

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns MIG 1 rating to Topeka's (KS) \$25M GO Temp Notes, Ser. 2013-A; Aa3 to \$9.8M GO Ser. 2013-B and \$5.0M GO Ser. 2013-C

Global Credit Research - 03 Sep 2013

Aa3 applies to \$173.5 M of outstanding general obligation debt

TOPEKA (CITY OF) KS
Cities (including Towns, Villages and Townships)
KS

Moody's Rating

ISSUE	RATING
General Obligation Temporary Notes Series 2013-A (General Improvements)	MIG 1
Sale Amount	\$24,900,000
Expected Sale Date	09/06/13
Rating Description	Note: Bond Anticipation
Taxable General Obligation Bonds Series 2013-C (Employee Retirement Benefit Funding)	Aa3
Sale Amount	\$5,000,000
Expected Sale Date	09/06/13
Rating Description	General Obligation
General Obligation Bonds Series 2013-B (Combined Utility Projects)	Aa3
Sale Amount	\$9,755,000
Expected Sale Date	09/10/13
Rating Description	General Obligation

Moody's Outlook NOO

Opinion

NEW YORK, September 03, 2013 --Moody's Investors Service has assigned a MIG 1 rating to the City of Topeka's (KS) \$24.9 million General Obligation Temporary Notes, Series 2013-A. Moody's has also assigned a Aa3 rating to the city's \$9.8 million General Obligation Bonds, Series 2013B and \$5.0 million Taxable General Obligation Bonds, Series 2013C. Concurrently, Moody's has affirmed the Aa3 rating on the city's outstanding long-term general obligation debt. The Aa3 rating applies to \$173.5 million of long-term general obligation debt. The Series 2013-A Notes are secured by the city's general obligation unlimited tax (GOULT) pledge. Both the Series 2013B and Series 2013C bonds are also secured by the city's GOULT pledge. The city's GOULT pledge benefits from a dedicated property tax levy unlimited by rate or amount. Proceeds of the Series 2013-A Notes will provide temporary takeout financing for a portion of the city's outstanding Series 2012 Temporary Notes, as well as provide approximately \$11.5 million of new money for a variety of capital improvement projects, including a portion associated with the city's combined utility. Proceeds of the Series 2013-B bonds will provide long-term takeout financing for a portion of the city's Series 2012 Temporary Notes, as well as provide new money for approximately \$6.4 million of capital projects. Proceeds of the Series 2012-C bonds will provide financing for the city's accumulated compensated absences liability. The city is issuing the debt to reduce short-term expenses associated with this liability while concurrently pushing payment out to 2019 as part of a number of budgetary solutions to balance its fiscal 2014 budget.

SUMMARY RATINGS RATIONALE

The Aa3 rating reflects the city's relatively stable economy anchored by its status as the state capital; trend of operating deficits that have resulted in narrowed reserve levels with continued pressure over the near term; and above average debt burden.

STRENGTHS

- State capital serves as regional economic center
- New management team has identified improved fund balance target for next five years

CHALLENGES

- Lowered reserve levels due to significant operating deficits in fiscals 2011 and 2012; additional budgetary actions taken to prevent reserve draws in fiscals 2013 and 2014
- Dependence on economically sensitive sales tax revenue streams for operations

DETAILED CREDIT DISCUSSION

FAVORABLE MARKET ACCESS EXPECTED TO CONTINUE FOR SHORT-TERM GENERAL OBLIGATION OFFERINGS

We expect that Topeka will continue to enjoy favorable capital market access for its debt offerings. The city issues debt frequently, typically offering multiple issues of general obligation bonds and notes each year through either competitive or negotiated sales. The Series 2013-A notes mature on October 1, 2014. The pricing date for the current issuance is September 10, well in advance of the October 1, 2013 maturity date of the Series 2012 notes.

KANSAS STATE CAPITAL HAS EXPERIENCED JOB LOSSES DUE TO STATE BUDGET REDUCTIONS; FAVORABLE DEVELOPMENTS IN MANUFACTURING EXPECTED IN 2013

The city's tax base is expected to remain stable in the near term, reflecting the stabilizing institutional presence of the state capital. Located in Shawnee County (GO rated Aa2/negative outlook), Topeka's large \$6.4 billion tax base has declined at an average annual rate of 2.0% since 2007. The declines in valuation reflect an overall decline in residential construction and housing values. Topeka serves as the Kansas state capital, and the State of Kansas (issuer rated Aa1/negative outlook) is the city's top employer. Reflecting the impact of the economic downturn on the state's budget in recent years, the number of state employees has decreased from over 8,000 in 2009 to approximately 6,400 currently. While the number of employees have decreased, the state government should continue to provide some stability to the local economy over the long term. In addition to a significant government presence, the city also benefits from a manufacturing presence, with Goodyear Tire & Rubber Co. (Corporate family rating Ba3/negative outlook) employing approximately 1,550. Favorably, Mars Chocolate North America will open a new \$250 million production facility in late 2013, which is expected to generate approximately 200 new jobs. The city's population has remained relatively stable over the past two decades, increasing by 2.1% from 1990 to 2000 and by 4.2% from 2000 to 2010, bringing the 2010 census population to 127,473. Residential income indices from 2006 to 2010 tracked below state and national levels, with median family income at 84.1% and 83.3% of state and national benchmarks for the same time period. At 7.3% in June 2013, the city's unemployment rate tracked above the state rate (5.8%) but below that national rate (7.8%) for the same time period.

MATERIAL DECLINES IN RESERVES DUE TO CONSECUTIVE OPERATING DEFICITS; ONGOING CHALLENGES TO ACHIEVING MULTI-YEAR RESERVE REPLENISHMENT TARGET

The city's financial operations are expected to remain challenged in the near term, as operating deficits in each of the past two fiscal years have resulted in material reserve declines. The city experienced a \$2.2 million General Fund deficit in fiscal 2011, bringing reserves to \$8.7 million, or a satisfactory 10.8% of revenues. The city attributes the deficit to higher than expected public safety expenditures, reduced franchise fee revenues, relatively stagnant sales tax revenues and health insurance cash flow needs. The city's General Fund experienced a \$2.6 million deficit in fiscal 2012, reducing reserves to \$6.1 million, or a narrow 7.9% of revenues. The deficit in fiscal 2012 is attributable to a reduction in franchise fee revenues associated with a warm winter and declines in natural gas prices, stagnating sales tax revenues and increased public safety costs.

The city reports its financial performance has somewhat stabilized in the current fiscal year 2013, driven by a 2.9 mill property tax increase and the close monitoring of departmental expenditures. Reported positive trends in sales tax revenues have been somewhat offset by increased property tax delinquencies as well as a \$5 million increase in police expenditures to improve staffing levels and for additional public safety wages. As a result, the city

currently projects that General Fund reserves will remain at year end fiscal 2012 levels in fiscal 2013, despite initially aiming to increase reserves. The city's new management team has identified a five year goal to rebuild reserves to 15% of General Fund revenues. However, the city could face challenges in the near term as revenues have been flat while continued expenditure growth is expected related to public safety. Looking ahead to fiscal 2014, the city initially identified a \$6.5 million General Fund deficit. However, management indicates that the city has balanced its fiscal 2014 budget through several actions, including a 4 mill property tax increase, an increase in franchise fees, approximately \$1 million in recurring expenditure reductions, and approximately \$500,000 of savings associated with the Series 2013-C bond issuance. The city anticipates an increase in pay-as-you-go costs for accrued leave benefits over the next two to three years, followed by an expected cost reduction after the matriculation of a large retirement cohort. The Series 2013-C bonds will allow the city to achieve short-term budgetary savings while concurrently pushing accrued leave costs through the final maturity of the Series 2013-C bonds, which is in 2019. We view the reliance on deficit financing for operations, even with a relative short maturity, as an indication of the financial challenges currently facing the city. These challenges were incorporated into our downgrade of the city's general obligation rating to Aa3 from Aa2 in May 2013. While the Series 2013-C bonds are relatively modest in size and mature quickly, further reliance on the issuance of debt to prevent reserve draw downs could result in additional rating pressure.

Like many Kansas municipalities, sales tax revenues are one of the city's largest income sources (approximately 34% of budgeted General Fund revenues in fiscal 2013). A permanent 1.0% citywide local option sales tax supports General Fund operations. After a 6.0% increase in fiscal 2011, collections were stagnant in fiscal 2012 and city officials are projecting a modest 1% to 1.5% increase in collections for fiscal 2013. Property taxes represent the second largest source of General Fund revenues, comprising 29% of fiscal 2013 budgeted revenues. Favorably, no property tax levy limits exist for Kansas cities and counties, providing significant revenue raising flexibility. The city has demonstrated its willingness to access this flexibility by increasing its property tax rate by 2.9 mills for fiscal 2013, and by approximately 4 mills for fiscal 2014. Future credit reviews will continue to focus on the city's ability to maintain and improve reserve levels toward its stated target.

HIGH DEBT LEVELS EXPECTED TO MODERATE DUE TO USE OF DEDICATED SALES TAX FOR CAPITAL NEEDS

The city's above average debt burden is expected to moderate over the long term given the city's targeted reduction of annual general obligation debt issuance. At 4.1% of full value (6.7% overall), the city's direct debt burden is high. Backing out sales tax supported debt, the adjusted overall debt burden is lower, but still above average, at 6.5% of full value. Principal amortization is below average, with 71% retired in ten years. Debt service comprised a high 21.2% of operating expenditures in fiscal 2012. The city plans to issue its annual bond and note offering for a variety of capital projects in the fall of 2014, but does not have further debt plans at this time. All of Topeka's outstanding debt is fixed rate, and the city is not a party to any interest rate swap agreements.

In April 2009, Topeka voters approved a ½ cent sales tax to finance street, sidewalk, gutter, and street lighting projects. Collections began on October 1, 2009, and the tax will sunset in 2019. The city uses collections from the tax to cash finance certain improvements, in turn reducing the city's reliance on additional debt issuance.

Budgetary pressure generated by Topeka's exposure to two statewide cost-sharing pension plans, the Kansas Public Employees Retirement System (KPERs) and Kansas Police and Firemen's Retirement System (KP&F), is expected to remain manageable in the near term. 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 2011 amounted to \$6.8 million, and contributions to the cost-sharing plans are expected to increase by up to 1.2% of payroll annually through fiscal 2017 as statutory contribution requirements are increased to eventually meet actuarial requirements. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is \$187.8 million, or 1.93 times operating revenues, including the General Fund and Debt Service Fund. This compares to approximately 1.0 times on average for local governments. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace Topeka's reported contribution information, but to improve comparability with other rated entities. We determined Topeka'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 concurrently adhering to its stated target of improving reserves in each of the next five years.

WHAT COULD CHANGE THE RATING - UP

-Substantial growth in the city's tax base and improvement in residential income indices

-Sustained improvement in reserves to levels consistent with higher ratings

WHAT COULD CHANGE THE RATING - DOWN

-Significant tax base valuation declines or erosion of the city's residential income profile

-Further narrowing of reserve levels due to operational imbalance

KEY STATISTICS

2010 Population: 127,473 (4.2% increase since 2000)

2012 Full value: \$6.4 billion (2.0% average annual decrease since 2007)

2012 Estimated full value per capita: \$50,025

2006 - 2010 per capita income: \$23,524 (90.8% of state / 86.1% of US)

2006 - 2010 median family income: \$52,483 (84.1% of state / 83.3% of US)

Unemployment rate (June 2013): 7.3%

Fiscal 2012 General Fund balance: \$6.1 million (7.9% of General Fund revenues)

Direct debt burden: 4.1% (6.7% overall)

Moody's Adjusted Net Pension Liability (ANPL): \$187.8 million (1.93x operating revenues)

Principal amortization (10 years): 70.7%

Post-sale long term general obligation debt outstanding: \$173.5 million

Post-sale short-term general obligation notes outstanding: \$24.9 million

PRINCIPAL METHODOLOGY USED

The principal methodology used in the short-term rating was Bond Anticipation Notes and Other Short-Term Capital Financings published in May 2007. The principal methodology used in the long-term rating was General Obligation Bonds Issued by US Local Governments published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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