

## CREDIT OPINION

6 September 2016

New Issue

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# Louisville & Jefferson Co. Metropolitan Government, KY

New Issue: Moody's assigns Aa1 to Louisville & Jefferson Co. Metro. Govt, KY's GO Bonds; downgrades Lease Revenue to Aa3

### Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 rating to Louisville & Jefferson County Metropolitan Government, KY's \$63.1 million General Obligation Bonds, Series 2016A and \$91.3 million General Obligation Bonds (Center City Project), Series 2016. Concurrently, Moody's affirms the Aa1 rating on \$295 million of outstanding general obligation (GO) bonds.

In addition, Moody's has downgraded to Aa3 from Aa2 the Louisville Parking Authority (River City), KY's outstanding lease revenue bonds and assigned a Aa3 to the authority's \$32.8 million First Mortgage Revenue Refunding Bonds, Series 2016B. The downgrade and new rating assignment affect \$97.2 million of outstanding parity lease revenue bonds. The ratings on the authority's parity debt were placed under review for downgrade on July 29, 2016 in conjunction with the updated methodology for rating [Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments](#). This rating action concludes the review.

The Aa1 rating reflects the city's large, diverse and regionally significant tax base, large population and average wealth levels. The Aa1 also reflects the city's stable financial position, adequate reserves and manageable debt and pension burdens.

The downgrade to Aa3 reflects the less essential nature of the project assets (parking facilities). The Aa3 also incorporates and the risk of non-appropriation of rental payments from Louisville & Jefferson Co. Metro Government equal to annual debt service on the bonds, the authority's sum sufficient debt service coverage and a debt service reserve funded at the lesser of the standard three-pronged test.

### Credit Strengths

- » Large, diverse and regionally significant economy
- » Trend of structurally balanced financial operations

### Credit Challenges

- » Below average operating reserves for the rating category

- » Reliance on economically sensitive occupational license tax revenues
- » Plans for additional near term borrowing

## Rating Outlook

The stable outlook reflects Moody's expectation the tax base will remain steady in the near term, operating reserves and liquidity will remain adequate for the rating level and that fixed costs will remain manageable. The stable outlook also reflects our expectation the parking authority's stable financial operations will continue to provide ample debt service coverage.

## Factors that Could Lead to an Upgrade

- » Continued trend of surplus financial operations resulting in materially improved operating reserves
- » Significant tax base growth and improved wealth levels
- » Substantially improved debt service coverage of the parking authority lease revenue bonds

## Factors that Could Lead to a Downgrade

- » Deterioration of operating reserves or liquidity
- » Substantial increase in debt service and pension expenditures
- » Tax base contraction or significantly weakened wealth levels
- » Increased debt or pension burdens

## Key Indicators

Exhibit 1

Louisville & Jefferson Co. Metro. Govt., KY	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 73,649,740	\$ 74,291,407	\$ 78,296,840	\$ 76,538,108	\$ 78,675,533
Full Value Per Capita	\$ 100,094	\$ 100,220	\$ 104,874	\$ 101,849	\$ 103,517
Median Family Income (% of US Median)	95.2%	95.0%	95.2%	95.1%	95.1%
Finances					
Operating Revenue (\$000)	\$ 590,725	\$ 591,211	\$ 602,946	\$ 613,175	\$ 654,871
Fund Balance as a % of Revenues	12.5%	12.5%	12.4%	12.8%	14.2%
Cash Balance as a % of Revenues	9.8%	10.0%	9.9%	10.8%	11.8%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 479,967	\$ 444,801	\$ 528,087	\$ 487,128	\$ 491,967
Net Direct Debt / Operating Revenues (x)	0.8x	0.8x	0.9x	0.8x	0.8x
Net Direct Debt / Full Value (%)	0.7%	0.6%	0.7%	0.6%	0.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.9x	2.0x	2.2x	1.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.5%	1.6%	1.7%	1.6%

Source: Moody's Investors Service; Louisville & Jefferson Co. Metro Government, KY's audited financial statements FYs 2011-2015

## Detailed Rating Considerations

### Economy and Tax Base: Growth Continues For Large, Regionally Significant Tax Base

Louisville & Jefferson County Metro Government's large tax base will continue to experience steady growth in the near term from market appreciation, as well as new residential and commercial development. The city's full values have grown an average 1.1% over

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the last five years to \$78.7 billion in fiscal 2015, which reflect values within the Metro Area and Urban Services District. From January 2015 to December 2015, the city issued 993 residential construction permits valued at \$288.4 million. Although new residential permit values are down about 16% from the prior year, the total value of new construction, repairs, alterations and installation permits is \$897.3 million; this represents the second largest post-recession amount. Property taxpayer concentration is modest as the 10 largest property taxpayers account for a limited 6.1% of fiscal 2015 full value, including [Louisville Gas & Electric Company](#) (A3 stable; 2.6% of full value) and [United Parcel Service, Inc.](#) (UPS; Aa3 negative; 0.9% of full value).

The city's large tax base provides employment to residents of Jefferson County, as well as adjacent areas of [Kentucky](#) (issuer long term Aa2 stable) and southern Indiana. The local economy is supported by manufacturing, health care and various professional services. Per Moody's Economy report dated July 2016, Louisville Metro's is advancing faster than the state, region and nation. The job market is benefitting from hospital expansions and the growing healthcare sector, as well as manufacturing investments and rapid growth in factory employment. Growing internet sales and manufacturing will support growth in the logistics sector, as online retail sales become a larger percentage of overall retail sales. This will benefit UPS and online retailers like [Amazon.com, Inc.](#) (Baa1 stable) and Zappos. UPS' Worldport Facility is located in Louisville and invested \$300 million to expand its Centennial Hub. Amazon and Zappos both have distribution centers within the metro area. The UPS expansion will triple the size of the current package facility and double its sorting capacity. Manufacturing sector employment grew 20.2% from 2009 to 2014, as manufacturers such as [Ford Motor Company](#) (Baa2 stable) [General Electric Company](#) (A1 stable) added shifts and expanded their respective operations. Recently, Ford Motor Company announced it will invest \$600 million in its Kentucky Truck Assembly plant. In addition, the financial services sector is poised to grow on the heels of increased demand for healthcare, nationally and within Kentucky. Health insurers, like [Humana, Inc.](#) (Baa3 ratings under review for possible upgrade) account for a large portion of the city's financial sector employment and have realized strong employment growth in recent years to serve a growing insured population from state Medicaid expansions. However, employment growth in the insurance sector will be moderate in the near term.

Since 2000, Jefferson County's population grew 6.8% to 741,096 residents as of the 2010 US Census. According to 2015 US Census estimates, the county's population is stable at 760,026 residents representing a 2.6% increase since 2010. Resident income levels are average with median family income equal to 95.1% of the US median. The city's full value per capita is healthy, yet below average for the rating category, at \$103,517. Since 2010, Jefferson County's annual unemployment rate has steadily improved. Unemployment in Jefferson County stood at 4.8% in June 2016, the lowest level in the last 10 years and below the state (5.4%) and national (5.1%) unemployment rate for the same period. This favorable employment trend is an important consideration given occupational license taxes levied on wages, salaries, business net profits and insurance premiums within the city account for 55.8% of the city's General Fund revenues in fiscal 2015.

### **Financial Operations and Reserves: Improving Reserves Provide Stable Financial Position; Balanced Operations Expected at FYE 2017**

The city's financial position is expected to remain stable in the near term as local economic growth leads to increasing operating revenues and management continues to control spending. After a multi-year trend of operating deficits for various one-time expenditures, increasing revenues and limited expenditure growth have led to operating surpluses in fiscal years 2013, 2014 and 2015.

In fiscal 2015, additional occupational license tax revenues from several large, one-time filings and increased franchise fees contributed to a 7% increase in total General Fund revenues. Despite a 5.3% increase in operating expenditures, favorable budget variances led to a \$13 million operating surplus at year-end and improved the city's available General Fund balance to \$93 million and adequate 14.2% of revenues. The unassigned balance increased to \$66.1 million, representing 10.1% of revenues and a modest 0.2% decline from a year ago when the unassigned fund balance represented 10.3% of 2014 revenues. Fiscal 2015 operating revenues consist of occupational license taxes (55.8%) and property taxes (22.4%). Improving labor market conditions and the large one-time tax filing supported a 6.2% increase in occupational license tax revenues in fiscal 2015.

At the mid-point of fiscal year 2016, the city's General Fund revenues exceeded forecast by nearly \$10 million, of which \$8.4 million are occupational license tax revenues. A portion of the additional revenues were allocated to street paving and the remainder will flow to the city's General Fund balance. Management conservatively estimates the city's unassigned General Fund balance increased by \$500,000 to \$66.6 million at year-end 2016.

The fiscal 2017 General Fund budget is balanced and includes the maximum \$9.8 million contribution to the [Louisville Arena Authority, Inc.](#) (Ba3 stable). Management estimates General Fund revenues will increase 1.6% from fiscal 2016, including a 3.6% increase in property tax revenues. The city has 25 collective bargaining units and the contract terms for the largest units, police and fire, are fixed through fiscal 2018. Annual cost increases of the police and fire bargaining agreements do not exceed managements projected revenue growth, adding predictability to personnel expenditures, the largest recurring operating expense for the city.

Louisville Parking Authority's financial operations have been stable over the last several fiscal years. Timely adjustments of parking fees have provided sum sufficient coverage of annual debt service on the lease revenue bonds from fiscal 2010 through fiscal 2015. In fiscal 2015, net revenues of \$11.9 million provided 1.4 times coverage of annual debt service compared to 1.2 times coverage in fiscal 2014. Projected net revenues of \$12 million are expected to provide 1.4 times coverage of total debt service in fiscal 2016.

#### LIQUIDITY

The city's liquidity is expected to remain healthy in the next year. At year-end 2015, the General Fund reported net cash and investments of \$74.7 million, representing a small, but improving 11.5% of revenues. The city's Operating Fund (consisting of the General Fund and Debt Service Fund) reported net cash and investments of \$77 million at year-end 2015, or 11.8% of Operating Fund revenues.

Louisville Parking Authority reported \$6.5 million of unrestricted cash at year-end 2015, representing a 46% increase from 2014 and a strong 335 days cash on hand.

#### Debt and Pensions: Manageable Debt and Pension Burdens; Additional GO Borrowing Expected in Near Term

The city's direct debt burden of 0.9% of fiscal 2015 full value will remain manageable in the near term as future borrowing will occur in tandem with full value growth. Post-sale, the city will have \$470.4 million of outstanding GO bonds, \$152.5 million of lease revenue bonds, \$26.2 million of capital leases and \$87.3 million of other guaranteed debt (the discounted present value of the city's financial guarantee to the Louisville Arena through fiscal 2039). The city's net direct debt burden incorporates support from the Commonwealth of Kentucky's Administrative Office of the Courts (AOC) on the Series 2007A lease revenue bonds (roughly 98% of annual debt service requirements).

The city's fixed costs, inclusive of GO debt service and pension contributions, of \$110 million in fiscal 2015 account for 17.3% of operating revenues and is average for the rating category. Management anticipates issuing additional GO bonds within the next few years for various capital improvements.

#### DEBT STRUCTURE

All of the city's outstanding debt is fixed rate and primarily consists of long term debt. The Series 2016 GO bonds will provide take out financing for the \$87 million outstanding GO bond anticipation note (BAN) that matures in December 2016. Principal amortization is below average for the rating category, but reflects the remaining useful life of the underlying capital assets, with 63.8% of principal retired in 10 years.

Per the master trust indenture and lease agreement, the Louisville Parking Authority's lease revenue bonds benefit from the presence of a debt service reserve funded at the lesser of the standard three-pronged test. The city must provide notice at least 90 days prior to the beginning of a lease term of its decision not to renew the lease agreement.

#### DEBT-RELATED DERIVATIVES

The city does not have any outstanding variable rate debt and is not a party to any derivative agreements.

#### PENSIONS AND OPEB

The city administers two closed single-employer pension plans (police officers and firefighters) and participates in the Kentucky County Employees Retirement System ("CERS"; a multi-employer cost sharing plan administered by the Commonwealth of Kentucky). We have excluded the liabilities of the city's component units from our calculation of Louisville Metro's adjusted net pension liability (ANPL) attributed to the KY CERS.

The three-year average ANPL of the three plans was \$1.2 billion at fiscal year-end 2015, which represents an above average 1.9 times fiscal 2015 operating revenues and 1.6% of fiscal 2015 full valuation. Although the city's ANPL is above average we expect its pension

burden will be manageable given the city's operating budget flexibility from revenue growth and that GO bond debt service accounts for a small 8.9% of total operating expenditures.

Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the districts reported contribution information, or the reported liability information of the statewide cost-sharing plans, but to improve comparability with other rated entities. For more information on Moody's insights on employee pensions and the related credit impact on companies, government, and other entities across the globe, please visit Moody's on Pensions at [www.moody.com/pensions](http://www.moody.com/pensions).

### Management and Governance

Kentucky cities have an institutional framework score of "Aa," or strong. Property and occupational license taxes, the primary revenue sources, are highly predictable. Cities have moderate revenue-raising ability and can increase property taxes by 4% annually up to a cap. Cities with populations of 15,000 and above also have a property tax cap of 15 mills. Cities with population of 1,000 or higher have the power to levy an occupational license tax. The tax rate is unlimited for cities with populations up to 300,000 and capped at 1.25% for larger cities. Expenditures are highly predictable and cities have a moderate ability to reduce them given a limited presence of unions and moderate fixed costs.

The Louisville & Jefferson County Metropolitan Government is a merged city/county form of government approved by voters and created in 2003. Louisville Metro is governed by a 26 member Metro Council elected to staggered, four-year terms and a Mayor elected to a four-year term. The city's formal financial policies and experienced management are expected to provide continued operating stability in the near term. The city has a formal policy to maintain one to two months of budgeted General Fund expenditures within a separate financial stabilization fund. Despite a large union presence, annual cost increases of the largest bargaining units (police and fire) do not exceed projected revenue growth.

The Louisville Parking Authority (River City) was established in 1966 by the City of Louisville to facilitate construction of downtown parking facilities as an economic development initiative. After merger, the authority functions as an instrumentality of the city. Louisville Parking Authority's operations are conducted by a seven-member Board of Commissioners consisting of four citizens appointed by the Mayor and approved by the Metro Council; the Deputy Director for Economic Development, the Louisville Metro Chief Financial Officer (CFO) and the Executive Director of the Downtown Development Corporation. The authority also relies on Louisville Metros financial and human resource operating systems. The authority operates 14 parking garages and six surface lots throughout downtown Louisville.

### Legal Security

The city's GO bonds are secured by a full faith, credit and taxing power and payable from taxes levied on all taxable property within the city without limitation as to rate or amount.

Pursuant to the master trust indenture and the lease agreement, the lease revenue bonds issued by the Louisville Parking Authority are secured by revenues of the authority and by rental payments from the city equal to annual debt service. During a lease term, the city is obligated to make debt service payments if adequate funds are not on deposit with the trustee in the debt service or debt service reserve funds 15 days prior to a debt service payment date.

### Use of Proceeds

Proceeds from the Series 2016A GO Bonds will fund various capital improvements throughout the city, including new public safety equipment, street and sidewalk improvements and various facility upgrades. The Series 2016 GO Bonds (Center City Project) will provide permanent financing and takeout the city's outstanding GO Bond Anticipation Note prior to maturity on December 4, 2016.

The Series 2016B revenue refunding bonds will refund certain maturities of the parking authority's Series 2009A bonds for an estimated 12% net present value savings and will not extend the final maturity of the refunded bonds.

### Obligor Profile

The Louisville & Jefferson County Metropolitan Government is a merged city/county form of government approved by voters and created in 2003. In 2015, the city's population included 760,026 residents.

## Methodology

The principal methodology used in the general obligation rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the lease-backed rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Ratings Methodologies page on [www.moody.com](http://www.moody.com) for a copy of these methodologies.

## Ratings

Exhibit 2

### Louisville & Jefferson Co. Metro. Govt., KY

Issue	Rating
General Obligation Bonds (Center City Project), Series 2016	Aa1
Rating Type	Underlying LT
Sale Amount	\$91,300,000
Expected Sale Date	09/13/2016
Rating Description	General Obligation
General Obligation Bonds, Series 2016A	Aa1
Rating Type	Underlying LT
Sale Amount	\$63,145,000
Expected Sale Date	09/13/2016
Rating Description	General Obligation
First Mortgage Revenue Refunding Bonds, Series 2016B	Aa3
Rating Type	Underlying LT
Sale Amount	\$32,800,000
Expected Sale Date	09/14/2016
Rating Description	Lease Rental: Appropriation

Source: Moody's Investors Service

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REPORT NUMBER 1040964

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