

RatingsDirect®

Summary:

Johnston, Iowa; General Obligation

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Credit Profile

US\$9.5 mil GO bnds ser 2018A due 06/01/2038

Long Term Rating AA+/Stable New

Johnston GO

Long Term Rating AA+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to Johnston, Iowa's series 2018A general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's existing GO debt. The outlook is stable.

The bonds are secured by the city's unlimited ad valorem tax GO pledge. Management indicates proceeds will be used to pay for public improvements within the city.

The 'AA+' rating reflects our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 41% of operating expenditures, and the flexibility to raise additional revenues despite statewide tax caps;
- Very strong liquidity, with total government available cash at 93.1% of total governmental fund expenditures and 3.9x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 23.6% of expenditures and net direct debt that is 325.1% of total governmental fund revenue; and
- Strong institutional framework score.

Very strong economy

We consider Johnston's economy very strong. The city, with an estimated population of 21,907, is located in Polk County in the Des Moines-West Des Moines, IA MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 147% of the national level and per capita market value of \$117,954. Overall, the city's market value grew by 11.2% over the past year to \$2.6 billion in 2019. The county's unemployment rate was 3.1% in 2017. Johnston is located in Polk County in central Iowa, approximately four miles northwest of the

state economic center and capital, Des Moines. The city's population has more than doubled since the 2000 U.S. census. Given Johnston's location, residents have easy access to employment in the city of Des Moines and throughout the metropolitan area. Largest employers in the city include John Deere (3,089 employees), DuPont Pioneer (2,495), and the local school district (967). The city is primarily residential, with 76.3% of the tax base residential properties, followed by commercial properties (19.3%). We anticipate that Johnston's local economy will remain very strong in the near term, and experienced continued growth during the next few years.

Strong management We view the city's management as strong, with "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

After experiencing an incident where an employee was caught embezzling approximately \$13,000 in city funds, the city implemented a number of enhanced controls designed to prevent a similar situation in the future. Given the city's robust response to this isolated incident, we still view the city's overall management conditions as being strong. Highlights include the use of three years of historical information when constructing the budget, monthly budget-to-actual reports provided to the council, the maintenance of a five-year capital plan that is adopted by the council and updated annually, a formal investment policy whereby the council reviews holdings in its monthly treasury investment reports, and a formal fund balance policy of 25% that the city will continue to exceed despite its planned use of reserves. The city also has a formal debt management policy that states the city's GO debt should not exceed 75% of the statutory limit. The city lacks a formal long-term financial plan.

Adequate budgetary performance

Johnston's budgetary performance is adequate in our opinion. The city had slight deficit operating results in the general fund of negative 0.7% of expenditures, and deficit results across all governmental funds of negative 4.3% in fiscal 2017.

After adjusting for recurring transfers and the spending of bond proceeds, the city posted a slight deficit of \$90,000 in fiscal 2017 (year ended June 30) in its general fund. This result represented a better outcome than originally budgeted, when the city forecast a \$500,000 deficit. Contributing to this result were savings achieved in the public works and public safety departments. Property taxes represent the city's highest source of revenue in its general fund at 74%, followed by charges for services, which make up 10.3% of general fund revenue.

For unaudited fiscal 2018, the city's general fund budget had called for a \$789,000 use of reserves, but we understand it will likely achieve a \$283,000 surplus. This expected result was caused in part by a better than anticipated result for the city's workers compensation insurance costs and due to the city deciding to wait to purchase certain equipment. The city anticipates that its total governmental funds performance will likely be positive, on an adjusted basis. With regard to fiscal 2019, the city has budgeted for a \$105,000 deficit in the general fund. Officials indicate that they plan to reduce reserves to a level closer to its reserve policy of 25% of expenditures in the general fund in fiscal 2019 and possibly in future years. Given the city's planned adherence to its reserve policy, we believe its budgetary performance will likely remain adequate, but stable.

Very strong budgetary flexibility

Johnston's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 41% of operating expenditures, or \$5.1 million. In addition, the city has the flexibility to raise additional revenues despite statewide tax caps, which we view as a positive credit factor.

Johnston, unlike most Iowa municipalities, is not levying at its maximum rates. In fiscal 2018, the city could generate an additional \$3.3 million, if it levied at its maximum rates, which we view as significant. The city is currently under its 8.10 general fund levy, does not utilize its 0.27 emergency levy, and has significant flexibility under its trust and agency levy. The city has a formal fund policy to keep at least 25% of expenditures in reserve and is seeking to reduce its available fund balance to this level. Despite the city's planned use of reserves in fiscal 2019, we expect budgetary flexibility to remain very strong.

Very strong liquidity

In our opinion, Johnston's liquidity is very strong, with total government available cash at 93.1% of total governmental fund expenditures and 3.9x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We believe the city has strong access to external liquidity, as it has issued GO and revenue bonds regularly over the past 20 years. The city's investments are primarily in certificates of deposit and cash, which we do not consider aggressive. We expect liquidity to remain very strong over the next two years.

Very weak debt and contingent liability profile

In our view, Johnston's debt and contingent liability profile is very weak. Total governmental fund debt service is 23.6% of total governmental fund expenditures, and net direct debt is 325.1% of total governmental fund revenue.

The city is expecting to issue an additional \$16 million in GO debt for capital improvement projects during the next two years. We expect its debt profile to remain very weak, as the city manages its capital needs as it continues to grow.

In March 2018, the city entered into a loan with a local bank for \$4.5 million for the cost of property acquisition. We have examined the loan agreement and it does not contain any unusual terms of default leading to immediate acceleration.

Johnston's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 2.4% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution in 2017.

Although pension and OPEB contributions remain a long-term credit consideration, we believe the liability is manageable. The city participates in the Iowa Public Employees Retirement System. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the city's proportionate share of the net pension liability as of 2017 was \$3.4 million. The largest plan maintained a funded level of 85.2% using the plan's fiduciary net position as a percentage of the total pension liability. The city operates a single-employer retiree benefit plan that provides medical benefits for retirees and finances this obligation on a pay-as-you-go basis. Retirees under the age of 65 pay 100% of the full active employee premium rates.

Strong institutional framework

The institutional framework score for Iowa cities with a population greater than 2,000 is strong.

Outlook

The stable outlook reflects our view of Johnston's very strong economy, budgetary flexibility, and liquidity, all of which are supported by strong management conditions. We expect the city's credit characteristics to remain relatively unchanged during the two-year outlook period and thus do not expect to change the rating. The city's participation in the broad and diverse Des Moines MSA provides additional support to the rating.

Downside scenario

We could lower the rating if the city's budgetary performance were to deteriorate to a level that we consider weak, leading to a worsening of budgetary flexibility.

Upside scenario

We could raise the rating if the city's debt and contingent liability were to improve significantly and if the city were to demonstrate economic characteristics commensurate with its higher-rated peers.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

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