CREDIT OPINION
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Contacts

Heather Correia +1.214.979.6868
Analyst
heather.correia@moodys.com

Christopher Coviello +1.212.553.0575
VP-Senior Analyst
christopher.coviello@moodys.com

Lafayette (City of) LA

Update to credit analysis following assignment of Aa2 GOLT rating

Summary

The City of Lafayette, LA's credit profile is stable overall, and supported by a large tax base, that is anchored by a university and several healthcare systems, and a currently healthy financial position, a result of several years of surplus operations. Due to 2020's economic slowdown, management is projecting deficits in fiscal 2020 and fiscal 2021; however, reserves are not expected to materially decline. The credit profile is somewhat constrained by average income indices and elevated fixed costs. The lack of rating distinction between the Aa2 issuer rating and initial Aa2 GOLT ratings reflects the ample taxing headroom that provides at least two times debt service coverage over the life of the bonds. The GOLT debt is secured by the city's constitutional millage, which also supports operations. Per state law, upon reassessment, millages must be set to be at least revenue neutral, providing some stability to the pledged revenue stream.

The Aa3 sales tax ratings for both the 1961 pledge and 1985 pledge is supported by strong coverage provided by pledged revenues for both liens and relatively stable local economy supported by institutional presence. The nature of both taxes are fairly broad, though the 1985 tax exempts food and medical while the 1961 does not. Based on year to date collections from November 2019 to June 2020, coverage on both liens remains adequate despite a softening in revenues due to the coronavirus pandemic. The profile further incorporates adequate legal provisions.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and financial market declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

On August 6, 2020, we assigned an initial Aa2 GOLT rating and affirmed the outstanding Aa2 issuer rating.

Credit strengths

» Large tax base that has steadily expanding over the past decade (issuer/GOLT)

» Local economy anchored by medical and higher education (issuer/GOLT & SPTAX)

» Healthy reserve position following multiple years of consistently strong financial performance (issuer/GOLT)

» Strong debt service coverage (SPTAX)

» Broad sales tax pledge that has generally improved over the past decade (SPTAX)

Credit challenges

» General fund has some exposure to sales taxes (around 25% of the budget), which are sensitive to economic volatility (issuer/GOLT)

» Moderately elevated debt and pension liabilities; elevated fixed costs (issuer/GOLT)

» Some concentration in top ten sales tax vendors (SPTAX)

Rating outlook

Moody's typically does not assign outlooks to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

» Significant economic expansion and diversification (issuer/GOLT & SPTAX)

» Moderation of fixed costs (issuer/GOLT)

» Material growth in sales tax collections, increasing debt service coverage (SPTAX)

Factors that could lead to a downgrade

» Significant economic contractions (issuer/GOLT & SPTAX)

» Substantial deterioration of reserve position (issuer/GOLT)

» Further leveraging of pledged revenue streams, reducing headroom (GOLT) or narrowing coverage (SPTAX)

Key indicators

Exhibit 1

Lafayette LA	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$11,525,309	$12,139,434	$13,265,182	$13,437,502	$13,468,009
Population	124,982	125,808	126,476	126,515	126,515
Full Value Per Capita	$92,216	$96,492	$104,883	$106,213	$106,454
Median Family Income (% of US Median)	98.2%	97.2%	94.7%	94.2%	94.2%
Finances					
Operating Revenue ($000)	$129,901	$128,602	$135,572	$130,345	$132,820
Fund Balance ($000)	$81,798	$77,285	$78,497	$79,140	$81,628
Cash Balance ($000)	$78,544	$74,235	$79,512	$79,411	$83,407
Fund Balance as a % of Revenues	63.0%	60.1%	57.9%	60.7%	61.5%
Cash Balance as a % of Revenues	60.5%	57.7%	58.6%	60.9%	62.8%
Debt/Pensions					
Net Direct Debt ($000)	$304,815	$275,830	$241,980	$222,410	$226,790
3-Year Average of Moody's ANPL ($000)	$257,679	$293,108	$304,393	$357,378	$401,795
Net Direct Debt / Full Value (%)	2.6%	2.3%	1.8%	1.7%	1.7%
Net Direct Debt / Operating Revenues (x)	2.3x	2.1x	1.8x	1.7x	1.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.2%	2.4%	2.3%	2.7%	3.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.0x	2.3x	2.2x	2.7x	3.0x

Source: City's audits; Moody's; US Census (MFI)

Profile

The city is located in south central Louisiana, about 135 miles northwest of New Orleans and 60 miles west of Baton Rouge. The city's 2019 population is estimated at 136,000.

Detailed credit considerations

Economy and tax base: institutional presence and regional draw keeps large tax base stable

The coronavirus is driving an unprecedented economic slowdown. We forecast US GDP to decline significantly during 2020 with a gradual recovery commencing during the second half of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts. It is possible that residential demand will slow during the pandemic. In the event that assessed values (AV) decline, the city would see this in their 2021 values, allowing time to adjust the fiscal 2022 budget as needed to maintain balanced operations.

In the immediate term, the tax base is expected to remain stable, anchored by a large university and two medical centers. Further, given the city's location along two major highways, Lafayette acts as a regional hub, attracting consumers from across the parish. Lafayette is home to University of Louisiana-Lafayette, the second largest system in the state, educating around 19,000 students. The University will hold in-person classes this fall. Along with the college, top employers include two medical centers, local government and retailers (Wal-Mart). The city's base is large, with a full value of approximately $13.5 billion.

Officials report that despite the pandemic, residential and commercial construction has not slowed, with several apartment complexes and small restaurant chains under development. KOPTER, a helicopter manufacturer, is planning to begin production in 2021, which will bring at least 120 direct jobs to the area.

Income indices are average, with median family income of 94.2% of the US (2018 ACS). It is likely that these figures are artificially low due to the large student population. Unemployment levels prior to the pandemic were around 4% or 5%, which is in line with the state's, but based on June 2020 figures, they are currently hovering at 9.3%, which is below the nation's 11.2%.

The city collects two 1% sales taxes, one enacted in 1961 and the other enacted in 1985. Both are considered broad, as they are a tax on all goods and services; however, the 1961 tax includes food and medical whereas the 1985 tax excludes it. Neither tax sunsets.

Financial operations and reserves: deficits projected for fiscal 2020 and fiscal 2021

The city's financial position is not expected to deteriorate during the pandemic. Primary operating revenues include sales taxes, property taxes and utility fees. Prior to the pandemic, all three were fairly stable, if not upward trending, and the city closely managed expenditures, resulting in a long period of surpluses. In response to COVID-19, the city has revised its revenue projections downwards, as well as reduced expenditures. The city is prepared to use reserves, if needed, but plans to maintain at least 35% in fund balance.

Lafayette ended fiscal 2019 (October 31 year-end) with a $4.2 million surplus, increasing general fund balance to $54.9 million, or a healthy 50.8% of revenues. Sales taxes, property taxes and utility fees (PILOT) each represent around 25% of the budget. Operating fund balance, including the general fund and debt service fund, is $81.6 million, or 61.5% of operating revenues.

The fiscal 2020 budget reflected an $18 million deficit, which was conservative: it indicated a decline in revenues to $96 million (compared to prior year's $108 million) and an increase in expenditures to $120 million (from prior year's $103.8 million). In response to the pandemic, the city assumed that sales taxes would decline by 50% before revising their assumptions downwards to 35%. In reality, based on collections from January to June 2020, sales taxes are down 7.7%. In addition, officials deferred capital spending, and furloughed non-essential employees. The city received around $6 million in CARES Act funding. Management is still conservatively projecting ending fiscal 2020 with an $11 million deficit.

The fiscal 2021 proposed budget forecasts a 27% decline in sales taxes and a 6% decline in property taxes (there is nothing to indicate that the base will contract). Expenditures reflect the cuts made in fiscal 2020 (e.g. furloughed employees). Management is expecting to end the year with a $4.6 million deficit. If the city uses $15 million in reserves in the next two fiscal years, reserves would decline to a still-adequate 40% of revenues.

General government liquidity

General fund cash is in line with general fund balance. At fiscal 2019 year-end, cash was $53.3 million, or 49.4% of revenues. Operating fund cash is $83.4 million, or 62.8% of operating revenues.

SPTAX coverage

Historic collections for both 1% taxes are fairly stable, although over the past ten years, there were a couple of instances of softening, although single year declines were less than 5%. The 1961 tax generated $44.3 million in fiscal 2019, providing a healthy 3.24 times maximum annual debt service (MADS) coverage. The 1985 tax generated $36.9 million in fiscal 2019, providing 3 times MADS coverage. The 1961 tax is broader, as it includes food (grocery) and medical purchases. Based on collections from November 2019 through June 2020, the 1961 tax has generated $28.4 million (resulting in 2 times coverage) and the 1985 tax has generated $23.2 million (resulting in 1.9 times coverage). The city has conservatively assumed fiscal 2020 and fiscal 2021 collections will be down by around 30%, but to date, true declines are less than 8%.

Debt and pensions: elevated fixed costs

The city's debt burden will likely decline over the mid-term given limited debt plans, coupled with rapid principal amortization. Lafayette's debt profile consists of $2.9 million in GOULT bonds (unrated), $25.9 million in GOLT bonds (Aa2) and $246 million in sales tax bonds (Aa3), which, in total, represents around 2% of full value, which is slightly above national peers. The city does not plan to issue debt in the near-term.

Legal security and bondholder provisions

The series 2020 limited tax bonds are secured by and payable from an irrevocable pledge and dedication of the funds to be derived by the Issuer from the levy and collection of a special tax of 5.42 mills (such rate being subject to adjustment from time to time due to reassessment), which the Issuer is authorized to impose and collect each year on all property subject to taxation within the corporate boundaries of the Issuer.

The series 2020, series 2020A, series 2020B and outstanding parity debt are payable solely from and secured by an irrevocable pledge and dedication of the avails or proceeds of the special one percent (1%) sales and use tax now being levied and collected by the Issuer, pursuant to elections held in the Issuer on May 13, 1961, November 20, 1965, March 22, 1977, and July 21, 2001 (the “1961 Tax”), subject only to the prior payment of the reasonable and necessary costs and expenses of collecting and administering the 1961 Tax (the "Net Revenues of the 1961 Tax").

The series 2020C, series 2020D and outstanding parity debt are payable solely from and secured by an irrevocable pledge and dedication of the avails or proceeds of the special one percent (1%) sales and use tax now being levied and collected by the Issuer, pursuant to elections held in the Issuer on May 4, 1985, November 15, 1997, and July 21, 2001 (the "1985 Tax"), subject only to the prior payment of the reasonable and necessary costs and expenses of collecting and administering the 1985 Tax (the "Net Revenues of the 1985 Tax").

All sales tax bonds, regardless of pledge, carry the same bondholder provisions, which include a debt service reserve fund, funded at the lesser of the three-prong test, and an additional bonds test of 1.5 times MADS.

Debt structure
All debt outstanding is fixed rate. Ten year principal amortization is rapid at 100%.

Debt-related derivatives
The city is not party to an interest rate swap or derivative agreements.

Pensions and OPEB
The consolidated government (city and parish) participates in six statewide cost-sharing defined benefit plans, whose benefits and contribution rates are determined and set by the state legislature. Of the six plans to which the consolidated government contributes, the city contributes to five of the plans. As of fiscal 2019, the city's total Moody's adjusted net pension liability (ANPL) under our methodology for adjusting reported pension data is $472 million or an above-average 3.6 times operating revenues. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities.

During fiscal 2019, the city contributed $21.3 million. These contributions were slightly above the Moody's calculated "tread water" level of $19.3 million. The "tread water" indicator measures the annual government contribution required to prevent the reported net pension liability from growing, under reported assumptions. Contributions above this level cover all net pension liability interest plus pay down some principal; this is stronger from a credit perspective compared to contributions below this level. Ratios comparing government contributions to the "tread water" level and "tread water" costs to government revenues shed light on budgetary fixed cost burdens. Officials anticipate the state will continue to increase required contributions but likely at a gradual pace.

The consolidated government provides other post-employment benefits (OPEB) in the form of retiree healthcare to its employees. The plan is currently funded on a pay as you go basis. Based on our calculations, at fiscal 2019 year-end, the adjusted net OPEB liability was $37.1 million, or 28% of operating revenues.

Fixed costs, including debt service, pension and OPEB contributions, represented a high 39% of operating revenues. Of that, debt service represents 21%, indicative of a front-loaded schedule that rapidly amortizes. It is likely that fixed costs will remain around current levels; however, we note that the operating revenues for the calculation exclude the sales tax capital improvement fund, which receives excess sales tax revenues that are ultimately legally pledged and available to pay for debt service. If these funds were included, the fixed cost ratio would moderate somewhat.

ESG considerations

Environmental
Environmental risk for the city is moderate, with natural hazards such as heavy rainfall, flooding, and hurricanes being the primary drivers of environmental risk. Positively, the city is slightly above sea level, which helps to mitigate the negative impact of flooding.

Social
Social considerations contribute to the relative stability of the city's local economy, with population trends and income indices relatively level. Similar to other local governments, the city's unemployment rates have increased during the coronavirus pandemic, and sit at 9.3% as of June 2020 relative to the nation's 11.2%.

Governance

Since consolidating in 1996 under a voter approved home rule charter, Lafayette Parish and the City of Lafayette have been governed by a City-Parish Council and Mayor President. Per the charter, the two entities remained legally separate entities. The funds of both entities have always been kept strictly separate with moneys flowing between the two only for the administrative and shared costs including the finance department, elected officials, public works, etc. On December 8, 2018, voters approved amendments to the home rule charter, most notably to separate the governing authority into a Parish Council and a City Council effective in January 2020. While the two governing bodies will have to jointly approve the cost allocations and shared services budget, all other decisions regarding the city and city activities will be decided by the City Council.

The city's management team has a policy to maintain at least 30% of operating expenditures in reserve.

Louisiana Cities have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue sources, property taxes and sales taxes, are largely subject to voter approval, with the exception of the constitutional millage. The requirement for voter approval limits revenue-raising ability. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Louisiana is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching adjustments dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Lafayette LA

Scorecard Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$13,436,276	Aaa
Full Value Per Capita	$106,203	Aa
Median Family Income (% of US Median)	94.2%	Aa
Notching Adjustments:[2]		
Institutional Presence		Up
Economic Concentration		Down
Finances (30%)		
Fund Balance as a % of Revenues	61.5%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	3.7%	A
Cash Balance as a % of Revenues	62.8%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	6.8%	A
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	Aa
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.0%	A
Net Direct Debt / Operating Revenues (x)	2.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.0%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.0x	A
Notching Adjustments:[2]		
Unusually Strong or Weak Security Features		Up
Other Scorecard Adjustment Related to Debt and Pensions:		Down
	Scorecard-Indicated Outcome	Aa2
	Assigned Rating	Aa2

(1) Economy measures are based on data from the most recent year available.
(2) Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
(3) Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Source: US Census, Moody's

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