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Ratings

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Summary:

Manchester, Tennessee; General Obligation

Primary Credit Analyst:
Thomas J Zemetis, Centennial 303.721.4278; thomas.zemetis@spglobal.com

Secondary Contact:
Joyce Jung, Centennial 303) 721 4189; joyce.jung@spglobal.com

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Summary:

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Credit Profile		
US$9.3 mil GO rfdg bnds ser 2017 due 06/01/2038		
Long Term Rating	AA/Stable	New
Manchester GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Manchester, Tenn.'s series 2017 general obligation (GO) refunding bonds. At the same time, we affirmed our 'AA' long-term rating and underlying rating (SPUR) on the city's existing GO debt. The outlook on all ratings is stable.

The city's full faith and credit pledge, payable from its levy of an unlimited ad valorem tax on all taxable property within its borders secures the series 2017 bonds. A portion of the bonds will also be payable, but not secured by, net revenues received by the city from its water and sewer system. In addition, the bonds will be payable from, although not secured by, revenues received by the city from the operation of the water treatment and distribution facility of the Duck River Utility Commission (DRUC).

We understand city officials intend to use proceeds from the series 2017 refunding bonds to refinance a portion of the series 2010 GO refunding bonds for debt service savings, with no extension of maturities.

The rating reflects our opinion of the following factors for Manchester, specifically its:

- Weak economy, with market value per capita of $62,819 and projected per capita effective buying income (EBI) at 78.1% of the national level;
- Strong management, with "good" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 50% of operating expenditures;
- Very strong liquidity, with total government available cash at 53.7% of total governmental fund expenditures and 9.2x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability position, with debt service carrying charges at 5.8% of expenditures and net direct debt that is 66% of total governmental fund revenue; and
- Very strong institutional framework score.

Weak economy

We consider Manchester's economy weak. The city, with an estimated population of 11,230, is in Coffee County in south-central Tennessee, approximately 65 miles southeast of Nashville and 70 miles northwest of Chattanooga. Manchester's economy has changed to weak from adequate, reflecting our view that the presence of regional institutions–colleges, universities, and a military base–does not directly or materially understate wealth and income characteristics of the underlying economy. The city has a projected per capita EBI of 78.1% of the national level and per capita market value of $62,819. Overall, market value grew by 8.7% over the past year to $705.5 million in 2017. The county unemployment rate was 4.8% in 2016, equal to the state (4.8%) and below the national (4.9%) average.

Interstate Highway 24–which is the main artery between Nashville and Chattanooga–traverses the city, connecting residents with regional employment centers. The broader regional economy remains stable, with anchoring employers in aerospace, automotive, and materials manufacturing, as well as the education and health care sectors.

The city also borders Arnold Engineering Development Center (2,310 employees), a joint-venture aerospace and flight simulation test facility between the U.S. Air Force and civilian contractors, which contributes significantly to the area's employment base. However, despite Manchester's proximity to the Arnold Air Force Base and several higher education institutions (within a 35-mile radius), we do not believe there is strong evidence demonstrating that colleges, universities, or the military base provide a direct stabilizing institutional presence that would otherwise alter our view of the city's underlying wealth and income conditions.

Although we believe the city's economy is somewhat limited, in our view, the 10 largest taxpayers make up an estimated 12.6% of net taxable assessed value (AV), which we consider very diverse. Furthermore, the city is the permanent home of Bonnaroo Music Festival, which attracts between 50,000 and 90,000 tourists annually, and provides an economic boost through direct local spending at city and county businesses, hotels, and restaurants.

In addition to maintaining a stable employment and taxpayer base, the city is exploring opportunities to attract more commercial retail and hospitality development, while also managing expected residential growth. Officials indicate the city is seeing increased housing demand due to its comparative affordability to the region and proximity to surrounding employment and education opportunities. Over the next two-to-three years, officials estimate construction of several single-family subdivisions could bring 300 to 350 new residences to the city.

Strong management

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

In preparation of its annual budget, the city's uses three-to-four years of historical information to formulate annual revenue and expenditure assumptions. In addition, management consults its appraisal district to adjust for annual changes in AV and property tax collections.

During each fiscal year, management monitors budgetary performance regularly, and provides a comprehensive monthly budget-to-actuals report for the city council. According to management, budget amendments are made on an as-needed basis. The city also maintains a formal investment policy that adheres to state guidelines. Although it does not have a substantial amount held in investments, management reports earnings and holdings to the city's governing board monthly.

Furthermore, management has historically met and sustained reserves in accordance with its informal fund balance practices. Currently, the city maintains an unassigned fund balance target of three months (or 25%) of general fund expenditures. At the same time, its formally adopted debt management policy targets the types of debt it could issue, as well as what percent of debt could be variable-rate debt. According to the policy, variable-rate debt cannot exceed 35% of total debt outstanding. In addition, the city cannot enter into interest rate swaps or use derivative instruments unless it adopts a debt derivative policy and receives approval from the state.

The city does not conduct formal long-term capital or financial planning.

Strong budgetary performance

Manchester's budgetary performance is strong, in our opinion. The city had operating surpluses of 17% of expenditures in the general fund and 11.3% across all governmental funds in fiscal 2016. Our assessment accounts for the fact that we expect operating results for fiscal years 2017 and 2018 will likely return to historical budgetary performance levels compared to results realized in fiscal 2016.

For analytical consistency, we adjusted fiscal 2016 general fund results to account for recurring transfers out to the general-purpose school, recreation, sanitation, and debt service funds from the general fund. It attributes the favorable operating result to an increase in local tax revenue, primarily due to a better-than-budgeted sales tax receipts. Officials also reported reduced spending and cost-saving measures across all government departments, which contributed to lower-than-budgeted general fund expenditures.

The city derives a majority of its general fund revenue from local sources, including property and local sales tax. Sales taxes, which have shown healthy growth in recent years, are the city's leading revenue source (44.5% of fiscal 2016 general fund revenues), followed by property taxes (37.1%). Altogether, the city's local revenue sources accounted for 81.6% of general fund revenues, followed by intergovernmental sources accounting for 15%.

The city adopted a $12.3 million general fund budget for the fiscal 2017, which includes a slight operating surplus of approximately $48,000. Management planned for a slight increase in sales and property tax revenue, and conservatively budgeted for a 4.2% increase in general fund expenditures over the previous year. However, officials indicate local tax receipts are trending better than budget, while expenditures are expected to be under budget due to unexpended departmental appropriations. Based on unaudited fiscal year-end results, city officials estimate a $500,000 surplus.

The city's approved fiscal 2018 budget includes a planned appropriation of $900,000 to finance one-time equipment purchases, including new public works and public safety vehicles. Based on year-to-date performance, the city indicates expenditures are in line with the budget. Although property tax revenue does not come in until later in the fiscal year, the city anticipates overall revenue being better than the approved budget, and management conservatively estimates closer to break-even results at fiscal year-end.

Based on the city's generally conservative revenue and expenditure projections, coupled with healthy revenue growth and intrayear expenditure monitoring, we do not expect budgetary performance to deteriorate materially over the next two fiscal years.

Very strong budgetary flexibility

Manchester's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 50% of operating expenditures, or $5.6 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

The city has an informal practice of maintaining a minimum unassigned fund balance at 25% of general fund expenditures. Due to management's expectation to report a surplus in fiscal 2017, and anticipation for near break-even results for fiscal 2018, we believe the city will sustain very strong reserves over the next two fiscal years.

Very strong liquidity

In our opinion, Manchester's liquidity is very strong, with total government available cash at 53.7% of total governmental fund expenditures and 9.2x governmental debt service in 2016. In our view, the city has strong access to external liquidity if necessary.

Our opinion that Manchester maintains strong access to external liquidity reflects its history of issuing GO debt over the past 20 years. Although the state allows for what we view as somewhat permissive investments, we do not consider the city's investments aggressive. Investments are primarily held in the state's highly liquid local government investment pool or certificates of deposit.

In our opinion, the city does not have contingent liabilities or financial instruments with payment provisions that could cause immediate or material liquidity pressure.

Strong debt and contingent liability profile

In our view, Manchester's debt and contingent liability profile is strong. Total governmental fund debt service is 5.8% of total governmental fund expenditures, and net direct debt is 66% of total governmental fund revenue.

For fiscal 2018, Manchester will have approximately $50.58 million of total direct debt outstanding, of which $30.91 million is tax-supported GO debt, and $19.67 million is revenue-secured debt, payable from the net operating revenue of the city's water and sewer system.

Furthermore, the city has issued enterprise-related GO debt–which we do not rate–on behalf of DRUC, which was formed pursuant to an agreement under the provisions of Tennessee Interlocal Cooperation Act, for providing Manchester and the city of Tullahoma with potable water. Although the bonds are secured by the city's GO pledge, they are payable from the net operating revenue of the municipality's water and sewer system. GO-related debt centers on three years of evidence that user charges have provided, at least, partial coverage to support obligations outstanding. As such, we adjusted approximately $9.15 million of enterprise-related GO debt out from our net direct debt calculations.

Officials indicate they have no specific plans to issue additional debt over the next two-to-three years, but the city is in preliminary planning stages of evaluating the feasibility of public infrastructure improvement projects that could spur future commercial and residential development.

Manchester's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 3.4% of total governmental fund expenditures in 2016. The city participates in the state-administered Tennessee

Consolidated Retirement System (TCRS), a defined-benefit plan to provide pension benefits for eligible retirees through the public employee pension plan. State law requires the city to make its full annual pension contribution, which is set by determined by an annual actuarial valuation.

The city had a net pension asset of approximately $279,000 as of June 30, 2015, the most recent actuarial valuation. Its proportionate share of TCRS' total pension liability was approximately $3.39 million, and it contributed about $211,300, or 100% of its actuarially determined contribution, in fiscal 2016. The city's portion of the plan's fiduciary net position for TCRS reflects a net asset of approximately 108.2%, which, in our view, is well-funded.

The city does not provide OPEBs for general and public safety employees, but its school system contributes to a self-insured, multiemployer, defined-benefit plan, which it funds on a pay-as-you-go-basis.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that Manchester will likely sustain, at least, strong and stable budgetary performance, supporting its very strong reserves and liquidity over the next two years. It also reflects our view that the city maintains good financial management practices and policies that allow officials to adjust for potential variances in revenue and expenditures, which will likely support overall credit stability. Therefore, we do not expect to change the rating within the two-year outlook period.

Upside scenario

If the city's economic conditions were to substantially improve to levels we consider commensurate with its higher rated peers, and if management were to approve and implement more robust long-term capital and financial planning, with all other rating factors remaining stable, we could raise the rating.

Downside scenario

We could lower the rating if the city's financial performance were to experience a substantial deterioration, leading to material weakening of its liquidity and reserves.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Ratings Detail (As Of October 23, 2017)		
Manchester GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Coffee Cnty Pub Bldg Auth, Tennessee		
Manchester, Tennessee		

Ratings Detail (As Of October 23, 2017) (cont.)		
Coffee Cnty Pub Bldg Auth (Manchester) GO (AMBAC)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.