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Franklin (City of) WI

Update to credit analysis

Summary

Franklin (Aa2) continues to experience strong tax base growth, supported by its location within the City of Milwaukee (A2 negative) metropolitan area. The steady increase in valuations and corresponding increases in property tax revenue, coupled with above-average resident income, serve as mitigants against the city's limited revenue-raising ability. The financial position remains solid and fixed costs are moderate.

Credit strengths

» Growing tax base with above-average resident income

» Solid financial position

Credit challenges

» Growth in property tax revenue constrained by strict state-imposed revenue limits

» Above-average debt burden

Rating outlook

Moody's does not typically assign outlooks to local governments with this amount of debt.

Factors that could lead to an upgrade

» Substantial growth in available operating reserves

» Continued expansion of the tax base and local economy

Factors that could lead to a downgrade

» Material narrowing of operating reserves

» Significantly increased leverage

Key indicators

Exhibit 1

Franklin (City of) WI	2016	2017	2018	2019	2020
Economy/Tax Base					
Total Full Value ($000)	$3,729,003	$3,888,926	$4,022,941	$4,360,269	$4,587,753
Population	36,155	36,295	36,185	36,064	36,064
Full Value Per Capita	$103,139	$107,148	$111,177	$120,904	$127,211
Median Family Income (% of US Median)	140.4%	144.2%	143.8%	141.3%	141.3%
Finances					
Operating Revenue ($000)	$27,713	$28,198	$30,683	$31,891	$31,965
Fund Balance ($000)	$8,579	$9,298	$8,125	$9,489	$6,527
Cash Balance ($000)	$9,722	$11,498	$22,598	$32,348	$16,433
Fund Balance as a % of Revenues	31.0%	33.0%	26.5%	29.8%	20.4%
Cash Balance as a % of Revenues	35.1%	40.8%	73.6%	101.4%	51.4%
Debt/Pensions					
Net Direct Debt ($000)	$31,445	$28,860	$48,810	$70,855	$66,600
3-Year Average of Moody's ANPL ($000)	$28,246	$31,569	$34,162	$35,991	$42,431
Net Direct Debt / Full Value (%)	0.8%	0.7%	1.2%	1.6%	1.5%
Net Direct Debt / Operating Revenues (x)	1.1x	1.0x	1.6x	2.2x	2.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.8%	0.8%	0.8%	0.8%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.0x	1.1x	1.1x	1.1x	1.3x

Sources: the city's audited financial statements, US Census Bureau and Moody's Investors Service

Profile

The city of Franklin encompasses 35 square miles in Milwaukee County (Aa2 stable), 10 miles south of the City of Milwaukee. It provides comprehensive municipal services, including public safety, public works and municipal utilities, to over 36,000 residents.

Detailed credit considerations

Economy and tax base: growing Milwaukee suburb

Franklin's proximity to Milwaukee and a large amount of available land for development will support further growth. The $4.9 billion tax base is primarily residential (74% of equalized value) with a sizable commercial presence (21%), and has averaged strong 5.6% annual growth over the past five years. Commercial development continues within the city's tax increment districts (TID) #5 and #7, collectively known as Ballpark Commons, with a hotel slated to break ground before year-end and mixed-use space and a brew pub also expected to begin construction. Industrial buildings are planned in TIDs #6 and #8 as well as 79 single-family homes in TID #6. City management anticipates closing TID #3 in 2022, which will add over $85 million in incremental value to the tax rolls. There is no taxpayer concentration; the top 10 taxpayers account for only 7.5% of assessed value.

Because of the city's proximity to Milwaukee, many residents commute for employment. Locally, the city's largest employers include Northwestern Mutual (Aaa stable, 1,938 employees), whose headquarters are located within Franklin, Covenant Healthcare Systems (853 employees), and Krones, Inc. (625 employees).

Financial operations and reserves: solid operating reserves and liquidity

Tax base growth has, by extension, resulted in increased property tax revenue and the city's conservative budgeting and history of positive variances will continue to support a solid financial position. Franklin closed fiscal 2020 with an available operating fund (general, TIF districts and debt service funds) balance of $6.5 million or a satisfactory 20% of operating revenue. Fiscal 2021 (year-end December 31) projections reflect a $327,000 use of general fund balance for maintenance projects. The city's largest source of revenue is property taxes, which comprised 75.6% of fiscal 2020 operating revenue, followed by state aid and charges for services at 7.4% each.

Franklin's allocation of American Rescue Plan Act (ARPA) funding is estimated at $3.5 million, which will be received in equal payments in fiscal 2021 and 2022. Management plans to use $1.5 million for public safety fiber optic projects in 2022. The remaining funds are expected to be used for one-time capital expenses.

Like many Wisconsin (Aa1 stable) municipalities, Franklin manages and finances development through TIDs, which could pose operating pressure if revenues were to fall short of projections. Franklin had six active TIDs at the close of fiscal 2020 with an aggregate unassigned fund balance of negative $2.9 million, primarily because of $4.3 million in advances payable to the development fund which were used for developer grants. Currently, three TIDs are generating incremental revenue and the city has not yet had to use general revenues to support TID debt. Moody's expects increments will strengthen and interfund advances will be repaid as economic development continues.

Liquidity

The city closed fiscal 2020 with a net cash position of $16.4 million, or a robust 51% of revenue.

Debt, pensions and OPEB: elevated debt burden but modest pension burden

Fixed costs will remain manageable though the debt burden is above average for the rating category because the city regularly borrows for capital projects. Following an upcoming sale for capital and TID projects, Franklin's debt burden will be 1.5% of full value and 2.2x operating revenue, net of $900,000 of general obligation unlimited tax (GOULT) debt supported by the city's water system. The city plans to issue $7.7 million in GOULT debt in 2022 for water projects, TID projects and other projects outlined in its Capital Improvement Program. Fixed costs, inclusive of debt service (net of refundings) and pension contributions, were 17% of operating revenue in fiscal 2020.

Legal security

Outstanding GOULT debt is backed by the city's full faith and credit pledge. Debt service is payable from a designated property tax levy that is unlimited as to rate or amount.

Debt structure

All of the city's debt is fixed rate. Principal amortization is average with 73% of debt retired within 10 years.

Debt-related derivatives

The city has no exposure to any debt-related derivatives.

Pensions and OPEB

All eligible public safety employees and all city employees hired after January 1, 2019 participate in the Wisconsin Retirement System (WRS), a statewide cost-sharing plan. Eligible public works employees participate in the City of Franklin Defined Benefit Retirement Income Plan, a single-employer defined benefit pension plan and all other eligible nonprotective employees (other than public works employees) participate in the City of Franklin Defined Contribution Plan, both of which are administered by the Principal Life Insurance Company (A1 positive). Existing employees were given the option of making an irrevocable election to join WRS as of January 1, 2019 or to remain in the supplemental pension plans.

WRS is a statewide cost-sharing plan. Contributions are determined using a level contribution actuarial method in an effort to keep employer and employee contribution rates at a level percentage of payroll over time, and are set at 100% of the plan’s funding requirement. As a result, WRS remains one of the best-funded public employee retirement systems in the country.

The city’s three-year adjusted net pension liability (ANPL) is $42.1 million, equivalent to 1.3x operating revenue or 0.9% of full value. Moody's ANPL reflects the use of a market-based discount rate to value pension liabilities rather than the assumed rate of investment return on plan assets. In comparison, the reported net pension liability (NPL), based on the plans' 7% discount rates, was negative $3.4 million in fiscal 2020, reflecting a net pension asset. The city’s ANPL is much higher than reported pension liabilities because the market interest rates that we use to value pension liabilities are far lower than reported discount rates (see Exhibit 2).

Exhibit 2

Adjusted pension liabilities notably higher than reported pension liabilities because of Moody's adjustments

$ thousands	2018	2019	2020
Net pension liability, reported basis	($2,354)	$4,709	($3,332)
Discount rate	7.17%	6.92%	6.96%
Net OPEB liability, reported basis	$2,504	$1,820	$876
Adj. net pension liability	$38,702	$35,691	$51,904
Discount rate	3.60%	4.22%	3.22%
Adj. net OPEB liability	$4,257	$4,487	$4,357

Sources: the city's audited financial statements and Moody's Investors Service

Franklin's other post-employment benefits (OPEB) obligations do not pose a material cost. The OPEB liability reflects an implicit rate subsidy for retirees who pay to remain on the city's healthcare plan and the city made contributions of $720,000 in fiscal 2020. Unlike the vast majority of municipalities, Franklin has $7.8 million an OPEB trust and reported a net OPEB liability of $876,000 in fiscal 2020. Moody's adjusted net OPEB liability, which is similar to our adjustments to pension liabilities, is $4.4 million, equivalent to 0.1% of full value and 0.1x fiscal 2020 operating revenue.

ESG considerations

Environmental

Environmental risk is generally low for the local government sector and does not factor materially into the city's credit profile. Data from Moody's affiliate Four Twenty Seven indicates that the city has relatively medium exposure to heat stress, water stress and extreme rainfall compared to other local governments nationally. Typically, counties maintains a comprehensive plan for mitigation and response in the event of disaster.

Social

Social considerations that factor into the city's credit profile include its demographic and socioeconomic characteristics. The city's population has grown roughly 2% since the 2010 census. Median family income is strong at 141% of the national median. As of August 2021, Franklin's unemployment rate was 3.5%, below both the state (4%) and nation (5.3%).

Governance

Governance is a key credit consideration for all local government issuers. City management is strong, employing reserve policies and long-term capital planning. Franklin's formal policy to maintain governmental fund balances between 20% and 30% and maintain at least 15% of the succeeding year's budgeted expenditures in working capital.

Wisconsin cities have an institutional framework score of “A,” which is moderate. The sector's major revenue source, property tax revenue, is subject to a cap that restricts cities from increasing their operating property tax levies except to capture amounts represented by net new construction growth. Revenues and expenditures tend to be predictable. Across the sector, fixed and mandated costs are generally high. Expenditures are somewhat flexible, as collective bargaining is allowed for public safety employees but is curbed for non-public safety employees. Many cities use tax increment districts to attract economic development, often issuing debt to fund initial infrastructure in undeveloped areas. While tax increment districts are ultimately expected to generate revenue sufficient to cover initial city outlay, cities are exposed to economic downturns which could halt development.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Franklin (City of) WI

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$4,887,373	Aa
Full Value Per Capita	$135,519	Aa
Median Family Income (% of US Median)	141.3%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	20.4%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	-5.2%	Baa
Cash Balance as a % of Revenues	51.4%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	18.2%	Aa
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	0.8x	B & Below
Notching Factors:[2]		
Other Scorecard Adjustment Related to Management: overly punative operating history due to debt issuances		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.5%	Aa
Net Direct Debt / Operating Revenues (x)	2.2x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.9%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.3x	A
	Scorecard-Indicated Outcome	Aa3
	Assigned Rating	Aa2

The city's operating history is significantly understated as bond proceeds are not included as operating revenue but capital outlay is considered an operating expense.
[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Sources: the city's audited financial statements, US Census Bureau and Moody's Investors Service

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