rate through the recovery.

Revenue Framework
The metro government is largely reliant on a variety of occupational taxes, which include an

employee withholdings tax, a net profits tax, and a tax on insurance premiums (a combined 57% of fiscal 2017 general fund revenue). The metro government's property tax levy accounts for approximately 22% of revenue.

The metro government's historical revenue growth has been at a rate below U.S. GDP, but slightly higher than inflation. Fitch believes that this level of growth is likely to continue given expected continued growth in the metropolitan area. Under Kentucky's House Bill 44 (H.B. 44), the property tax levy on existing property is limited to 4% increases, although new development is excluded from the cap. H.B. 44 also limits the metro government's downside risk, as the cap is only on the total levy and not the rate, allowing the metro government to keep property tax revenue constant year over year despite potential property value declines. Management reports that fiscal 2018 revenue will likely exceed budgeted revenue growth of 3.1% and is budgeting 2.8% growth in revenue in fiscal 2019.

Fitch believes that the metro government has ample legal ability to independently increase revenue. While management operates under the 4% levy cap as a practical limit, it maintains the ability to raise the levy above that cap from a legal perspective. Property tax increases above the 4% levy cap could potentially be subject to a recall vote as per H.B. 44. The metro government also has the ability to increase fees and other locally controlled revenues.

Expenditure Framework

The metro government's main expenditure item is public safety (57% of fiscal 2017 general fund expenditures).

Expenditures have risen in line with revenues, leading to a strong trend of balanced operations. This rate of growth is expected to continue as the majority of growth is tied to labor force salary expenses, which are generally expected to increase with inflation. The metro government's non-union personnel received a 2% cost of living adjustment in fiscal 2019, while union personnel salary increases have varied by contract, but are generally in the 2.5% range.

The metro government has a solid degree of flexibility with its main expenditure items. Carrying costs are moderate, with pension, other post-employment benefits, and debt service costs well under 20% of governmental expenditures net of short-term note repayments. Management estimates increasing pension costs (already over 6% of fiscal 2017 governmental spending) of approximately 12% per year through fiscal 2022, but is being proactive in identifying expenditure savings in other areas in anticipation of this. The metro government's declining debt service schedule also offsets some of the expected increases in pension costs.

The metro government also has an agreement to make annual payments on behalf of the Louisville Arena Authority (LAA) to repay debt issued for the arena project. The annual payments are $10.8 million continuing until through the first to occur of the termination of the commitment of the Commonwealth to pay TIF payments, the final date of the bonds, or Sept. 30, 2054. Management has consistently included and made required payments in annual budgets. Fitch does not expect the arena payments to impact annual budgetary balance.

Long-Term Liability Burden
Overall long-term liabilities are low, with debt and unfunded pension liabilities at less than 6% of personal income. Just over half of the total fiscal 2017 $1.9 billion liability burden is in the form of Fitch-adjusted unfunded pension liabilities. The metro government participates in the cost-sharing defined benefit Kentucky County Employee Retirement System (CERS) and two single employer defined benefit plans for police and firemen, making 100% of the actuarially based contribution annually. Fitch calculates the combined adjusted ratio of assets to liabilities to be a low 47% assuming a 6% discount rate.

Operating Performance
The metro government has maintained a high level of available fund balance throughout the recession and subsequent recovery relative to potential revenue declines as depicted by the Fitch Analytical Sensitivity Tool (FAST) in a moderate economic downturn. Fitch expects that available general fund and capital project fund reserves would remain well above the 'aaa' reserve safety margin level in a moderate recessionary period. Moreover, Fitch expects that the government would make use of its strong budget controls in response to revenue deterioration.

The metro government has made consistent efforts to maintain a high level of financial flexibility in the recent economic recovery. Management ended fiscal 2017 with a small draw on available reserves, but expects growth in reserves in fiscal 2018 and has budgeted for a slight surplus in fiscal 2019. Available reserves were over 17% of general fund expenditures in fiscal 2017 and have been over 15% in every year since fiscal 2011.

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Applicable Criteria

U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
(https://www.fitchratings.com/site/re/905637)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)
(https://www.fitchratings.com/site/re/10024656)

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