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Ratings

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Summary:
Topeka, Kansas; General Obligation

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Summary:

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Credit Profile		
US$35.385 mil GO rfdg bnds ser 2021A dtd 04/13/2021 due 08/15/2035		
Long Term Rating	AA/Stable	New
US$2.915 mil GO bnds taxable ser 2021-B due 08/15/2028		
Long Term Rating	AA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA' rating and stable outlook to Topeka, Kan.'s roughly $35.385 million series 2021A general obligation (GO) refunding and improvement bonds and roughly $2.915 million series 2021B taxable GO bonds.

Topeka's full-faith-and-credit pledge, including an unlimited-ad valorem-property-tax pledge, secures the GO bonds. The series 2021A bonds are also partially payable from special-assessment taxes levied against real property in the city that benefited from certain improvements.

We understand officials will use series 2021A bond proceeds to refinance portions of series 2015A GO bonds for debt-service savings and series 2021B bond proceeds to fund a portion of Topeka Zoo improvement costs.

Credit overview

We expect Topeka's role as a northeast Kansas economic hub and vital retail center will likely continue to support its economy. Although COVID-19-related restrictions are challenging the sales tax base, the city's major revenue source, we expect property tax base growth, expenditure reductions, and very strong financial management will likely support finances as Topeka manages through the pandemic.

We imagine challenges associated with COVID-19 and the related recession could pressure the city's budgets, as it will most local governments, during the next one year to two years.

In-line with our view of the ongoing economic contraction, we expect sales taxes could lag historical performance. We, however, do not expect it to have an effect on Topeka's ability to maintain very strong reserves during the next few fiscal years due to the city's formal minimum-fund-balance policy. (For more information on COVID-19's effect on the U.S. public finance sector, see the articles, titled "Staying Home For The Holidays," published Dec. 2, 2020; "Outlook For U.S. Local Governments: Revenue Pressures Mount And Choices Get Harder," published Jan. 6, 2021; and "Within Reach: How Stimulus Proposals Lift U.S. GDP to Pre-Pandemic Levels," published Feb. 1, 2021, on RatingsDirect.)

Management will likely continue to monitor budget-to-actual performance closely and make adjustments as necessary. We expect budgetary performance will likely remain relatively stable in fiscal 2021 due to management's desire to maintain reserves above its policy level. Therefore, we do not expect to change our rating during the next few years. Although our outlook is generally for two years, we recognize the potential for downside risk because of COVID-19 and recent related recessionary pressure during the next six months to 12 months.

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

- Adequate economy, with projected per capita effective buying income at 80.2% of the national level and market value per capita of $64,141, that benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Very strong financial management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with a slight operating deficit in the general fund but an operating surplus at the total governmental-fund level in fiscal 2019;
- Very strong budgetary flexibility, with available fund balance in fiscal 2019 at 23% of operating expenditures;
- Very strong liquidity, with total government available cash at 115.2% of total governmental-fund expenditures and 8.4x governmental debt service, and access to external liquidity we consider strong;
- Weak debt-and-contingent-liability position, with debt service carrying charges at 13.6% of expenditures and net direct debt that is 112.2% of total governmental-fund revenue; 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 determined all are in-line with our view of the sector standard. We imagine severe weather conditions that result in floods, wind, tornadoes, or hail present the greatest environmental threat to Topeka, but we understand the city's public-works and utility teams include flood-mitigation designs for new projects and existing infrastructure upgrades where possible.

Stable Outlook

Downside scenario

We could lower the rating if Topeka's economy were to deteriorate substantially or budgetary performance were to weaken, resulting in available fund balance we consider just strong.

Upside scenario

All else being equal, we could raise the rating if economic indicators were to improve to levels we consider comparable with higher-rated peers with management sustaining the levels.

Credit Opinion

Adequate economy

We consider Topeka's economy adequate. The city, with a population estimate of 127,007, is in Shawnee County in the Topeka MSA, which we consider broad and diverse. Projected per capita effective buying income is 80.2% of the national level and per capita market value is $64,141. Overall, market value grew by 2.7% during the past year to $8.1

billion in fiscal 2020. County unemployment was 3.3% in 2019. Following an unemployment increase to 12.2% in April 2020 due to COVID-19, the county's preliminary December 2020 rate decreased to 4.1%. Topeka's preliminary December 2020 unemployment rate was similar at 4.2%.

Topeka, 60 miles west of Kansas City, Mo., serves as the state's capital and Shawnee County's seat. Leading employers include:

- Kansas government (7,600 employees),
- Stormont-Vail Health Care (4,200),
- Hill's Pet Nutrition Inc. (3,400),
- Shawnee County Unified School District No. 501 (2,100), and
- Goodyear Tire & Rubber Co. (2,000).

Other leading employers include:

- BNSF Railway Co.,
- Blue Cross Blue Shield of Kansas,
- University of Kansas Health Systems, and
- Colmery-O'Neil VA Medical Center.

Diverse leading taxpayers account for just 12.6% of the total tax base. Preliminary expectations are for continued tax base growth, albeit not as strong as recently. The retail sector, accounting for about 58.5% of local sales tax collections, draws a large population from outside the city. Due to better-than-expected collections, the city projects it ended fiscal 2020 with a year-over-year 2.95% sales-tax increase compared with the $7.4 million sales-tax-revenue loss projected at the beginning of the pandemic.

Current economic developments include:

- Walmart Inc. beginning construction of a new $200 million, 1.8-million-square-foot distribution center in the city, projected to employ more than 300 new full-time positions;
- Mars, a food manufacturer, announced a $30 million capital investment for its Topeka plant; and
- Topeka Foundry & Iron Works announced a downtown-business-expansion project that will bring roughly $5 million of capital investment for additional equipment and 75 new jobs during the next five years.

Economic projects in Shawnee County but outside Topeka's boundaries that will likely have an effect on the city's economy include:

- Hill's Pet Nutrition plans to build a new facility with $31.4 million in capital investment and the creation of 33 new jobs.
- HME Inc. (Haas Metal engineering) plans for a business-expansion project that will bring 167 new jobs to the community during the next five years. This project will also include $6 million of capital facilities and equipment

investments.

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.

Financial management practices include short- and long-term historical trend analysis and the use of independent sources, such as Kansas' consensus revenue forecasting, to project budgeted revenue and expenditures. Management regularly monitors budget performance and provides monthly written reports to the city council and quarterly reports on budget-to-actual financial results to the council and public. Topeka maintains multiyear financial revenue and expenditure forecasts that identify troublesome trends and provide budget feedback.

Management also maintains a 10-year capital improvement plan that outlines projects with corresponding funding sources, which it reviews annually. Investment and debt-management policies reflect statutory limitations and city-specific metrics. Management prepares monthly investment reports, including holdings and earnings, for the council.

A formal debt-management policy limits new GO borrowing, among other things; the governing body annually reviews debt. A formal reserve policy calls for maintaining unassigned fund balance equal to 15% of general fund revenue. As part of its long-term financial plan, Topeka aims to sustain unassigned reserves at 20% of general fund revenue.

Adequate budgetary performance

Topeka's budgetary performance is adequate, in our opinion. The city had slight deficit operating results in the general fund at 0.7% of expenditures but surplus results across all governmental funds at 3.1% in fiscal 2019. General fund operating results have been stable during the past three fiscal years at 1.1% of expenditures in fiscal 2018 and 0.4% in fiscal 2017.

We have adjusted for, what we view as, recurring transfers into the general fund with capital spending from grants and debt financing. Our forward-looking opinion of adequate budgetary performance reflects uncertainty concerning the effect and duration of COVID-19 and the related recession on the city.

Officials largely attribute fiscal 2019 results to lower-than-budgeted general fund revenue due primarily to lower-than-expected property tax and franchise fee collections. In July 2020, management projected a 3.7% operating deficit for fiscal 2020 in expectation of underperforming sales-tax collections due to COVID-19 based on a sales-tax-scenario analysis that assumed moderate lost sales tax revenue and the application of expenditure reductions in various identified areas, including health holidays, vacancy credits, and others. Due to sales tax revenue growing by fiscal year-end 2020, along with delayed savings in personnel costs and contractual services due to COVID-19, management estimates it ended fiscal 2020 with an operating surplus rather than the projected deficit.

Officials adopted a balanced fiscal 2021 budget without using reserves. We expect similar performance across all governmental funds to historical results. Therefore, we expect budgetary performance will likely be, at least, adequate during the next two fiscal years.

In fiscal 2019, sales taxes generated 32% of total governmental activities revenue while property taxes generated 26%

and franchise fees accounted for 8%. Topeka benefits from a dedicated half-cent citywide sales tax for infrastructure, which the electorate recently renewed until October 2029. In addition, the city receives funds from a half-cent countywide sales tax expiring in 2031, which it primarily uses for economic development and quality-of-life improvements.

At the beginning of COVID-19, officials were projecting the greatest sales tax loss at nearly $7.4 million. Officials, however, project year-over-year sales tax exceeded expectations in fiscal 2020 and grew by 2.95%, or $905,356. In the fiscal 2021 adopted budget, management assumes sales tax will be 97% of the fiscal 2020 adopted budget.

Very strong budgetary flexibility

Topeka's budgetary flexibility is very strong, in our view, with available fund balance in fiscal 2019 at 23% of operating expenditures, or $21.6 million. During the past three fiscal years, total available fund balance has remained consistent overall at 24% of expenditures in fiscal 2018 and 23% in fiscal 2017.

Topeka has historically maintained very strong reserves. Available reserves remain above the formal reserve policy of maintaining, at least, 15% of general fund revenue. Despite current trends, we expect very strong budgetary flexibility will likely continue during the next few fiscal years. For unaudited fiscal 2020, while officials estimate adding to available reserves, it was too early to quantify the amount. Officials expect balanced general fund operations for fiscal 2021 with no plans to draw down reserves.

Very strong liquidity

In our opinion, Topeka's liquidity is very strong, with total government available cash at 115.2% of total governmental-fund expenditures and 8.4x governmental debt service in fiscal 2019. In our view, the city has strong access to external liquidity if necessary.

We expect cash will likely remain very strong during the next two fiscal years. The city has neither variable-rate debt nor swaps in its portfolio nor any obligations that would challenge near-term liquidity. Investments are limited to pools and investments such as certificates of deposit and U.S. treasuries and agencies, as prescribed by Kansas law.

Topeka demonstrates strong access to external liquidity through its consistent ability to access capital markets with routine GO- and revenue-supported debt issuance.

Weak debt-and-contingent-liability profile

In our view, Topeka's debt-and-contingent-liability profile is weak. Total governmental-fund debt service is 13.6% of total governmental-fund expenditures, and net direct debt is 112.2% of total governmental-fund revenue. Officials plan to retire about 63% of total direct debt within 10 years; if we exclude revenue-supported debt from our calculations, however, they could amortize 88% of net direct debt within 10 years.

Total direct debt is roughly $483 million, including $295 million in self-supported utility revenue debt, which we did not include in our debt calculations. Overall net debt equals 5.6% of market value. We understand officials currently plan to issue roughly $16 million of additional GO debt in fiscal 2021. Since we do not consider this additional amount significant, we expect the debt-and-contingent-liability profile will likely remain weak during the next two years.

Topeka does not have any direct-purchase obligations with acceleration provisions in its portfolio. It, however, has traditional fixed-rate GO and revenue debt.

Pension and other postemployment benefits (OPEB)

- 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 have an effect on fiscal stability due to sizable reserves officials could use for contingencies, if needed.

At June 30, 2019, the latest measurement date, Topeka participates in Kansas Public Employees' Retirement System (KPERS), which is 69.9% funded with a net pension liability equal to $96.6 million. The state actuarially determines contributions, and the city has historically funded annual required costs in full.

Actuarial assumptions include a 7.75% discount, which we view as aggressive, representing market risk and resulting in contribution volatility if KPERS 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.

Topeka's self-funded health plan is a single-employer plan for retiree health benefits. Retirees can remain on the city plan if they pay the monthly premium. Once the retiree drops coverage, however, they forfeit their right to coverage. The city offers major-medical-health insurance and prescription coverage to employees and retirees. Officials finance the current plan on a pay-as-you-go basis; retirees pay the same premium as active employees. The city does not contribute to the plan.

Topeka also has a KPERS-administered, multiple-employer, defined-benefit OPEB plan that provides long-term disability and life-insurance benefits for disabled KPERS members. Officials administer the plan on a pay-as-you-go basis. In fiscal 2019, Topeka contributed $302,000 toward the OPEB plan. We do not expect pension and OPEB costs to be a budgetary pressure during the next few fiscal years. Topeka's combined required pension and actual OPEB contribution totaled 7.2% of total governmental-fund expenditures in fiscal 2019.

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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.