

## CREDIT OPINION

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### New Issue

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## City of Lawrence, KS

### New Issue - Moody's Assigns Aa1 to Lawrence, KS' GOULT 2017 Bonds

#### Summary Rating Rationale

Moody's Investors Service has assigned an Aa1 rating to the City of Lawrence's (KS) \$3.16 million General Obligation Improvement Bonds, Series 2017-A, the \$11.375 million General Obligation Energy Improvement Bonds, Series 2017-B, the \$654,000 General Obligation Improvement Bonds, Series 2017-C, and the \$6 million General Obligation Temporary Notes, Series 2017-I. We maintain the Aa1 rating on the city's outstanding general obligation debt, and a MIG-1 rating on the outstanding temporary note. Post-sale, the city will have \$113.2 million of GO debt outstanding and \$16.8 million of temporary notes outstanding.

The Aa1 rating reflects the large and stable tax base, anchored by the University of Kansas (Aa2 negative), strong fiscal management evidenced by a history of surplus operations and adequate operating reserves, average wealth indices and a manageable debt burden.

#### Credit Strengths

- » Large and stable tax base
- » Institutional presence of the University of Kansas
- » Stable financial operations with healthy reserve levels

#### Credit Challenges

- » Moderate dependence on economically sensitive sales tax revenues
- » Above-average annual fixed costs relative to operating revenues

#### Rating Outlook

Outlooks are generally not assigned to local government credits with this amount of debt outstanding.

#### Factors that Could Lead to an Upgrade

- » Reduction in long term liabilities
- » Sustained increases in reserve and liquidity levels

#### Factors that Could Lead to a Downgrade

- » Material declines in operating reserve or liquidity levels

- » Substantial increases to the debt profile
- » Protracted declines in assessed value

## Key Indicators

Exhibit 1

Lawrence (City of) KS	2011	2012	2013	2014	2015
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$ 7,107,085	\$ 7,107,085	\$ 7,053,269	\$ 7,261,947	\$ 7,422,645
Full Value Per Capita	\$ 81,543	\$ 80,796	\$ 79,321	\$ 80,515	\$ 81,295
Median Family Income (% of USMedian)	104.7%	104.5%	106.7%	107.1%	106.0%
<b>Finances</b>					
Operating Revenue (\$000)	\$ 64,008	\$ 66,196	\$ 68,226	\$ 70,224	\$ 72,528
Fund Balance as a % of Revenues	34.0%	34.1%	33.8%	34.6%	33.2%
Cash Balance as a % of Revenues	34.8%	35.7%	34.6%	33.2%	32.9%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$ 82,114	\$ 88,216	\$ 120,588	\$ 111,875	\$ 102,395
Net Direct Debt / Operating Revenues (x)	1.3x	1.3x	1.8x	1.6x	1.4x
Net Direct Debt / Full Value (%)	1.2%	1.2%	1.7%	1.5%	1.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.6x	2.1x	2.4x	2.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.4%	2.0%	2.3%	2.3%

Source: Moody's Investors Service; city audited financial reports

## Detailed Rating Considerations

### Economy and Tax Base: Large and Stable Tax Base Anchored by University of Kansas

The city's tax base will remain stable and continue to post modest annual growth supported by the stabilizing presence of the University of Kansas. Lawrence is located in northeastern Kansas, approximately 28 miles east of Topeka (Aa3) and 40 miles west of Kansas City, MO (Aa2 negative), and is the home of the University of Kansas. The city's population is approximately 95,600, up from approximately 87,700 as of the 2010 census. The \$7.9 billion fiscal 2017 full value has grown for the past four years following modest declines during the recession, equating to a five year average annual growth rate of 1.8%. The pick up in taxable value growth can be attributed to new development and market appreciation. New development includes a mix of residential, industrial and commercial/mixed use. Going forward, the city's financial planning based on an annual growth rate of 2% over the near term.

Modest growth in the employment base and above-average wage increases are supporting economic strength and expansion. Unemployment in the city was a low 3.4% as of January 2017, below state and national levels of 4.3% and 5.1%, respectively, over the same period. While unemployment remains low, the labor force continues its modest growth. City officials expect the completion of the K-10 highway, which now connects with Interstate 70, will be a major growth driver going forward. In addition, the University of Kansas, a research institution and anchor to the Lawrence community, has been expanding and growing in its national research profile. Most notably, the university is now allowed to bid on classified contracts with federal agencies and has started to receive grant money for defense related research. Student enrollment is approximately 25,000, or approximately one-quarter of the city's total population. Despite the city's large student population, wealth indices are just above average with the median family income of 106% of the nation per the 2015 American Community Survey which has been increasing over the past four decades.

### Financial Operations and Reserves: History of Surplus Operations Point to Continued Stable Financial Profile

The city's financial position will remain stable due to the presence of healthy reserves, history of stable operations, and strong financial management. The city's reserve policy calls for maintaining an unassigned General Fund balance between 15-30% of expenditures, a level it has historically met and budgets to adhere to going forward. The city's fiscal 2015 available General Fund balance was \$13.2

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million, representing 21.4% of General Fund revenues. The city ended 2015 as expected with a \$218K draw on reserves. While the General Fund was operationally balanced, the city opted to grant approximately \$500,000 to a vocational training center used by a multitude of schools and colleges in the region.

Unaudited fiscal 2016 financial information points to healthy operating results and growing reserves. City officials report that the year ended with a \$1.6 million operating surplus, or 2% of 2016 revenues. However, General Fund reserves will show a larger increase to \$20 million, or 28.3% of revenues, due to the city shifting the balance of the sales tax reserve to the General Fund. Looking to fiscal 2017, the city has budgeted for balanced operations and a modest increase to reserves.

The city maintains outside liquidity in the Equipment Reserve Fund, which sourced its revenues from the General Fund and is not pledged to specific projects. The Equipment Reserve reported a balance of \$5.5 million in fiscal 2015, though the city has budgeted use of a portion of the balance for capital expenditures. At the close of fiscal 2017 the city anticipates reporting a balance of \$3 million in the fund, approximately 4% of projected fiscal 2017 revenues.

The city is moderately reliant on economically sensitive sales tax revenues from its pro rata share of a 1% countywide sales tax and 1.55% citywide sales tax for operations. In fiscal 2015, sales tax revenues and property tax revenues each accounted for just under a third of operating revenues (General Fund and Debt Service Fund). Sales tax revenue trends have been strong, with the revenue source growing at an average annual rate of 4.5% over the past five years.

#### **LIQUIDITY**

The net cash balance in the combined operating funds (General Fund and Debt Service Fund) as of fiscal 2015 was \$23.9 million, a strong 32.9% of operating revenues.

#### **Debt and Pensions**

The city's net direct debt as a percent of the fiscal 2017 tax base is 1.6% which is manageable for the city though slightly elevated for the rating category. The debt levels relative to the size of the tax base will remain stable over the near term given annual planned issuances balanced by tax base growth and principal amortization. The net debt burden includes \$123.6 million of debt, representing the \$113.2 million of general obligation debt (net of \$6.5 million in debt supported by the water and sewer system) and \$16.8 million in temporary notes.

Fixed costs (debt service, pension and OPEB expenses) for the city are elevated relative to peers. Over the past five years, debt service costs as a percent of operating revenues has consistently hovered around 15%. Inclusive of pension contributions, total fixed costs represented 26.9% of fiscal 2015 operating revenues.

#### **DEBT STRUCTURE**

All of the city's direct debt is fixed rate. Principal amortization on the city's \$113.2 million general obligation debt is slightly below average, with 70% retired within ten years. Post-sale, the city will have two temporary notes outstanding in the aggregate par amount of \$16.8 million. Note financings mature in 2017 and 2020 and are planned to be paid through long-term take out financings.

#### **DEBT-RELATED DERIVATIVES**

The city is not a party to any derivative agreements.

#### **PENSIONS AND OPEB**

Lawrence has a manageable level of exposure to two statewide cost-sharing pension plans, the Kansas Public Employees Retirement System (KPERS) and the Kansas Police and Fireman's Retirement System (KP&F). Both plans are administered under KPERS, and the city has consistently made its required contributions to both plans in accordance with statutory requirements. Total city pension contributions in fiscal 2015 amounted to \$7.9 million or a high 10.9% of 2015 operating revenues. KPERS recently reduced the assumed rate of return from 8% to 7.75%, which will translate to increased contributions starting in fiscal 2019. The increased pension costs are expected to be manageable, and potentially fall under an exemption of the property tax lid legislation.

Moody's three year average (2013-2015) adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is \$172.3 million, or 2.4 times operating revenues, including the General Fund and Debt Service Fund.

Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace Lawrence's reported liability, but to improve comparability with other rated entities. We determined the city's share of liability for the cost-sharing plans administered under KPERS in proportion to its contributions to the plan. We expect that the city will adequately incorporate rising pension costs into its budget while maintaining balanced operations.

### Management and Governance

Kansas Cities have an Institutional Framework score of Aaa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector has one or more major revenue sources that are not subject to any caps. Specifically, large revenue sources for cities include property taxes and sales taxes. Sales taxes can be increased via voter referendum. Property taxes are now subject to an annual lid which limits the additional amount of taxes generated to the previous year plus the five year rolling average of the Consumer Price Index; however, numerous exemptions are stipulated in the legislation including expenses for debt service, public safety, and state and federal mandates among others. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Kansas is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

The city of Lawrence is governed by a 5-member city commission and operated under a commission-manager form of government. The city's management team exhibits prudent fiscal and debt management evidenced by the city's healthy operating results.

### Legal Security

The bonds are secured by the city's general obligation unlimited tax pledge in which the full faith, credit and resources of the city are pledged and will be payable from ad valorem taxes, which may be levied without limitation as to rate or amount.

The city intends to pay debt service on the 2016-A Bonds from special assessments deriving from neighborhood improvements, water and sewer revenues, and ad valorem taxes. The 2016-B bonds are intended to be revenue-neutral due to energy efficiency savings guarantees from the service provider. The 2017-C bonds will be paid from ad valorem taxes. Finally, the 2017-I notes are intended to be paid from a take out financing backed by ad valorem taxes.

### Use of Proceeds

Approximately ⅓ of the 2017-A bonds will fund neighborhood improvements, \$915,000 will be applied to take-out of outstanding notes, and the remainder will fund utility and general city improvements. The 2017-B bonds will fund energy efficiency equipment. The 2017-C bonds will fund the purchase of a fire truck. Finally, the 2017-I notes will provide interim funding for the construction of a new fire station.

### Obligor Profile

The city of Lawrence is located 28 miles east of Topeka and 40 miles west of Kansas City, MO, and is the home of the University of Kansas. The current population is approximately 95,600.

### Methodology

The principal methodology used in these ratings was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

## Ratings

Exhibit 2

### Lawrence (City of) KS

Issue	Rating
General Obligation Improvement Bonds Series 2017-A	Aa1
Rating Type	Underlying LT
Sale Amount	\$3,160,000
Expected Sale Date	05/02/2017
Rating Description	General Obligation
General Obligation Energy Improvement Bonds Series 2017-B	Aa1
Rating Type	Underlying LT
Sale Amount	\$11,375,000
Expected Sale Date	05/02/2017
Rating Description	General Obligation
General Obligation Improvement Bonds Series 2017-C	Aa1
Rating Type	Underlying LT
Sale Amount	\$654,000
Expected Sale Date	05/02/2017
Rating Description	General Obligation
General Obligation Temporary Notes, Series 2017-I	Aa1
Rating Type	Underlying LT
Sale Amount	\$6,000,000
Expected Sale Date	05/02/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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