

## CREDIT OPINION

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 Rate this Research

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# Lafayette (City of) LA

Update to credit analysis following assignment of issuer rating

## Summary

The City of Lafayette, LA's (Aa2 issuer rating) credit profile is strong, anchored by a large and generally stable local economy and very healthy reserve position. Despite recent weakness in the oil and gas industry, the city's tax base has continued to see growth, benefitting from institutional presence. Consistently strong financial performance in recent years has improved reserves to very healthy levels. A key challenge for the credit profile is moderately elevated debt and pension liabilities which will continue to drive high fixed costs and potentially limit financial flexibility.

On February 20, 2019, we assigned an initial Aa2 issuer rating to the City of Lafayette to serve as a reference rating for the rated city sales tax bonds (Aa3). For more information regarding the key credit fundamentals of the city sales tax debt, please see the November 2018 credit opinion.

## Credit strengths

- » Large tax base that continues to see steady growth
- » Relatively stable local economy with strong health care and higher education presence
- » Very healthy reserve position following multiple years of consistently strong financial performance

## Credit challenges

- » Moderately elevated debt and pension liabilities
- » Elevated fixed costs
- » Exposure to oil and gas industry

## Rating outlook

Moody's generally 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
- » Moderation of fixed costs
- » Improvement in the credit quality of the parish and consolidated government overall

## Factors that could lead to a downgrade

- » Significant economic contraction
- » Substantial deterioration of reserve position
- » Deterioration in the credit quality of the parish and consolidated government overall

## Key indicators

Exhibit 1

City of Lafayette, LA	2013	2014	2015	2016	2017
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$10,929,169	\$11,280,431	\$11,525,309	\$12,139,434	\$13,265,182
Population	122,009	123,528	124,982	125,808	126,476
Full Value Per Capita	\$89,577	\$91,319	\$92,216	\$96,492	\$104,883
Median Family Income (% of USMedian)	96.8%	96.5%	98.2%	97.2%	94.7%
<b>Finances</b>					
Operating Revenue (\$000)	\$136,433	\$130,113	\$129,901	\$128,602	\$135,572
Fund Balance (\$000)	\$70,521	\$76,654	\$81,798	\$77,285	\$78,497
Cash Balance (\$000)	\$70,409	\$74,415	\$78,544	\$74,235	\$79,512
Fund Balance as a % of Revenues	51.7%	58.9%	63.0%	60.1%	57.9%
Cash Balance as a % of Revenues	51.6%	57.2%	60.5%	57.7%	58.6%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$350,375	\$328,375	\$304,815	\$275,830	\$241,980
3-Year Average of Moody's ANPL (\$000)	N/A	N/A	N/A	N/A	\$304,393
Net Direct Debt / Full Value (%)	3.2%	2.9%	2.6%	2.3%	1.8%
Net Direct Debt / Operating Revenues (x)	2.6x	2.5x	2.3x	2.1x	1.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	N/A	N/A	N/A	2.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	N/A	N/A	N/A	2.2x

Pension breakdown for consolidated government obtained for fiscal 2017 and used for two years prior to generate three year average

Source: Lafayette's CAFRs, Moody's Investors Service

## Profile

The city is located in south central Louisiana, about 135 miles west of New Orleans (A3 stable) and 60 miles west of Baton Rouge (Baton Rouge Combined City-Parish Government, Aa2 stable issuer rating). The city's population is approximately 126,000.

## Detailed credit considerations

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 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.

## Economy and tax base: institutional presence and regional draw keeps large tax base stable despite weakness in oil and gas industry

Ongoing development and institutional presence will provide stability for the local economy despite recent weakness in the oil and gas sector. The city benefits from its location at the intersection of two major highways which enables the city and its retailers to easily attract consumers from elsewhere in the parish and the broader region in addition to city residents. While the oil and gas sector

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continues to represent more than 8% of employment within the parish, ongoing development in other sectors and the city's role as a regional trade, retail, and entertainment hub are helping mitigate the recent weakness in the oil and gas sector. Over one million tourists visit the area annually. Big box retailers have opened in recent years, and the city continues to see new small businesses opening up along with additional retail and restaurant development offsetting some closures. A strong local fiber network has attracted several technology firms to the area. Substantial health care and higher education presence also provide institutional stability; two of the top ten employers in the city are medical centers. Lafayette is home to the University of Louisiana-Lafayette that has an enrollment of over 19,000 and is the second largest university in the state. The university has reached new peak enrollments in each of the last few years and is working on a large student housing complex.

The city's tax base is large and has realized steady growth in recent years. As of fiscal 2017, the city's estimated actual value (full value) is sizeable at \$13.3 billion after growing 5.2% on average annually over the past five years. The base is relatively diverse with the top ten taxpayers accounting for 8% of assessed values. Residential development is ongoing though permits are recently down. Several hundred apartments are also under construction. Overall, officials report modest levels of development and anticipate stable tax base values over the next several years.

While the population trends have been strong, employment trends in the region have weakened since 2014, as indicated by a shrinking labor force and declining number of jobs. As of December 2018, the city's unemployment rate was 4% which was slightly lower than the state (4.3%) but slightly higher than the nation (3.7%) for the same period. While unemployment levels are favorable compared to the last several years, the labor force still remains 10.4% lower than at its peak in 2014. The trend is similar across the broader parish as well. Lower employment levels can challenge sales tax collections, which is a key revenue source for the city. Resident income levels are slightly below national levels and are likely somewhat depressed given the large university presence. As of the 2017 American Community Survey per capita income and median family income are 99.4% and 94.7% of national levels, respectively.

#### **Financial operations and reserves: consistently strong financial performance yields healthy reserve position**

The city's financial position will remain strong supported by solid financial management and conservative budgeting. The city's general fund has realized six consecutive surpluses as building reserves has been a key focus. The \$48.5 million in available general fund balance as of fiscal year 2017 (October year end), or 47.7% of revenues, is much improved from the fiscal year 2012 fund balance of \$17.9 million. For fiscal 2018, officials project a \$1-\$2 million general fund surplus compared to the budgeted \$3 million draw. The 2019 budget was adopted with a \$4.7 million draw which includes \$1.2 million for capital. The city targets a general fund balance of 20% which it currently well exceeds. There are no plans to draw down reserves significantly but officials report the city may use modest amounts for capital needs as necessary.

The operating funds, which include the city's general fund, debt service funds, recreation and parks fund, and code and permits fund, have likewise exhibited strong performance in recent years. As of fiscal 2017, the city's available operating fund balance totaled \$78.5 million or a healthy 57.9% of revenues. Operating fund performance will likely largely continue to be driven by performance in the general fund.

The city's operating fund revenues are relatively diverse with sales taxes comprising 37.4% of total fiscal 2017 operating revenues followed by property taxes (20.2%) and payments in lieu of taxes (PILOTs) from the utility system. With the exception of the constitutional millage, all property and sales taxes have been approved by voters, some for specific purposes. The governing authority can roll forward the millage in a reassessment year to increase revenues. Positively, the state began collecting sales taxes on all online sales beginning January 1, 2019. While the city was already collecting sales taxes from online sales at very large online retailers, the statewide collection on all online sales is positive. The PILOTs are determined by a formula comparing the taxable revenues and the net revenues available following the payment of utility operating expenses and debt service. No additional new revenue streams for city operations are anticipated at this time.

#### **LIQUIDITY**

Liquidity in the city's general fund totaled \$46.9 million as of fiscal 2017 or a healthy 46.2% of revenues. The city's operating funds also have very healthy liquidity positions, with cash and investments totaling \$79.5 million as of fiscal 2017 or an extremely healthy 58.6% of revenues; a portion of this is the city sales tax debt service reserve funds.

### Debt and pensions: moderate long term liabilities drive high fixed costs

The city's long term liabilities are moderate but will continue to drive high fixed costs. As of fiscal 2017, the city had \$206.8 million in outstanding sales tax debt and \$35.1 million in other limited tax or excess revenue debt for a total outstanding debt load of \$242 million or an above average 1.8% of full value and 1.8 times revenues. With the issuance of additional sales tax bonds in 2019 and maturities in fiscal 2018, the total sales tax debt increases to \$216 million. Future debt issuance plans for the city include \$70 million in sales tax bonds which will likely be issued in tranches over the next five years. The city also maintains a separate sales tax capital improvement fund that receives excess sales tax revenues after the payment of debt service which enables the city to cash fund some capital projects on an annual basis.

#### DEBT STRUCTURE

All of the city's debt is fixed rate and amortizes over the long term. Annual debt service for the 1961 sales tax bonds peaks at \$13.7 million in fiscal 2022 before declining through maturity in fiscal 2038. For the 1985 sales tax bonds, annual debt service peaks at \$13.2 million in fiscal 2020 before declining through maturity in 2044. Annual debt service on the remaining city debt is approximately \$4 million annually with all non-sales tax debt retired by 2028.

#### DEBT-RELATED DERIVATIVES

The city is not party to an interest rate swap or derivative agreements.

#### PENSIONS AND OPEB

The consolidated government 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 and accounted for approximately 63% of total contributions in fiscal 2017. Various city-parish shared funds contributed about 3.6% of total contributions with the remainder coming from city enterprises (24.1%) and parish funds (9.4%); the city enterprise and parish fund contributions as well as their proportional liabilities are excluded from this analysis. As of fiscal 2017, the city's total Moody's adjusted net pension liability (ANPL) under our methodology for adjusting reported pension data is \$310.4 million or an above average 2.3 times revenues and 2.3% of full value. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities.

During fiscal 2017, the city contributed \$13.4 million net of enterprise and parish contributions. These contributions were slightly below the Moody's calculated "tread water" level of \$13.7 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, and in fiscal 2017, the consolidated government contributed approximately \$2.5 million to the plan, of which a portion was funded by city funds. At fiscal year end, the plan reported an actuarial accrued liability of \$29.6 million, all of which was unfunded.

In fiscal 2017, fixed costs including debt, pensions, and OPEB totaled \$47.2 million or a high 34.8% of operating revenues. If the city had contributed to the pension plans at the "tread water" amount, total fixed costs would have consumed 35% of operating revenues. Expected increasing contributions and future debt issuance will likely keep fixed costs elevated. 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, which is the largest component of the city's fixed costs.

### Management and governance: governing authority for consolidated government to split in 2020

Since consolidating with Lafayette Parish in 1996 per a voter approved home rule charter, the city has been governed by a City-Parish Council and Mayor-President. In December 2018, voters approved amendments to the home rule charter, most notably the separation of the legislative body into a separate City Council and Parish Council effective January 2020. The city and parish have

always maintained separate funds but the budget was approved by the joint City-Parish Council. After January 2020, the two councils will have to jointly approve the shared administrative budget but will otherwise approve the city and parish funds' budgets separately.

The consolidated government uses conservative budgeting practices and monitors the budget monthly. The financial staff is tenured and oversees a complex system of funds for the city, parish, and enterprises. A consultant is hired to ensure accurate cost allocations for shared services between the city and parish.

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.

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