

# **FITCH RATES MANHATTAN, KS ULTGO BONDS 'AA+'; OUTLOOK STABLE**

Fitch Ratings-New York-31 May 2019: Fitch Ratings has assigned a 'AA+' rating to the following city of Manhattan, Kansas bonds:

- \$13,120,000 general obligation (GO) bonds, series 2019-A;
- \$3,720,000 taxable general obligation bonds, series 2019-B.

The bonds are being issued to pay the costs of certain internal improvements. The bonds will be sold via competitive sale on June 4.

In addition, Fitch has affirmed the following ratings for Manhattan:

- Issuer Default Rating (IDR) at 'AA+';
- Approximately \$108.7 million outstanding GO bonds and GO temporary notes at 'AA+';
- \$15.9 million taxable STAR bonds, series 2009-2 at 'AA+';
- \$14.9 million senior lien special obligation revenue (TIF) bonds, series 2009A at 'AA+';
- \$4.6 million transportation development district (TDD) sales tax bonds, series 2010 at 'AA'.

The Rating Outlook is Stable.

## **SECURITY**

The GO bonds are backed by the city's full faith and credit and its ad valorem taxing power, without limitation as to rate or amount.

The TDD and TIF bonds are payable by the city's pledge of any legally available funds, subject to annual appropriation, as well as a cash-funded debt service reserve for each series. Each of these bond programs is also payable in the first instance by various dedicated tax revenue streams. The TDD bonds have a lien on a 0.5% sales tax levied within the TDD (coterminous with a development known as the north project area). The TIF bonds have a lien on city and local sales tax collected within the north project area along with an incremental property tax collected within the north and south project areas.

## **ANALYTICAL CONCLUSION**

The 'AA+' IDR and GO rating reflect the city's significant ability to raise revenues, adequate expenditure flexibility, manageable long-term liabilities, high fundamental financial flexibility and sound operating performance. Fitch considers the appropriation pledge to be stronger than the intended source of repayment for the TDD, STAR, and TIF bonds. As such, the rating on these bonds is one notch below the IDR, reflecting the slightly higher degree of optionality associated with appropriation-backed obligations relative to the IDR.

## **Economic Resource Base**

Manhattan is located in northeastern Kansas in Riley and Potawatomie Counties, roughly 55 miles west of Topeka. The city serves as the economic and cultural center for the region. Fort Riley, a military base with approximately 15,000 military personnel located 15 miles west of the city limits, and Kansas State University (KSU), anchor the local economy. KSU's enrollment has declined from over 24,000 to under 21,000 in recent years, leading to some weakness in the city's sales tax revenue.

## KEY RATING DRIVERS

### Revenue Framework: 'aa'

Revenues are expected to increase above the rate of inflation based on expectations for continued growth in the city's population, tax base, and general economic conditions. The city has ample ability to raise revenues sufficient to cover expected cyclical revenue declines.

### Expenditure Framework: 'aa'

Fitch expects that expenditures may grow in line with to marginally above organic revenue growth. The city has an adequate ability to cut expenses, including pay-go capital, in times of economic downturn.

### Long-Term Liability Burden: 'aa'

Long-term liabilities are moderate when compared with the city's economic resource base.

### Operating Performance: 'aaa'

The city's reserve levels, significant revenue control and adequate spending flexibility combine to provide the highest level of financial resilience against cyclical revenue declines.

## RATING SENSITIVITIES

Financial Flexibility: The rating is sensitive to the maintenance of financial flexibility, inclusive of non-general fund resources, and conservative budgeting practices.

## CREDIT PROFILE

Manhattan's regional economic prospects are strong, with continued assessed valuation growth, low unemployment rates, and sustained population growth. The 2017 population at approximately 55,000 has increased 5% since 2010 through both real gains and limited annexations. The presence of KSU's large student population skews the per capita personal income level downward, which is below state and national performance. Management reports TAV growth of 7% for 2018. Approximately one-fifth of the city's value is tax-exempt due to KSU's notable presence.

### Revenue Framework

The city is heavily reliant on sales tax revenue, which comprises around half of general fund revenues. Property taxes account for a relatively low proportion of general fund revenue relative to most U.S. local governments in part due to the presence of tax-exempt property within city limits.

Fitch expects future revenue growth to increase at a rate above inflation but below U.S. GDP growth. Sales tax revenue has historically tended to track closely to inflation, although the revenue stream has exhibited some weakness in 2017 and 2018, coinciding with a decline in enrollment at KSU. While assessed values have seen significant growth in the last several years, the impact of the gains on revenues has been limited as property taxes comprise a small 14% of general fund revenues.

Effective January 2018 the city is subject to property tax-lid limitations that restrict tax revenue growth to the five-year rolling average of the consumer price index. Property tax levies in excess of the lid require voter approval. Several property tax categories are exempt from the tax-lid such as increases in bond principal and interest payments, payment of court judgments or settlements, police and fire spending, tax increment financing districts, and state or local emergency (including financial emergencies). Fitch believes the exemptions for key spending areas and the city's ability to use utility fund revenue for general purposes provide ample flexibility for the city and alleviate budgetary restrictions imposed by the tax-lid limitations.

### Expenditure Framework

Public safety is one of the city's largest expenditures. The city is responsible for 80% of the operational budget for the Riley County Police Department, a city/Riley County consolidated law enforcement agency. The city supports public safety through both the general fund and the Riley County Police Department Fund, which has a dedicated property tax rate that is controlled by the county. In the general fund, general governmental expenditures make up 29% of expenditures, followed by culture and recreation (28%) and public safety (26%).

Fitch expects the pace of spending growth to be in line with to marginally above expectations for revenue growth. Fitch also expects that labor costs will increase at a rate approximating inflation.

Manhattan has an adequate level of flexibility to reduce main expenditure items and is committed to cutting non-essential spending, including pay-go capital, in times of economic downturn. Management has moderate control over labor expenses. While the city has a high level of control over headcount and strikes are prohibited, public employee union contracts are subject to binding arbitration. Management has a positive working relationship with labor and has been able to find public safety cost savings when needed. The general fund budget also allocates a considerable amount of spending to cultural and recreational programs, which Fitch views as inherently more flexible relative to public safety or public works spending. Carrying costs for debt, pensions, and other-post employment benefits (OPEB) are elevated at 35%. That metric includes paying down temporary GO notes with cash instead of with long term debt, which would spread out the amortization and reduce the carrying cost metric. Most of the carrying costs are attributable to debt service.

#### Long-Term Liability Burden

Overall debt plus Fitch-adjusted net pension liability as a percent of personal income is moderate at over 18%, of which about 50% is attributable to direct debt. The current debt structure features a rapid amortization schedule for existing debt, retiring about 74% within the next 10 years.

Employees are covered by the Kansas Public Employees Retirement System (KPERs) and Kansas Police and Firemen's Retirement System (KP&F) cost-sharing multiple-employer defined benefit pension plans. Combined, the plans have a ratio of assets to liabilities of approximately 53% when adjusted by Fitch to a 6% rate of return. Pension funding has been negatively affected by a statutory cap on local employer contributions that have historically been less than the full actuarially determined rate in certain years.

#### Operating Performance

Manhattan has a high gap-closing ability, and Fitch expects the city will maintain reserves in excess of a 'aaa' reserve safety margin in an economic downturn. Manhattan had available reserves in excess of 33% of general fund expenditures from 2010 through 2015, inclusive of special revenue fund reserves that could be transferred to the general fund by a budget amendment and a vote by the City Commission, most notably amounts held in the sales tax fund and economic development fund. Available reserves declined in 2016 due to the reclassification of certain reserves as restricted in the economic development fund, but Fitch assumes that the city would continue to be able to access over \$8 million in reserves from that fund if necessary, representing an additional cushion equivalent to 31% of spending. Management reports that the city commission could make those funds available through passing a resolution to do so. Fitch expects that the city would draw on reserves but also that it would use its revenue-raising capacity and expenditure controls to maintain a high level of financial flexibility in a moderate downturn leading to a decline in revenues.

Management has maintained consistent efforts in support of financial flexibility, having built and maintained high available reserves levels. The city has had general fund deficits in recent years, but has supported operations through transfers from utility funds. Management reports that it finished fiscal 2018 with balanced operations inclusive of those transfers.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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#### Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)  
<https://www.fitchratings.com/site/re/10024656>

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