FitchRatings

FITCH AFFIRMS LAFAYETTE, LA'S SALES TAX BONDS AT 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-23 April 2015: Fitch Ratings has affirmed the 'AA' rating on the following bonds of Lafayette, Louisiana (the city):

--$112.4 million public improvement sales tax bonds, series 2004, 2004A, 2005A, 2005C, 2006A, 2006B, 2006C, 2007A, 2007B, 2009A, and 2009B.

Fitch also affirms the city's implied unlimited tax general obligation (GO) rating at 'AA'.

The Rating Outlook is Stable.

SECURITY

Of the bonds, $50.7 million (2006B, 2007A, and 2009A) is payable from revenues generated by a 1% sales tax (the 1961 tax) levied against general commercial activity within the city; $61.7 million in bonds (2004, 2004A, 2005A, 2005C, 2006A, 2006C, 2007B, and 2009B) are payable from a separate 1% sales tax (the 1985 tax) also levied against general commercial activity with food and drug purchases exempted.

All above series and all outstanding parity debt have a first lien on the respective pledged sales tax revenues.

KEY RATING DRIVERS

STRONG COVERAGE; RATING CAPPED: The 'AA' rating on the sales tax bonds reflects the strong coverage provided by the pledged revenues, which are also a key source of operating revenue, as well as the bonds' sound legal provisions and the general creditworthiness of the city. The rating is capped at the city's GO rating.

SOUND FINANCIAL FLEXIBILITY: Strong general fund reserves provide the city with adequate financial flexibility. Recent spending reductions, revenue increases, and adopted financial policies appear to have reversed a period of budget imbalance.

SALES TAX RELIANCE: The city's reliance on sales tax revenue for operations presents risk due to the economic sensitivity of the revenue source.

HEALTHY AND DIVERSIFYING ECONOMY: Lafayette is a regional economic hub with an oil and gas-based economy that is complemented by growing retail and healthcare sectors. Population, wealth, and taxable assessed valuation (TAV) continue to register moderate growth and the housing market is healthy.

AFFORDABLE DEBT; GROWING PENSION COSTS: The city's debt profile is average with manageable future capital plans. Annual required pension contributions are above average and growing. Continuing increases could present budget pressure.

RATING SENSITIVITIES

RETURN TO STRUCTURAL IMBALANCE: Fitch views maintenance of strong reserve levels as key to rating stability. Reductions to fund balance driven by budget imbalance due to declining revenues or rising pension costs could pressure the ratings.

CREDIT PROFILE

Lafayette is about 130 miles west of New Orleans in south central Louisiana. It is the fourth largest city in the state with a population of approximately 124,000. Population growth has been steady after a one-time boost in 2005 following hurricanes Katrina and Rita.

The city and Lafayette Parish have operated under a consolidated form of government since 1996. The consolidated government is governed by a city-parish president and a nine-member council. The city and parish provide shared municipal services, and audited financial statements are presented on a consolidated basis, although the city and parish issue debt on an individual basis.

REGIONAL ECONOMIC HUB COMPLEMENTS OIL/GAS ECONOMY

Lafayette's dominant economic sector is oil and gas operations, making it susceptible to the cyclicality associated with energy prices. However, the local economy is increasingly diversifying due to the city's status as a regional economic hub for retail, healthcare, and higher education in the eight-parish region known as Acadiana. The city is home to the University of Louisiana at Lafayette, the state's second largest university, as well as five acute care hospitals. Other top employment sectors include trade, transportation, and utilities; government; leisure and hospitality; and business services.

Employment concentration in the oil/gas sector is above national norms, totaling 10.7% of the parish-wide non-farm employment, compared to 0.6% nationwide. There is some diversity among top employers, with growth in the healthcare and manufacturing sectors also playing a part in the robust employment gains seen recently. Parish employment has risen steadily since a recessionary contraction in 2009 and has outpaced labor force growth. The parish's December 2014 unemployment rate grew slightly to 4.5% from 3.3% in 2013, reflecting softening of the energy sector. However, this is still well below the state (6.2%) and U.S. (5.4%) rates.

Recent economic activity has also spurred increases in TAV and wealth levels. Per capita income now approximates the national average and market value per capita has risen to $101,000 in fiscal 2015 from $68,000 in fiscal 2008. Residential and commercial development, coupled with a stable housing market, has supported consistent and moderate annual TAV growth. The city's TAV climbed 7.1% in the fiscal 2013 reassessment, and new construction has produced growth for fiscals 2014 and 2015. Reassessment of properties occurs every four years in Louisiana, and Fitch expects moderate TAV growth to continue based on ongoing and planned economic development.

STANDARD LEGAL PROVISIONS AND STRONG DEBT SERVICE COVERAGE

Neither the 1961 nor the 1985 sales tax expires, and Fitch considers legal provisions, which are identical for each security, to be standard. Bond covenants preclude the city from issuing additional debt unless average annual revenues for the two years immediately preceding the issuance exceed 1.5x maximum annual debt service (MADS).

Sales tax collections have grown in each of the past 10 years, except for a recessionary decline in fiscals 2009-2010. Pledged 1961 taxes equaled $42 million in fiscal 2013, up by 16% from fiscal 2009, and covered MADS 2.5x. Pledged 1985 taxes equaled $35.7 million in fiscal 2013, reflecting a similar 6.7% increase, to cover MADS 2.83x. The different collection amounts for the 1% sales taxes reflect an exemption granted under the 1985 sales tax for food and drug purchases.

FISCAL CUSHION LARGELY RESTORED

The consolidated city-parish general fund has largely restored fund balance and fiscal balance after three years of draws in fiscal years 2009-2011 from a combination of capital outlays and structural budget imbalance. Combined city-parish reserves fell significantly, from 35% to 14% of spending at fiscal year-end 2011. Sizable spending adjustments and one-time budget savings were implemented in the fiscal 2012 budget to restore fund balance, including a hiring freeze, elimination of positions, and refunding of special millage bonds paid from the general fund.

In fiscal 2013, the city eliminated positions left vacant from the prior year and limited pay raises to the 2% state-mandated increase for fire personnel. These cuts combined with strong property tax revenue growth produced a healthy $4.3 million general fund surplus, bringing the unrestricted reserve to $28.7 million, or a sound 25.5% of spending. Unaudited results for fiscal 2014 point to another strong operating surplus that exceeds conservative budget projections.

The city-parish's fiscal 2015 budget and multi-year projections forecast fund balance draws in fiscals 2015-2017 based on conservative revenue and spending assumptions. However, Fitch believes that, given the conservative assumptions, the city-parish is likely to outperform the forecasts. Fitch views the maintenance of healthy reserves as an important offset to Lafayette's sales tax dependence. A return to the degree of structural imbalance seen in prior years would be a negative credit factor.

MANAGEABLE DEBT BURDEN, ELEVATED FIXED COSTS
Overall debt ratios for the city are moderate at 3.8% of market value and $3,811 per capita. This includes large overlapping debt issuances by Lafayette Parish School Board, which has significant capital needs. The pace of principal retirement is above average with 63% to be retired within 10 years. Both the 1961 and the 1985 taxes have been leveraged regularly, with approximately $273 million outstanding combined. The city's non-utility capital improvement plan is manageable and reflects about $251 million through fiscal 2019. Fifty-six percent of capital plans are to be funded with available resources, and the remaining 44% will use bond proceeds. The borrowing plan calls for annual sales tax debt offerings between $10 million and $30 million.

Pension and other postemployment benefits (OPEB) are provided to employees through one of four state-run plans. Contributions to the statewide plans have increased significantly, driven by the under-funded position and lower investment returns of the CSME police, fire, and municipal employee plans. Each plan's benefits and contributions are set by the legislature, and Fitch believes further increases to contribution rates are likely. Total pension payments by the consolidated government increased 9% from 2011-2013 and consumed 6.7% of governmental fund spending in fiscal 2013. Excluding costs for utility enterprise employees, city-parish contributions totaled 4.8% of spending.

Continued pension contribution rate increases could pressure the city's budget and require spending adjustments to maintain structural balance. Total fixed charges for debt service, pension annual required contribution, and OPEB consumed a moderately high 23.6% of governmental fund spending. These costs represent 21.8% of governmental fund spending when utility pension costs are excluded.

Contact:

Primary Analyst
Shane Sellstrom
Analyst
+1-512-215-3727
Fitch Ratings, Inc.
111 Congress Avenue, Suite 2010
Austin, TX 78701

Secondary Analyst
Steve Murray
Senior Director
+1-512-215-3729

Committee Chairperson
Karen Ribble
Senior Director
+1-415-732-5611

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, and the National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314