New Issue: Moody's assigns A2 to City of Clinton, IA's $3.2M GO Capital Loan Notes, Ser. 2014B

Global Credit Research - 03 Sep 2014

Maintains A2 on $15.9M of Moody's rated debt

CLINTON (CITY OF) IA
Cities (including Towns, Villages and Townships)
IA

Moody's Rating

ISSUE	RATING
General Obligation Capital Loan Notes, Series 2014B	A2

Sale Amount	$3,225,000
Expected Sale Date	09/09/14
Rating Description	General Obligation

Moody's Outlook NOO

Opinion

NEW YORK, September 03, 2014 --Moody's Investors Service has assigned an A2 rating to the City of Clinton, IA's $3.2 million General Obligation Capital Loan Notes, Series 2014B. Debt service on the notes is secured by the city's general obligation unlimited tax (GOULT) pledge which benefits from a dedicated property tax levy not limited by rate or amount. Proceeds of the Series 2014B notes will finance various projects, including improvements to city streets, sidewalks, and city facilities as well as the acquisition of an ambulance and transit dispatch software. Moody's maintains the A2 rating on the city's outstanding rated general obligation (GO) debt. Post-sale, the city will have $25 million of GOULT debt outstanding, of which $15.9 million is rated by Moody's.

SUMMARY RATING RATIONALE

The A2 rating incorporates the city's moderately-sized and concentrated tax base in eastern Iowa; below average income levels; adequate General Fund balance but narrow cash balance as a result of advances to the city's solid waste enterprise; manageable debt burden; and moderate exposure to unfunded pension liabilities.

STRENGTHS

- Capacity to raise revenues through implementation of $0.27 emergency levy and franchise fees

- Manageable debt burden supported in part by a voter approved local option sales tax

CHALLENGES

- Concentrated tax base coupled with recent appeals by one of the largest taxpayers, Archer-Daniels-Midland Company (ADM; A2 stable)

- Narrow General Fund cash balance

- Deficit position in the city's solid waste enterprise following years of operational imbalance

DETAILED CREDIT DISCUSSION

IMPROVED GENERAL FUND BALANCE BUT NARROW LIQUIDITY AS A RESULT OF ADVANCE TO SOLID WASTE FUND

The city's General Fund position is expected to remain satisfactory in the near term, though operational pressures remain. At the close of fiscal 2011, the city's General Fund had fallen to a deficit position of $829,000 following three consecutive years of operational imbalance under prior management. During fiscal 2012, under a new administration, the city successfully sold its municipal dock and used a portion of the proceeds to restore the General Fund balance to a positive position. The transfer of approximately $3 million from the municipal dock fund supported a year-end General Fund balance of $2.1 million, or an adequate 13.3% of revenues not including the one-time transfer of sale proceeds. The General Fund's cash balance was $2 million, or 12.6% of revenues. Absent the one-time transfer, the city's operations would have been essentially balanced and the deficit position would have persisted.

The city adopted a balanced budget for fiscal 2013, but unexpected legal costs tied to a lawsuit initiated by the city as well as a judgment with a former employee contributed to a $253,000 decline in the General Fund balance to $1.9 million, or 11.5% of revenues. As a result of an advance to the city's Solid Waste Fund, the General Fund's cash balance was a narrow $775,000, or 4.7% of revenue. Fiscal 2014 audited financial statements are not yet available, but management reports that operations were essentially balanced, and the General Fund ended the year with a total fund balance of $1.9 million. The city had budgeted for an $88,000 surplus, but the surplus funds were used to cover unanticipated legal fees from a prior lawsuit. The 2014 General Fund cash balance is expected to have improved modestly as the Solid Waste Fund posted a small operating surplus, but the General Fund cash balance will remain narrow at approximately $870,000, or 5.3% of 2013 revenues. In fiscal 2015, the city lowered its overall tax levy by approximately $1 million, but its budget projects a modest $145,000 surplus as a result of expenditure reductions. The city cut five positions and closed one of its library branches. Management anticipates that the General Fund will end the year with a total fund balance of $2 million, or 12% of fiscal 2013 revenues. The General Fund cash balance is expected to increase by a similar amount.

Property taxes comprised over 80% of the city's General Fund operating revenues in fiscal 2013 inclusive of transfers from the Employee Benefits Fund, which is funded with a dedicated property tax levy. The city levies the statutory maximum of $8.10 per $1,000 of assessed valuation for the General Fund. In fiscal 2015, the city did not levy its $0.27 emergency levy. If the city were to implement the emergency levy, it could collect an additional $274,000. The city could also implement a franchise fee of up to 5% on gas and electric utilities. Currently, there is no plan to do so, but the fee would generate close to $3.8 million in annual revenue if the full 5% were implemented. The city also collects a 1% local option sales tax (LOST) that generates approximately $3 million annually and does not sunset. LOST revenues are dedicated for property tax relief (50%) and the city's pavement management program (50%).

CONTINUED DEFICIT CASH POSITION IN ENTERPRISE FUND MAY BE SOURCE OF ADDITIONAL PRESSURE

The city's Solid Waste Enterprise has a history of imbalanced operations which has required advances from the General Fund to cover its negative cash position. By the close of fiscal 2012, the Solid Waste Fund reported a cash overdraft of $1.8 million and its net position was a deficit $183,000. In fiscal 2013, the city implemented a new solid waste collection fee, and the fund reported a $57,000 operating surplus. As a result of an accounting change, the fund's cash position was recorded as $0, but the fund had $1.7 million due to other funds; the advances are split between the city's General Fund and the Transit Fund. The Solid Waste Fund's 2013 net position improved modestly, but remains a deficit $125,000. In fiscal 2014, management reports that the fund had a $90,000 surplus on a cash basis, so while the fund's position has improved, it will remain negative. The city did not increase fees in 2014 and does not have plans to increase fees in 2015. Given the recent operating surpluses, we expect the fund's position to modestly improve each year, but it will likely continue to depress the General Fund's liquidity until significant increases in the Solid Waste Fund's cash position have been achieved. The solid waste enterprise has no outstanding debt.

MODERATELY-SIZED AND CONCENTRATED TAX BASE IN EASTERN IOWA

The city's tax base will likely remain fairly stable going forward despite recent declines associated with an appeal successfully filed by the largest taxpayer, ADM. While the five-year average annual change in full valuation is a positive 2.5%, the trend is skewed by a sizeable 34.5% increase in 2009 and subsequent decline of 15.4% in 2010 due to ADM's construction of a new cogeneration plant and change in classification of the plant from new construction to industrial property. The city's 2013 full valuation of $1.5 billion reflects a 1.1% increase over the prior year. The two ADM facilities account for 12.7% of the city's current taxable valuation. In 2013, as a result of a property tax appeal, ADM's taxable value was reduced and the company was granted $2.7 million in tax credits against future property tax liabilities for overpayment in prior years. A portion of the tax credits were applied fiscal 2014, and the remaining tax credits outstanding that are applicable to the city are estimated to be $289,871 in fiscal

2015 and $280,830 in fiscal 2016, based on fiscal 2015 tax rates. Management reports that it has adjusted its fiscal 2015 budget to accommodate the loss in tax revenue. The second largest taxpayer is Interstate Power and Light, which comprises 10.9% of the city's taxable value. The top ten taxpayers represent a concentrated 32.1% of taxable valuation.

In addition to ADM, principal employers include Mercy Medical Hospital (1,000 employees), Custom Pak, Inc. (835 employees), and the Clinton Community School District (746 employees). One of the city's larger employers, Evergreen Packaging, recently announced that it is closing, which will result in the loss of 125 jobs. Management reports that the city's other major employers remain stable. Recent and ongoing development within the city includes a $6.2 million investment by Data Dimensions to construct a new facility in the city's business and technology park and investments by two new railroad-related companies in the city's Lincoln Way Industrial Rail Park. City officials estimate that over 200 new jobs will be created by the three companies' investments. Additionally, a new 6,000 square foot urgent care clinic recently opened.

City population has steadily declined over the past four decades, a trend that includes a 3.2% drop recorded in the 2010 US Census. The city's unemployment rate of 5.5% in June 2014 continued to surpass that of the state (4.5%) but remained below that of the nation (6.3%). Median family income within the city is below average at 87% of the U.S. according to the American Community Survey 2008-2012 estimates.

MANAGEABLE DEBT BURDEN WITH RAPID PAYOUT; ADDITIONAL BORROWING PLANNED

Inclusive of the current offering, the city's direct debt burden is a manageable 1.6% of full valuation. In 2015, the city anticipates borrowing $7.6 million for a combination of sewer projects and its annual capital improvement projects. Going forward, the city plans to issue $2 to $3 million annually for capital improvements. It also expects to issue $15 million over the next five years for sewer improvements. The city plans to use LOST revenues to support the debt service on the sewer related debt, reducing the burden on property tax payers. The city's debt service schedule is rapid with 86.5% of principal repaid within ten years. Net of refunding, debt service comprised a sizeable 17.3% of operating expenditures in fiscal 2013, though it was partially supported by local option sales taxes. All of the city's debt is fixed rate and there is no exposure to interest rate swap agreements.

MODERATE EXPOSURE TO UNFUNDED PENSION LIABILITIES

Clinton's fiscal 2013 Moody's adjusted net pension liability (ANPL) is $44.7 million, equivalent to 2.85% of full valuation and 2.41 times operating revenue. The ANPL is based upon our allocation of the reported unfunded liabilities of two multi-employer cost-sharing pension plans, the Iowa Public Employees Retirement System (IPERS) and the Municipal Fire and Police Retirement System of Iowa (MFPRSI). Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. The actuarial valuation dates for the plans are June 30, 2013. The city's fiscal 2013 contribution to the plan was $1.7 million, or 8% of operating expenditures.

WHAT COULD CHANGE THE RATING - UP

- Sustained growth of the city's tax base or improvement in the demographic profile

- Trend of stable financial operations and increased General Fund reserves

- Positive operating trend in the Solid Waste Enterprise leading to stronger cash balances in the General Fund and Solid Waste Fund

WHAT COULD CHANGE THE RATING - DOWN

- Deterioration of the city's tax base or weakening of the demographic profile

- Narrowing of General Fund reserves or lack of financial improvement in the city's solid waste enterprise

- Material growth in the city's debt burden

KEY STATISTICS:

Tax Base Size - 2013 Full Value: $1.5 billion

Full Value Per Capita: $57,440

Socioeconomic Indices - MFI: 87.1% of the US

Fiscal 2013 Available Operating Funds Balance: 9.8% of revenues

5-Year Dollar Change in Available Operating Fund Balance as % of Revenues: -0.8%

Fiscal 2013 Operating Funds Cash Balance: 4.2% of revenues

5-Year Dollar Change in Cash Balance as % of Revenues: -6.3%

Institutional Framework: Aa

Operating History: 5-Year Average of Operating Revenues / Operating Expenditures: 0.98x

Net Direct Debt / Full Value: 1.6%

Net Direct Debt / Operating Revenues: 1.24x

3-Year Average of Moody's Adjusted Net Pension Liability / Full Value: 2.9%

3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues: 2.20x

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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