



RATING ACTION COMMENTARY

Fitch Rates Louisville-Jefferson Cty. Metro Govt.'s (KY) \$41.9 MM GO Bonds 'AAA'; Outlook Stable

Wed 30 Sep, 2020 - 11:03 AM ET

Fitch Ratings - New York - 30 Sep 2020: Fitch Ratings has assigned a 'AAA' rating to the following Louisville-Jefferson County Metro Government, KY bonds:

-- \$41.9 million general obligation bonds, series 2020A.

The Rating Outlook is Stable.

The bonds are expected to sell competitively on Oct. 14, 2020 via competitive sale. Proceeds from the 2020A bonds will finance various capital projects.

SECURITY

The bonds are GOs 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.

ANALYTICAL CONCLUSION

The 'AAA' rating reflects 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.

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 760,000, 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 superior gap-closing capacity and is expected to manage through the current economic downturn, while maintaining a strong level of fundamental financial flexibility.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to a Positive Rating Action/Upgrade

Not applicable.

Factors that Could, Individually or Collectively, Lead to a Negative Rating Action/Downgrade

--Deterioration in the metro government's expenditure flexibility, including an increase in carrying costs as a percentage of governmental expenditures to consistently above 20%.

--Lower expectations for revenue growth prospects to a level in line with inflation.

--Economic contraction consistent with Fitch's coronavirus downside scenario that triggers sustained and deep revenue declines and materially erodes the metro government's gap-closing capacity to a degree where financial resilience is not consistent with the current rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-

specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>].

CURRENT DEVELOPMENTS

Sector-Wide Coronavirus Implications

The ongoing coronavirus pandemic and related government containment measures have created an uncertain environment for U.S. state and local governments and related entities. Our ratings are forward-looking in nature; as such, Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 4Q21. In its baseline scenario, Fitch assumes continued strong GDP growth in 3Q20 followed by a slower recovery trajectory from 4Q20 onward amid persisting social distancing behavior and restrictions, high unemployment and a further pullback in private-sector investment.

Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases -- Update"

(<https://www.fitchratings.com/research/sovereigns/fitch-ratings-coronavirus-scenarios-baseline-downside-cases-update-08-09-2020>), published Sept. 8, 2020 on www.fitchratings.com.

Louisville-Jefferson County Coronavirus Effects

Metro government management had budgeted for fiscal 2020 (FYE June 30) to be in line with 2019 actuals but had estimated revenue to come in higher than budget due to strong revenue collections prior to the current downturn. After the shutdown measures due to the coronavirus pandemic, the metro government now estimates a small yoy decline of around \$11 million, \$27 million or 1% below the prior estimate for fiscal 2020. This includes a shortfall of an estimated \$11.5 million in net profits revenue that will now be collected in fiscal 2021 due to an extension of the tax payment deadline from April 15 to July 15.

The metro government's expectations for a relatively small decline are due to strong collections prior to the downturn and the relative lack of volatility in property and

occupational taxes as wages and profits did not fall as much as management had originally estimated in April. The metro government has updated its projections and now expects not to have utilized any available reserves in fiscal 2020 due to expense savings and using the Coronavirus Aid, Relief and Economic Security (CARES) Act funds to cover the costs of the coronavirus response and to reimburse itself for substantially dedicated personnel providing a response. Management reports that it spent \$14.4 million in CARES funds in fiscal 2020, leaving \$6.4 million for fiscal 2021, of which it plans to budget for small business grants. This is in addition to the original fiscal 2021 budgeted CARES expenditures of \$113 million.

Management kept fiscal 2021 budgeted revenue in line with fiscal 2020 estimated revenue, although this is partially due to recognizing an estimated \$11.5 million o \$12.5 million of fiscal 2020 net profits revenue in fiscal 2021 due to the tax payment deadline being delayed. Absent that shift, the metro government would be estimating around a 3.5% decline in revenue. The budget includes a 3.8% decline in payroll taxes and a 4% increase in property tax revenue.

The metro government anticipates balanced fiscal 2021 operations, maintaining available reserves in line with fiscal 2019 and 2020 levels. The state General Assembly also deferred a planned 12% increase in County Employee Retirement System pension contribution costs, and Fitch expects that increases will likely need to be reinstated or extended to future years.

CREDIT PROFILE

Population gains and a relatively stable economic picture contributed to recovery in property values over the past several years. While taxable assessed value (TAV) dropped significantly during and after the great recession, it increased significantly from 2015 through 2020, with TAV now exceeding the pre-recession peak.

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 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. The unemployment rate has generally been in line with the national rate through the recovery but has been volatile since the onset of the pandemic.

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 59% of fiscal 2019 general fund revenue. The metro government's property tax levy accounts for approximately 23% 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 population. Under Kentucky's House Bill 44 (H.B. 44), increases in the tax levy on existing property above 4% annually are subject to a recall vote. 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 yoy despite potential property value declines. The 10-year general fund revenue CAGR through 2019, adjusted for tax rate increases, is 2.4%.

Fitch believes that the metro government has ample legal ability to independently increase revenue. Fitch does not view the 4% levy cap as an absolute constraint as it can be exceeded unless there is a recall vote. 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 (53% of fiscal 2019 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 salary expenses, which are generally expected to increase slightly above inflation.

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 around 17% of governmental expenditures in fiscal 2019. Management had estimated increased pension costs of approximately 12% in fiscal 2021 and 2022 but the increase was paused in fiscal 2021. Fitch expects that the increases will be reinstated in future years to make up for the current pause.

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 tax increment financing payments, the final date of the bonds, or Sept. 30, 2054. Management has consistently included and made required payments in annual budgets, and Fitch incorporates them into the carrying cost calculation.

LONG-TERM LIABILITY BURDEN

Overall long-term liabilities are low, with debt and Fitch-adjusted net pension liabilities at around 5% of personal income. Over half of the total fiscal 2019 liability burden is in the form of Fitch-adjusted net 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. The metro government makes a statutorily based contribution annually to CERS, which has exceeded the actuarially determined contribution (ADC) over the past several years. Contributions to the police and fire plans have also exceeded the ADC since 2016. Fitch calculates the combined adjusted ratio of assets/liabilities to be 51%, assuming a 6% discount rate. Fitch does not expect the current issuance to have a significant impact on carrying costs or the long-term liability burden.

OPERATING PERFORMANCE

The metro government has maintained a high level of available fund balance through the recent recovery relative to potential revenue declines as depicted by the Fitch Analytical Sensitivity Tool (FAST), and is well positioned for the current downturn. Management reports that it likely will not have a draw on available reserves in fiscal 2020 and anticipates balanced operations in fiscal 2021, leaving available general fund and capital project fund reserves well above the 'aaa' reserve safety margin level even if revenue declined by a higher amount as depicted in Fitch's baseline FAST scenario. Fitch expects that the government would make use of its strong budget controls in response to revenue deterioration indicated by FAST.

The metro government ended fiscal 2019 with an increase in available general fund reserves, although a sizable amount of capital projects reserves which Fitch views as available for general operating purposes, were restricted in the fiscal 2019 Comprehensive Annual Financial Report. Available reserves were still nearly 15% of general fund expenditures in fiscal 2019 and have been at or above 15% in every year since fiscal 2013.

DATE OF RELEVANT COMMITTEE

12 August 2020

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of Environmental, Social and Corporate Governance (ESG) Credit Relevance is a Score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature

or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Louisville-Jefferson County Metro Government (KY) [General Government]				
● Louisville-Jefferson County Metro Government (KY) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

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Louisville-Jefferson County Metro Government (KY)

EU Endorsed

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