

# RatingsDirect®

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## Summary:

# Union City, Tennessee; General Obligation

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### Credit Profile

US\$1.985 mil GO bnds (federally taxable) ser 2020B due 06/01/2030		
<i>Long Term Rating</i>	AA-/Stable	New
US\$1.885 mil GO rfdg bnds (Bank Qualified) ser 2020A due 06/01/2028		
<i>Long Term Rating</i>	AA-/Stable	New
Union City GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Union City GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed

## Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Union City, Tenn.'s series 2020 series A refunding general obligation (GO) bonds and series 2020B GO bonds. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the city's GO debt outstanding. The outlook is stable.

Revenue from unlimited ad valorem taxes on all taxable property within the city secures the series 2020 series A and B GO bonds. The bonds will be used to refund series 2013 A and B bonds outstanding for interest savings.

The city's unlimited ad valorem property tax secures the bonds outstanding. The series 2016 GO bonds are payable with revenue from unlimited ad valorem property taxes, but the portion of the bonds that finances extensions and improvements to the water and sewer system is additionally payable from, but not secured by, revenue derived from the operations of the water and sewer system. Therefore, we rate these bonds only to the city's GO pledge.

## Credit overview

Union City's economic base is focused on manufacturing, with recent and new developments entering the area. Big actors such as Tyson Foods Inc. and Williams Sausage have expanded their facilities in the city, which aids in employment and assessed value (AV) growth. Although recent developments to the area are a positive factor for the city's revenue-generating capacity, personal income and wealth metrics remain weak. Offsetting the city's weak economy is its very strong budgetary flexibility, which has been bolstered by consistent operating surpluses. City officials made plans to draw on these very strong reserves to assist with various capital projects related to street and park upgrades, but have scaled back because of current economic conditions. With limited future debt plans and a stable economy, we believe that the city's reserves will remain level.

While the COVID-19 pandemic and associated recession have threatened to disrupt this stability, particularly given the city's reliance on economically sensitive income tax revenue, we believe that Union City should be able to withstand pressures from the pandemic. (For further information, please see "The U.S. Faces A Longer and Slower Climb From

The Bottom," published June 25, 2020, on RatingsDirect.)

Generally, our rating outlook timeframe is up to two years. Given the uncertainty around the pandemic, our view of the credit risks to the city centers on the more immediate budget effects in 2020 and 2021. The stable outlook reflects our view of the city's very strong budgetary flexibility and liquidity, and our anticipation that management will make adjustments as it believes necessary in response to a loss in tax revenue stemming from the COVID-19 pandemic.

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

- Weak economy, with market value per capita of \$65,741 and projected per capita effective buying income at 78.4% of the national level;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with operating deficits in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 46% of operating expenditures;
- Very strong liquidity, with total government available cash at 29.8% of total governmental fund expenditures and 7.8x governmental debt service, and access to external liquidity we consider strong;
- Very strong debt and contingent liability profile, with debt service carrying charges at 3.8% of expenditures and net direct debt that is 49.4% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 71.7% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

### **Environmental, social, and governance factors**

Currently, we are not aware of any environmental, social, and governance risks that could threaten our view of the city's creditworthiness. Given the growing risk associated with cyber-security, the city has put in place the necessary infrastructure to mitigate these risks. We have incorporated our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the city's local economy. Absent the implications of COVID-19, we consider the city's social risks to be in line with those of the sector. We also view governance and environmental risks as being in line with our view of the sector as a whole.

## **Stable Outlook**

### **Downside scenario**

All else being equal, should the city realize prolonged revenue pressure leading to material drawdowns in its reserve position, we could consider lowering the rating. We could also consider lowering the rating if layoffs or furloughs among the city's major employers materially increase or persist in a manner that leads to declines in property tax collections.

## **Upside scenario**

We could raise the rating if the city strengthens its economic indicators to levels that we consider commensurate with those of higher-rated peers while maintaining very strong liquidity and very strong level of reserves. However, given our expectations of current economic volatility because of the recession, we view this as unlikely.

## **Credit Opinion**

### **Weak economy**

We consider Union City's economy weak. The city, with an estimated population of 10,325, is located in Obion County. The city has a projected per capita effective buying income of 78.4% of the national level and per capita market value of \$65,741. Overall, the city's market value grew by 3.5% over the past year, to \$678.8 million in 2020. The county unemployment rate was 4.9% in 2019.

Union City is approximately 125 miles northeast of Memphis, adjacent to the Tennessee-Kentucky border. The city's economy primarily centers on manufacturing and health care. Leading employers are Tyson Foods Inc., Williams Sausage, and Baptist Memorial Hospital.

The city's tax base growth has shown slow and steady growth over the past several years. AV has grown by 8.5% since fiscal 2018, to \$217 million. Management attributes AV growth to ongoing residential and commercial development and small fluctuations to depreciation. The top 10 taxpayers represent 10.5% of AV, which we consider very diverse. As of May 2020, Obion County unemployment rate is down 7.7% from April, to 10.3%.

Over the past several years, economic development supported by new and expanding county employers has aided in Union City's employment base recovery. Williams Sausage Co. factory came fully online in November 2018, with a \$40 million expansion and 250 new jobs. Furthermore, Tyson is expanding its facility this year with an \$80 million project, offering the community 300 new jobs. Excel Boats will break ground within the year with a \$7 million project, bringing approximately 200 jobs.

In addition to commercial development, hotel and residential development are in progress within the community. Three new hotel chains are entering the area, which officials believe will help with sales tax revenue growth, but the city will not see the effects of property tax revenue because these hotels are entering tax increment financing districts. Excel Boats is moving its headquarters from Arkansas, so more homes will need to be built in the near future.

As a result of development expectations over the next two years, we believe that stable AV and employment growth are likely.

### **Adequate management**

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

Highlights include what we view as management's sound budget process, which includes conservative assumptions, three years of historical trend analysis, and the consultation of outside resources. Budget-to-actual reports are presented to the council monthly, with more detail provided on a quarterly basis, and with amendments as needed.

The city has also adopted a debt management policy, pursuant to the state recommendation in 2011. Management adheres to state guidelines regarding investment management and provides quarterly updates to the council. Management does not maintain a comprehensive and rolling capital improvement plan or long-term financial plan. The council has an informal goal of maintaining a minimum of \$2 million in operating reserves and has historically exceeded the target.

### **Weak budgetary performance**

We consider Union City's budgetary performance is weak factoring in current volatility because of COVID-19 and our expectation of structural improvement in fiscal 2020 after the city made budgetary adjustment for fiscal 2021.

The city had operating deficits of 7.1% of expenditures in the general fund and of 2.3% across all governmental funds in fiscal 2019.

The city's weak budgetary performance is supported by consecutive general fund drawdown and the current economic environment, which could affect revenues. In each of the past two fiscal years, management has elected to use an average of \$1.2 million annually for capital outlay for highways, streets, and parks. In fiscal 2019, the city's primary sources of general fund revenue were local taxes and intergovernmental revenue, at 71% and 17% of operating revenue, respectively.

Management reduced its budget assumptions for sales tax revenue to \$3.0 million, from \$3.5 million in previous years, but sales tax revenue stayed relatively flat, at around \$3.9 million. Officials report that they changed this assumption as a result of the aging of its main tourist attraction, Discovery Park, a museum and garden, which may lead to decreased tourism activity. Management budgeted for slightly more sales tax revenue in fiscal years 2019 and 2020, about \$3.8 million, given the businesses entering the city.

For fiscal 2020, management budgeted for a \$2.5 million deficit, but year-to-date results through June 2019 led it to using \$818,000. For fiscal 2021, officials have placed all new projects on hold. Many current projects will be paid for by grant proceeds and future reimbursement, but some will be from reserve drawdowns. Based on these current- and subsequent-year expectations, we expect the city's budgetary performance to deteriorate from its strong 2018 level. However, we expect that actual operations will continue to outperform the budget, which will likely result in smaller-than-anticipated deficits over the next two years.

### **Very strong budgetary flexibility**

Union City's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 46% of operating expenditures, or \$6.6 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.

Following consecutive general fund surpluses for four consecutive years into fiscal 2018, management elected to use restricted reserves for capital projects in 2019 and 2020. We do not expect these planned drawdowns to materially affect the city's available high level of reserves. Additionally, while the city maintains an informal target of keeping at least \$2 million in reserves, it has no plans to significantly draw down reserves to that level over the current and subsequent fiscal years. Even with the planned capital outlay for fiscal 2021, we expect that the available fund balance will remain above 30% of expenditures for the next two years.

### **Very strong liquidity**

In our opinion, Union City's liquidity is very strong, with total government available cash at 29.8% of total governmental fund expenditures and 7.8x governmental debt service in 2019. In our view, the city has strong access to external liquidity, if necessary.

The city's investments are held in highly liquid certificates of deposit and U.S. Treasury notes. Based on past debt issuances, we believe the city has strong access to capital markets to provide further liquidity. Furthermore, we expect the city's liquidity position to remain strong, given the liquidity of its investment portfolio and a lack of near-term plans to significantly expend cash on hand.

### **Very strong debt and contingent liability profile**

In our view, Union City's debt and contingent liability profile is very strong. Total governmental fund debt service is 3.8% of total governmental fund expenditures and net direct debt is 49.4% of total governmental fund revenue. Overall net debt is low, at 2.3% of market value, and approximately 71.7% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Officials placed approximately \$2.4 million in debt with the State of Tennessee, as part of the state's Energy Efficiency School Initiative (EESI), to fund some projects related to heating, ventilation, and air conditioning, and electric improvements throughout the city's schools. The program is funded with lottery proceeds and, according to management, does not contain any acceleration risk or cross-default provisions. The loan is payable only from energy savings, though the state could withhold money from the schools if the debt service is not paid. Given the low par amount of the loan compared with the city's normal operations, we do not expect the EESI loan issuance to materially affect the city's debt profile.

The city does not have direct-purchase debt outstanding and does not anticipate issuing any additional GO debt in the next 24 months. Therefore, we expect that the city's debt profile will remain very strong for the near term.

Union City's pension contributions totaled 3.2% of total governmental fund expenditures in 2019. The city made its full annual required pension contribution in 2019.

### **Pension and other postemployment benefits**

- We do not consider the city's pension liabilities to pose a significant credit pressure, given the overfunded status and manageable contributions relative to the budget.
- Required pension contributions could increase because of negative asset performance realized thus far through fiscal 2020.

The city participates in the following pension plans as of fiscal year-end June 30, 2019:

- Tennessee Consolidated Retirement System (TCRS) Public Employee Retirement Plan (PERs), an agent multiple-employer, defined-benefit pension plan that is 104.1% funded, with a proportionate share of the plan's net pension asset of \$1.2 million.
- TCRS' Teacher Legacy Pension Plan (TLPP), a cost-sharing, multiple-employer plan that is 102.4% funded with a proportionate share of the plan's net pension asset of \$1.1 million.

The city participates in the state-administered public employee retirement (PERs) plan, an agent multiple-employer plan. Significant funding progress was made in the most recent year for PERs and TLPP, with contributions significantly in excess of our minimum funding progress metric. We believe that the PERs plans' closed, level-dollar amortization of less than 20 years will lead to timely paydown of unfunded liabilities. However, both plans' 7.25% assumed discount rate leaves some risk of rising pension costs as a result of market volatility.

The city does not provide other postemployment benefits 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 Tennessee cities is very strong.

## **Related Research**

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

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