

CREDIT OPINION

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Owensboro (City of) KY

Update to credit analysis

Summary

[The City of Owensboro, KY's](#) (A1) moderately-sized tax base is demonstrating healthy year over year growth driven by a combination of ongoing development, land annexations, and appreciation of property values. The city benefits from its position as a regional economic, manufacturing, and healthcare center. The city's credit profile reflects a satisfactory reserve and liquidity position that, following a multi-year trend of draws, is improving due to a combination of conservative budgeting, revenue growth supported by rate increases, and a reduction in the use of fund balance for one-time capital expenses. While Owensboro's debt burden is well above the national A1 medians, it will remain manageable due to a lack of future debt plans and continued tax base and revenue growth. Pensions are manageable, and although overall fixed costs are elevated, the city maintains dedicated revenue streams outside of the general fund and began receiving TIF revenues in fiscal 2019, which will supplement debt service payments and ease overall fixed costs.

Credit strengths

- » Regionally important economy with history of stable tax base growth
- » Demonstrated willingness and ability to increase tax rates
- » Improving financial position and adopted formal fiscal policies

Credit challenges

- » Elevated debt burden compared to similarly-rated cities
- » Resident wealth levels below the national median
- » Reliance on economically sensitive revenues
- » Concentration in local payroll taxpayers
- » Riverfront location susceptible to weather-related events

Rating outlook

Outlooks are not usually assigned to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

- » Moderation of debt burden

- » Sustained trend of surpluses resulting in increased reserves and liquidity
- » Substantial tax base growth coupled with improvement in the city's socioeconomic profile

Factors that could lead to a downgrade

- » Material declines in tax base values and wealth levels
- » Significant increase in debt burden
- » Trend of structural imbalance resulting in deteriorated financial position

Key indicators

Exhibit 1

Owensboro (City of) KY	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$3,232,451	\$3,302,116	\$3,416,611	\$3,526,479	\$3,620,870
Population	58,350	58,350	58,791	59,404	59,809
Full Value Per Capita	\$55,398	\$56,592	\$58,115	\$59,364	\$60,541
Median Family Income (% of US Median)	74.0%	74.0%	71.2%	71.2%	68.4%
Finances					
Operating Revenue (\$000)	\$48,071	\$51,421	\$53,427	\$57,993	\$61,304
Fund Balance (\$000)	\$10,178	\$9,507	\$7,476	\$9,306	\$15,013
Cash Balance (\$000)	\$11,880	\$11,009	\$11,433	\$13,409	\$18,094
Fund Balance as a % of Revenues	21.2%	18.5%	14.0%	16.0%	24.5%
Cash Balance as a % of Revenues	24.7%	21.4%	21.4%	23.1%	29.5%
Debt/Pensions					
Net Direct Debt (\$000)	\$158,378	\$159,567	\$169,084	\$159,096	\$150,940
3-Year Average of Moody's ANPL (\$000)	\$108,884	\$110,436	\$103,799	\$111,248	\$116,759
Net Direct Debt / Full Value (%)	4.9%	4.8%	4.9%	4.5%	4.2%
Net Direct Debt / Operating Revenues (x)	3.3x	3.1x	3.2x	2.7x	2.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.4%	3.3%	3.0%	3.2%	3.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.3x	2.1x	1.9x	1.9x	1.9x

Sources: Owensboro, KY audited financial statements, US Census Bureau, & Moody's Investors Service

Profile

The City of Owensboro, KY is located in [Daviness County, KY](#) (Aa2) along the Ohio River in the western coal field region of the [Commonwealth of Kentucky](#) (Aa3 stable), approximately 110 miles southwest of Louisville & Jefferson County Metro Government (Aa1 stable). The city encompasses 20.4 square miles and has an estimated 2019 population of 59,809.

Detailed credit considerations

Economy and tax base: sizeable tax base that serves as a regional hub; below average resident income levels

The City of Owensboro, KY's sizeable \$3.8 billion (2020) tax base compares favorably to the national medians (\$889 million) for the A1 rating category and is demonstrating steady year-over-year increases, averaging 3.2% annually over the last five years. The city benefits from its position as a regional economic, manufacturing, and healthcare center, and is home to [Owensboro Medical Health System](#) (Owensboro Health Inc., KY, Revenue Rating Baa3 positive), the city's largest employer with over 3,600 employees. The city is also home to a large home mortgage processing center for US Bank, employing approximately 2,000. The city's tax base will continue to

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experience modest annual increases in value given ongoing residential and commercial development as well as its position as a regional economic and healthcare hub.

The city's Gateway 54 development project is a multi-year effort to develop over 200 acres of land annexed into the city along a newly constructed bypass on the city's eastern edge. The \$350 million project is expected to bring commercial, entertainment, office, and residential spaces to the area. The build-out is scheduled for seven years and is projected to create 2,000 new jobs once completed. Additionally, the city's 392 acre Downtown Riverfront Redevelopment project includes the construction of the Bluegrass Hall of Fame and a new parking garage. Both projects are in tax increment financing districts (TIFs) that were activated on January 1, 2018. In addition to incremental local revenues, the city will also be receiving 80% of the state's incremental revenues resulting from developments within the two TIFs to be put toward financing the development projects. Further, the city annexed an additional 17 acres with commercial presence, that will add to the city's tax base.

Between 2012 and 2019, the district's population increased by 4.1% to 59,809 residents according to U.S. Census Bureau. Resident wealth levels fall below similarly rated cities, with the 2018 median family income at 68% of the national level, and full value per capita of \$63,369 (which falls below the national A1 median of \$71,371). The rate of unemployment in the city was 3.6% in December 2019, which is below the state (3.9%) and slightly above the national (3.4%) rates for the same period.

Financial operations and reserves: fund balance levels improve following years of imbalanced operations

Owensboro's financial position has stabilized and will likely continue to improve over the next several years due to a combination of conservative budgeting, revenue growth supported by rate increases, and a reduction in the use of fund balance for one-time capital expenses. Further, the city adopted a formal fund balance policy of maintaining unassigned general fund balance of 17% of expenditures.

Following four consecutive draws on reserves between fiscal 2014 and 2017, the city experienced positive operations in fiscal 2018 and 2019. Past deficits were the result of budget amendments to account for expenditure growth in public safety, general government and public works costs as well as the use of fund balance for one-time capital expenses related to the city's economic development projects. In fiscal 2018, the city implemented a 4% property tax rate increase and also set its occupational license tax rate to 1.78%, which helped drive revenue growth.

In fiscal 2019, the city finished with a \$5.7 million general fund surplus, which brought available (unassigned, assigned, committed) fund balance to \$15 million (25.7% of revenues). Revenues exceeded budgetary expectations by \$2.7 million, primarily due to higher occupational and net profit taxes. Expenditures were less than the amended budget by \$2.6 million because of savings in salaries and benefits due to unfilled vacancies, as well as timing of unfinished projects of approximately \$1 million. The city's two capital projects funds also held a total of \$14 million, slated for projects taking place in fiscal 2020.

Available operating fund balance (inclusive of both the general and debt service fund), also totaled \$15 million, which represents 24.5% of combined operating fund revenues. Although this figure falls below the national A1 median of 36%, the size of the city's budget is notably larger with revenues of \$61.3 million relative to the median of \$11.3 million.

The city is reliant on economically sensitive revenues for both general operations and debt service. Occupational taxes (a payroll withholding tax) are the city's primary revenue source, representing 32% of total general fund revenues in fiscal 2019. Additionally, this revenue source exhibits an elevated degree of taxpayer concentration, with the top 10 occupational taxpayers representing 50% of total revenues (Owensboro Health Inc. is the largest, accounting for 21% of occupational revenues). The second largest revenue source is property taxes, which accounted for 19% of fiscal 2019 general fund revenues. At 14%, the third largest revenue source is transfers in from the city's combined utility which represent cash dividends and a PILOT.

The fiscal 2020 amended budget estimates general fund revenues of \$57.7 million relative to expenditures of \$57.3 million. Year-end fund balance is anticipated to be \$13.7 million. The majority of the improvements will be funded by the capital projects funds, which will hold a total of nearly \$3 million at the fiscal year-end.

Further credit reviews will focus on the city's ability to maintain healthy reserves in compliance with formal policies.

LIQUIDITY

Owensboro ended fiscal 2019 with an operating fund (inclusive of both the general and debt service funds) cash position of \$18 million, or 29.5% of combined operating fund revenues. This figure falls below the A1 median of 37% of revenues, but, similar to fund balance, is nominally greater than the median of \$5 million.

Debt and pensions: aggressive economic development plan leading to above average debt burden

Owensboro's debt burden is elevated compared to similarly rated cities nationwide, however, it will remain manageable given continued tax base and revenue growth and a lack of additional borrowing plans. Beginning in fiscal 2008, the city issued debt for various economic development projects. Post-issuance, the city's debt burden will represent 4.1% of 2020 full value, or 2.5 times operating fund revenues, which is above the national A1 median of 1.6%. and 0.7 times, respectively.

The city has issued general obligation bonds to finance various less essential projects including an ice rink, a convention center as part of the city's downtown revitalization and riverfront redevelopment plans, as well as to purchase and construct parking structures. The city also issued bonds to finance the construction of bank facilities, repaid from bank lease payments and additional occupational license taxes generated from new jobs created with the bank's expansion. Additionally, the city issued bonds for the Owensboro Riverport Authority (ORA) to construct and equip a milling facility.

While the bonds are backed by Owensboro's full faith and credit, a portion of the debt is expected to be repaid with dedicated revenues sources such as a portion of the city's insurance premium license tax and tax increment financing (TIF) revenues. The two TIF districts were developed in conjunction with the state, which reimburses the city for taxes (sales tax, payroll withholding and property tax) generated in the TIF designated areas, for up to \$20.5 million for the Gateway Commons TIF and up to \$24.5 million for the Downtown Riverfront TIF. The city began receiving TIF revenues in fiscal 2019, which are currently in line with projections. Additionally, the city is being reimbursed by ORA for debt service on the bonds issued for the milling facility.

Debt service in fiscal 2019 comprised 22.7% of operating expenditures.

DEBT STRUCTURE

All of the city's debt is fixed rate and amortized over the long-term.

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

City employees participate in the County Employees Retirement System (CERS), a cost-sharing multi-employer defined benefit pension plan administered by Kentucky Retirement Systems. The city also has exposure to two single-employer plans, the City Employees' Pension Fund and the Police and Firefighters' Retirement Fund, both of which have been closed to new employees. Owensboro's combined adjusted pension liability, assuming a 4.1% discount rate, is \$114.5 million, or 1.9 times operating revenues and 3.2% of full value, which is elevated compared to the national median for the A1 rating category. Comparatively, the GASB reported net pension liabilities, based on a 6.11% discount rate, totaled \$73.8 million.

In fiscal 2019, the city contributed \$4.6 million to the plan, which represents 88% of the "tread water indicator"¹

Other post-employment benefits are also provided through the state system. In fiscal 2019, the adjusted net OPEB liability was \$35 million, and the city contributed \$1.8 million, which is slightly below the "tread water indicator" of \$2.7 million. Pension and OPEB contributions totaled 10.9% of 2019 operating expenditures.

Total fixed costs (including debt service, OPEB treadwater, and pension treadwater payments) represents an elevated 36% of operating fund expenditures in fiscal 2019.

ESG Considerations

Environmental considerations are somewhat material to the city's credit quality given its location along the Ohio River. While Owensboro is exposed to some flooding events during wet-weather seasons, the city benefits from the county's participation in the National Flood Insurance program. The county also requires mortgage holders to have flood insurance if property is located in a flood prone area, as determined by FEMA. Additionally, the city is actively protecting vulnerable areas. In 2016, Owensboro completed a

\$4.9 million project in 2016 to mitigate flooding, which was designed to divert rainwater from the streets to two large basins. Most weather-related events are manageable with the city and county's communication to residents and providing necessary equipment and infrastructure during storms. Owensboro's exposure to long-term environmental trends is consistent with that of the US local government sector, which as a whole, is low.

Social considerations are material and incorporated by way of full value per capita and median family income. Additionally, the cost of living is below average and affordable in the city, and employment amongst the total labor force is increasing, a positive indicator, and poverty levels have remained fairly level.

The City Commission's targets achieving and maintaining unassigned fund balance in the general fund equal to no less than 17% of general fund expenditures. If the unassigned fund balance falls below its goal, the city shall develop a corrective action plan and take actionable steps.

Kentucky cities have an institutional framework score of "Aa," or strong. Property and occupational license taxes, the primary revenue sources, are highly predictable. Cities have moderate revenue-raising ability and can increase property taxes by 4% annually. Cities with populations of 15,000 and above also have a property tax cap of 15 mills. Cities with population of 1,000 or higher have the power to levy an occupational license tax. The tax rate is unlimited for cities with populations up to 300,000 and capped at 1.25% for larger cities. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Expenditures are highly predictable and cities have a moderate ability to reduce them given a limited presence of unions and moderate fixed costs. Fixed costs are driven mainly by debt service and pension costs.

Rating methodology and scorecard factors

The [US Local Government General Obligation Debt Rating 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 factors 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

Owensboro (City of) KY

Scorecard Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$3,790,013	Aa
Full Value Per Capita	\$63,369	A
Median Family Income (% of US Median)	68.4%	Baa
Notching Factors: ^[2]		
Regional Economic Center		Up
Economic Concentration		Down
Finances (30%)		
Fund Balance as a % of Revenues	24.5%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	4.7%	A
Cash Balance as a % of Revenues	29.5%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	6.9%	A
Notching Factors: ^[2]		
Outsized Enterprise or Contingent Liability Risk		Down
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Notching Factors: ^[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	4.1%	Baa
Net Direct Debt / Operating Revenues (x)	2.5x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.1%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.9x	A
Notching Factors: ^[2]		
Unusually Strong or Weak Security Features		Up
Scorecard-Indicated Outcome		A1
Assigned Rating		A1

[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.

Sources: Owensboro, KY audited financial statements, US Census Bureau & Moody's Investors Service

Endnotes

- 1 Our "tread water" indicator measures annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.

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