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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$41.94 mil GO bnds ser 2020A due 06/30/2041		
Long Term Rating	AA/Stable	New
Louisville & Jefferson Cnty Metro Govt GO		
Long Term Rating	AA/Stable	Downgraded
Louisville Pkg Auth of River City, Kentucky		
Louisville & Jefferson Cnty Metro Govt, Kentucky		
Louisville Pkg Auth of River City (Louisville) (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Stable	Downgraded

Rating Action

S&P Global Ratings lowered its rating to 'AA' from 'AA+' on Louisville & Jefferson County Metropolitan Government, Ky.'s outstanding general obligation (GO) bonds. At the same time, S&P Global Rating lowered its rating to 'AA-' from 'AA' on the metro government's outstanding Parking Authority of River City (PARC) bonds. Finally, we assigned our 'AA' long-term rating to the metro government's anticipated $41.94 million series 2020A GO bonds. The outlook is stable.

The series 2020A bonds will be used to finance various capital projects. The 2020A bonds and outstanding GO bonds are secured by the metro government's full-faith-credit-and-resources pledge and an agreement to levy ad valorem property taxes. There are property tax limitations set forth in the state constitution and statutes. Section 157 of the constitution sets maximum property tax rates based on the obligor's population, and aggregate property tax revenue cannot grow more than 4% year over year, excluding new property, under Kentucky Revised Statutes (KRS) 132.020. Tax increases greater than 4% can be challenged by a voter recall, which could require a referendum if more than 10% of voters file a petition objecting to the tax increase. In practice, Kentucky local governments typically do not exceed the 4% collection increase limitation. We rate Kentucky local government GO debt, including that of the metro government, based on the application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Nov. 20, 2019). Any limitation imposed on the obligor's ability to raise revenue is embedded in our view of the obligor's general creditworthiness.

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 government's GO debt to reflect the risk of appropriation.

Credit overview

The downgrade reflects our view of a challenging revenue climate and the pressure that we expect will come from absorbing perpetually larger pension contributions, an overall very weak debt profile, and policy reforms. While we note management has incorporated conservative budget expectations that allowed it to manage negative budget pressure in fiscal 2020 and adopt a balanced 2021 budget, we believe the combination marks a turn in credit quality that we think is significant enough to warrant the lower rating. If left unaddressed, we believe the aforementioned pressures could threaten budget stability beyond 2021.

The ongoing pandemic has caused economically sensitive revenue to decline, though we note the drop off is not as sharp as the metro government initially expected and its preemptive measures to manage expenses should allow for the maintenance of steady unassigned general fund reserves in fiscal 2020. The recovery from the pandemic-induced national recession is likely to be slow and difficult, facing headwinds from the exhaustion of federal stimulus funds and rising trade tensions. S&P Global Economics' latest forecast ("The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect) anticipates potentially slow and uneven GDP growth and unemployment that will likely not recover to pre-pandemic levels until mid-2024.

We will monitor the metro government's response to these challenges as fiscal 2021 progresses and beyond the current fiscal year. Downside rating pressure will ensue if we believe the metro government's budget stability is compromised, exemplified by widening structural gaps, a reliance on one-time budget measures, and a use of reserves that, in our view, jeopardize financial flexibility and liquidity. Downside pressure could be exacerbated by the lack of a plan to bring the budget back into alignment and if economic recovery is worse than anticipated, particularly compared to similarly rated national peers.

The 'AA' rating further reflects our assessment of the metro government's:

- 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;
- Weak budgetary performance, potentially challenged by recessionary pressure on the budget relative to fiscal 2019, which closed with a slight operating surplus in the general fund but an operating deficit at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 12.4% of operating expenditures, and an ability to avoid financial imbalances with a demonstrated capacity and willingness to cut operational spending as of the onset of the pandemic;
- Very strong liquidity, with total government available cash at 16.5% of total governmental fund expenditures and 1.6x governmental debt service;
- Very weak debt and contingent liability position, with debt service carrying charges at 10.1% of expenditures and net direct debt that is 105.9% 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.

Environmental, social, and governance factors

The rating downgrade also reflects our view of the metro government's elevated governance and social risk relative to sector norms. In our view, the metro government's governance risks owe to its weakly funded pension plans and its exposure to escalating contributions, in combination with what we expect will be prolonged recessionary pressure brought about by the ongoing COVID-19 pandemic. We believe the metro government is exposed to indirect social risk brought on by the COVID-19 pandemic. Additionally, the fatal shooting of Breonna Taylor by a metro government police officer has spurred nationwide and local demonstrations that surged again after recent developments. In September, the metro government reached a $12 million settlement with the Taylor family and agreed to various reforms, both in the police department and in community support. The reforms will likely incur financial costs. At present the metro government has expressed their ability to incorporate these items into its budget and maintain balanced operations, but we view the possibility of additional protests or other civil unrest as a social risk under our ESG framework. Environmental risks are in line with the sector.

Stable Outlook

Downside scenario

Our outlook horizon typically encompasses a period of up to one-to-two years, but the additional rating action could occur in a shorter timeframe, depending on emerging information that could signal a change in credit quality. We could lower the metro government's rating if budget pressures become unmanageable and we perceive the budget is heading to structural imbalance. We could also lower the rating if the metro government's progress in addressing its challenges stall and its budgetary flexibility and liquidity weaken.

Upside scenario

We could raise the rating if the metro government maintains structural budget stability as the pandemic eases and recessionary pressures subside, while concurrently absorbing growing pension contributions and other budget policies and reforms.

Credit Opinion

Strong economy

We consider the metro government's economy strong. Louisville & Jefferson Metropolitan Government, with an estimated population of 776,768, is located in the Louisville/Jefferson County, KY-IN MSA, which we consider to be broad and diverse. The metro government has a projected per capita effective buying income of 96.9% of the national level and per capita market value of $99,849. Overall, the metro government's market value grew by 1.8% during the past year to $77.6 billion in 2019.

Louisville & Jefferson County Metropolitan Government is home to UPS' WorldPort hub, with 25,090 employees and a large health care service sector (with the leading three providers in the metropolitan area employing over 33,000). Leading employers after UPS include Jefferson County Public Schools (14,484 employed), Ford Motor Co. (13,020 employed), and Humana Inc. (12,360 employed).

The metro government's budget relies on occupational taxes, which are economically sensitive to employment cycles. We note county unemployment historically has closely mirrored national trends. The county's unemployment rate was 4.0% in 2019. We note that Jefferson County's unemployment rate is stabilizing after spiking during the early months of the pandemic. In April, unemployment rose to 16.5% but dropped to 5.3% in June. Preliminary data for July shows a rate of 6.4%. These levels are somewhat higher than the state's rates, which showed a spike to 16.2% in April before coming down to 5.0% in July. The state's preliminary unemployment rate for August, for which local data is not yet available for comparison, is 7.5%.

The metro government's leading employers have restored most jobs that were idled during the recession and the social distancing measures adopted at that time. The metro government's major hospitals--Baptist Health, Norton Healthcare, and University of Louisville Health--have resumed elective surgeries. Most, if not all, the employees at Humana were telecommuting. UPS retained its workforce and is currently adding jobs in anticipation of the holiday season. Ford Motor Co.'s two Louisville plants, the truck plant and the assembly plant, were idled for two months but reopened in mid-May. However, Ford recently announced plans in September to lay off nearly 300 employees at its two plants.

Strong management

We view the 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 or monitor all of them on a regular basis.

The government performs a line-by-line approach for its 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.

The government does not have a formal long-term financial plan but does forecast internally general fund revenues and expenses over a 10-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.

The government has a formal debt management policy, which requires that 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.

Weak budgetary performance contributes to the rating downgrade

Louisville & Jefferson Metropolitan Government's budgetary performance is weak in our opinion. The metro government had slight surplus operating results in the general fund of 0.9% of expenditures, but a deficit result across all governmental funds of negative 1.5% in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could be challenged by the dampening effect of the pandemic and social distancing measures on revenue, as well as the implementation of new policy measures, but could be better than expected due to proactive budget efforts.

General fund operating results of the metro government have been stable during the past three years, with a result of 0.9% in 2018 and a result of negative 0.5% in 2017. Weakening our view of Louisville & Jefferson Metro Government's budgetary performance is its deferral of pension contributions that were equal to the plans' required amounts, but fell short of full actuarial funding, which we think inflates the budgetary result ratios.

Furthermore, the budget faces the challenges of maintaining stability in the face of increased scrutiny on policies and procedures, exposure to event risk owing to recessionary pressure, and rising pension contributions. We believe officials have thus far managed through revenue pressures brought on through the recession due to their conservative revenue assumptions and a proactive plan of adjusting expenditures, which in our view benefits budgetary performance. However, we believe the revenue climate, set against unexpected expenditure fluctuations that may arise beyond those already identified, could lead to weakened budgetary performance. These expenses could include legal expenses, unanticipated worker compensation claims, and police overtime. While the metro government has announced reforms in addition to its financial settlement with Breonna Taylor's family, we would expect the metro government to incorporate those items into subsequent budgets in a sustainable manner.

On a budgetary basis, officials ended fiscal 2020 with a breakeven general fund result. Officials point to adopting conservative revenue assumptions and offsetting expenditure controls at the onset of the pandemic as the reason the year ended on better than expected footing. The original budget also included $25 million of budget cuts to make room for increased pension contributions of $99.3 million. Officials took the same approach with the 2021 budget and balanced it with no use of unassigned general fund reserves. The 2021 budget also benefits from a pause on pension contribution increases; officials budgeted $97.3 million.

Taxes account for 82% of total general fund revenue. Occupational taxes and property taxes are the largest sources of tax revenue, accounting for 59% and 23%, respectively.

While the 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) and we view these as deferred payments. To improve funding levels in the plan, metro and other local governments are required to increase contributions by 12% annually through 2023 (with 2021 being an exception), which will likely continue to challenge the metro government's finances, particularly in years of stagnant economic growth.

We adjusted general fund revenue and expenditures for routine transfers. Transfers into 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.

Very strong budgetary flexibility

Louisville & Jefferson Metro Government's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 12.4% of operating expenditures, or $90.9 million. During the past three years, the total available fund balance has remained at a consistent level overall, totaling 12.4% of expenditures in 2018 and 11.8% in 2017.

The available fund balance consists of the unassigned fund balance, which was $70.9 million in 2019, plus $20 million of assigned amounts. Officials expect to hold the unassigned general fund balance steady in 2020 and in budget year 2021, about 10%, which we still consider strong.

Qualitatively, we view the metro government's current efforts to adjust the budget as of the onset of the pandemic, both in terms of revenue expectations and its ability to avert structural imbalance through offsetting expenditure adjustments, as a positive factor supporting our expectation that budgetary flexibility will remain very strong in the current and following year. Future, accelerating pension contributions and other budget pressures could potentially hinder budgetary flexibility in the medium-term.

Very strong liquidity

In our opinion, Louisville & Jefferson Metro Government's liquidity is very strong, with total government available cash at 16.5% of total governmental fund expenditures and 1.6x governmental debt service in 2019.

The metro government has shown strong access to external liquidity, having regularly issued GO bonds for the past 20 years. There are no direct purchase obligations that would threaten the metropolitan government's liquidity.

Our overall liquidity assessment reflects our view that the metro government currently has outsized exposure to contingent risk stemming from other potential sources of legal liability. The metro government's $12 million settlement with the Taylor family will be covered by $7 million from its self-insurance trust fund and $5 million from its own cash, which we adjusted out of total government cash. Overall, we expect its cash levels will likely remain very strong.

Very weak debt and contingent liability profile

In our view, Louisville & Jefferson Metro Government's debt and contingent liability profile is very weak. Total governmental fund debt service is 10.1% of total governmental fund expenditures, and net direct debt is 105.9% of total governmental fund revenue. Overall net debt is low at 1.7% 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 first mortgage bonds by its component unit enterprise fund revenue. 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.

Officials plan to issue roughly $100 million of debt in the next two fiscal years to address various capital improvement projects.

Pensions and OPEB

In our opinion, a credit weakness is Louisville & Jefferson Metro Government's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation, despite the progressively larger contributions being made. CERS plans, and their associated actuarial assumptions, are administered at the state level, and the metro government does not have the ability to increase contributions beyond what is required to improve funding levels. Louisville & Jefferson Metro Government's combined required pension and actual OPEB contributions totaled 7.6% of total governmental fund expenditures in 2019. The metro government made 102% of its annual required pension contribution in 2019. The funded ratio of the largest pension plan is 46.6%.

We view pension and OPEB liabilities as a potentially worsening source of credit pressure in the medium term, as the metro government is exposed to large unfunded liabilities and high fixed costs that we expect will continue to rise and could lead to additional credit deterioration in the absence of additional budget balancing measures. However, we anticipate the metro government will take steps to adjust its budget to accommodate growing contributions.

The metro government participates in the following plans as of June 30, 2019:

- CERS non-hazardous: 51% funded, with a net pension liability of $409 million;
- CERS hazardous: 47% funded, with a net pension liability of $766 million;
- Firefighters' Pension Fund and the Policeman's Retirement Fund, combined: 56% funded single-employer plan, with a net pension liability of $14 million;
- The net OPEB obligation for the single-employer plans was $122 million as of fiscal 2019.

The metro government does not maintain a separate OPEB plan for CERS members. CERS members receive health insurance subsidies through the CERS plan.

While the metro government has made its full ADC to CERS in recent years, changes in actuarial assumptions (including lower investment rates of return and payroll growth) were expected to increase the 2019 ADC by about 60%. These changes were made to address the plan's poor funding level, which has persisted even though employers have historically paid the full ADC. However, the legislature passed a bill that caps CERS employer-contribution increases at 12% annually through 2028. While the legislation will reduce immediate, acute budgetary stress for the metro government, we believe it slows progress in improving the weak funding levels and could lead to higher pension payment acceleration over the long term. The statutory contributions were only 65% of static funding, meaning contributions were not enough to cover present value of current-year benefits and interest on unfunded liabilities. Additionally, risky actuarial assumptions include a long amortization period of the unfunded liability (26 years), combined with a level percent of payroll amortization method (based on an assumption of 3.55% payroll growth) and extremely low funding levels, which we believe will result in large spikes in future contributions. Based on these factors, we do not believe there is a sufficient plan in place to address the large pension obligation.

Strong institutional framework

The institutional framework score for first class Kentucky local governments is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of October 2, 2020)		
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	Downgraded
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	Downgraded
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA-/Stable	Downgraded
Louisville Pkg Auth of River City (Louisville & Jefferson Cnty Metro Govt) APPROP		
Long Term Rating	AA-/Stable	Downgraded
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	Downgraded

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.

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