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Ratings

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Summary:

Missouri Development Finance Board City of Independence; Appropriations; General Obligation

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*(**Editor's Note:** This article has been republished to clarify the revenue source.)*

Credit Profile		
US$38.78 mil Infrastructure facs rfdg rev bnds (Independence) ser 2021 due 03/01/2051		
Long Term Rating	BBB+/Stable	New
Independence ICR		
Long Term Rating	A/Stable	Affirmed
Missouri Dev Fin Brd, Missouri		
Independence, Missouri		
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	BBB+/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'BBB+' long-term rating to the Missouri Development Finance Board's approximate $38.8 million series 2021 infrastructure facilities refunding revenue bonds, issued for the City of Independence, Mo. At the same time, we affirmed our 'BBB+' long-term rating on the city's existing infrastructure facilities revenue appropriation debt involving the Crackerneck Creek project area. In addition, we affirmed our 'A-' long-term ratings on the city's other infrastructure facilities revenue appropriation debt. Further, we affirmed the city's existing 'A' issuer credit rating (ICR). The outlook on all ratings is stable.

The series 2021 bonds and 2015C Crackerneck Creek bonds are special obligations of the city, secured by annually appropriated legally available funds. We rate these obligations two notches lower than the city's general creditworthiness (as reflected in the ICR), in part because we consider the project funded by the original bonds as not central to the city's basic functions and purpose and we view the intended payment source as narrow and potentially insufficient to meet debt service requirements. The bonds' reliance on vulnerable revenue streams and the need for general fund appropriations to cure deficiencies, over time, could lead to diminished support for the bonds.

The series 2021 bond proceeds will refund the city's series 2006B, 2013A bonds, and 2013B bonds to restructure debt service payments and extend certain maturities by more than 20 years to better align projected revenues from the Crackerneck Creek project and future debt service payments. The city plans to reallocate certain revenue streams to better support debt service. Significantly, historical revenue sources such as payments in lieu of taxes (PILOTs) and state TIF revenues will sunset in 2026. In addition, the project area's largest tenant, Bass Pro Shop, has a lease that expires in 2026 (although with options to renew). To mitigate this, the city plans to use future anticipated revenue from other expiring TIFs for debt service on the fiscal 2021 and 2015C bonds, as well as sales tax revenues subject to annual appropriation by the city. Independence has also adopted a policy to manage the receipt and disbursement of general and special purpose sales taxes and property tax collected and available for appropriation to reduce pressure on the general fund.

With the 2021 restructuring, the city seeks to reduce upcoming large debt service payments by extending them more than 20 years to limit their budgetary impact on the city's general fund and other revenue sources. This raises medium-to-long-term payment source risks in our view and a moderate intended payment source assessment given the city's historical trend requiring general fund appropriation to support debt service. Furthermore, these risks could be elevated should project area revenue underperform and if proposed new revenue sources fail to meet expectations, leading to continued deficiency appropriation and stress on the city's finances. Despite this, the city has a long track record of appropriating for similar obligations. There is no unusual political, timing or administrative risk related to the debt payments, as we consider this aspect of Independence's relationship with the Crackerneck Creek project to be strong. To date, management has shown no unwillingness to appropriate for debt service and the restructuring should allow for the intended payment sources to cover debt service. However, should the city need to restructure again or show any sign of not meeting its appropriation obligations, the rating would be lowered by multiple notches.

The city's other appropriation bonds (excluding the Crackerneck Creek bonds) are special obligations of the city, secured by annually appropriated legally available funds. We rate these obligations one notch lower than the city's general creditworthiness (as reflected in the ICR) to reflect the appropriation risk associated with the annual payment. We view these bonds as having a moderate-to-strong relationship to the obligor. These obligations provide funding for projects that we believe are either important or at least serve an ancillary function of the city. Independence pledges to annually appropriate from its operating revenues and has a long track record of appropriating for similar obligations. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment.

Credit overview

Weakening our view of the city's credit profile is its historically heavy debt burden, which strained general fund finances in recent years. A significant portion of the city's debt relies on tax base growth of TIF areas to support debt service, which to date has not occurred, leading to the current restructuring. The city's reserves are relatively thin, in our view, due to historical inconsistent budgetary performance, increasing operational risks in the event of unforeseen expenditures. We also note that the city has historically contributed less than actuarily determined towards its pension contributions, which can lead to cost acceleration and credit pressure in the medium-to-long term.

Independence benefits from its close access to the surrounding Kansas City metropolitan statistical area (MSA). The city's revenue composition primarily consists of economically sensitive revenue streams, which put it at risk when economic activity declines. To date, management's approach in addressing the budgetary effects of the COVID-19 pandemic has limited significant adverse budgetary impacts to the city, in our view.

The 'A' underlying ICR rating reflects our assessment of the following factors:

- Adequate economy, with market value per capita of $59,415 and projected per capita effective buying income (EBI) at 78.6%, but that is benefitting from access to a broad and diverse MSA;

- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2020;
- Adequate budgetary flexibility, with an available fund balance in fiscal 2020 of 7.7% of operating expenditures;
- Very strong liquidity, with total government available cash at 1.6x total governmental fund expenditures and 15.0x governmental debt service, and access to external liquidity that we consider exceptional;
- Very weak debt and contingent liability profile, with debt service carrying charges at 10.8% of expenditures and net direct debt that is 116.3% of total governmental fund revenue, as well as a large pension and other postemployment benefits (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Adequate institutional framework score.

Environmental, social, and governance (ESG) factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Absent the implications of the pandemic, we consider the county's social and environmental risks as being in line with our view of the sector. However, we consider the city's governance risks as being above the sector standard because of a cyber attack that occurred in December 2020. We understand that the attack forced the city's online utility bill payment service offline for over a month leading to a significant delay in payments, which the city expects to get caught up with by the end of 2021. The city has substantially completed a $4 million information security upgrades to mitigate further cyber security risks.

Stable Outlook

Downside scenario

We could lower the rating if the city cannot improve its weak budgetary performance or if liquidity becomes pressured as a result of pledged revenues and other revenue sources being insufficient to meet debt service payments requiring further subsidies from the general fund. In the event of continued weak budgetary performance, we could determine the city is structurally imbalanced, without a plan to correct the imbalance, or if we view liquidity as weak, we could cap the rating at 'BBB+'. In addition, should the city's available reserves worsen materially, we could lower the rating. Furthermore, should the city demonstrate an unwillingness to meet its appropriation obligations, the rating would be lowered by multiple notches.

Upside scenario

Should the city's debt profile and budgetary flexibility improve to levels commensurate with those of its higher-rated peers, we could raise the rating.

Credit Opinion

Adequate economy, with access to the broad and diverse Kansas City MSA

We consider Independence's economy adequate. The city, with an estimated population of 116,673, is in Jackson County in the Kansas City MSA, which we consider to be broad and diverse. The city has a projected per capita EBI of 78.6% of the national level and per capita market value of $59,415. Overall, the city's market value fell by 2.7% over the past year to $6.9 billion in 2021.

Directly east of Kansas City, Independence is the county seat of Jackson County. The predominantly residential city has experienced steady tax base growth in recent years, highlighted by a 15% increase in assessed valuation (AV) in 2019 because of a countywide reassessment. The city's largest employers include the local public school district (2,200 employees), small arms ammunition manufacturer Orbital ATK (1,900), and Centerpoint Medical Center (1,400). The top 10 taxpayers represent 5% of AV, representing a very diverse tax base, in our view.

After the initial onset of the COVID-19 pandemic, Jackson County's unemployment rate increased to 14.2% in April 2020 before declining to 5.5% in December 2020. We understand that the pandemic did not lead to the permanent closure or relocation of any significant taxpayers or employers within the city. For more information regarding recent developments involving COVID-19's effect on the U.S. public finance sector and our latest economic forecast, see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, on RatingsDirect. We expect the city's economy remain adequate during the next few years.

Adequate management, with standard financial policies and practices

We view the city's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

In developing its annual budget, the city looks back at 10 years of budget history and uses line-by-line budgeting. The city provides monthly budget-to-actual reporting to its council and can amend its budget at any time. In terms of long-term financial forecasting, the city maintains a limited five-year general fund revenue and expenditure forecast. Independence also maintains a robust six-year long-term capital improvement plan which it updates annually, with funding sources and costs identified. The city has adopted an investment policy and provides quarterly updates regarding investment holdings and earnings to its council. While the city has adopted a debt management policy, we view this document as limited. In addition, the city maintains an unassigned fund balance policy of 16% of general fund expenditures, with which it is currently not in compliance.

Weak budgetary performance

Independence's budgetary performance is weak , in our opinion. The city had deficit operating results in the general fund of 4.8% of expenditures, but a surplus result across all governmental funds 2.5% in fiscal 2020 (year-ended June 30, 2020). We consider the city to be subject to significant performance volatility because of event risk associated with the lingering effects of the COVID-19 pandemic.

In analyzing the city's budgetary performance, we have added recurring PILOTs from its utility fund to revenue and added amounts to the city has fallen short of in making its actuarially determined pension (ADC) contributions to expenditures. The city's inability to make its full ADC payments in recent years has masked weaker budgetary performance.

In fiscal 2020, the city's budgetary performance was weakened by the effects of the COVID-19 pandemic. The city reported a reduction in court costs and fee revenue because of the pandemic. Despite this, the city reduced certain expenditures in the amount of $1.5 million, limiting the size of its deficit. These cuts included the closure of certain recreation facilities and a decrease in capital projects. Independence's largest general fund revenue source is sales taxes (24%), and other major revenue sources include property taxes (10%), and licenses and permit revenue (9%).

For fiscal 2021, the city is forecasting an approximate $600,000 general fund surplus result. Driving this projection, in part, are continued reductions in general fund expenditures and higher-than-anticipated sales tax revenue. The city recognized approximately $6.9 million in COVID-19 relief aid in fiscal 2021. For fiscal 2022, the city expects to adopt a surplus budget. Pursuant to the American Rescue Plan Act, the city expects to receive approximately $20 million in COVID-19 relief aid. We expect the city's budgetary performance will remain adequate.

Adequate budgetary flexibility

Independence's budgetary flexibility is adequate, in our view, with an available fund balance in fiscal 2020 of 7.7% of operating expenditures, or $6.0 million.

The city's available fund balance peaked in fiscal 2018, at 10.4% of expenditures, or $8.3 million, but recent deficits in fiscal years 2019 and 2020 have reduced its available reserves to current levels. We consider Independence's reserve level to be below average for a city its size. As the city expects a surplus in fiscal 2021 and attempts to build reserves closer to its 16% reserve policy, our view of its budgetary flexibility could improve to strong during the next few years.

Very strong liquidity

In our opinion, Independence's liquidity is very strong, with total government available cash at 1.6x total governmental fund expenditures and 15.0x governmental debt service in 2020. In our view, the city has strong access to external liquidity.

The city's available cash was approximately $198 million at the end of fiscal 2020. Its liquidity is primarily concentrated in enterprise funds, with enterprise fund cash comprising over 75% of its liquidity, or $150.1 million. The remainder of the city's cash is found in its governmental funds, which held $47.8 million at the end of fiscal 2020. The enterprise funds would generally not be available for debt service on the TIF revenue bonds in the event of continued revenue shortfalls. Rather, it would be taken from the smaller governmental funds cash amounts, which raises contingent liability risks for the city, in our view, and could weaken liquidity and the rating.

The city entered into a lease-purchase agreement in 2019, which does not contain any non-standard events of default that could lead to immediate acceleration causing a contingent liquidity risk.

Very weak debt and contingent liability profile

In our view, Independence's debt and contingent liability profile is very weak. Total governmental fund debt service is 10.8% of total governmental fund expenditures, and net direct debt is 116.3% of total governmental fund revenue.

Independence has nearly $500 million in debt outstanding, backed by an annual appropriation pledge plus other underlying revenue sources. A large amount of the city's debt has been issued to fund various economic development projects and was to be paid from TIF revenues. Debt service schedules relating to these financings were sized to meet revenue growth projections, but, in some cases, new development and corresponding increases in TIF revenues have fallen short of expectations. The city has shown the capacity to fund near-term shortfalls in pledged revenues from its general fund operations, but this presented budgetary challenges, led to thin budgetary flexibility, and elevated fixed charges. With the series 2021 bonds it has restructured components of its debt to lower annual debt service and aligned it with currently expected project revenues and other available funds, although this weakens its amortization, which we consider below average. Amortization is below average, with 40% of debt retired within 10 years. The city has plans to issue approximately $6.5 million in new money debt for maintenance projects involving its Events Center.

Pension and OPEB liabilities

In our opinion, a credit weakness is Independence's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Independence's combined required pension and actual OPEB contributions totaled 19.1% of total governmental fund expenditures in 2020. Of that amount, 13.3% represented required contributions to pension obligations, and 5.8% represented OPEB payments. The city made 84% of its required pension contribution in 2020.

- The city participates in the Missouri Local Government Employees Retirement System (LAGERS), which was 83% funded, with a net pension liability of $94.5 million; and
- The city's OPEB liability was $204.5 million at the end of fiscal 2020.

Regarding the city's annual contribution to LAGERS, we note that the city is exceeding its static funding contribution level but falling short of minimum funding progress. In addition, we consider the LAGERS discount rate of 7.25% as being higher than our baseline of 6%. Coupled with its level-percent amortization method could lead to contribution volatility.

The city provides OPEB for all active and retired employees and their eligible dependents. Beginning in January 2020, Medicare eligible retirees became covered on a stand-alone plan which has resulted in an actuarial liability reduction of approximately $118 million.

Adequate institutional framework

The institutional framework score for Missouri municipalities is adequate.

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
- 2020 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 17, 2021)		
Missouri Dev Fin Brd, Missouri		
Independence, Missouri		
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
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Long Term Rating	A-/Stable	Affirmed
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Long Term Rating	BBB+/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
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Long Term Rating	BBB+/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed
Missouri Dev Fin Brd (Independence) APPROP		
Long Term Rating	A-/Stable	Affirmed

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.