

RatingsDirect®

Summary:

Lebanon, Indiana; General Obligation; General Obligation Equivalent Security

Primary Credit Analyst:

Moreen T Skyers-Gibbs, New York (1) 212-438-1734; moreen.skyers-gibbs@spglobal.com

Secondary Contact:

John Sauter, Chicago (1) 312-233-7027; john.sauter@spglobal.com

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Summary:

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Credit Profile

US\$3.265 mil econ dev lse rental bnds ser 2018 due 02/15/2043

Long Term Rating AA-/Stable New

Lebanon Dept of Storm Wtr Mgmt, Indiana

Lebanon, Indiana

Lebanon Dept of Storm Wtr Mgmt (Lebanon) storm wtr

Long Term Rating AA-/Stable Affirmed

Lebanon Redevelopment Commission, Indiana

Lebanon, Indiana

Lebanon Redevelopment Commission (Lebanon) redev dist bnds (Lebanon) (Downtown Proj) ser 2018 dtd 04/05/2018 due 02/01/2040

Long Term Rating AA-/Stable Affirmed

Lebanon Redev Auth, Indiana

Lebanon, Indiana

Lebanon Redev Auth (Lebanon) lse rental bnds (Lebanon) (Downtown Proj) ser 2018 dtd 04/13/2018 due 02/15/2040

Long Term Rating AA-/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Lebanon, Ind.'s series 2018 economic development lease rental bonds. At the same time, we affirmed our 'AA-' long-term rating on the city's existing debt as well as the debt of the Lebanon Redevelopment Commission and the Lebanon Redevelopment Authority, both issued on behalf of the city and reflecting an ad valorem property tax pledge. The outlook on all ratings is stable.

The lease-rental bonds are issued pursuant to a trust indenture between the city and the trustee, and a lease between the Lebanon Public Building Corp., as lessor, and the Lebanon Redevelopment Commission, as lessee. The bonds are secured by lease-rental payments paid by the city, acting on behalf of the commission, directly to the trustee. Rent is payable from certain tax-increment revenues within the Gateway Marketplace allocation area and revenues from food and beverage taxes, as well as ad valorem taxes against all taxable property within the city's redevelopment district, which is coterminous with the boundaries of the city. The 'AA-' rating is based on the ad valorem tax pledge, which we consider stronger than the tax-increment and food and beverage pledge.

The levy of taxes to pay rentals is not subject to annual appropriation under Indiana law. However, lease payments are subject to abatement risk as the city is required to abate lease rentals if the leased premise is not available for use. This risk is mitigated, in our view, by the lease requiring the city to maintain at least two years of lease interruption insurance, as well as casualty insurance equal to the full replacement cost of the damaged equipment. In addition, the

lease allows and requires the city to substitute the leased premise for a different leased premise with equal or greater value if the original premise is considered unusable.

Additionally, there is construction risk given that lease payments can only begin after the project is complete and accepted. However, interest will be fully capitalized through and including Aug. 15, 2020, and partially capitalized through and including Feb. 15, 2021. Project completion is expected for October 2019. In addition, a debt service reserve fund (DSRF) is expected to be funded at maximum annual debt service (MADS) from the bond proceeds. The DSRF also provides additional security for the bonds.

The tax pledge is subject to state circuit-breaker legislation, which places caps on the property tax burden for taxpayers based on a percentage of the real estate parcels' gross assessed value (AV). This can and often reduces the aggregate tax levy. The levy to cover debt service, however, is statutorily protected, allowing the city to distribute circuit-breaker losses first across nondebt service funds that receive property taxes. We rate this debt at the same level as our view of the city's general creditworthiness.

The proceeds from the bonds are expected to provide funds to finance the demolition of existing structures and various improvement such as road construction, utility, grading, and general site preparation for future mixed-use development.

The 'AA-' rating reflects the following factors, including Lebanon's:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available cash reserve in fiscal 2017 of 96% of operating expenditures;
- Very strong liquidity, with total government available cash at 115.2% of total governmental fund expenditures and 19.4x governmental debt service, and access to external liquidity we consider strong;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Very weak debt and contingent liability profile, with debt service carrying charges at 6.0% of expenditures and net direct debt that is 188.6% of total governmental fund revenue; and
- Strong institutional framework score.

Adequate economy

We consider Lebanon's economy adequate. The city, with an estimated population of 16,656, is the seat of Boone County, in the Indianapolis-Carmel-Anderson MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 77.9% of the national level and per capita market value of \$87,540. Total market value, measured as gross AV less tax-exempt properties, is \$1.46 billion.

Lebanon benefits from its location along Interstate 65, about midway between Indianapolis and Lafayette, which are both growing job bases within a 30-minute commute of the city. Lebanon remains mostly a residential city, but with a growing industrial and business park, which is in part generating modest tax base concentration (the ten leading

taxpayers' combined net AV accounts for 29.9% of total net AV). Including incremental property tax revenues, the city reports that over 40% of property taxes are generated from this area. Its businesses are mostly in light manufacturing, distribution, and logistics, reflecting the city's beneficial geographic footprint. Duke Realty owns a significant amount of property in the park, of which we understand is mostly occupied and leased. The three largest employers in the city are Witham Memorial Hospital (932 employees), XPO Logistics (630), Hachette Book Group (598), and the county government (520). The county unemployment rate 2.8% in 2017.

Should city incomes improve, the economy score could improve. At the same time, if there is an increase in leading taxpayer concentration, the score could weaken.

Strong budgetary performance

Lebanon's budgetary performance is strong, in our opinion. The city continues to demonstrate a track record of stable financial operations in the general fund and across all its total governmental funds. Based on 2018 estimates, it expects the general fund to operate with positive operating results.

The city had operating surpluses of 16% of expenditures in the general fund and 7.5% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results to remain positive, but not as consistently strong as 2017 results in the near term.

The city has produced consistent operating surpluses over the past few years, as it benefits from a growing tax base and limited losses from circuit-breaker tax caps, as well as limited fixed costs. Its main revenue sources are property taxes (30% of general fund revenues) and income taxes (57%). The county began collecting revenues from a new countywide public safety income tax in calendar year 2017. The city's share generated \$2.7 million in what is a new, recurring annual revenue. These receipts are deposited into a separate public safety income tax fund, which we have combined with the general fund to reflect its core operations. Both the property and income taxes are performing well, and we anticipate they will continue to grow as the city and countywide tax base further develop.

The general fund had small surpluses in 2015 and 2016, which were followed by the larger combined funds' surplus of \$1.8 million in 2017 (with spending at \$11.4 million). For the current year, the city anticipates another year of positive performance. We anticipate that the city will continue to operate with balanced budgets, but that the annual operating surpluses will likely lessen as the city budgets use of the new income tax.

Outside of the general fund, key governmental funds include the motor vehicle highway, park, cumulative capital development (CCD), food and beverage tax, and enterprise tax-increment financing (TIF) allocation funds. Combined, total governmental funds typically produce surpluses, after adjusting for receipt and spending of bond proceeds, which was the case in 2017.

Our analysis relies on unaudited, Dec. 31 fiscal-year-end cash reports that are submitted to the state. These reports subscribe to the state's uniform system of accounting and reporting that all local governments are required to follow, and based on prior-year comparisons with state-examined data, we consider them reliable to serve as a basis of our analysis.

Very strong budgetary flexibility

Lebanon's budgetary flexibility is very strong, in our view, with a high available cash reserve in fiscal 2017 of 96% of operating expenditures, or \$10.9 million. We expect the available cash reserve to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The cash reserve includes \$6.6 million (57.7% of expenditures) in the general fund and \$4.3 million (38%) that is outside the general fund but legally available for operations. Impairing budgetary flexibility, in our view, is Lebanon's use of cash accounting, which reduces clarity about the amount of funds that are truly available.

As previously mentioned, we have combined the public safety income tax fund with the general fund as the main operating fund. Funds outside of the general fund, but with cash reserves that have no restriction on its usage, so they are included as non-general available funds, include the rainy day, food and beverage tax, CCD, cumulative capital improvements, and riverboat gaming funds. The city anticipates most of these funds' cash reserves remaining stable in the near term. The city has historically annually budgeted to spend portions of the rainy day and food and beverage funds, but generally, revenues exceed spending. We anticipate that the combined available reserve position will remain very strong.

Very strong liquidity

In our opinion, Lebanon's liquidity is very strong, with total government available cash at 115.2% of total governmental fund (adjusted) expenditures and 19.4x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary. This is demonstrated by its history of issuing tax-secured bonds. We note that the city does not have any permissive investments, rather, its cash is all pooled in local interest-bearing bank accounts. Also, cash flow is strong, with incomes taxes being distributed monthly, and property taxes semi-annually.

The city has issued several series of bonds to private banks or single buyers. Most of these obligations are secured by either net sewer revenues or tax-increment revenues, with no recourse to the city. Only one obligation (outstanding in the amount of \$1.795 million) contains a general city tax backing, but there is no acceleration risk associated with the debt. Based on review of the bond terms for these obligations, we do not consider them an added liquidity risk.

We anticipate the liquidity will remain very strong, based on continued strong budget performance.

Adequate management

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.

Highlights includes the city's strong revenue and expenditure assumptions for budgeting purposes, which takes into account multiple years of historical data reviewed and consultation with professional advisers and other public organizations. The city now provides council with monthly budget-to-actual appropriation reports. As of August 2018, the city implemented a multiyear (current year plus three future years) comprehensive financial plan for its operating funds. It is the city's intention to review the plan on an annual basis and share with council. However, we understand that the city will only make updates to the plan as it sees necessary. It has various asset replacement plans, a downtown improvement plan, and a five-year projection of revenues and spending for its industrial/business park allocation area, but does not have a comprehensive, rolling capital improvement plan identifying all needs and spending projections for the next five years. All city cash reserves are kept at local banks, but there is no reporting on

investments, cash balances. There are no debt or investment policies, but the city does continue to meet its general fund reserve target of 20%.

Very weak debt and contingent liability profile

In our view, Lebanon's debt and contingent liability profile is very weak. Total governmental fund debt service is 6.0% of total governmental fund (adjusted) expenditures, and net direct debt is 185.0% of total governmental fund (adjusted) revenue.

The city has approximately \$56 million in outstanding debt, including \$17.6 million in net utility-secured debt and another \$6.0 million with only tax increment. As previously noted, it has several series of privately placed debt, none of which we consider a contingent liability risk. At this time, the city does not have any additional debt plans that would be secured by its taxing authority. Currently, 61% of the city's principal (excluding \$2.8 million in bond anticipation notes) is scheduled to mature within ten years. As debt matures and if there is not additional debt issued, the debt and contingent liability profile could improve to a level we consider adequate.

We understand that future debt needs will be for the sewer and waterworks projects.

Additionally, the city actively contributes to two pension plans administered by the state: Indiana Public Employees' Retirement Fund (PERF) and the 1977 Police Officers' and Firefighters' Retirement Fund ('77 Fund). These are both cost-sharing, multiemployer defined-benefit plans.

Certain employees are also covered by legacy single employer, defined-benefit police and firefighter retirement plans (1925 Police Pension, 1937 Firefighters Pension). While the liabilities of these plans are still an obligation of the city, the state has assumed 100% of these costs for all local governments and has been historically funding the benefits on a pay-as-you-go basis through its pension relief fund. Given the state commitment to funding these costs, we do not consider them liabilities of local governments.

As required by state law, the city paid 100% of its required pension contributions (which are actuarially determined) in 2017, equal to \$857,000, or 4.5% of total governmental fund (adjusted) expenditures. As of June 30, 2017, the PERF was 76.6% funded and '77 Fund was 100.3% funded, in accordance with Governmental Accounting Standards Board Statement No. 67 and 68. The plans use a discount rate of 6.75%. Additionally, retirees may continue on the city's health insurance policy, though they bear 100% of the cost of premiums. No retirees are currently on the plan. At this time, we do not anticipate the city's pension costs placing any significantly increasing pressure on the budget.

Strong institutional framework

The institutional framework score for Indiana municipalities is strong.

Outlook

The stable outlook reflects our expectation that Lebanon will continue its trend of producing balanced operating results, thereby sustaining its very strong budget flexibility and liquidity. This is supported by strong income tax and property tax performance, which reflect the stable and growing tax base. We anticipate the economy will continue to develop, and support stable operating revenues without significantly increasing operating demands.

Upside scenario

We may raise the rating within the two-year outlook period if the city implements and demonstrates commitment to more robust financial planning and reporting practices, while also seeing continued strengthening of the economy and maintaining its strong budgetary performance and very strong budget flexibility and liquidity.

Downside scenario

We could lower the rating if the city's budget were to fall out of balance, leading to substantial draws on the available cash reserve. Significant increases in the debt burden or deterioration of the available reserve position to levels more comparable to lower rated peers, even if through one-time spending, could also weaken the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

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.

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