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Ratings

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Summary:

Louisville & Jefferson County Metropolitan Government, Kentucky; Appropriations; General Obligation

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Credit Profile		
US$43.435 mil tax-exempt GO bnds ser 2019A due 08/01/2039		
Long Term Rating	AA+/Stable	New
Louisville & Jefferson Cnty Metro Govt GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Louisville & Jefferson County Metropolitan Government, Ky.'s series 2019A general obligation (GO) bonds. Furthermore, we affirmed our 'AA+' long-term rating on the metro government's outstanding GO debt and 'AA' long-term rating on the outstanding Louisville Parking Authority of River City (PARC) debt, issued for the metro government. The outlook is stable.

A pledge of the metro government's full-faith-credit-and-resources and an agreement to levy ad valorem property taxes without limitation as to rate or amount secure the bonds. It is our understanding that bond proceeds for the series 2019 will be used to finance various capital projects.

The PARC debt reflects bonds secured by and payable from revenue associated with the various public parking garages and on-street parking meters operated by PARC, as well as the revenue and rents derived from an annually renewable lease with the metro government. Our rating on PARC is one notch below the 'AA+' rating on Metro GO debt to reflect the risk of appropriation.

Credit Summary

The Louisville & Jefferson County Metropolitan Government has a vibrant economy that continues to grow. However, its biggest challenge, from our perspective, is with respect to its rising pension contributions. Our view of management is that it is strong, and we would expect that officials would continue to find a combination of cost cuts and revenue enhancements that will allow them to absorb the growing contributions without tipping the budget into structural imbalance. This could become increasingly challenging if its revenue base, which is currently growing, starts to lag, and as pensions take up more and more space in the budget.

The 'AA+' rating reflects our assessment of the following factors for the metro government:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our financial management assessment methodology;

- Adequate budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Strong budgetary flexibility, with an available fund balance in fiscal 2018 of 12.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 13.1% of total governmental fund expenditures and 1.6x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 8.3% of expenditures and net direct debt that is 107.9% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Strong economy

We consider the Louisville-Jefferson County economy strong. The metro government, with an estimated population of 769,804, is located in the Louisville/Jefferson County, KY-IN MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 102.1% of the national level and per capita market value of $99,001. Overall, the county's market value grew by 6.8% over the past year to $76.2 billion in 2018. The county unemployment rate was 4.1% in 2018.

Louisville-Jefferson County Metro Government is home to UPS' WorldPort hub, with 23,533 employees and a large health care service sector (with the leading seven providers in the metropolitan area employing nearly 35,000), both of which provide stability. Leading employers after UPS include Jefferson County Public Schools (14,250 employed), and Ford Motor Co. (13,042). Notable local development includes Ford's $550 million expansion and a new hotel development.

Strong management

We view the metro government's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize all of them on a regular basis.

Officials perform a line-by-line approach for the budgetary process, relying on multiple years of historical information and utilizes the past three years of historical information. The budget can be amended if needed and budget to actual reports are reported on a quarterly basis. Management does not have a formal long-term financial plan but does forecast internally general fund revenue and expenses over a four-year period that include the largest items on both sides. The metro government does not have a formal long-term capital plan. Officials prepare an annual capital improvement budget with proposed capital expenditures for the coming year. Management has a formal debt management policy, which requires certain thresholds that must be met before issuing debt. It has its own investment policy and reports on its performance and holdings monthly. The reserve policy focuses on the unassigned general fund balance. The policy calls for an unassigned reserve between one and two months of monthly average current year general fund budgeted expenditures; officials believe this is a prudent level of financial resources to protect against service reductions or tax increases because of temporary revenue shortfalls or unanticipated one-time expenditures.

Adequate budgetary performance

The metro government's budgetary performance is adequate in our opinion. The metro government had slight operating surpluses of 0.9% of expenditures in the general fund and of 0.7% across all governmental funds in fiscal 2018. The general fund has been stable with essentially breakeven results the past three audited fiscal years. We adjusted our view of the metro government's overall budgetary performance to reflect the deferral of pension contributions, which we think inflates the budgetary result ratios.

While Louisville & Jefferson County Metro Government made full payments required by the state to the County Employees Retirement System (CERS) pension plan, the required payments were not based on the actuarially determined contribution (ADC). Because pension contributions are below the ADC, we view these as deferred payments.

We adjusted general fund revenue and expenditures for routine transfers. Transfers in to the general fund are mainly reimbursements coming from special revenue and other governmental funds. Transfers out of the general fund are for debt service and grant matches in the other governmental funds. We adjusted total governmental fund expenditures downward to reflect bond proceed spending. Officials expect to add $500,000 to its unassigned general fund balance in fiscal 2019 and have budgeted for breakeven general fund results in fiscal 2020. Overall stable financial performance owes much to the metro government's growing tax base and management's expenditure controls, such as adjustments to its healthcare plan, service reductions, and staff adjustments mainly through attrition.

Taxes account for 82% of total general fund revenue. Occupational taxes and property taxes are the largest sources of tax revenue, accounting for 58% and 23%, respectively. In August, the metro government for the first time raised its property tax levy by the allowable 4% level, which will generate an additional $1.2 million of revenue. The metro government also cut about $25 million out of its budget. These are some of the strategies that management has deployed to help it absorb its increasing pension contributions. In 2020, the pension contribution increases $14 million year over year to $100 million. The metro government projects similar year over year increases through 2023, which could pose a challenge for the metropolitan government, particularly in years of stagnant economic growth. We expect results for total governmental funds to be similar to previous years' outcomes, and overall, we expect the metro government's budgetary performance to remain at least adequate. However, our assessment could be weakened in the future if we believe its budget shows signs of strain in accommodating future pension contributions.

Strong budgetary flexibility

Louisville-Jefferson County Metro Government's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2018 of 12.4% of operating expenditures, or $87.9 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 11.8% of expenditures in 2017 and 12.0% in 2016.

The available fund balance consists of the unassigned fund balance, which was $69.4 million in 2018, plus $18.5 million of assigned amounts. Officials expect to add $500,000 to its unassigned general fund balance in 2019 and hold it level in 2020. Given the trends in the metropolitan government's budget, and our expectation of at least adequate performance, we expect budgetary flexibility to remain strong through the current and following year.

Very strong liquidity

In our opinion, the metro government's liquidity is very strong, with total government available cash at 13.1% of total governmental fund expenditures and 1.6x governmental debt service in 2018. In our view, the county has strong access to external liquidity if necessary.

We adjusted cash by deducting $35 million of unspent bond proceeds. The metro government's adjusted cash was $107 million; it also holds about $95 million of investments. As per its policy and state statutes, permitted investments are conservative and mostly are in instruments guaranteed by the U.S. Government or its agencies. The metro government has shown strong access to external liquidity, having regularly issued GO bonds for the past 20 years. We do not expect the metropolitan government's cash position to change much over the next two years, with respect to its total governmental expenditures and debt service. There are no contingent liabilities that would threaten the metropolitan government's liquidity.

Very weak debt and contingent liability profile

In our view, Louisville-Jefferson County Metro Government's debt and contingent liability profile is very weak. Total governmental fund debt service is 8.3% of total governmental fund expenditures, and net direct debt is 107.9% of total governmental fund revenue. Overall net debt is low at 1.6% of market value, which is in our view a positive credit factor.

Our analysis of the metro government's debt burden includes its long-term obligation to the arena authority, consisting of $10.8 million in annual payments. We have also adjusted the metro government's debt to recognize self-support of PARC (Parking Authority of River City) first mortgage bonds by its component unit enterprise fund revenues. This is annual appropriation debt, and under terms of the lease, the metro government agrees to pay rental payments sufficient to pay debt service on the bonds, plus the costs to operate, maintain, and insure the leased facilities. PARC revenues include on-street parking meter revenues and contractual revenues from several corporate sources. Management has confirmed it has no alternative financings.

In our opinion, a credit weakness is the metro government's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. The metro government's combined required pension and actual OPEB contributions totaled 7.5% of total governmental fund expenditures in 2018.

Given the strength of its revenue base and economy, we do not view pension and OPEB liabilities as an immediate source of credit pressure for the metro government despite lower funding levels and projected rising contributions.

The metro government participates in CERS, a cost-sharing, multiple-employer defined-benefit pension plan administered by the Board of Trustees of the Kentucky Retirement Systems. The CERS plan includes separate "hazardous" and "non-hazardous" pension funds. In 2018, the CERS hazardous and non-hazardous funds were 50% and 53% funded, respectively. The metro's share of the net pension liability across the hazardous and non-hazardous plans was $957.4 million as of June 30, 2018; $621 million is the hazardous portion and $336 million is the non-hazardous portion. The net pension and OPEB liabilities are calculated by KRS.

The CERS board revised the plan's actuarial assumptions, using a lower investment rate of return and lower payroll growth at 2% from 4%, but the increases in contributions to CERS were capped at 12% annually through fiscal 2028.

While the cap on contribution growth means less pressure on municipal budgets in the short term, we believe it does not optimally benefit the plan's underfunding.

CERS members receive health insurance subsidies through the CERS plan. At June 30, 2018, the metro government reported a net OPEB liability of $345 million ($229.5 million for hazardous and $115.5 million for nonhazardous) for its proportionate share of the CERS net OPEB liability. In addition, the metro government operates two single-employer defined-benefit pension and retiree healthcare benefit plans covering eligible police officers and firefighters. The plans were closed in 1986 and 1989 but it continues to contribute to those plans. Retirees in these plans may purchase healthcare insurance at their own cost, and are eligible to receive reimbursement from the metro government up to certain limits. In 2018, the metro government paid $891,790 in OPEB reimbursements to eligible employees, down from $936,263. The police pension plan has a net pension liability of $5.9 million and the plan fiduciary net position as a percentage of the total pension liability is 59%. The firefighters' pension fund has a net pension liability of $8.8 million and the plan fiduciary net position as a percentage of the total pension liability is 56%.

Strong institutional framework

The institutional framework score for first class Kentucky municipalities is strong.

Outlook

The stable outlook reflects our view that Louisville-Jefferson County Metro Government will maintain structurally balanced budgets while it incorporates growing pension contributions into its budget. As such, we anticipate it will maintain at least strong budgetary flexibility and very strong liquidity. Its strong management profile and growing revenue base further support the stable outlook.

Downside scenario

If the metro government's budgetary flexibility and budgetary performance were compromised by growing pension contributions and potentially stagnating revenue growth, suggesting that it was heading toward structural imbalance, the rating could be lowered within the outlook's two-year horizon.

Upside scenario

Though we don't anticipate either situation occurring during the outlook horizon, if the metro government's economic metrics improve to very strong levels and the debt profile improves to a level we consider strong, all other factors remaining equal, the rating could be raised.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of September 27, 2019)

Ratings Detail (As Of September 27, 2019) (cont.)		
Louisville Pkg Auth of River City, Kentucky		
Louisville & Jefferson Cnty Metro Govt, Kentucky		
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt)		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) taxable 1st mtg rev bnds (Louisville & Jefferson Cnty Metro Govt) ser 2016		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) 1st mtg rfdg bnds (Louisville & Jefferson Cnty Metro Govt) ser 2016B due 12		
Long Term Rating	AA/Stable	Affirmed
Louisville Pkg Auth of River City (Louisville) 1st mtg rev bnds ser 2002 dtd 12/01/2002 due 06/01/2003-2018 2020 2022 2026 2029 2032		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.