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Ratings

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Summary:

Etowah, Tennessee; General Obligation; General Obligation Equivalent Security

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Credit Profile		
US$3.08 mil GO rfdg bnds ser 2020 due 06/01/2033		
Long Term Rating	A/Stable	New
Etowah GO		
Long Term Rating	A/Stable	Affirmed
Blount Cnty Pub Bldg Auth, Tennessee		
Etowah, Tennessee		
Blount Cnty Pub Bldg Auth (Etowah) (AMBAC)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A' long-term rating to Etowah, Tenn.'s expected $3.08 million series 2020 general obligation (GO) refunding bonds. At the same time, we affirmed our 'A' underlying rating (SPUR) on the city's existing GO bonds. The outlook is stable.

The series 2020 refunding bonds are secured by the city's full faith and credit pledge, payable from unlimited ad valorem taxes to be levied on all taxable property within the city.

Additionally, the bonds are payable from and secured by a pledge of the revenues to be derived from the operation of the city's electric system. Some of the city's outstanding debt is payable from and secured by pledges from the revenues derived from the city's utilities systems. We rate the bonds based on the GO pledge of the city.

Officials intend to use the series 2020 bond proceeds to refund the city's outstanding series 2013A bonds for interest cost savings. The city is not extending maturities and intends to use the savings to pay down other outstanding debt.

Credit overview

Etowah's very strong reserves, low debt burden, and well-funded pensions systems provides financial flexibility to navigate any unforeseen budgetary pressures related to COVID-19. S&P Global Economics indicates that the COVID-19 pandemic has caused the national economy to fall into a recession (see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect), which we expect will cause a near-term economic slowdown at the local level. Etowah's partial reliance on sales tax, which generates 14% of total general fund revenue, leaves the city's finances exposed to credit vulnerabilities related to COVID-19. And while the city officials anticipates a slight deficit in fiscal 2020, management continues to make adjustments to shore up general fund operations. Therefore, we expect the city to maintain its very strong flexibility and liquidity profile in the coming years. However, credit vulnerabilities remain, including the city's limited economy and we view its variable-rate and derivative exposure as a credit risk, though it currently has the ample cash and reserves to offset any harm to its fiscal position.

The stable outlook reflects our expectation that the city will sustain budget neutral general fund performance and maintain very strong budgetary flexibility and liquidity. The city's very strong debt and contingent liability position provides additional stability to the rating. Our outlook is generally for two years, but we see significant downside risks as a result of the COVID-19 pandemic and U.S. recession over the next six to 12 months.

The rating reflects our assessment of the city's following factors:

- Very weak economy, with a concentrated employment base;
- Adequate management, with "standard" financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 43% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.0x total governmental fund expenditures and 49.0x governmental debt service, and access to external liquidity we consider strong, but an exposure to a non-remote contingent liability risk;
- Very strong debt and contingent liability position, with debt service carrying charges at 4.2% of expenditures and net direct debt that is 22.5% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value; and
- Very strong institutional framework score.

Environmental, social, and governance (ESG) factors

Our rating action incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. We consider the county's social risks in line with that of the sector, absent the implications of COVID-19. There have not been any major weather events or environmental factors which may affect the county's credit quality, therefore, we view its environmental and governance risks as in line with that of the sector.

Stable Outlook

Upside scenario

If the city's economy were to further diversify while wealth and income metrics were to improve to levels comparable with those of its higher-rated peers and the city were to consistently achieve positive general fund performance, we could raise the rating, all else being equal.

Downside scenario

We could lower the ratings if the city's budgetary performance were to become negative, deteriorating its very strong flexibility and liquidity to levels we no longer consider to be commensurate with that of its peers.

Credit Opinion

Very weak economy

We consider Etowah's economy very weak. The city, with an estimated population of 3,611, is located in McMinn County in southeastern Tennessee. Etowah is about 52 miles north of Chattanooga and 58 miles south of Knoxville. The city has a projected per capita effective buying income of 62.8% of the national level and per capita market value of $70,745. Overall, the city's market value grew by 6.9% over the past year to $255.5 million in 2020. We believe the tax base is very diverse, with the 10 leading taxpayers accounting for 0.6% of total assessed value (AV).

Residents have access to employment opportunities in the area due to the city's proximity to Interstate-75 and U.S. Highway 411. The city's economy is, in large part, manufacturing based, including DENSO, Johnson Controls, and Hackney Home Furnishing, but also has education, health care, and commerce components. Officials informed us that all the factories are open after some shutting down operations in the spring for a short period of time. Weakening Etowah's economy is a concentrated employment base, with the manufacturing sector accounting for more than 30% of total county employment. The county unemployment rate was 3.8% in 2019, however, we expect that its unemployment rate will increase due to the COVID-19 pandemic in the near term.

Adequate management

We view the city's management as adequate, with standard financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Management employs well-grounded revenue and expenditure assumptions, using a zero-based budgeting approach, with three to five years of historical data and consulting outside sources. Officials report budget-to-actual expenditure performance to the council monthly and the budget can be amended as needed, at least once a year. The city follows state guidelines for both investment and debt management, and investment earnings are reported to the council annually. Management targets maintaining a fund balance of three to six months of operating expenditures, which it is currently meeting, but lacks a formal reserve policy. The city does not maintain a long-term capital improvement plan or financial forecast.

Weak budgetary performance

Etowah's budgetary performance is weak in our opinion. The city had deficit operating results in the general fund of negative 2.6% of expenditures, but a surplus result across all governmental funds of 4.5% in fiscal 2019. Our view of the city's budgetary performance reflects adjustments to include recurring transfers out to the general purpose school fund, sanitation fund, and state street aid fund; while including annual revenue from the Etowah utilities board to the general fund and takes into account one-time revenue and expenditures. The city's general fund deficit, after adjusting for transfers, was driven by the one-time expenditures of purchasing a new firetruck and beginning construction on a new city hall and swimming pool, though the city issued debt for these purchases and projects.

Our assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures. Roughly half of the city's revenue comes from local sources, as property and sales taxes consisted of 35% and 13% of total general fund revenue, respectively, in fiscal 2019 (June

30). The city also receives roughly $540,000 annually from the Etowah utilities board, through a pilot program, which was 14% of the city's total general fund revenue in fiscal 2019. The city's reliance on sales to fund governmental services may leave Etowah vulnerable to the COVID-19 pandemic and economic recession, however, management informed us that sales tax revenue thus far is down slightly, about 10%, or $4,000 a month, since March. Neither the city nor the utilities board anticipates any changes in pilot payments to the city, and with most of the area's major employers resuming operations, utility's revenue is not expected to be significantly impacted.

While audited figures are not yet available, management expects the fiscal 2020 to be a slight deficit as expenditures exceeded revenue. Officials informed us that there were some additional expenditures related to COVID-19 and the construction of a new city hall, but actual revenue was near budgeted levels. Additionally, Etowah closed most of its buildings and reduced its staff to reduce expenses. We expected the general fund deficit in fiscal 2020 to be small.

The city passed a balanced budget for fiscal 2021 as management believes that revenue will continue to stabilize which will result in balanced operations. Officials expect sales tax revenue to increase as a result of the county's recent rate increase and do not foresee a decline in property tax revenue. Management continues to monitor revenue and expenditures and are prepared to re-evaluate the budget if it appears operations were becoming unbalanced. Therefore, we expect the fiscal 2021 budget to be near balanced.

Very strong budgetary flexibility

Etowah's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 43% of operating expenditures, or $1.8 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. Reserves were in excess of 40% of expenditures in the past three fiscal years and management does not have plans to spend down its fund balance in the coming years. Therefore, despite an expected small drawdown of reserves in fiscal 2020, we expect Etowah's fund balance to remain very strong--remaining within rage of the city's informal reserve target of three to six months of general fund expenditures.

Very strong liquidity

In our opinion, Etowah's liquidity is very strong, with total government available cash at 2.0x total governmental fund expenditures and 49.0x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary. Weakening Etowah's liquidity position, in our assessment, is the city's variable-rate and derivative exposure.

Etowah maintains an interest rate swap and the loan is hedged with a floating- to fixed-rate swap agreement with Morgan Keegan Financial Products as the counterparty, Deutsche Bank as the credit support provider, and a collateral trigger at 'BBB-#?#Stable'. The combined mark-to-market value of the swap is estimated at a negative $2.02 million as of June 30, 2020. The city has no plans to terminate the swaps at this time. Under this agreement, dated Sept. 15, 2006, with a termination date of June 1, 2036, the authority receives a floating rate based on 63.0% of the five-year USD-ISDA-Swap rate and pays a 3.681% fixed rate. However, the current termination payment is estimated at $450,000 and, in our view, Etowah has ample liquidity (about $16.3 million in cash and cash equivalents) to cover a termination event. We do not view the city as within proximity to the collateral or termination triggers, nor do we believe it has exposure to instrument provisions for the swap and the direct purchase variable-rate loan that could result in ongoing debt service payments greater than 10% of governmental revenues. We believe there is currently an adequate spread between the ratings on the counterparties and the district and the rating termination triggers. Also, the mark-to-market value is relatively small in relation to the district's cash position. However, we consider swap exposure an offsetting credit risk despite the low likelihood of swap termination because the district has exposure to ongoing basis risk.

The city's total debt includes the series VII-G-I $7.2 million directly placed variable-rate debt secured by the city's utility system. The variable-rate debt is with U.S. Bank and represents about 41% of the total debt portfolio. The direct purchase debt has a cross-default provision and also includes an acceleration provision in case of an event of default, where the total principal and interest would come due with a cure period of less than 180 days following the event date. The events of default are not consistent with our standby bond purchase agreement termination event criteria. However, we do not believe the events of default create additional credit risk, in our view. The city does have sufficient liquidity on hand to support an acceleration event and the cure period is long enough to allow it to address one by accessing the capital markets and we do not believe breach of the covenants is likely.

The city has exposure, through its variable rate debt obligations and associated derivatives, to the LIBOR benchmark which is set to expire at the end of 2021. Officials have indicated that discussions to replace LIBOR have begun, but no plans to transition its LIBOR based instruments to any fallback benchmarks have been finalized. This may pose transition pressure as we approach the expiration date of the current benchmark.

Officials do not anticipate any liquidity issues in the near term as a result of the COVID-19 pandemic due to reserves and cash on hand.

Very strong debt and contingent liability profile

In our view, Etowah's debt and contingent liability profile is very strong. Total governmental fund debt service is 4.2% of total governmental fund expenditures, and net direct debt is 22.5% of total governmental fund revenue. Overall net debt is low at 0.7% of market value, which is in our view a positive credit factor. Amortization is rapid with approximately 84% of the city's net direct debt to be repaid in 10 years.

The city's net direct debt is roughly $1.757 million. We consider electric, gas, water, and sewer enterprise revenue debt self-supporting, so we have not included such debt in the city's net direct debt burden. The city's total direct debt is $17.414 million, and amortization is average with approximately 55% of the city's total debt to be repaid in 10 years. Roughly 41% of the city's debt is variable rate, which we view as high. Management confirmed both the city and the utilities board do not currently plan to issue any additional debt over the next two years.

The city also has an outstanding loan. The series 2019 GO note was placed with the First Horizon TE1, LLC (subsidiary of First Tennessee Bank National Association) with an outstanding amount of $1 million. The loan bears a fixed interest rate at 3.55% through maturity, Oct. 1, 2039. Under the loan agreement, there are no provisions that we view as permissive.

Pension and other postemployment benefit liabilities

We do not view pension liabilities as an immediate credit risk for Etowah, given our opinion of the city's strong plan funding status and currently affordable contributions, although we see a small risk of cost escalation.

The city's combined required pension and other postemployment benefits (OPEB) contributions totaled 9.6% of total governmental fund expenditures in 2019, which we view as moderate.

The city administers a single-employer defined-benefit health care plan, contributions are on a pay-as-you-go basis, and changes in assumptions or increases in the liability may result in increased costs.

Etowah participates in the following plans as of June 30, 2018:

- City of Etowah Retirement Plan: a multi-employer plan administered by the Tennessee Consolidated Retirement System (TCRS), 104.2% funded, with a proportionate share of the plan's net liability of negative $187,550.
- Etowah City Schools System Retirement Plan: a multi-employer plan administered by TCRS, 104.5% funded, with a proportionate share of the plan's net liability of negative $134,354.
- Etowan Utilities Board Retirement Plan: a single-employer plan, which was 74.8% funded, with a proportionate share of the plan's net liability of $2.734 million.
- Other Postemployment Benefit Plans: 0% funded, with a proportionate share of the plan's net liability of $589,000.

Both TCRS and the Etowan Utilities Board Retirement Plan made significant funding progress was made in the most recent year, with contributions in excess of our static and minimum funding progress metrics. We believe that TCRS plan's closed, level dollar amortization of less than 20 years will lead to timely pay down of unfunded liabilities. However, the plan's 7.25% assumed discount rate leaves some risk of rising pension costs due to market volatility. The city made its full annual required pension contribution of $862,634 in fiscal 2018 to its plans, and continues to overfund the utilities board plan, which we view as a credit positive. The city's OPEB liability of $589,000 across three plans is, in our view, manageable and we do not anticipate that costs associated with the city's pension and OPEB will increase substantially in the near term.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of July 14, 2020)		
Etowah GO (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		