

RatingsDirect®

Summary:

Johnston, Iowa; General Obligation

Primary Credit Analyst:

Blake E Yocom, Chicago (1) 312-233-7056; blake.yocom@spglobal.com

Secondary Contact:

Joseph Vodziak, Chicago + 1 312 233 7094; joseph.vodziak@spglobal.com

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Credit Profile

US\$4.925 mil GO bnds ser 2019A due 06/01/2029

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 2019A 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 city's unlimited ad valorem tax GO pledge secures the bonds. Debt service is expected to be partially abated by tax-increment financing (TIF) revenues. Bond proceeds will be used to pay for public improvements.

Johnston is a strong and stable credit. Management is proactive and tenured 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 is a very weak debt profile that is not expected to improve in the near term. 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 2018, 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 2018 of 42% of operating expenditures, and the flexibility to raise additional revenues despite statewide tax caps;
- Very strong liquidity, with total government available cash at 100.2% of total governmental fund expenditures and 3.1x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 32.6% of expenditures and net direct debt that is 384.6% 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 22,365, is in Polk County central Iowa, approximately four miles northwest of the state economic center and capital, Des Moines. It is in the Des Moines-West Des Moines MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 140% of the national level and per capita market value of \$118,127. Overall market value grew by 2.2% over the past year to \$2.6 billion in 2020. The county unemployment rate was 2.5% in 2018.

Johnston's population has more than doubled since the 2000 U.S. Census. 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. We anticipate that Johnston's local economy will remain very strong in the near term, and experience continued growth during the next few years.

The tax base (including TIF) is 75% residential with an important commercial component of 25%. Larger taxpayers include Deere Credit Services, divisions of Pioneer Hi-Bred, and Mid-American Energy.

Strong management

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. It lacks a formal long-term financial plan for general fund operations.

Adequate budgetary performance

Johnston's budgetary performance is adequate, in our opinion. The city had operating surpluses of 7.3% of expenditures in the general fund and 3.3% across all governmental funds in fiscal 2018. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2018 results in the near term.

We adjusted audited data to account for recurring transfers and the spending of bond proceeds.

For unaudited fiscal 2019, estimates indicate a small \$185,000 (negative 1.2%) deficit. The city anticipates that its total governmental funds performance will likely be positive, on an adjusted basis. It has budgeted for a large deficit in fiscal 2020 of \$1.1 million (8.3%). 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 our view, the city is likely to outperform its budget. Given its planned adherence to its reserve policy, we believe its budgetary performance will likely remain at least adequate, but stable.

A recent voter-approved local option sales tax is expected to generate \$3.2 million with 50% designated for property tax relief. The state "backfill" amount as result of property tax reductions is approximately \$350,000.

Property taxes represent the city's highest source of revenue in its general fund at 72%, followed by charges for services at 11%.

Very strong budgetary flexibility

Johnston's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 42% of operating expenditures, or \$5.7 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 41% of expenditures in 2017 and 42% in 2016. 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 2020, the city could generate an additional \$4.1 million, if it levied at its maximum rates, which we view as significant. It is currently under its 8.10 general fund levy (unusual for Iowa municipalities), does not use 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 its planned use of reserves in fiscal years 2019 and 2020, 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 100.2% of total governmental fund expenditures and 3.1x governmental debt service in 2018. In our view, the city has strong access to external liquidity if necessary.

At fiscal year-end 2018, the city had nearly \$29 million in liquidity. 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.

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 32.6% of total governmental fund expenditures, and net direct debt is 384.6% of total governmental fund revenue.

The city's debt profile is a credit weakness that we do not expect to improve in the near term and in fact, could weaken, depending on the size and structure of the town center debt.

The city is expecting to issue an additional \$32 million for a town center project. The security is expected to be the city's GO pledge with debt service paid from property taxes and TIF. We will examine the relevant documents and its effects on the GO rating, if any, at the time of issuance--likely in fall 2020.

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 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 benefit (OPEB) contributions totaled 2.6% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

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, its proportionate share of the net pension liability as of 2018 was \$3.7 million. The largest plan maintained a funded level of 83.6% 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. Its 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. Additionally, should the very weak debt profile materially affect the other credit factors, the rating would be pressured.

Upside scenario

We could raise the rating if the city's debt and contingent liability were to improve significantly, with all other credit factors remaining unchanged.

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

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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