MOODY'S INVESTORS SERVICE

CREDIT OPINION

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Contacts

Joseph Manoleas +1.212.553.7106
Analyst
joseph.manoleas@moodys.com

Orlie Prince +1.212.553.7738
VP-Sr Credit Officer/Manager
orlie.prince@moodys.com

Hattiesburg (City of) MS

Update following assignment of initial rating

Summary

The City of Hattiesburg, MS (Aa3) benefits from stable finances and a growing tax base with notable institutional presence in southeastern Mississippi. Local resident wealth and incomes are low and the city's poverty is high. Hattiesburg's debt burden is average, but the city's pension burden is high and mandatory contributions to the state-administered Public Employees Retirement System of Mississippi are scheduled to increase in the coming years.

The city was assigned an initial Aa3 rating on December 20, 2018.

Credit strengths

» Growing tax base with significant institutional presence

» Stable financial position

» New leadership team assumed office in July 2017

» Lagoon system in compliance with Stipulated Order

Credit challenges

» Low resident wealth and incomes

» Elevated pension burden

Rating outlook

Outlooks are usually not assigned to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

» Significant growth in reserves and liquidity

» Material tax base expansion

» Improved local resident wealth and incomes

Factors that could lead to a downgrade

» Growth to debt or pension burdens

» Erosion of financial position

» City falling out of compliance with MDEQ requirements, resulting in material fines or capital investment

» Inability to produce timely and accurate financial information

Key indicators

Exhibit 1

Hattiesburg (City of) MS	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$2,805,262	$2,897,518	$2,960,357	$3,030,986	$3,139,792
Population	46,716	46,629	46,762	46,846	46,377
Full Value Per Capita	$60,049	$62,140	$63,307	$64,701	$67,701
Median Family Income (% of US Median)	58.8%	55.3%	54.9%	58.4%	58.4%
Finances					
Operating Revenue ($000)	$58,755	$61,261	$57,757	$64,552	$64,158
Fund Balance ($000)	$12,170	$8,941	$6,766	$10,833	$11,412
Cash Balance ($000)	$14,615	$14,214	$15,163	$22,844	$18,514
Fund Balance as a % of Revenues	20.7%	14.6%	11.7%	16.8%	17.8%
Cash Balance as a % of Revenues	24.9%	23.2%	26.3%	35.4%	28.9%
Debt/Pensions					
Net Direct Debt ($000)	$30,242	$27,931	$24,567	$38,179	$34,407
3-Year Average of Moody's ANPL ($000)	$142,076	$153,042	$147,019	$159,846	$177,677
Net Direct Debt / Full Value (%)	1.1%	1.0%	0.8%	1.3%	1.1%
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.4x	0.6x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	5.1%	5.3%	5.0%	5.3%	5.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.4x	2.5x	2.5x	2.5x	2.8x

Source: Moody's Investors Service and audited financial statements

Profile

Hattiesburg has a population of approximately 46,846 and is located in southeastern Mississippi. The city is home to the University of Southern Mississippi (Aa2 revenue rating; Approximately 15,000 student enrollment), Camp Shelby (2,200 employees) as well as several regional health care providers. Hattiesburg is approximately 70 miles from Gulfport (A2 negative) and 90 miles from state capital of Jackson (Baa3 negative).

Detailed credit considerations

Economy and tax base: Growing tax base anchored by Southern Miss and Camp Shelby

Hattiesburg's full value will continue to grow modestly in the near term due to several ongoing local development projects as well as the significant higher education, military and health care presence in the city. Hattiesburg's $3.2 billion full value has grown at a five-year average annual rate of 2.7%, comparing favorably to the statewide average. Management reports several ongoing manufacturing and industrial development projects in the city as well as a large scale solar project, all of which will contribute to taxable values in the future. Hattiesburg benefits from the presence of the University of Southern Mississippi, with an enrollment of approximately 15,000 students, and Camp Shelby, the largest state-owned military training site in the nation, which employs 2,200. Hattiesburg also serves as a regional health care hub, with Forrest General Hospital, Hattiesburg Clinic, Merit Health-Wesley Medical Center, and Southern Bone & Joint Specialists collectively employing approximately 9,000 employees. Notably, management estimates the city's daytime population nearly triples to nearly 150,000 persons, significantly greater than its 46,846 population as of 2016.

The presence of the institutional facilities helps partially offset the city's weak wealth and income indicators. The city's median family income is below average at just 78.3% of the state and 58.4% of the nation. Poverty in the city is high, with 36.9% of the population below the poverty level. The city's top ten taxpayers account for a modest 18.6% of total taxable valuation in 2018.

Financial operations and reserves: Healthy and stable financial position

Hattiesburg's finances will remain stable due to the city's conservative budgeting and demonstrated ability to match recurring revenues with recurring expenditures. From 2012 to 2017 the city maintained balanced operations and kept available General Fund balance at levels between 17% and 20% of revenues. Driving the stability was a combination of conservative budgeting for sales tax receipts, timely ad valorem rate increases, and sufficient expenditure controls. In fiscal 2017 the city incurred a modest $373 thousand surplus bringing General Fund balance to $10.4 million or a healthy 20% of revenues. Available Operating Fund balance, which includes the city's Other Governmental Funds, was equally strong, with fiscal 2017 ending fund balance of 17.8% of revenues.

In 2018 the city increased its ad valorem rate by 3 mills, which when combined with 2% tax base growth resulted in a 14% increase in general property tax revenues. Additionally, the city achieved expenditure savings though staff attrition which the city anticipates will drive an approximately $1 million surplus and growth to fund balance. The surplus comes despite the city budgeting for a $3 million use of fund balance to balance fiscal 2018 operations, reflective of the city's conservative budget practices.

The city's fiscal 2019 General Fund budget is balanced at $56.3 million, which represents a 1% increase over the prior year's budget. The forecast includes a $2.7 million fund balance appropriation, slightly below historically planned levels, and a 1.8 mill increase to the city's general government operations mill rate, which the city is reallocating from the debt service fund millage. 2019 expenditures include a $3 million increase in salary and career development expenditures for public safety and various one-time capital expenditures.

Sales tax is the city's largest revenues source at 44% followed by property taxes at 29%, permits and licenses at 10% and intergovernmental sources at 8%.

LIQUIDITY

The city's 2017 General Fund net cash was $6.7 million or 13.1% of revenues. The city's Operating Funds, including Other Governmental Funds, is a healthy 28.9% of revenues.

Debt and pension: Moderate debt and pension burdens

Hattiesburg's debt position is expected to remain manageable over the medium term given moderate future borrowing plans. Inclusive of the city's Special Obligation Bonds, Series 2019, the city's will have $64.3 million in direct debt outstanding representing an average 1.8% of full value or 1.25 times operating revenues.

The city has $15 million in remaining bonded authorization that it anticipates issuing in the coming years to fund future capital needs.

DEBT STRUCTURE

All of the town's debt is fixed rate and amortizes over the long term. The city's payout is slow with 47% of principal retired within 10 years

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

Hattiesburg participates in the Mississippi Public Employee's Retirement System (PERS), a multiple-employer, cost sharing pension plan. Moody's 2017 adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $201 million, or 3.9 times fiscal 2017 operating revenues. The three year average of the city's ANPL to operating revenues is 3.5 times.

Statewide employer contributions to PERS currently fell below amounts needed for the plan to forestall growth in reported net pension liabilities assuming other plan assumptions are realized, that is, tread water. As long as contribution rates are set below tread water our expectation is that ANPL will grow. Funding ratios of PERS liabilities should improve in coming years as the PERS board will increase plan contributions starting July 1, 2019, which will require municipalities to increase their contributions from 15.75% to 17.40% of payroll. Positively, the city has already incorporated increased PERS contribution in its 2019 budget.

The city offers post-employment benefits for city employees on a pay-as-you-go basis. In 2017 the city made a $211 thousand contribution. As of October 1, 2017, the most recent actuarial valuation date, the city had a $6.6 million unfunded actuarial accrued liability (UAAL).

The city's fixed costs including debt service (inclusive of Special Obligation Bonds, Series 2019), pension contributions, and OPEB amounted to $10 million representing a manageable 19% of General Fund revenues.

Management and Governance: Solid financial management; Revised MDEQ agreement alleviates significant future capital needs

Management's sound budgeting practices are evidenced through its trend of multiple break even operations while maintainting healthy fund balance levels.

In August 2017 Hattiesburg, the Gulf Restoration Network and the Mississippi Department of Environmental Quality entered into a Stipulated Order agreement regarding the city's management of its wastewater at its South Lagoon location. The Order required the city to seek a revised NPDES treatment permit, which has been applied for and received, with updated effluent limits, monitoring provisions and maintenance schedules. The Stipulated Order represents a settlement that supersedes prior arrangements and precludes the city from having to build a fully mechanical wastewater treatment facility with an estimated cost of $150 million. In the event that the city is in violation of agreed upon terms, the city will be forced to pay a penalty of $1,500 per day; however, the city reports it is currently in compliance with all MDEQ permitting requirements.

A new mayor and management team assumed office in July 2017. Historically the city has been slow to generate its audited financial statements, but has produced its 2015, 2016 and 2017 audits within the last 17 months. The city is in the process of finalizing its fiscal 2018 financial statements and we expect the administration to produce its audits in a timely manner moving forward.

Mississippi cities have an institutional framework score of “Aa,” or strong. Revenues are moderately predictable as cities rely on economically sensitive streams, including sales tax, for about 30%-50% of total operating revenues. Cities have a moderate revenue raising ability to increase property tax revenues by raising the operating levy by 10% annually, excluding new additions to the tax base. Expenditures, which are substantially related to public safety, are highly predictable. Cities have a moderate ability to reduce expenditures; while there is no union presence, pension contributions and other fixed costs are substantial.

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