S&P Global Ratings

RatingsDirect®

Summary:

Sumner, Washington; General Obligation

Primary Credit Analyst:
Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@spglobal.com

Secondary Contact:
Benjamin P Geare, San Francisco (415) 371-5047; benjamin.geare@spglobal.com

Table Of Contents

Summary:

Sumner, Washington; General Obligation

Credit Profile		
Sumner GO (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) to 'AA+' from 'AA-' on Sumner, Wash.'s general obligation (GO) bonds. The outlook is stable.

The rating action reflects our view of the city's declining debt burden and additional debt and pension disclosures that have given us a more precise view of the city's debt profile, as well as a sustained strengthening in the city's property tax base that has improved our view of its economic profile.

The bonds are secured by the city's full faith and credit, including the obligation to levy ad valorem taxes subject to statutory limitations that include a revenue growth limitation of 1% per year (excluding new construction) and a levy rate cap.

The ratings reflect our assessment of the following factors for the city:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and break-even operating results at the total governmental fund level in fiscal 2015;
- Strong budgetary flexibility, with an available cash reserve in fiscal 2015 of 20% of operating expenditures;
- Very strong liquidity, with total government available cash at 138.9% of total governmental fund expenditures and 27.2x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability position, with debt service carrying charges at 5.1% of expenditures and net direct debt that is 26.0% of total governmental fund revenue, as well as rapid amortization, with 70.3% of debt scheduled to be retired in 10 years; and
- Adequate institutional framework score.

Very strong economy

We consider Sumner's economy very strong. The city, with an estimated population of 9,705, is located in Pierce County in the Seattle-Tacoma-Bellevue MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income (EBI) of 99.5% of the national level and per capita market value of $250,627. Overall, the city's market value grew by 9.8% to $2.4 billion in 2017. The county unemployment rate was 6.3% in 2015.

Sumner serves as a light industrial and distribution center proximate to the active Port of Tacoma seaport and enjoys good regional highway and freight rail links. No single property taxpayer dominates, with the largest, an industrial landlord, representing 3% of total assessed value.

We believe that the city's high per capita market value, which is a key driver in our assessment of a municipality's economic profile under our local GO criteria, reflects the prominence of commercial and industrial land uses rather than very strong real estate values. For example, in our most recent analysis, we reported that its neighbor, Bonney Lake, which is predominantly residential, has a projected per capita EBI of 117% of the U.S. but a much lower per capita market value of $106,900.

Market value is on a strong upswing after a period of contraction at the end of the Great Recession, with an 18% three-year aggregate decline through 2013 followed by 10% average annual growth to $2.4 billion for collection year 2017. Management has provided us an inventory of multiple commercial projects in the development pipeline and we understand that the city's home prices have been growing for a sustained period, consistent with the Seattle region as a whole.

Strong management

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

Highlights of the city's financial policies and practices include:

- The use of extensive analyses of revenue and expenditure trends and external economic analyses to build revenue and expenditure assumptions;
- Quarterly budget-to-actual intrayear updates to the council, accompanied by an analytical narrative;
- Annually updated six-year financial forecast that integrates with the budget cycle with an aim of maintaining structural balance;
- Annually updated six-year capital plan that identifies projects but lacks specificity as to timing of projects and funding sources;
- Limited internal investment policy, with formal reporting to the council limited to the notes in the annual audit;
- Debt policy that lacks a robust conceptual framework or numerical constraints; and
- Compliance with a minimum reserve policy to address the risk of one-time expenditures or economic downturns, with a one-month (8%-of-expenditures) minimum and 15% best practice threshold.

Strong budgetary performance

Sumner's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 1.6% of expenditures, and balanced results across all governmental funds of 0.3% in fiscal 2015.

Our calculation of total governmental funds expenditures includes an adjustment to smooth capital spending based on a rolling three-year average. These adjustments moderate the effects of a surge in what we consider one-time capital spending for a major road project spread over 2015 and 2016. Based on prior performance, we think that net total governmental funds performance would have fallen below negative 1% of expenditures in 2016 if not for robust general fund performance that we think is likely to continue in some form for 2017. The city's most recent actual results show a 41% positive general fund net result for 2016, reflecting what management reports was a combination of one-time sales tax revenue associated with construction, higher building permit revenue, and a contracting-out of court services to a neighboring city. The city's financial model for the general fund as of October 2016 shows slight deficits in 2018 and 2019, followed by surplus operations through 2022, suggesting continued strong performance.

Partly as a result of the city's significant commercial and light industrial sector, we think that the city is also exposed to a potentially substantial revenue decline during the next recession, although this sector also presents an opportunity, as the city could institute a temporary or permanent gross receipts tax (known as a "B&O" tax in the state) without a public vote. This tax is common elsewhere in the Seattle, but we understand that the city has historically declined to impose it as an economic development differentiator.

Strong budgetary flexibility

Sumner's budgetary flexibility is strong, in our view, with an available cash reserve in fiscal 2015 of 20% of operating expenditures, or $2.1 million. Negatively affecting budgetary flexibility, in our view, is Sumner's use of cash accounting, which reduces clarity about the amount of funds that are truly available.

In addition to actual results showing a major general fund surplus in 2016, we understand that the city is poised to realize a substantial cash infusion from the pending sale of the municipal golf course it shuttered in 2013. Management reports that the city and the buyer agreed to a two-phase purchase totaling $50 million as of 2014 but that a federal environmental review process is holding up the sale. We understand that the city has used its property tax levy capacity above state limitations (known as "banked levy capacity") to fund remaining debt associated with the property (and to resolve interfund loans). It is unclear when the environmental review process will conclude and how any mitigation measures, should they be imposed or negotiated, might affect the sale agreement, but we note that proceeds that approximate the agreement would increase the city's available reserves by about 12x. We understand that the city council has discussed possible uses that include flood mitigation and sewer projects but believe that closing such a transaction would make a significant contribution to financial flexibility.

Very strong liquidity

In our opinion, Sumner's liquidity is very strong, with total government available cash at 138.9% of total governmental fund expenditures and 27.2x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

We consider the city's access to external liquidity strong as a result of the issuance of GO and utility revenue bonds during the past 20 years. We do not consider the city's investment portfolio, which consists of deposits in the state pool and U.S. treasuries and agencies, aggressive. Management has confirmed that the city has no alternative financing outstanding.

Very strong debt and contingent liability profile

In our view, Sumner's debt and contingent liability profile is very strong. Total governmental fund debt service is 5.1% of total governmental fund expenditures, and net direct debt is 26.0% of total governmental fund revenue. Approximately 70.3% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

We understand that the city could issue additional special assessment debt in the coming years but we also think that the possible infusion of resources from a pending golf course sale reduces the need for debt financing, should the sale be completed.

Sumner's combined required pension and actual other postemployment benefits (OPEB) contributions totaled 4.7% of total governmental fund expenditures in 2016. The city made its full annual required pension contribution in 2016.

Consistent with other cities in the state that report on a cash basis of accounting, the city does not disclose its pension contributions in its annual financial statements, but we were able to obtain unaudited contribution figures from management and the state auditor publishes actuarial valuations for plans in which the city participates. As of the end of 2015, the city's largest plan, PERS 2#?#3, had actuarial assets of 88% of its actuarial liability and its second-largest, LEOFF 2 (for public safety), was funded at 105%. The city's OPEB exposure is limited to public safety employees hired prior to October 1977.

Adequate institutional framework

The institutional framework score for Washington municipalities is adequate.

Outlook

The stable outlook reflects our view that the city will largely retain gains in property values that it has accumulated in recent years and that we will be able to obtain timely information regarding the city's pension contributions and overlapping debt for the foreseeable future. We also anticipate that the city will maintain its general fund position relative to expenditures at the 2015 level, at a minimum, through 2018 and could add to it during this period based on partly one-time influences supporting what appears to be a strongly positive 2016. We do not expect to change our rating during our two-year outlook horizon.

Upside scenario

We could raise our rating if the city's available general fund position significantly strengthens and we come to believe that such gains are likely to be sustained, particularly if the city formally sets out its goals for its general fund position if the position rises well above the policy minimum. We think that this could occur in either the form of strongly positive net operations comparable to those suggested by the latest estimates for 2016 or from the proceeds of the proposed golf course sale. Also potentially leading us to raise the rating would be a strengthening in the city's policies and practices as measured in our FMA, particularly a comprehensive debt management policy.

Downside scenario

We could lower the rating if the city experienced weakening in multiple factors that we view as important to credit quality, such as a major reversal in recent strong financial performance that negatively affects financial flexibility and/or liquidity. We would also take a negative view of difficulty in obtaining information regarding the city's pension contributions or direct and overlapping debt burden, but we don't anticipate that lack of timely disclosure would lead to a lower rating unless accompanied by weakening in other factors.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 27, 2016
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 2016 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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2017 by Standard & Poor’s Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.