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Summary:

Lafayette, Louisiana; Sales Tax

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Credit Profile		
US$30.0 mil pub imp sales tax bnds ser 2019A due 05/01/2044		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' rating and stable outlook to Lafayette, La.'s series 2019A public improvement sales tax revenue bonds.

The city's net direct debt is roughly $250 million.

A first-lien revenue pledge, generated by a 1% sales-and-use tax collected by the city, originally authorized in 1985, secures the series 2019A bonds. We note the pledge excludes the sales tax on food and prescription drugs.

We rate the bonds under our criteria, titled "Priority-Lien Tax Revenue Debt," published Oct. 22, 2018, on RatingsDirect, which factors in both the strength and stability of pledged revenue, as well as the general credit quality of the municipality where taxes are distributed or collected (the obligor's creditworthiness).

We understand officials intend to use series 2019A bond proceeds to fund various capital projects, including road, bridge, and drainage improvements.

Key credit considerations include the city's:

- Consistent expansion of its economy, supported by its role as a regional commercial-retail and economic center;
- Low revenue volatility, supported by a stable consumer-retail sales tax base; and
- Maintenance of, at least, strong coverage.

Despite the city's additional parity debt plans within the next two years, we think the city's underlying economic strength and moderate-to-low volatility ensure coverage will likely remain strong during the next two years. Lafayette's general creditworthiness supports the bond rating. Although the city has exhibited overall financial stability and economic fundamentals are relatively strong and positive, we believe its weak debt-and-liability profile limits financial flexibility. The priority-lien rating on these bonds is not limited by our view of the obligor's general creditworthiness.

Economic fundamentals: adequate-to-strong

Lafayette, with a population estimate of 129,468, is the fourth-most populated municipality in Louisiana. The city is in south-central Louisiana, roughly 30 miles north of the Gulf of Mexico. The city serves as a regional economic center (education, medical services, and retail) for the surrounding parishes. Historically, the oil-and-gas sector anchors the city's economy, which has diversified into the retail, service, commercial, education, health-care, technology, and manufacturing sectors. As of 2018, the tax base is diverse with the leading taxpayers representing 7% of assessed value. While three of the leading taxpayers are in the oil-and-gas industry, which is prone to volatility, we expect the tax base to remain relatively stable due to its diversity.

Market value has grown consistently by an average of 5% per year for the past three years to $14.1 billion in fiscal 2017, which equates to a strong, in our opinion, $109,052 per capita. However, we note market value per capita is inflated due to a relatively large tax base compared to the population. Income for Lafayette residents, measured by per capita effective buying income, is adequate at roughly 88% of the national level. Unemployment currently exceeds the national average at 5.1%. However, officials expect unemployment to improve during the next two years because they expect the addition of numerous jobs to the technology sector.

Coverage and liquidity: strong

Given the city's additional plans to issue parity debt within the next two years, we based our coverage assessment on the additional bonds test. Although the city plans to issue additional parity debt for the 1961 pledge, issuing between $20 million and $40 million within the next two years, we expect maximum annual debt service (MADS) coverage to exceed 2x. Despite the additional bonds test requirement of 1.5x MADS, the city has exceeded this requirement during the past 10 years, maintaining at least 1.9x annual debt service and 2.2x MADS for both pledges. Furthermore, additional debt assumptions are conservative; the city will likely issue less than the projected amount, allowing coverage to remain strong.

For the city's 1961 pledge, tax collections totaled $43 million in fiscal 2017, providing 3.15x MADS, which occurs in fiscal 2022. For the city's 1985 pledge, tax collections totaled $36.5 million in fiscal 2017; city estimates have collections at $36.2 million for fiscal 2018, providing roughly 2.8x MADS, which occurs in fiscal 2020 and includes the series 2019A issuance. While pledged revenue for fiscal 2018 remained relatively flat, the city expects 1%-2% growth for the 1961 and 1985 pledges, respectively.

Liquidity is provided through a debt-service-reserve fund funded at the standard three-pronged test, which is the least of MADS, 125% of average annual debt service, or 10% of par. With very strong coverage and a low volatility assessment based on our view of the dependability of sales taxes, there is no downward adjustment to the very strong coverage score that would indicate potential liquidity pressure.

Volatility: moderate-to-low

We assess the volatility of revenue to determine the likelihood of revenue availability during different economic cycles. We have two levels of volatility assessment: macro and micro.

Our macro volatility assessment begins with an assessment of the historical volatility of the taxed economic activity and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity we believe most closely represents the taxing base over multiple economic cycles, we use historical volatility to inform our opinion of future volatility. To determine our view of sales tax volatility, we used total sales data from the U.S. Census Bureau for 1993-2014.

On a micro level, there is an external influence we think worsens the macro assessment of low volatility. Most sales tax revenue comes from consumer goods; retail stores; and restaurants, which mitigates the risk of sales tax volatility during economically challenging times. However, the city's sales tax declined by roughly 4% during the downturn in the oil-and-gas industry in fiscal years 2009 and 2016 due to some concentration in the energy industry. While we recognize this minor volatility in sales tax revenue, we note Lafayette's sales tax revenue has generally increased during the past 10 years. Furthermore, the city expects additional sales tax revenue growth once the state begins collecting online sales tax revenue. Given these factors, we expect sales tax collections within Lafayette will likely remain relatively stable throughout economic cycles.

Obligor linkage: close

All sales taxes are collected by Lafayette Parish School Board's sales tax division and distributed directly to the city monthly. Once collected, the city distributes funds to trustees. Under our criteria, we believe pledged revenue has exposure to operating risk and bond provisions are less restrictive with respect to revenue collection and distribution. We believe this increases the linkage between the priority-lien pledge and the obligor's creditworthiness, which is indicative of the degree of exposure of the pledged revenue stream to the obligor's operating risks.

Rating linkage to Lafayette

We assess the city's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including special-tax-secured bonds.

The city's economic growth supports adequate budgetary performance, very strong flexibility, and very strong liquidity. Management's conservative budget assumptions and good practices and policies led to operating surpluses from fiscal years 2015-2017. For fiscal 2017, the city reported a 4.2% general fund surplus and a 6.6% total governmental-funds surplus, which boosted available reserves to 49.7% of operating expenditures.

However, based on fiscal 2018 unaudited results and the fiscal 2019 budget, we expect budgetary results to deteriorate somewhat from fiscal 2017. For fiscal 2018, the city expects to report breakeven operating results. In fiscal 2019, it plans to draw down roughly $5 million, or 3.5% of operating expenditures. Since current reserves exceed the city's administrative reserve policy of maintaining 20% of operating expenditures, the city council approved this spend down to fund one-time expenditures and salary increases in fiscal 2019. While the city could draw down reserves further during the next few fiscal years, it intends to maintain at least $40 million in reserve for the next two fiscal years.

In our view, the city's debt-and-contingent-liability profile is very weak with net direct debt at 134% of revenue and total governmental-funds debt service at 17.8% of governmental funds expenditures. In addition, the city's unfunded retirement liabilities, with a 63% funded ratio, place a burden on financial performance we expect to grow during the next few fiscal years; we view this as a limiting factor that constrains credit quality. Should revenue growth fail to keep pace with growing pension costs, it could create an operating imbalance that would further pressure the credit.

Outlook

The stable outlook reflects S&P Global Ratings' view of very strong coverage based on the most recent full year of pledged revenue collections, supported by strong sales tax revenue collections. We believe the city's role as a regional economic hub for the surrounding parishes provides additional rating stability. We do not expect to change the rating during the two-year outlook period. However, under our criteria, there is a link between the attributes of the priority-lien pledge and the obligor's creditworthiness. Therefore, in some cases, the obligor's creditworthiness could dictate or limit movement in the priority-lien rating.

Upside scenario

We could raise the rating if economic fundamentals were to improve to levels we consider comparable with higher-rated peers.

Downside scenario

We could lower the rating if revenue volatility, an economic downturn, or additional bond issuance were to dilute coverage substantially or if the obligor's creditworthiness were to deteriorate materially.