S&P Global Ratings

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Summary:

Johnston, Iowa; Appropriations; General Obligation

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Credit Profile		
US$2.81 mil taxable GO urban renewal cap loan notes ser 2020E due 06/01/2031		
Long Term Rating	AA+/Stable	New
Johnston ann approp GO bnds		
Long Term Rating	AA/Stable	Affirmed
Johnston GO		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Johnston, Iowa's series 2020E taxable general obligation (GO) urban renewal capital loan notes. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating on the city's existing GO debt, and its 'AA' long-term rating to the city's series 2020A annual appropriation GO bonds. The outlook is stable.

The city's unlimited ad valorem tax GO pledge secures the series 2020E bonds. Debt service is expected to be paid from tax increment revenue. Bond proceeds will be used for urban renewal projects for the Johnston East Central TIF Urban Renewal Area. The series 2020A bonds are subject to annual appropriation and are rated one notch off the GO rating.

Credit overview

Generally, our rating outlook time frame is up to two years, but our view of the credit risks to Johnston is centered on the more immediate economic and budget effects over the next six-to-12 months as a result of the COVID-19 pandemic (see ", "The U.S. Economy Reboots, With Obstacles Ahead," published on Sept. 24, 2020, on RatingsDirect.) Despite these risks, we view Johnston as a strong and stable credit. Management is proactive and has a long track record of producing mostly balanced budgets and maintaining very strong reserves. Additionally, unlike many of its peers, it has additional revenue-raising flexibility. Johnston is a desirable suburb in the Des Moines metropolitan statistical area (MSA) and has a very strong economy with well above-average incomes and a sizable tax base that is growing. Its clear credit weakness its weak debt profile that and may worsen given significant future debt plans. Debt service carrying charges are approaching high levels and should planned additional debt materially weaken its overall credit profile, the rating could be pressured.

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 (FMA)

methodology;

- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 46% of operating expenditures, and the flexibility to raise additional revenue despite statewide tax caps;
- Very strong liquidity, with total government available cash at 64.1% of total governmental fund expenditures and 2.4x governmental debt service, and access to external liquidity that we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 27.2% of expenditures and net direct debt that is 307.1% of total governmental fund revenue, but rapid amortization, with 69.6% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social and governance factors (ESG)

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the city's local economy. Absent the implications of the pandemic, we consider the city's social risks to be in line with those of the sector. We also view environmental risks as being in line with our view of the sector. Because of our view of the very strong management of the city, we consider its governance risks as being below the sector standard.

Stable Outlook

Downside scenario

The city's rating could be lowered if its debt profile were to worsen because of its substantial future borrowing plans, which in our view could lead to materially higher debt service carrying charges, slower amortization, and become a source of fiscal stress, weakening our view of management. In addition, if its budgetary performance were to decline to a level we view as weak or very weak, causing a material deterioration to its budgetary flexibility, a lower rating is possible.

Upside scenario

Given current economic conditions, we do not anticipate raising our rating on the city, but could do so if the city's economic metrics were to improve to levels commensurate with those of higher-rated peers, specifically if its incomes and market value per capita were to increase significantly.

Credit Opinion

Very strong economy, with access to the broad and diverse Des Moines MSA

We consider Johnston's economy very strong. The city, with an estimated population of 23,224, is 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 137% of the national level and per capita market value of $123,347. Overall, the city's market value grew by 8.4% over the past year to $2.9 billion in 2021. The county unemployment rate was 2.8% in 2019. In 2020, the city's unemployment rate reached 12.7% in April 2020, before falling to 7.5% in July 2020.

Johnston is in Polk County central Iowa, approximately four miles northwest of the state economic center and capital, Des Moines. Given its location, residents have easy access to employment in the city of Des Moines and throughout the MSA. Largest employers in the city include John Deere (3,089 employees), Corteva Agriscience/division of DowDuPont (2,500), and the local school district (967). Johnston is also home to Camp Dodge, where the Iowa National Guard employs at least 800. The city is not aware of any closures or departures of major taxpayers or employers as a result of the effects of the COVID-19 pandemic.

The tax base (including TIF) is 77% residential with an important commercial component of 19%. Larger taxpayers include Deere Credit Services, divisions of Pioneer Hi-Bred, and Mid-American Energy. The city's top 10 taxpayers represent 15.8% of its taxable valuation, a level that we consider diverse. We anticipate that Johnston's local economy will remain very strong in the near term, and experience continued growth during the next few years.

Strong management, with good management policies under our FMA methodology

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

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 GO debt should not exceed 75% of the statutory limit. However, this excludes voter-authorized debt. It lacks a formal long-term financial plan for general fund operations.

Adequate budgetary performance, with performance volatility a risk

Johnston's budgetary performance is adequate in our opinion. The city had operating surpluses of 9.3% of expenditures in the general fund and of 6.2% across all governmental funds in fiscal 2019 (year ended June 30). Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2019 results in the near term, and we view the city as subject to significant performance volatility because of cyclical revenues or event risk.

In analyzing the city's budgetary performance, we have adjusted audited data to account for recurring transfers and the spending of bond proceeds. For audited fiscal 2019, the city reported a large $1.3 million surplus after estimates of a small $185,000 (negative 1.2%) deficit. For unaudited fiscal 2020, the city anticipates posting a $1.1 million deficit (7.9%), generally consistent with budgeted expectations. Officials structured the 2020 budget with a use of reserves to reduce its general fund balance to a level closer to its reserve policy of 25% of expenditures. On Jan. 1, 2020, the city began collecting revenue derived from a recent voter-approved local option sales tax, which generated approximately $1 million in the final six months of fiscal 2020. Management states that the COVID-19 pandemic has had a very limited impact on the city's finances in fiscal 2020, and reports that it has received 98% of the property taxes that it budgeted. Property taxes represent the city's highest source of revenue in its general fund according to the city's fiscal 2019 audit at 74% of revenue, followed by charges for services at 10%.

The city's fiscal 2021 budget is structured with a $408,000 deficit, or 2.7% expenditures, as part of its ongoing plan to reduce its reserves closer to its 25% fund balance policy level. The city increased its general fund levy to increase revenue to fund the hiring of public safety personnel and is forecasting approximately $2.4 million in revenue from the first full fiscal year of its local option sales tax. While we anticipate the city will likely achieve results in line with its budget, given the risks and uncertainty associated with the pandemic and recession we believe there is a possibility of volatility that may weaken overall budgetary performance.

Very strong budgetary flexibility, with the added flexibility to raise additional revenue

Johnston's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 46% of operating expenditures, or $6.4 million. In addition, the city has the flexibility to raise additional revenue despite statewide tax caps, which we view as a positive credit factor.

Based on current unaudited fiscal year-end 2020 estimates, we anticipate the city's available fund balance will decline to approximately 36% of expenditures, or $5.2 million. Johnston, unlike most Iowa municipalities, is not levying at its maximum rates. It is currently under its 8.10 general fund levy (unusual for Iowa municipalities) and has an estimated $4 million in additional flexibility in fiscal 2021. 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 its of use of reserves in fiscal 2020 and expected drawdown in fiscal 2021, we expect budgetary flexibility to remain very strong.

Very strong liquidity, with strong access to external liquidity

In our opinion, Johnston's liquidity is very strong, with total government available cash at 64.1% of total governmental fund expenditures and 2.4x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

At fiscal year-end 2019, the city had over $19 million in liquidity (excluding unspent bond proceeds). We believe it has strong access to external liquidity, as it has issued GO and revenue bonds regularly over the past 20 years. Its 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.

Weak debt and contingent liability profile, with substantial additional debt plans

In our view, Johnston's debt and contingent liability profile is weak. Total governmental fund debt service is 27.2% of total governmental fund expenditures, and net direct debt is 307.1% of total governmental fund revenue. Approximately 69.6% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city anticipates issuing approximately $50.6 million of additional debt during the next two years. The largest portion of this future borrowing will be for a new Town Center project in spring 2021, which is estimated to be a $33.4 million issuance. In addition, the city anticipates issuing $12.7 million for annual capital improvement projects during this period. The city has also announced plans for the construction of a large indoor track and field facility in early 2020 which we understand will be privately owned and operated.

We note that our view of the city's debt profile could worsen should its amortization within ten years falls below 65%, which is a possibility given its future debt plans. Moreover, we consider its debt service carrying charges fairly elevated at present time, and should this level materially increase with future debt, our view of Johnston's overall credit quality could worsen.

Johnston's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 2.8% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

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Pension and OPEB highlights include:

- The city's pension and OPEB costs are modest as a share of total spending and are not likely to accelerate significantly in the medium term, especially given the pension plan's relatively strong funded status.
- Johnston participates in the Iowa Public Employees' Retirement System (IPERS), a multiple-employer, defined-benefit pension plans that uses reasonable assumptions.
- Although the city funds its OPEBs on a pay-as-you-go basis, exposing it to potential cost acceleration, we expect that medium-term costs will remain only a small share of total spending and, therefore, not a significant budgetary pressure.

The city participates in the following pension and OPEB plans:

- IPERS: 84% funded (as of June 30, 2019), with a city proportionate share of the plan's net pension liability of $3.5 million.
- An implicit rate subsidy arising from retirees staying on the city's plan while paying active premium rates: 0% funded with a liability of $1.4 million.

The district's combined pension and OPEB contributions were 2.8% of governmental fund expenditures in fiscal 2019, of which 2.7% represented required pension contributions and 0.1% OPEB payments. The city's 2019 actuarially determined IPERS contribution exceeded 100% of our static funding metric but fell short of our minimum funding progress metric. In general, we expect progress toward full funding to be slower given the IPERS' amortization basis of level percent over a closed period of 28 years. Furthermore, we believe IPERS' discount rate of 7.0% could lead to contribution volatility. We expect contributions will remain relatively stable, and, given the plan's strong funded status and strong contribution practices, we expect contributions will remain affordable

Strong institutional framework

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

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
- 2019 Update Of Institutional Framework For U.S. Local Governments