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Ferguson (City of) MO

Update following upgrade of GOULT rating to Ba1; outlook positive

Summary

The credit profile of Ferguson, MO (Ba1 stable) benefits from the city's improved financial performance and reserves coupled with notable progress and implementation of the DOJ consent decree. Progression toward substantial completion of the DOJ consent decree will continue to play a significant role in the city's financial performance with protracted implementation likely to result in significant additional costs that will stunt material financial improvement. The city also benefits from manageable fixed costs comprised of average debt and below average pension burdens compared to peers. These positive attributes are weighed against the city's moderately sized tax base with weak resident income indices, elevated poverty levels, and a reliance on economically sensitive sales tax revenues.

On August 1, 2019, we upgraded the city's general obligation unlimited tax (GOULT) rating to Ba1 from Ba3 and upgraded to Ba2 from B1 and to Ba3 from B2, the city's appropriation debt issued for more and less essential purposes, respectively.

Credit strengths

» Manageable fixed costs comprised of average debt and below average pension burdens compared to peers

» Improved financial operations and maintenance of healthy reserve levels

Credit challenges

» Consent decree implementation to continue to pressure operations

» Weak resident income and elevated poverty levels

» Reliance on economically sensitive revenue streams

Rating outlook

The positive outlook reflects management's commitment of continued progress toward substantial completion of the consent decree and mitigation of factors that led to the civil unrest in 2014. The outlook also considers the likelihood of continued positive operating performance leading to modestly improved reserve levels.

Factors that could lead to an upgrade

» Continued implementation of consent decree requirements

» Reduced uncertainty toward what constitutes substantial completion of the consent decree

» Trend of surplus operations leading to materially bolstered reserves

Factors that could lead to a downgrade

» Failure to implement consent decree requirements resulting in additional related expenditures or litigation costs

» Erosion of reserves

» Trend of tax base contraction or loss of major taxpayer

» Further leveraging of the city's tax base absent corresponding growth in taxable values

Key indicators

Exhibit 1

Ferguson (City of) MO	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$820,046	$730,894	$765,548	$706,675	$758,102
Population	21,151	21,120	21,035	20,927	20,728
Full Value Per Capita	$38,771	$34,607	$36,394	$33,769	$36,574
Median Family Income (% of US Median)	71.2%	70.9%	67.9%	63.7%	63.7%
Finances					
Operating Revenue ($000)	$16,305	$14,233	$13,197	$14,812	$16,455
Fund Balance ($000)	$10,657	$7,366	$3,982	$4,165	$5,256
Cash Balance ($000)	$11,694	$8,842	$5,863	$6,402	$7,919
Fund Balance as a % of Revenues	65.4%	51.8%	30.2%	28.1%	31.9%
Cash Balance as a % of Revenues	71.7%	62.1%	44.4%	43.2%	48.1%
Debt/Pensions					
Net Direct Debt ($000)	$21,731	$21,141	$18,820	$17,242	$15,717
3-Year Average of Moody's ANPL ($000)	$8,225	$9,187	$9,697	$9,945	$10,172
Net Direct Debt / Full Value (%)	2.6%	2.9%	2.5%	2.4%	2.1%
Net Direct Debt / Operating Revenues (x)	1.3x	1.5x	1.4x	1.2x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.0%	1.3%	1.3%	1.4%	1.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.5x	0.6x	0.7x	0.7x	0.6x

Source: Ferguson's audited financial statements fiscal years 2014-18; US Census Bureau

Profile

The City of Ferguson is located within St. Louis County (Aaa stable), approximately 13 miles northwest of downtown St. Louis (Baa1 stable) with a population of approximately 21,000.

Detailed credit considerations

Economy and tax base: limited, built out tax base with proximity to St. Louis

The city's tax base is expected to remain stable over the near term as management reports slow and steady investment in the city. Ferguson is a seven square mile city with access to employment opportunities in the greater St. Louis metro area. The city is largely built out and is therefore largely dependent on assessment gains and redevelopment to drive taxable value growth. The district's tax base experienced modest incremental growth each of the past two years following several years of oscillation between growth and contraction.

The tax base stood at a modest $765.3 million for fiscal 2019 (derived from an assessed valuation of $183.9 million). Positively, and in line with other St. Louis County municipalities, preliminary valuation for fiscal 2020 indicates healthy double-digit increase, however, preliminary valuation is subject to protest and likely to change prior to certification in September. The city is somewhat concentrated with the ten largest taxpayers accounting for 17.8% of assessed valuation. Emerson Electric Company (A2 stable) is headquartered in Ferguson and is the city's largest taxpayer at 7.1% of assessed valuation and the third largest employer with more than 750 employees. None of the remaining ten largest taxpayers account for more than 2.5% of assessed valuation and are comprised of retail shopping and apartment rentals.

Resident income levels are weak with a median family income at 63.7% of the nation. Poverty levels are elevated with 22.5% of the city's population living below the poverty line. The St. Louis County May 2019 unemployment rate of 2.9% compared favorably with both state (3.1%) and national (3.4%) levels for the same period.

Financial operations and reserves: healthy reserves yet operational risks remain with consent decree implementation

While fiscal 2019 is projected to produce the city's third consecutive year of surplus operations, implementation of the consent decree will continue to present a challenge to the city's finances over the near term, although we expect the city will maintain positive operating performance and healthy reserves during this time. Fiscal years 2014-16 saw the city consume roughly two-thirds of general fund reserves as the city grappled with the aftermath of the civil unrest that occurred in August 2014, including increased public safety expenditures coupled with a significant reduction in fines and court revenue. However, over the past two fiscal years, financial performance has stabilized and the city's general fund produced consecutive years of surpluses.

Following a $189,000 surplus in fiscal 2017, the general fund produced a sizable $838,000 surplus in fiscal 2018 as the city benefited from the additional one-cent public safety sales tax authorized by county voters in April 2017 and full year collection of the economic development sales tax authorized by city voters in April 2016; Proposition P provided an additional $837,000 in revenues (9 months of collection) and the economic development tax generated $402,000. Additionally, the city realized salary savings from several open senior level management positions. The surplus improved general fund reserves to $4.6 million, representing a healthy 34.3% of revenues. On an operating basis (general, parks, and debt service funds), the city produced a $1.1 million surplus and improved operating reserves to $6.4 million, representing 39.1% of operating revenues.

Management estimates the city will post a $450,000 general fund surplus in fiscal 2019 pushing reserves to nearly $5.1 million. Management attributes the surplus to salary savings from unfilled positions (primarily from four open police positions) and a full year of public safety sales tax collections. The city's fiscal 2020 budget was adopted with a nominal surplus after incorporating significant additional consent decree costs and management expects to outperform the adopted budget.

Consent Decree Update

Implementation of the consent decree remains a challenge for the city that is expected to continue over the medium to long-term. The city is working towards substantial completion of the consent decree. Two years after that designation is achieved and certified by the judge and monitor, the consent decree will come to an end. The city has stated its commitment to fulfilling the consent decree requirements and the city and monitor continue to participate in quarterly Status Conferences with the judge.

Since entering into the consent decree in April 2016, the city has dismissed more than 44,000 cases under the amnesty provisions of the consent decree. The city has also refocused its policing on public safety; in 2013 and 2014 the police department averaged 21,000 citations a year and by 2018 that number declined to 3,500. The city has also seen significant turnover in its police force - roughly 80% of the officers that were employed in 2014 are no longer with the department. The department has worked through crafting a number of updated policing policies and received significant input from the community; the policies are now available on the city's website. Officers will also undergo de-escalation training in the near term.

Two major areas the city continues to struggle include hiring a Consent Decree Coordinator and implementing data collection efforts. At the July 2019 Status Conference, the city relayed to the judge that it has candidates for the Consent Decree Coordinator and expects to fill the position by September 2019. Additionally, at the suggestion of the Department of Justice (DOJ) the city will begin working with a data collection consultant that assisted the City of New Orleans (A3 stable) with their consent decree efforts. The city's fiscal 2020 budget includes approximately $700,000 in consent decree related costs, including ongoing costs for the monitor, the salary for the Consent Decree Coordinator, and costs associated with data collection. Progress on the consent decree marks significant milestones designed to mitigate the conditions that contributed toward the unrest experienced in 2014. Failure by the city to continue marking progress toward substantial completion could negatively impact the city's credit profile.

LIQUIDITY

The city closed fiscal 2018 with general fund cash and investments of $3.4 million, representing 25.1% of general fund revenues. On an operating basis, inclusive of general, debt service, and parks funds, the city closed with $7.9 million in cash and investments, or a healthy 48.1% of operating revenues.

Debt and pensions: manageable debt and pension burdens; fixed costs to remain below average

The city's debt burden will remain manageable given average principal amortization and limited near term issuance plans. In total, the city closed fiscal 2018 with $15.7 million in debt outstanding, representing 2.1% of full value which is average compared to peers. The city's debt was comprised of general obligation unlimited tax (GOULT; $5.6 million), certificates of obligation ($8.1 million), variable rate capital improvement bonds ($1.2 million) and capital leases ($872,000).

Management reports the city plans to issue a capital lease of approximately $1 million in fiscal 2020 to purchase a new fire truck.

DEBT STRUCTURE

Principal amortization is average with approximately 73.5% of GOULT and 72.5% of all principal repaid over ten years.

The majority of the city's outstanding debt is fixed rate except for $1.2 million in annual appropriation capital improvement bonds (unrated) maturing in 2021 placed with Bank of America, N.A. (Aa2 not on watch); the bonds are variable-rate obligations with interest set at 60.938% of LIBOR plus 100 basis points. Events of default on the loan could become an issue for the city because they include failure to appropriate, failure to observe any covenants, and a material adverse change in the city's financial condition, which includes a judgment of more than $100,000 from a court or governmental agency. Upon default, the bank could accelerate repayment of the loans, which could pose considerable financial impacts with regards to any litigation settlements or findings against the city. There is no rating trigger.

DEBT-RELATED DERIVATIVES

The variable rate bonds are hedged by an interest rate swap agreement with Bank of America. The city pays an overall effective interest rate of 3.99%, inclusive of the swap rate and the capital improvement bonds rate. The swap agreement can be terminated upon a default by the city under the contract including failure to pay, bankruptcy, and illegality. The swap also does not have a rating trigger. As of June 30, 2018, the mark to market termination value was a $27,582 liability for the city.

PENSIONS AND OPEB

The city participates in the City of Ferguson Pension Plan, a single-employer, defined benefit pension plan. The city contributed $363,000 toward the plan in fiscal 2018, representing a minimal 2.2% of operating revenues. Moody's three-year average adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, was $10.2 million, representing a manageable 0.6 times operating revenues and 1.3% of full value. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities and are not intended to replace the city's reported liability information.

After exceeding “tread water” in fiscal years 2015 and 2016, contributions have narrowly fallen below “tread water” each of the past two fiscal years; in fiscal 2018 the shortfall was $5,000. The “tread water” indicator measures the annual government contribution required to prevent the reported net pension liability (NPL) from growing, under reported assumptions. Contributions above this level cover all NPL interest plus pay down some principal, making them stronger from a credit perspective that contributions below this level.

Fiscal 2018 fixed costs, including debt service ($1.35 million), pension tread water ($368,000) and minimal OPEB contributions ($23,647), totaled $1.7 million or a relatively moderate 10.6% of operating revenues.

Management and governance: recent senior level management turnover a challenge to consent decree implementation

The city is governed by six council members and a mayor. Two council members are elected from each of the three wards while the mayor is elected at large; all are elected to three year terms. The council and mayor appoint the city manager who is responsible for the day-to-day management of the city.

Over the past year, the city experienced turnover in the city manager, police chief, municipal judge, and human resource manager positions. The city recently hired a new police chief and human resource manager as well as appointed a new municipal judge. The open city manager position was filled on an interim basis by the city's long-time director of finance. The senior level turnover has caused a slowdown with implementation of the consent decree. However, the city has filled all open senior level positions and as these individuals get up to speed we expect implementation of the consent decree will continue forthwith.

Missouri Cities have an Institutional Framework score of “A”, which is moderate. Major revenue sources are a mix of sales and property tax revenues. Sales tax revenues require voter approval and typically contain sunset provisions. Ad valorem property tax revenues are subject to a cap via the Hancock Amendment which can be overridden with voter approval only. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Ferguson (City of), MO

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$765,342	A
Full Value Per Capita	$36,923	A
Median Family Income (% of US Median)	63.7%	Baa
Notching Factors:[2]		
Other Analyst Adjustment to Economy/Taxbase Factor: Population declines and weak income and poverty levels		Down
Finances (30%)		
Fund Balance as a % of Revenues	31.9%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	-47.1%	B & Below
Cash Balance as a % of Revenues	48.1%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	-16.8%	Ba
Notching Factors:[2]		
Outsized Enterprise or Contingent Liabliity Risk		Down
Unusually volatile revenue structure		Down
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	0.9x	Ba
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.1%	A
Net Direct Debt / Operating Revenues (x)	1.0x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.3%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.6x	Aa
	Scorecard-Indicated Outcome	Baa3
	Assigned Rating	Ba1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16, 2016.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication.
Source: Ferguson's audited financial statements fiscal years 2014-18; US Census Bureau

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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