S&P Global
Ratings

RatingsDirect®

Summary:

Dayton, Tennessee; General Obligation

Primary Credit Analyst:
Michael J Mooney, New York (1) 212-438-4943; michael.mooney1@spglobal.com

Secondary Contact:
Randy T Layman, Centennial + 1 (303) 721 4109; randy.layman@spglobal.com

Table Of Contents

Summary:

Dayton, Tennessee; General Obligation

Credit Profile		
US$6.765 mil GO rfdg bnds ser 2020A due 06/01/2041		
Long Term Rating	AA-/Stable	New
Dayton GO		
Long Term Rating	AA-/Stable	Affirmed
Dayton GO bnds		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Dayton, Tenn.'s series 2020A general obligation (GO) refunding bonds, with a preliminary par amount of $6.7 million. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating on the city's existing GO bonds. The outlook is stable.

The city's full-faith-and-credit pledge, payable from the revenue of an unlimited ad valorem tax to be levied on all taxable property within the city, secures the 2020A bonds. A portion of the bonds are additionally payable from, but are not secured by, net revenue of the city's electric system and its water and sewer system. The series 2020A bond proceeds will refund the city's series 2011 and 2013 GO bonds.

The city's full-faith-and-credit pledge secures the GO bonds outstanding. A portion of the city's GO bonds are payable from water and sewer system net revenues. Furthermore, the series 2017 GO bonds are payable and secured by net revenue of the city's electric system. In accordance with the "Methodology: Rating Approach To Obligations With Multiple Revenue Streams" criteria, published Nov. 29, 2011, we rate the bonds based on the city's GO pledge, which we view as the stronger pledge.

Credit overview

S&P Global Economics reports that the COVID-19 pandemic has sent the national economy into recession, which we think signals a strong likelihood of a strong local economic slowdown. (For further information, see "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect.) We expect any near-term budgetary pressure, particularly potential state-funding decreases, will likely become more apparent during the next six to 12 months.

The rating reflects our opinion of the city's:

- Weak economy, with projected per capita effective buying income (EBI) at 57.8% of the national level and market value per capita of $80,578;
- Strong management, with the ability to consistently maintain balanced operations and standard financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2019, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 109% of operating expenditures;
- Very strong liquidity, with total government available cash at 118.6% of total governmental fund expenditures and 47.1x governmental debt service, and access to external liquidity that we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 2.5% of expenditures and net direct debt that is 127.1% of total governmental fund revenue, as well as significant medium-term debt plans; and
- Very strong institutional framework score.

The stable outlook reflects our opinion that the city will maintain its very strong financial position while managing through revenue pressure as a result of COVID-19. We also expect that the local economy will remain concentrated in industry and economic indicators will improve above weak, which coupled with a very weak debt profile, will continue to constrain the rating. While we think the economy is susceptible to recessionary pressures, we believe the very strong reserves mitigate near-term pressures the city will face.

Environmental, social, and governance factors

We analyzed the city's environmental, social, and governance (ESG) risks relative to its economy, management, financial measures, and debt and liability profile and determined that all are in line with our view of the sector standard, absent any risks related to COVID-19, which we view as a health and safety risk.

Stable Outlook

Downside scenario

We could lower the rating if the city's financial performance declines, leading to a significant deterioration in the city's budgetary flexibility or liquidity.

Upside scenario

We could consider a higher rating if the city's economy diversifies, resulting in less reliance on manufacturing, coupled with improved economic metrics, barring no significant deterioration to any other credit factors.

Credit Opinion

Weak economy

We consider Dayton's economy weak. The city, with an estimated population of 7,704, is in Rhea County. The city has a projected per capita EBI of 57.8% of the national level and per capita market value of $80,578. Overall, the city's market value grew 5.6% over the past year at $620.8 million in 2020.

The city is in southeastern Tennessee, roughly 38 miles north of Chattanooga. The local economy primarily revolves around manufacturing, leading to employment concentration and income levels that are below the national average. Rhea County's unemployment rate continues to trend well above both state and national averages. The leading employers include La-Z-Boy (1,400 employees), the Tennessee Valley Authority (1,100), and the Rhea County School

District (650).

The city's tax base has remained relatively stable in recent years, increasing 6.5% annually from 2017-2020. Although the city expects to add Nokian Tires' $360 million facility, management expects the tax base to remain fairly flat for the next two years due to the 30-year tax-abatement agreement, as well as the current COVID-19 impact on the area. Officials report that many of the city's major employers have performed layoffs in recent months as a result of COVID-19, but the layoffs were not expected to be permanent and many positions have already been brought back as the economy opens up.

Strong management

We view the city's management as strong, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas. In addition, our assessment of management incorporates the city's consistent maintenance of balanced operations. Over the past three years, general fund operating results have ranged from 8.0%-8.9%.

Key practices include the use of historical trend analysis and outside consultation when developing the budget, as well as monthly budget-to-actual monitoring and quarterly budget-to-actual reporting to the city council. The city also has an adopted investment management policy, although there is no regular reporting of holdings and earnings to the council. It also has a formal debt management policy, outlining the use of variable-rate debt and derivatives as well as identifying affordability metrics. While the city lacks a formal or informal reserve policy, officials do not want to reduce reserves. The city also lacks formal long-term capital and financial plans.

Adequate budgetary performance

Dayton's budgetary performance is adequate, in our opinion. The city had operating surpluses of 15.2% of expenditures in the general fund and of 7.4% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2019 results in the near term.

Our opinion of Dayton's budgetary performance includes adjustments for routine operating transfers in and out of the city's general fund and governmental funds, as well as the removal of significant one-time revenues and expenditures. Dayton reviews its operating expenditures annually and levels out the capital projects to ensure structural balance and fiscal stability. The city has reported surpluses in each of the past six fiscal years, which management attribute to conservative budgeting. We note that revenues have routinely outperformed the budget, while expenditures have generally come in near budgeted levels. The city has seen large increases in general fund revenues in fiscal years 2018 and 2019, which it attributes to hosting more large events over the past couple years, which includes Major League Fishing and Bassmasters events, as well as a lot of ongoing construction within the city. Prior to the COVID-19 impact, the city's operating revenues and expenditures were relatively stable and management has not needed to adjust the tax levy to support operating expenditures, which the city has no plans to do.

The fiscal 2020 general fund budget was balanced and totaled just over $8 million. Prior to COVID-19's impact, city officials report that revenues had been trending favorably against budget and expenditures had been staying within budget. The city's largest and most vulnerable source of revenue, as a result of COVID-19, are sales taxes, which composed 37.2% of fiscal 2019 general fund revenue. ayton did not make any expenditure cuts for the remainder of the fiscal 2020 year, as officials believe the city will finish with close to breakeven operations in both the general fund and it its governmental funds, coupled with the city's very strong available fund balance.

Heading into fiscal 2021, the city plans to budget for a 20% cut to its sales tax revenue, which it is doing in response to expected sales tax losses from COVID-19. City officials believe this could be a conservative estimate, as a majority of the city has been reopening in recent weeks. In addition, the city is selling an industrial building, which it expects to sell in the next few months. Whatever revenue the city receives for the sale will go into the industrial park fund, and the city will begin receiving property taxes on the building. Management reports the city is not budgeting any revenue for the transaction. At this point, officials report that the city has no plans to spend down reserves, despite the impact from COVID-19. Therefore, we expect budgetary performance will remain at least adequate.

Very strong budgetary flexibility

Dayton's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 108.9% of operating expenditures, or $7.7 million. The available fund balance consists of $7.5 million of unassigned fund balance and $213,667 of committed fund balance that is committed for fire equipment, but that could be made available with counsel approval, if the need arises. 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.

Dayton has historically maintained very strong reserves, well exceeding 30% of general fund expenditures. The city's reserves rose above 75% of expenditures following the surpluses in fiscal years 2018 and 2019; given the city's expectations for sales-tax-revenue losses, we believe budgetary flexibility could decrease as a percent of expenditures, but will remain well above 30%. The city expects to finish fiscal 2020 with close to breakeven operations. However, with no plans to spend down available reserves in fiscal 2021, despite the expected sales tax losses, as well as the city's current level of very strong available reserves and its plan to continue to build available reserves when revenues recover, we believe budgetary flexibility will remain very strong.

Very strong liquidity

In our opinion, Dayton's liquidity is very strong, with total government available cash at 118.6% of total governmental fund expenditures and 47.1x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary, based on the city's access to the capital markets over the past 20 years, primarily in the form of GO bonds.

We note that the city's series 2008 GO bonds (issued through the Tennessee Municipal Bond Fund [TMBF]) are variable rate and are subject to acceleration in the event of default. If accelerated, the approximately $1.7 million in bonds outstanding would have to be repaid over 60 months, thereby lessening any potential strains on the city's liquidity. However, with $18.8 million in total governmental funds liquidity, and with the city reporting it is in the process of paying off the full principal of the loan before calendar 2020 is over, we do not believe that the potential for acceleration materially weakens the city's liquidity profile.

Very weak debt and contingent liability profile

In our view, Dayton's debt and contingent liability profile is very weak. Total governmental fund debt service is 25% of total governmental fund expenditures, and net direct debt is 127.1% of total governmental fund revenue. We note that a significant majority of this debt is self-supporting, despite it being secured by an ultimate GO pledge. Negatively affecting our view of the city's debt profile are its significant medium-term debt plans.

After this issuance, the city plans to issue an additional $21 million-$23 million in bonds to support a sewer plant project, and it plans to issue an additional $1.6 million of debt to purchase meters for the city's water department. Both of these debt issuances are expected to take place over the next six to 12 months. While management intends for a portion of its future debt plans to be self-supporting, we nevertheless believe the city's debt profile will remain elevated in the near term.

The series 2008 TMBF loan is privately placed variable debt. However, we believe that the interest rate risk is low, as the city budgets for a higher interest rate than the historical average. In addition, the city has sufficient liquidity to cover the interest rate difference. As of May 2019, the amount outstanding was $1.7 million, which represents 5.6% of direct debt, which the city is paying off early and expects to be retired by the end of calendar 2020.

We do not view pension liabilities as an immediate credit risk for Dayton due to our opinion of the town's strong plan funding and currently affordable contributions. However, we see small cost-escalation risk.

Dayton provides pension benefits for all eligible employees through an agent multiple-employer, defined-benefit plan known as the Public Employees' Retirement Plan, administered by Tennessee Consolidated Retirement System (TCRS). Pension contributions are statutorily determined.

Dayton participates in the following plans as of June 30, 2019:

- Teacher Retirement Plan, which was 118.1% funded, with a proportionate share of the plan's net asset of $27,000.
- Teacher Legacy Pension Plan, which was 102.4% funded, with a proportionate share of the plan's net asset of $265,000
- Other postemployment benefit (OPEB) plans: funded on a pay-as-you-go basis, with a proportionate share of the plan's net asset of $497,000.

TCRS made significant funding progress during the most recent fiscal year, with contributions exceeding our minimum-funding-progress metric. We think the plan's closed, level-dollar amortization of less than 20 years will lead to the timely pay down of unfunded liabilities. The plan's 7.25% assumed discount rate, however, leaves some increasing-pension-cost risk due to market volatility.

Teachers of Dayton City Schools are provided retirement benefits through the Teacher Retirement Plan and the Teacher Legacy Pension Plan (closed to new membership), both cost-sharing multiple-employer defined benefit plans administered by TCRS. The city is obligated to ensure that contributions to both plans are fully funded.

OPEBs, in the form of retiree health insurance, are provided to both city and school employees. The city finances these OPEBs on a pay-as-you-go basis. Given the strong plan funded levels and the low contribution amounts, we do not expect retiree benefits to materially affect the city's finances.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments