MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A1 rating to Kansas City's (MO) $72.2M Special Obligation Bonds, Series 2013B-C; Outlook is stable

Global Credit Research - 07 Aug 2013

Aa2 rating affirmed on $434.8M of outstanding General Obligation debt

KANSAS CITY (CITY OF) MO
Cities (including Towns, Villages and Townships)
MO

Moody's Rating

ISSUE		RATING
Special Obligation Refunding and Improvement Bonds , Series 2013B		A1
Sale Amount	$52,670,000	
Expected Sale Date	08/15/13	
Rating Description	Lease Rental: Appropriation	
Taxable Special Obligation Improvement Bonds, Series 2013C		A1
Sale Amount	$19,560,000	
Expected Sale Date	08/15/13	
Rating Description	Lease Rental: Appropriation	

Moody's Outlook STA

Opinion

NEW YORK, August 07, 2013 --Moody's Investors Service has assigned an A1 rating to the city's $52.67 million Special Obligation Refunding and Improvement Bonds, Series 2013B and $19.56 million Taxable Special Obligation Improvement Bonds, Series 2013C. Concurrently, Moody's has affirmed the Aa2 rating on the city's general obligation debt, affecting $434.8 million of outstanding debt. We have also affirmed the A1 rating on the city's special obligation and General Fund appropriation backed debt, affecting $1.1 billion of post-sale debt. The city's outlook is stable.

SUMMARY RATINGS RATIONALE

Debt service payments on the Special Obligation bonds are secured by general municipal revenues of the city legally available for such purpose, subject to annual appropriation. The Series 2013B bonds are being issued to refund the Kansas City Municipal Assistance Corporation (KCMAC) Series 2003C Leasehold Refunding and Improvement Revenue Bonds and the Tax Increment Financing Commission Series 2004 TIF Revenue Bonds for interest rate savings, finance public safety capital projects, and provide funds for park and auditorium capital improvements. The Taxable Series 2013C bonds are being issued to permanently finance a promissory note with Bank of America N.A. (Long term rated A3/stable), and provide funds for Soccer Village and City Market infrastructure improvements.

The Aa2 General Obligation Unlimited Tax rating reflects the city's sizable full value and role as the economic hub for western Missouri (Aaa/stable) and eastern Kansas (Aa1/negative) and stabilized financial position that has benefitted from the stabilization of economically sensitive revenues in recent years. The A1 rating on the city's Special Obligation Bonds incorporates the city's fundamental credit quality , the risk of appropriation, the lack of pledged assets securing the debt, and the non-essential nature of the projects financed. The ratings also incorporate the city's large and diverse economy that serves as a population and employment hub for the region; leveraged debt profile that may increase in the near term and potential increased fiscal stress to the General Fund for supporting debt service payments related to bonds that were originally intended to be repaid by increased special taxes and other revenues derived from the financed projects, coupled with a high debt burden that is likely to remain high and potentially increase; and strong financial management that has been able to regain structural balance, even in times of declining revenues, modest General Fund revenues that could be insufficient absorb potential negative variances, particularly given a high percentage of the budget dedicated to debt service and other fixed costs.

The stable outlook reflects the city's substantial economy and its regional role as the hub for a larger metropolitan area. Additionally, recently implemented codified policies and managerial practices will likely strengthen the city's operations over the long term.

STRENGTHS

-Large and diverse economy; population and employment hub of western Missouri/eastern Kansas

-Management's success at closing large, multi-year budget gaps

-Continued collection of earnings tax revenues, the city's largest General Fund revenue source, following 2011 ballot initiative

CHALLENGES

-General Fund appropriation for debt obligations that were originally intended to be paid by project revenues and dedicated taxes related to the financed projects

-Uncertainty over long term collection of the Earnings Tax due to new statutory requirement for voter reapproval every five years

-Modest General Fund reserves, relative to budget, that provide somewhat limited cushion for negative budget variances, particularly given a high percentage of the budget dedicated to debt service and other fixed costs

-Planned investments in economic development that is likely to maintain, or potentially increase, city's debt burden over time

DETAILED CREDIT DISCUSSION

FINANCIAL POSITION EXPECTED TO REMAIN STABLE DUE TO CLOSE MANAGERIAL OVERSIGHT

The city's financial position will likely remain stable in the near term; however, long term risks exist due to requirement to obtain voter approval of the earnings tax every five years. While voters overwhelmingly approved the tax in April 2011, future support is not guaranteed; further the periodic election will require investment by the city to campaign for continuation of the levy.

Audited figures from fiscal 2011 reflect a General Fund operating surplus of $5.7 million. Despite facing a $65 million budget gap, the favorable result was both revenue and expenditure driven. Economically sensitive revenues, including utility, sales, and earnings taxes, all exceeded budget. Additionally, the General Fund experienced favorable variances in budgeted health and TIF liability expenditures. The operating surplus increased General Fund reserves to $46.3 million, or 9.2% of General Fund revenues.

In April 2011, voters faced a referendum regarding the renewal of the city's earnings tax for a five-year period. Favorably, voters overwhelmingly supported the continuation of the 1% tax by 78%. The tax comprises a substantial 38.6% of General Fund revenues and represents the largest General Fund operating revenue, providing about $192 million out of $497 million in total General Fund revenue in fiscal 2011. The vote is a credit positive for the city as its rejection would have led to the 10% annual phase out of the revenue beginning in 2012. Additionally, if the tax had been repealed, the measure would have been permanent and the tax would have been ineligible for reinstatement at a future date. The successful passage of the referendum prevented the need for substantial budget cuts for fiscal 2012. While initial fiscal 2012 projections, inclusive of earnings tax revenues, expected a $15 million shortfall, audited figures reflect a more modest $2.7 million shortfall. The draw decreased General Fund reserves to $44.7 million, or 9.3% of revenues. While management forecasted modest declines in primary operating revenues, audited figures show a greater negative variance is primarily in the earnings, utility, and gaming taxes. Mitigating the negative variances in the economically sensitive revenues was departmental expenditure cuts, reductions in appropriations for unexpended capital projects and the maintenance of approximately 100 vacant positions. The city also maintains available reserves in its capital fund that could be used for operational purposes by a two-thirds vote of Council. The Capital Improvement Fund held a reserve balance of $118 million at the conclusion of fiscal 2012. The use of such funds would require repayment within a designated timeframe and with a reasonable interest rate under terms set by the Council, but provides a measure of available liquidity if needed.

While audited figures have yet to be released for fiscal 2013, which concluded on April 30th, preliminary results expect a $1.5 million addition to General Fund reserves. While management budgeted for a 3.8% decline in earnings tax- preliminary figure show a favorable $11.5m variance attributable to strong business withholdings. The sizable revenue variance was partially offset by higher personnel related expenditures. Based on conservative assumptions and the introduction of new revenues, management expects to add $1 million to General Fund reserves in fiscal 2014. The budgeted operating surplus is expected to yield a reserve balance in line with the city's recently adopted fund balance target of 16% of revenues across all operating funds.

HIGH DEBT POSITION MADE MANAGEABLE WITH NON-LEVY SUPPORT FOR DEBT SERVICE

Inclusive of the current transaction, the city's overall debt position remains leveraged at 8.1% of taxable valuation. The direct debt burden is similarly high at 5.5%. Several special taxes, including a dedicated public safety sales tax, the health fund property tax levy, as well as special assessment revenues support various debt service obligations. While non-levy revenue sources offset the burden on its property tax levy base, debt service expenditures remain a significant budgetary pressure, with debt service making up an above-average proportion of the operating budget at 24.4% of combined General and Debt Service Fund operating revenues in fiscal 2012. Total appropriation backed debt service for fiscal 2012 was $89.8 million. Of this amount, $20.9 million, or 23.3%, was financed from general revenue support.

The city's exposure to variable rate debt has moderated significantly compared to historic levels. Variable rate debt comprises 8.5% of the city's outstanding debt, compared to 22% in April 2011. The city's variable rate debt portfolio is currently enhanced by direct pay LOCs provided by JP Morgan Chase Bank N.A. (Aa3/stable), Sumitomo Mitsui Banking Corporation (Aa3/stable), and US Bank N.A. (Aa3/stable). After recently renewing and replacing several liquidity facilities, all of the city's LOCs are in place until 2014 and 2015. The city is also a party to two floating-to-fixed interest rate swap agreements that hedge the city's Series 2008E and 2008F variable rate bonds. The swaps have a combined negative mark-to-market valuation of approximately $20 million (as of August, 2013), payable to the counterparties upon termination. Citibank N.A. (A3/stable), is the swap provider for both outstanding swaps. The city has the option to terminate and the counterparty may terminate the swaps upon downgrade of the city's annual appropriation backed debt rating below Baa2 (or equivalent rating) from Moody's or S&P. Favorably, the Citibank swaps have one-way collateral posting requirements for the counterparty only. While the city is not likely exposed to termination or collateral posting events on the swaps given current rating levels, the terms of the swaps have resulted in increased net swap exposure due to current market conditions and the relationship between LIBOR and SIFMA rates.

The city is considering plans to issue up to $100 million in appropriation-backed debt to finance a 2.2 mile downtown streetcar route operating between City Market and Union Station. The bonds would be paid in part by Transportation Development District (TDD) sales tax revenues and TDD special assessments. Given the city's leveraged debt position, which is primarily comprised of appropriation-backed debt, future borrowing for economic development projects without a dedicated funding source to allocate to debt service payments, requiring General Fund support, may place downward pressure on the city's credit rating.

SIZABLE PENSION BURDEN ADDS TO FISCAL CHALLENGES

The city continues to have a sizable employee pension burden despite a history of efforts by officials to address the liability. Reported unfunded pension liabilities consist primarily of $193 million for the Kansas City Police Retirement System Plan, $162.6 million for the Kansas City Employees Retirement System Plan (net of self supporting utilities), $81.2 million for the Fire Fighters Plan, and $30.7 million for the Police Civilian Plan. Together, these reported liabilities amount to $467.5 million.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, was $1.04 billion. This was equivalent to 1.82 times fiscal 2011 operating revenues, compared to an average ratio of less than 1.0 times for all local governments. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported contribution information, but to improve comparability with other rated entities.

LARGE AND DIVERSE REGIONAL ECONOMY EXPECTED TO REMAIN SOUND OVER THE LONG TERM

Kansas City benefits as the regional economic center for a fifteen county metropolitan area with an estimated population in excess of two million. The city's economic stability has been enhanced by successful efforts by the city to retain and attract a diverse set of employers and taxpayers including those in the manufacturing, commercial, government and "green" technology industries. Positively, Ford Motor Company (Long term rated Baa3/ stable) recently announced investment of $1.1 billion in the Claycomo facility within the metro area, including replacement of a product line that was recently shifted to Kentucky. The city's tax base remains sound at a substantial $28.8 billion.

Coupled with the potential for new development in the northern portions of the city, management continues to make concerted efforts to revitalize the downtown, including the establishment of several TIF districts and substantial brown-field remediation efforts. Downtown residential population has been steadily increasing, with 2010 population estimates surpassing 21,000. Activity in the East Village area of downtown continues resulting in increased business and retail occupancy and foot traffic from major events within the KC Live! entertainment district. This activity has reportedly led to increased downtown employment as businesses relocate in the area to take advantage of proximity to restaurants, housing and entertainment facilities. Despite ongoing modest economic pressures related to a slowly-recovering national economy, the city is likely positioned to experience ongoing health and stability over the long term.

OUTLOOK

The stable outlook reflects the city's substantial economy and its regional role as the hub for a larger metropolitan area. Additionally, recently implemented codified policies and managerial practices will likely strengthen the city's operations over the long term.

WHAT COULD CHANGE THE RATING - UP

-Material, multi-year General Fund operating surpluses that bolster General Fund financial flexibility, though overall reserve levels remain relatively modest

-Improved performance by dedicated operating revenues to support debt service payments and alleviate reliance on the General Fund

-Moderation of the city's above average debt burden

WHAT COULD CHANGE THE RATING - DOWN

-Inability to close budgetary gaps to maintain balanced operations in the General Fund, leading to draws on the General Fund balance or liquidity

-Ongoing leveraging of the debt position without corresponding revenues to support debt service payments, exacerbating fiscal stress on the General Fund

KEY STATISTICS:

2010 Population: 459,787 (+4.1% since 2000 Census)

2012 estimated full valuation: $28.8 billion (1.1% average annual growth between 2007 and 2011)

Estimated Full Value per Capita: $61,931

2006-2010 median family income96.8% of state; 88.7% of U.S.

2006-2010 per capita income: 103.9% of state; 94% of U.S.

FY12 General Fund Balance $44.7 million (9.3% of General Fund revenues)

General Obligation debt outstanding: $434.8 million

Post-sale lease and appropriation-supported debt outstanding: $1.1 billion

Overall debt burden: 8.1%

Direct debt burden: 5.5%

Moody's ANPL: 1.82 times

PRINCIPAL METHODOLOGY USED

The principal methodology used in rating the lease revenue debt was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. The principal methodology used in rating the general obligation debt 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 this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Mark G. Lazarus
Lead Analyst
Public Finance Group
Moody's Investors Service

Jeffery Yorg
Additional Contact
Public Finance Group
Moody's Investors Service

Hetty Chang
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA

MOODY'S
INVESTORS SERVICE