S&P Global Ratings

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Summary:

Olathe, Kansas; General Obligation; Note

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Credit Profile		
US$111.615 mil GO imp and rfdg bnds ser 234 due 10/01/2041		
Long Term Rating	AA+/Stable	New
US$51.130 mil GO temp nts ser 2021A due 08/01/2022		
Short Term Rating	SP-1+	New
Olathe GO		
Long Term Rating	AA+/Stable	Affirmed
Olathe GO temp nts		
Short Term Rating	SP-1+	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating and stable outlook to Olathe, Kan.'s roughly $111.615 million series 234 general obligation (GO) improvement and refunding bonds and affirmed its 'AA+' long-term rating, with a stable outlook, on the city's existing GO debt.

S&P Global Ratings also assigned its 'SP-1+' short-term rating to Olathe's roughly $51.13 million series 2021A GO temporary notes and affirmed its 'SP-1+' short-term rating on the city's existing GO temporary notes.

The city's full-faith-and-credit pledge, including its unlimited-ad valorem-property-tax pledge, secures the GO bonds. The city also pays debt service on certain GO bonds, partially from special assessments levied against properties that benefited from certain improvements. We rate special assessments-supported debt based on the city's GO pledge.

Officials intend to use series 234 bond proceeds to permanently finance the construction of certain public improvements ($90.46 million) and retire portions of the city's series 220, 221, and 222 GO bonds ($21.155 million) for debt service savings. They also plan to use series 2021A note proceeds ($51.13 million) to provide interim financing for the construction of certain public improvements. Officials will also use a portion of note and bond proceeds to retire the city's series 2020A temporary notes due Aug. 1, 2020.

Credit overview

We expect ongoing economic development will likely continue to support growing sales and property tax bases, the city's two leading general revenue sources. In our opinion, Olathe will benefit from its access to the broad and diverse Kansas City metropolitan statistical area (MSA), which we view as a positive credit factor. What we consider very strong management, which has resulted in consistently strong operating performance, further supports credit quality. We also expect very strong management will likely be a key factor in successfully navigating ongoing growth challenges. However, given the nature of a growing city, we expect the debt burden will remain elevated for the near term, which constrains the rating.

The long-term rating also reflects our opinion of the city's:

- Strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could weaken in the near term relative to fiscal 2019, which closed with balanced operating results in the general fund and an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 29% of operating expenditures;
- Very strong liquidity, with total government available cash at 147.2% of total governmental fund expenditures and 7.0x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 21.1% of expenditures and net direct debt that is 172.0% of total governmental fund revenue, but rapid amortization, with 83.1% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

The short-term rating reflects our opinion of the city's:

- GO debt,
- Low market-risk profile,
- Authority to issue takeout debt, and
- Pertinent information it discloses.

Environmental, social, and governance (ESG) factors

We have analyzed the city's environmental factors, 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 determined all are in line with our view of the sector standard. While in line with the sector standard, we note that stormwater and flooding are the greatest environmental threats to the city. However, management has been proactively addressing identified flooding issues during the past decade as part of its Federal Emergency Management Agency flood plain map; improvement projects are continuing during the next five years to address additional locations.

Stable Outlook

Downside scenario

Albeit unlikely, we could lower the rating if available fund balance were to deteriorate to levels we consider just strong due to consistently weak budgetary performance.

Upside scenario

We could raise the rating if income and market value per capita were to reach levels we consider comparable with those of higher-rated peers, and if the debt burden improved to levels we consider adequate.

Credit Opinion

Strong economy

We consider Olathe's economy strong. The city, with an estimated population of 140,749, is located in Johnson County in the Kansas City, Mo.-Kan., MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 105.6% of the national level and per capita market value of $114,106. The city's market value grew by 5.0% over the past year to $16.1 billion in 2020. The county unemployment rate was 5.1% in 2020.

Olathe, Johnson County's seat, is 20 miles southwest of downtown Kansas City, Mo. Residents have access to employment opportunities throughout the Kansas City MSA, and as well as local employment opportunities in education, healthcare, insurance, government and freight and distribution. The city's tax base is primarily consists of commercial properties (roughly 70%), with residential properties (30%). The city continues to see growth in both of these developments, with several manufacturing facilities, warehouses, residential subdivisions, and apartment complexes. Despite the pandemic, the new building and improvement permits have been strong, and we view as realistic the city's projected tax base growth of roughly 3.5% annually. The pandemic impact has been minimal on the city's economy. While the county unemployment rate spiked to 11% in April 2020, it has been below 4% since October 2020, well below the national and state averages.

Very strong management

We view the city's financial management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Highlights include management's:

- Use of extensive planning and analysis to devise revenue and expenditure assumptions based on historical trend analysis, coupled with using data from outside sources to assist with forecasting;
- Quarterly budget updates to the city council, including budget-to-actual performance;
- Use of a rolling five-year financial forecast that identifies potential expenditure pressure with an emphasis on maintaining structural balance;
- Use of a rolling five-year capital improvement plan with identified funding sources;
- Formal investment management policy that follows state guidelines with monthly performance and holdings reports to the council;
- Formal debt management policy, supplemented by administrative guidelines, that outlines certain metrics and ratios it needs to comply with annually; and
- Formal fund balance policy of maintaining minimum general fund balance at 15% of revenue, based on potentially unexpected needs, with an annual target of 30%.

Adequate budgetary performance

Olathe's budgetary performance is adequate, in our opinion. The city had balanced operating results in the general fund of 0.4% of expenditures, and surplus results across all governmental funds of 24.6% in fiscal 2019. While we expect Olathe to have at least balanced operating results, we do not expect fiscal 2020 results to be as favorable as they were in 2019. General fund operating results have been stable, at 1.4% in 2018 and 0.9% in 2017.

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, with the use of debt proceeds.

Based on the fiscal 2021 year-to-date budget-to-actual report (fiscal year-end Dec. 31), we believe that the city will outperform its conservative budget assumptions and its budgetary performance will remain at least adequate for the next two years. For fiscal 2021, the city conservatively adopted a deficit budget reflecting a 1% reduction from the fiscal 2020 budget, projected flat sales tax revenues, a lower-than-actual property tax value increase, and vacant positions from the hiring freeze implementation from the previous years. However, with the vaccination rollout, and as the restrictions on businesses and the mask mandates have been lifted, the city's sales tax revenues are trending better than budgeted. Overall, the primary operating revenue sources (sales tax at 51% and property tax at 21%) both increased from year to year, while expenditures remained relatively flat.

Additionally, management has navigated the revenue shortfall in fiscals 2019 and 2020. Despite the unexpected sales tax revenue shortfall due to the unknown sales tax rebate from the state economic incentive project, the management team has been swift to control its expenditures to sustain balanced operating performance. The management team implemented hiring freezes, limited expenditures, and deferred unnecessary capital expenditures to control its operating expenditures and maintain sound financial performance during these two fiscal years. Furthermore, the city received $4.23 million from Coronavirus Aid, Relief, and Economic Security Act funding, which offset most of its COVID-related expenditures during fiscal 2020.

Lastly, the city received roughly $7.5 million in federal stimulus fund from the American Rescue Plan, and expects to receive the $7.5 million in fiscal 2022. At this time, the city is developing its use of the funds, which can free up additional local revenues for its operating or additional capital needs. Officials note that these funds will be maintained in a separate fund, outside of the general fund for accounting purposes.

Very strong budgetary flexibility

Olathe's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 29% of operating expenditures, or $30.8 million. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 29% of expenditures in 2018 and 29% in 2017.

Olathe has historically maintained very strong reserves, in our view, exceeding 29% of operating expenditures during the three most recent fiscal years. Its formal reserve policy requires maintaining a minimum general fund balance of no less than 15% of revenue with an annual target of 30%, which it has regularly exceeded. We note our ratios differ slightly from the city's policy due to our available fund balance calculations including assigned and unassigned portions; meanwhile, Olathe successfully stays within its targeted 30% of expenditures, using total general fund balance.

For fiscal 2020, the fund balance decreased slightly to $30.7 million due to a minor operating deficit. However, based on the year-to-date results, we expect the drawdown will be recovered in fiscal 2021. While the city council approved the use of reserves for fiscal 2021 for a potential revenue shortfall, officials do not anticipate it to materialize.

Very strong liquidity

In our opinion, Olathe's liquidity is very strong, with total government available cash at 147.2% of total governmental fund expenditures and 7.0x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

Olathe demonstrates strong access to external liquidity with its access to the debt market during the past two decades, including issuing numerous GO and utility revenue-supported bonds. Olathe has historically maintained what we consider very strong cash. We estimate available cash remained relatively stable for unaudited fiscal 2020. All investments comply with state statutes and Olathe's internal investment management policy. Olathe held investments primarily in certificates of deposit, the state investment pool, and government agencies and treasury notes; we do not consider any of these aggressive. Accordingly, we do not expect very strong liquidity will likely deteriorate during the next few fiscal years.

Weak debt and contingent liability profile

In our view, Olathe's debt and contingent liability profile is weak. Total governmental fund debt service is 21.1% of total governmental fund expenditures, and net direct debt is 172.0% of total governmental fund revenue. Approximately 83.1% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

Total direct debt is roughly $454.5 million and includes the city's special purpose and utility revenue debt. Olathe's overall net debt equals 5.3% of market value. We understand management currently plans to issue roughly $47 million of additional GO debt in 2022 to take out the temporary notes and to fund annual capital improvement projects. Given the additional annual debt plan, we expect the debt burden to remain weak for the next two years.

Pensions and other postemployment benefits (OPEB):

Olathe's combined required pension and actual OPEB contributions totaled 7.1% of total governmental fund expenditures in 2019. Of that amount, 5.9% represented required contributions to pension obligations, and 1.2% represented OPEB payments. The city made its full required pension contribution in 2019.

- We do not view pension and OPEB liabilities as an immediate credit pressure because required contributions currently make up a small portion of total governmental expenditures.
- If required material contributions were to increase unexpectedly during the next few fiscal years, we think this would not affect fiscal stability due to the sizable reserves officials could use for contingencies, if needed.

As of June 30, 2019, the latest measurement date, Olathe participates in Kansas Public Employees' Retirement System, which is 69.9% funded with a net pension liability equal to $30.1 million. The state actuarially determines contributions, and Olathe has historically funded annual required costs in full. Actuarial assumptions include a 7.75% discount rate, which we view as aggressive, representing market risk and resulting in contribution volatility if the plan fails to meet assumed investment targets. In addition, contributions are likely to grow due to level payroll funding rather than level-dollar contributions, which would result in consistent payments.

Olathe also provides health insurance to retirees and their dependents, which it funds through pay-as-you-go financing. The city's OPEB liability is roughly $27.4 million.

Strong institutional framework

The institutional framework score for Kansas municipalities with more than $275,000 in annual gross receipts and more than $275,000 in GO or revenue bonds outstanding is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2020 Update Of Institutional Framework For U.S. Local Governments
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of June 7, 2021)		
Olathe GO		
Long Term Rating	AA+/Stable	Affirmed
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