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Summary:

McPherson, Kansas; General Obligation

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Credit Profile		
US$9.705 mil GO bnds ser 141 dtd 08/19/2020 due 08/01/2040		
Long Term Rating	AA-/Stable	New
McPherson GO		
Long Term Rating	AA-/Stable	Affirmed
McPherson GO		
Long Term Rating	AA-/Stable	Affirmed
McPherson GO		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to McPherson, Kan.'s $9.7 million general obligation (GO) refunding and improvement bonds, series 141 of 2020. At the same time, S&P Global Ratings affirmed its 'AA-' long-term ratings on the city's existing debt. The outlook is stable.

The series 141 of 2020 and several of the city's GO bonds are payable, in part, from special assessments levied on the property benefited by the projects being financed with the bond proceeds, and, if not paid, from ad valorem taxes levied without limitation as to rate or amount on all taxable property in the city. However, we rate these issues based on the city's unlimited-ad valorem pledge. We do not believe we have sufficient information to rate the special-assessment pledge.

We understand bond proceeds will refund a portion of the city's debt outstanding for interest savings with the remainder funding various public improvement projects. Inclusive of the series 2020 issuance, we expect the city will have approximately $24.7 million of net direct debt.

Credit Overview

Despite employment concentration in the manufacturing sector, a diverse tax base, including essential retailers, healthcare providers, and education services, has aided in relative stability through the onset of the COVID-19 pandemic. (See "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020.) Officials note that although the economy briefly halted during its onset, its primary manufacturers were mostly fully operational after roughly 45 days, and its retailers have started to rebound. Recent years of surplus operating results, aided by prudent spending and strong management policies and practices, has led to healthy reserves that we expect will provide the city with flexibility should revenue declines caused by COVID-19 be more severe than anticipated. Provided the city's flexibility, we view the credit as stable despite the noted risks.

The rating reflects our view of the city's:

- Weak economy, with a concentrated employment base, and projected per capita effective buying income at 100.2% of the national level and market value per capita of $80,114;
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with balanced operating results in the general fund but an operating deficit at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available cash reserve in fiscal 2019 at 88% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.8x total governmental fund expenditures and 15.7x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 17.9% of total governmental expenditures and net direct debt that is 77.8% of total governmental fund revenue, as well as rapid amortization, with 87.3% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We have analyzed the city's environmental factors, including health-and-safety risks posed by COVID-19, coupled with social-and-governance risks relative to the economy; financial management; budgetary performance; and budgetary flexibility, as well as its debt-and-liability profile, and have determined all are in-line with our view of the sector standard. Severe weather resulting in flooding is the main environmental threat to McPherson; however, drainage studies are performed to ensure systems can appropriately channel water during extreme weather events. Moreover, it is common practice that officials budget a contingency for storm damage when formulating its expenditure assumption.

Stable Outlook

Downside scenario

If significant or sustained budget deficits cause a material decline in reserves, we could consider a lower rating.

Upside scenario

Assuming no deterioration to other credit metrics, we could consider a higher rating if the city's economic indicators improve to levels comparable to higher-rated peers, or if the city can demonstrate its ability to maintain its reserves above 75% despite potential revenue declines.

Rating Action

Economy

We consider McPherson's economy weak. The city, with an estimated population of 13,084, is located in McPherson County. The city has a projected per capita effective buying income at 100.2% of the national level and per capita market value of $80,114. Overall, the city's market value decreased modestly from 2019 by 0.6%, bringing it to $1.05 billion in 2020. Weakening McPherson's economy is a concentrated employment base, with a single sector accounting for more than 30% of total county employment. Unemployment for 2019 was 2.2%; however, data for Apr. 2020 reflects an increase to 5.8%, partially reflecting the effects of COVID-19 and resulting business closures.

McPherson is the county seat and principal commercial center of McPherson County. The city, encompassing 7.4 square miles, is located approximately 50 miles northwest of Wichita. The local economy has a significant industrial component that includes oil refining, plastics, pharmaceuticals, and fiberglass. Manufacturing accounts for just over 30% of countywide employment, which we view as a credit weakness. Officials note low energy costs are a primary draw for the industry. Aside from manufacturing, education and health services also make up an important part of the economy, representing roughly 17% of countywide employment. The most significant employers include; Pfizer (1,500 employees), Unified School District No. 418 (720), and CHS Refinery (540). Despite the concentrated employment base, the 10 leading taxpayers account for only 7.8% of the total assessed value (AV).

Since 2014, AV has increased an average of 2.7% per year; but gains below 1% in 2019 and 2020 pull the average down. City officials are hopeful for higher growth over the coming years due to ongoing residential and commercial developments at various stages of completion; however, the severity of the recession and possibility for additional business closures related to spikes in COVID-19 cases could limit future gains. Although some of the city's smaller retail shops will undoubtedly have to permanently close, various grants provided to many of its local businesses have helped them financially through mandated closures. Officials note that its manufacturing sector slowed for a period of roughly 45 days during the onset of the pandemic, but that most of those businesses are back up and running. Also, a portion of its principal taxpayers, including its largest, Wal-Mart, are classified as essential and remained open throughout mandated closures. We do not anticipate any material deterioration in the city's economy over the short term. However, we will continue to monitor the effects of the recession on the city's key economic fundamentals.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them regularly.

Key practices include

- Revenue and expenditure budget assumptions formulated using up to five years of historical data as well as discussions with the county appraisal office;
- Monthly budget-to-actual results shared with the city commission and amendments performed as needed;
- Formal investment policy adhering to state statutes and quarterly earnings and holdings reports shared with the city commission;
- Formal debt management policy identifying restrictions on debt issuances, refunding guidelines, amortization requirements, and specifies the timeframe for reviewing the policy and the city's debt outstanding;
- An annually updated five-year capital improvement plan identifying anticipated capital projects and funding sources; and
- Informal reserve policy to maintain a minimum reserve balance of $3.0 million as a disaster contingency and for future capital expenditures.

The city does not maintain a financial forecast beyond the current budget year.

Weak budgetary performance

McPherson's budgetary performance is weak, in our opinion. The city recognized surplus operating results in the general fund of 0.2% of expenditures, but a deficit result across all governmental funds of 6.2% in fiscal 2019. Our forward-looking opinion of weak budgetary performance reflects uncertainty concerning the effect, and duration, of COVID-19 and the related recession on the city.

In assessing budgetary performance, we adjusted for annually recurring transfers into and from the general fund and one-time capital-project expenditures across total governmental funds, funded with debt proceeds. Property taxes generated the largest portion of 2019 revenue (28% of the total), followed by local sales taxes (22%), and transfers from its electric utility, solid waste, wastewater, and water utility funds (18%). Provided the importance of sales tax collections, and the ongoing COVID-19 pandemic, we have applied a performance volatility adjustment indicating we believe that the COVID-19 pandemic could reduce revenues in the future.

Consistent with 2018 results, the city outperformed its general fund budget in 2019 by more than $3 million, primarily related to a $3.2 million allocation for storm damage that did not occur either year. The city's two primary revenue sources, property, and sales taxes, both increased in 2019 due to a favorable economic environment, which helped the city add to its general fund cash balances in each of the last three fiscal years. The COVID-19 pandemic halted economic growth across the country, and with anticipated sales tax declines resulting from closed businesses, the city has shifted from building reserves to focusing on maintaining them. Officials are conservatively projecting a decrease in its general fund cash balances during the current year of approximately $391,000, which would reduce its cash balance to $4.4 million. The city has an additional $3.2 million in general fund reserves.

Officials note that initial revenue loss estimates provided by the League of Kansas Municipalities for 15% ad valorem and 25% sales tax declines were significantly overstated compared to current data indicating a decline in property tax delinquencies compared to 2019. Moreover, sales tax collections are currently trending on target with budgeted amounts through May, which accounts for March collections. Management has prudently identified several areas in the budget to save on costs, including placing a hiring freeze on all open positions, a reduction in seasonal and temporary employees, and modification of general fund transfers.

McPherson's budgets include uses of existing reserves, consistent with state budget law; however, we recognize that actual results are often significantly better than budgeted. We anticipate that although some revenue declines will occur as a result of the recession, that management will adjust budgets accordingly and that budgetary performance will not materially worsen in the short term. We may change our view if a resurgence in cases causes additional business shut-downs and will continue to monitor the effects of COVID-19 on the city's financial results.

Very strong budgetary flexibility

McPherson's budgetary flexibility is very strong, in our view, with an available cash reserve in fiscal 2019 at 88% of operating expenditures, or $9.2 million. We expect the available cash reserve to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. The cash reserve includes $4.8 million (45.6% of expenditures) in the general fund and $4.4 million (42.1% of expenditures) that is outside the general fund but legally available for operations.

McPherson reports on the regulatory basis of accounting per the Kansas Municipal Audit and Accounting Guide (KMAAG). However, the KMAAG regulatory basis is not generally accepted accounting principles (GAAP) compliant. It does not recognize capital assets, long-term debt, accrued receivables, and payables, or any other assets, liabilities, or deferred inflows or outflows. There is little clarity regarding the value of truly available funds, and we view this basis of accounting as a negative credit factor.

In addition to the general fund unencumbered balances, we view funds in the city's capital improvement and equipment reserve funds as available, which adds flexibility to McPherson's reserves. As of fiscal 2019, the city maintained $6.4 million and $1.3 million in unencumbered balances in the capital improvement and equipment reserve funds. However, these funds are not budgeted, and the city utilizes these funds to address ongoing capital needs. Also, we have adjusted the aforementioned unencumbered balances by removing any unspent bond proceeds. The city maintains an informal fund balance policy to maintain a general fund balance of at least $3 million. It has historically maintained very strong unencumbered cash levels that have consistently been above 30% of expenditures. Given the city's generally stable operating performance and goal of maintaining reserves throughout the duration of the recession, we believe budgetary flexibility will remain at levels we consider very strong over the next two years.

Very strong liquidity

In our opinion, McPherson's liquidity is very strong, with total government available cash at 2.8x total governmental fund expenditures and 15.7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

The city's strong access to external liquidity is demonstrated through its access to the market over the past two decades. McPherson has issued GO- and revenue-backed bonds in recent years. The city historically had what we consider very strong cash balances; therefore, we do not believe its cash position will materially weaken despite plans to continue utilizing reserves to address ongoing capital needs. Currently, all of the city's investments comply with Kansas statutes and are primarily held in state pools, which we do not consider aggressive.

The city's series 2019-B general obligation temporary notes were issued via a direct placement with a local bank. The par-amount outstanding is $1.8 million or 5% of the total direct debt. Upon reviewing the documents, we note that the debt does not contain any permissive provisions, such as acceleration, that we view as a potential liquidity risk.

Weak debt and contingent liability profile

In our view, McPherson's debt and contingent liability profile is weak. Total governmental fund debt service is 17.9% of total governmental fund expenditures, and net direct debt is 77.8% of total governmental fund revenue. The city's amortization tables show a rapid amortization schedule, with 87% of debt expected to be retired within 10 years, which we view as a positive credit factor.

There are currently no plans to issue additional GO debt over the next few years. Management is open to issuing GO bonds backed by specials assessments to fund infrastructure improvement projects in new residential or commercial developments if the opportunity presents itself. We do not anticipate that the city's debt profile will further weaken over the next couple of years.

Pension and OPEB

McPherson's pension contributions totaled 5.1% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution. McPherson participates in the Kansas Public Employees' Retirement System (KPERS) and the Kansas Police and Firemen's Retirement System (KP&F). Both plans are cost-sharing, multiple-employer, state-administered defined-benefit plans. According to state law, Kansas determines employer contributions based on the results of an annual actuarial valuation. McPherson's combined contribution to KPERS and KP&F was $1.5 million in fiscal 2019, and its proportionate share of the combined net pension liabilities was $12.2 million. The city has historically met the statutorily required contribution in full.

On June 30, 2019, KPERS' fiduciary net position as a percent of total pension liability was 69.9%. The discount rate for KPERS was recently reduced to 7.75% from 8.00%, which we view positively; however, the discount rate remains somewhat optimistic, in our view, relative to the national median. Unfavorable actual results relative to assumptions with a relatively high discount rate can lead to an outsized acceleration of required contributions. However, based on contributions that remain small relative to the city's budget, we expect the city's very strong budgetary flexibility will allow it to absorb increases to required contributions, which may be necessary given the plan's relatively low funded ratio. However, if the plan experience is unfavorable relative to assumptions, leading to weakened plan liquidity and substantial increases to required contributions, our view of the city's pension liability position could weaken.

As provided by K.S.A. 12-5040, McPherson allows retirees to participate in the city's group health insurance plan until they reach 65 years of age. While each retiree pays the full amount of the applicable premium, conceptually, the local government is subsidizing the retirees, because each participant is charged a level of premium regardless of age. However, the cost of the subsidy has not been quantified.