S&P Global
Ratings

RatingsDirect®

Summary:

Spring Hill, Kansas; General Obligation

Primary Credit Analyst:
Randy T Layman, Centennial + 1 (303) 721 4109; randy.layman@spglobal.com

Secondary Contact:
Daniel Golliday, Dallas + 1 (214) 765 5881; daniel.golliday@spglobal.com

Table Of Contents

Summary:

Spring Hill, Kansas; General Obligation

Credit Profile		
US$11.275 mil GO rfdg & imp bnds ser 2019B due 09/01/2039		
Long Term Rating	AA-/Stable	New

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Spring Hill, Kan.'s 2019B general obligation (GO) refunding and improvements bonds. The outlook is stable.

The 2019 GO bonds are secured by the city's full faith and credit, including its ability to levy ad valorem property taxes without limitation as to rate or amount.

Proceeds from the bonds will:

- Provide long-term financing for the 2017A tax anticipation notes (TANs) and finance various capital projects within the city's Dayton Creek Phase II special benefit district project (the special assessment portion),
- Provide long-term financing the 2017B TANs (the property tax portion),
- Refinance a portion of the 2009B GO bonds for debt service savings with no extension of maturity, and
- Finance various park-related improvement projects (the sales tax portion).

We note the entire 2019B series carries the city's GO pledge. The special assessment portion (approximately $3.7 million in principal) is also secured by special assessments levied on certain benefited parcels within the city's Dayton Creek special benefit districts, though we do not rate to the special assessment pledge considering it covers only a portion of debt service. The sales tax portion is intended to be paid from a special 0.5% sales tax levied within the city, though the tax is not explicitly pledged toward debt service.

The city has experienced solid economic growth in recent years on the back of population growth in the Kansas City metro area. This has contributed to budgetary performance gains and a strengthened reserve and liquidity profile. However, the city maintains a very high debt burden, though a majority of the city's general debt is supported by dedicated revenue streams. The city's liability profile is aided by pension and other postemployment benefit (OPEB) carrying charges that remain manageable relative to the budget, though the plan has a relatively low funded ratio and maintains a high discount rate, which could lead to higher contributions.

The GO rating reflects our view of the city's:

- 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 operating results that we expect could deteriorate in the near term relative to fiscal 2017, 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 2017 of 28% of operating expenditures;
- Very strong liquidity, with total government available cash at 93.1% of total governmental fund expenditures and 4.3x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 21.5% of expenditures and net direct debt that is 316.0% of total governmental fund revenue, as well as high overall net debt at greater than 10.0% of market value; and
- Strong institutional framework score.

Strong economy

We consider Spring Hill's economy strong. The city, with an estimated population of 6,158, is located in Johnson and Miami counties in the Kansas City MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 111% of the national level and per capita market value of $62,545. Overall, the city's market value grew by 14.4% over the past year to $385.2 million in 2019. The weight-averaged unemployment rate of the counties was 3.3% in 2017.

The approximately 8.3-square-mile Spring Hill is in eastern Kansas, 35 miles south of downtown Kansas City, Mo. Spring Hill is located along U.S. Highway 169, providing residents access to Interstate 35 and employment opportunities throughout the Kansas City MSA. Spring Hill has experienced substantial residential growth over the past 15 years with its estimated population more than doubling since the 2000 U.S. Census, far exceeding state and national figures. The city's growth has benefited from incoming residents primarily from the broader Kansas City MSA, annexation efforts, and the reputation of the city's school system.

According to officials, development continues on several subdivisions with the potential for several hundred more residential lots. In addition, industrial development opportunities remain available at two of the city's industrial parks. Leading city employers include Spring Hill Unified School District, AGC Glass Co. (a glass manufacturer), and A&M Products Manufacturing (a cat litter producer). A significant portion of city residents finds employment throughout the metropolitan area.

Strong management

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

Key practices and policies include management's conservative budgeting, including the analysis of historical revenue and expenditures. Year-to-date budgetary performance information is available to the city council monthly. The city maintains informal five-year general fund financial forecasts, though we consider some of the assessed value (AV) growth assumptions aggressive. In addition, it annually produces a five-year, rolling capital improvement plan with funding sources identified. The city does not maintain a formally adopted investment management policy, but makes investment earnings available to the council monthly. Spring Hill maintains a formally adopted debt management policy that includes limitations beyond those prescribed by the state. The city's informal target is to maintain unassigned general fund balance at a minimum of $750,000.

Adequate budgetary performance

Spring Hill's budgetary performance is adequate, in our opinion. The city had operating surpluses of 2.0% of expenditures in the general fund and of 5.9% across all governmental funds in fiscal 2017. Our assessment accounts for our expectation that budgetary results could become more balanced relative to the strong results realized in fiscal 2018.

We adjusted operating results across total governmental funds to remove capital outlays financed from bond proceeds and lease proceeds. We also adjusted our results to remove the one-time transfer from the excise tax fund to the general fund to establish a contingency reserve and to include regularly occurring transfers. Prior to fiscal 2016, the city realized several years of operating deficits in the general fund as expenditure growth, largely from personnel costs, exceeded revenue growth. The city realized a surplus in 2016 as a result of property tax revenue growth from AV increases and a modest millage rate increase. Fiscal 2017 yielded a positive result for the city given strong AV growth and positive expenditure variances, primarily stemming from unfilled vacancies. Officials and the city's general fund forecast show 2018 will also end with an addition to fund balance, on strong revenue growth.

The fiscal 2019 budget does carry forward the use of $441,050 in operating reserves, in line with prior budgets, though the city's forecast indicates results will be closer to balanced, with the use of only $61,000 in reserves as revenue growth is anticipated to exceed the budget. Ad valorem taxes generate 42% of budgeted general fund operating revenue, followed by local sales taxes at 34%. Our future assessments of the city's budgetary performance and flexibility will incorporate the city's management of operating performance with the new tax lid limitation, effective with the fiscal 2018 budget, against capital expenditure pressures. The tax lid limitation limits growth in localities' property tax levies to growth in the Consumer Price Index, excluding growth generated from new improvements and annexation. Our assessment of the city's budgetary performance score accounts for the anticipation that budgetary results will moderate relative to the strong performance exhibited in 2017 and 2018.

Very strong budgetary flexibility

Spring Hill's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 28% of operating expenditures, or $1.3 million.

As anticipated in our previous review, reserves have improved in fiscal 2017 as management approved the transfer of $750,000 from its excise tax fund to the general fund to use as a contingency reserve. The city had accumulated a relatively large reserve from its excise tax, which generates revenue from the platting of property and is primarily used for street-related capital projects. Given economic development activity within the city, officials report that about half of what was transferred as a contingency reserve has already been recovered. Spring Hill ended fiscal 2017 with assigned and unassigned general fund reserves equal to $1.3 million, or 27.6% of expenditures.

Although the city has not formally adopted a reserve policy or target, officials report that the $750,000 will be used only for emergency purposes, and we view this positively. The balance of the city's reserves is considered an operating reserve that is generally carried forward into the next budget year to balance the budget. Officials report that this is typically used for delayed expenditures and equipment purchases. The city's general fund forecast shows this balance remaining positive. However, the city's forecast is based on AV growth exceeding 7% in each of the out-years, which is aggressive, in our opinion, considering our view of the late stage of the economic expansion. However, given that results for 2018 and 2019 are anticipated to be positive, we expect the city's budgetary flexibility to remain at least very strong for the next several years.

Very strong liquidity

In our opinion, Spring Hill's liquidity is very strong, with total government available cash at 93.1% of total governmental fund expenditures and 4.3x governmental debt service in 2017.

We anticipate the city's liquidity position will remain very strong. Our view of the city's strong access to external liquidity reflects its issuance of GO debt over the past 20 years. As of Dec. 31, 2017, city investments primarily consisted of money held in checking accounts with local banks for the Kansas municipal investment pool, U.S. Treasury bills, and the state investment pool. We do not view these investments as aggressive and thus possibly contributing to substantial liquidity volatility. We understand the city has no contingent liabilities that we believe would cause liquidity pressures.

Very weak debt and contingent liability profile

In our view, Spring Hill's debt and contingent liability profile is very weak. Total governmental fund debt service is 21.5% of total governmental fund expenditures, and net direct debt is 316.0% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 25% of market value.

Officials report that following this issuance, the city will issue approximately $2.1 million in debt over the next several years for various capital projects.

We note that the city's dedicated revenue sources partly alleviate its comparatively high debt burden and debt service carrying charge. Although the city has not legally pledged utility revenue to any of its GO bonds outstanding, we note the city's water/sewer enterprise fund supports approximately 24% of its GO debt with debt service paid from utility revenue. Furthermore, special assessments levied within benefit districts on parcels specifically benefiting from capital projects support approximately 42% of the city's GO bonds and notes. The city's sales tax will support a portion of the 2019B GO bonds. Per our debt statement analysis criteria, we apply only self-support credit to the city's utility-supported GO bonds. Although dedicated utility revenue and taxes support a portion of debt service, we believe that the city's debt burden is high relative to its taxing base when compared with that of similarly rated peers, and we believe that this could challenge its ability to raise taxes for operating purposes.

Spring Hill's required pension and actual OPEB contributions totaled 3.6% of total governmental fund expenditures in 2017. The city made its full annual required pension contribution.

Spring Hill participates in the Kansas Public Employees' Retirement System (KPERS), a cost-sharing, multiple-employer defined benefit pension plan. KPERS provides retirement, life insurance, disability income, and death benefits. Although KPERS administers one cost-sharing, multiple-employer defined benefit pension plan, the state prepares separate actuarial valuations to determine funding and contributions for the plan's subgroups: state/school employees, local government, police and fire, and judges. The city provides benefits for and is accounted under the KPERS subgroups for local and police and fire employees.

Based on legislation passed in 1993, employer contributions, certified by KPERS' board of trustees for this group, may not increase by more than a statutory cap. The state modeled the expected KPERS' employer-statutory contributions for future years assuming all actuarial assumptions are met. In recent years, the statutory contribution rate has led to funding rates equal to or below actuarially determined contribution rate, meaning required contributions have been met. The statutory cap increase over the prior-year contribution rate was 1.2% of total payroll for fiscal 2017. The city has historically made 100% of its required statutory contribution to both plans. Although actuarially determined contributions have been met, it is our opinion that the statutorily determined contributions can limit the flexibility of actual contributions, the growth of which may need to increase beyond the statutory rate in the event of assumption changes or negative performance relative to assumptions.

At June 30, 2017, KPERS' fiduciary net position as a percentage of total pension liability was 67.12%. The city's share of the local and police and fire subgroups were 72.15% and 70.99%, respectively. The discount rate for KPERS was recently reduced to 7.75% from 8.00%, which we view as a positive change, though the discount rate remains aggressive, in our view, relative to the national median, which we consider a negative credit factor. Unfavorable actual results relative to assumptions with a relatively high discount rate can lead to an outsized acceleration of required contributions. However, based on contributions that remain small relative to the city's budget, we believe the city's strong budgetary flexibility will allow the city to absorb increases to required contributions, which may be necessary given the plan's relatively low funded ratio. However, if plan experience is unfavorable relative to assumptions, leading to weakened plan liquidity and substantial increases to required contributions, our view of the city's pension liability position could weaken.

Spring Hill also maintains OPEB for retired employees and their dependents until the age of 65. The city funds the plan on a pay-as-you-go basis. Plan participants contribute 100% of the total premium to the plan through a required contribution of $7,486 to $8,264 for retiree-only coverage and $10,234 to $11,279 for retiree-plus-dependent coverage. The city paid $1,000 in OPEB costs for fiscal 2017. The unfunded liability of the OPEB plan was $49,412 at July 1, 2015, the latest valuation date. In our opinion, the OPEB plan carries a limited liability risk for the city.

Outlook

The stable outlook reflects our view of the city's strengthened financial position and continued growth in the local economy. We do not anticipate changing the rating over the two-year outlook horizon.

Downside scenario

All else equal, should the city realize a recurring gap between operating revenue and expenditures in a manner that leads to draws on its reserve positions, leading to a budgetary flexibility position we no longer consider at least strong, we could lower the rating. A lower rating could also result from growing liability pressure or lower income or wealth figures relative to those of peers.

Upside scenario

All else equal, we could raise the rating if the city's economic metrics continue to improve relative to those of higher-rated peers, along with continued growth in the city's reserve position and a moderation of its liability profile.