

# RatingsDirect®

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## Summary:

# Smithville, Tennessee; General Obligation

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## Summary:

# Smithville, Tennessee; General Obligation

### Credit Profile

US\$2.5 mil GO bnds ser 2020 due 06/01/2040

*Long Term Rating*

AA-/Stable

New

## Rating Action

S&P Global Ratings assigned its 'AA-' rating to Smithville, Tenn.'s \$2.5 million series 2020 general obligation bonds. The outlook is stable.

Revenue from an unlimited ad valorem tax levied on all taxable property within the city secures the bonds. Bond proceeds will be used for the acquisition, construction, and equipping of a new police station in the city

### Credit overview

While the scope of the economic and financial challenges posed by the COVID-19 outbreak remains to be seen, we believe that Smithville is well positioned to navigate the possible effects of the pandemic and recession through its very strong available reserves and the presence of stable employers and taxpayers with a growing demographic trend. S&P Global Economics indicates that the COVID-19 pandemic has caused the national economy to fall into a recession and recovery will be slow (see "The U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect), which we expect will cause severely limited growth at the local level. While our outlook generally covers up to two years, we believe that the next six-to-12 months are critical when evaluating the impact on the city's revenues, and any corresponding expenditure adjustments. Therefore, rating stability will depend on Smithville adjusting for any potential midyear changes in revenues and lingering financial and economic effects from the pandemic, although we acknowledge that the city recently raising property tax rates will have a stabilizing effect on revenues to maintain structural fiscal balance throughout this period of uncertainty.

The 'AA-' rating reflects our view of the city's:

- Weak economy, with a concentrated employment base and a concentrated local tax base;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with a high available fund balance in fiscal 2019 of 107% of operating expenditures;
- Very strong liquidity, with total government available cash at 2.7x total governmental fund expenditures and 359.0x governmental debt service;
- Strong debt and contingent liability profile, with debt service carrying charges at less than 1% of expenditures and

net direct debt that is approximately 60% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value upon issuance of the series 2020 bonds; 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 weaken our view of the city's creditworthiness. We have incorporated our view of the health and safety risks posed by the COVID-19 pandemic, which we consider a social risk factor that could affect the city's economy should the pandemic and related recession persist. Furthermore, we view the demographic trend, with population growth of 7.5% over the past decade, as a social opportunity that could support economic growth over the long term and potentially offset some weakness related to the recession, particularly given Smithville's reliance on property tax collections as a major source of revenue. We view management's willingness and approach to address cyber-security risks as a positive governance factor. We also view 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 Smithville'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 Smithville strengthens its economic indicators to levels that we consider commensurate with those of higher-rated peers while maintaining very strong liquidity and at least a strong level of reserves.

However, given our expectations of current economic volatility because of the recession, we view this as unlikely. We could also raise the rating if management formalized certain policies and adopted long-term planning.

## **Credit Opinion**

### **Weak economy**

We consider Smithville's economy weak. The city, with an estimated population of 4,838, is the county seat of DeKalb County, approximately 60 miles east of Nashville. It has a projected per capita effective buying income of 83.8% of the national level and per capita market value of \$100,217. Overall, the city's market value was stable over the past year at \$484.9 million in 2020. The primarily bedroom community has experienced significant population growth in the past decade, with a growth rate of 7.5% during that period, and management attributes this to people taking advantage of housing around nearby Center Hill Lake and attractive property tax rates. Management expects this growth to continue, given approximately 100 new houses are scheduled to be completed within the next 18 months and an investor is purchasing and redeveloping a marina.

Offsetting the strengths of the growing tax base is the concentrated employment base, with a single sector,

manufacturing, accounting for more than 30% of total county employment and a concentrated local tax base, with the 10 largest taxpayers accounting for 39.8% of the total tax base. While many of the manufacturers in the area, particularly those in the automobile industry, experienced closures as a result of COVID-19, they have since reopened with social distancing measures in place. The local economy's exposure to the manufacturing sector is an ongoing credit risk, particularly during the pandemic and ensuing recession. Should pressure from the pandemic persist, or a prolonged recession result in a significant continued downturn in demand, we believe the exposure to manufacturers could inhibit the city's operations, causing significant decreases in tax collections as residents move elsewhere for work. The county unemployment rate was 4.3% in 2019; we expect this might rise in 2020 due to the pandemic and recession. However, May unemployment was 16.3%, down from an April peak of 22.1%.

### **Adequate budgetary performance**

The city had adjusted operating surpluses of 8.0% of expenditures in the general fund and of 7.9% across all governmental funds in fiscal 2019. Our adjustments take into consideration one-time expenditures split over fiscal years 2018 and 2019 for the city to purchase a new fire truck. Smithville's budgetary performance is adequate, in our opinion, as our analysis does account for the city's future budgetary performance, given the heightened uncertainty related to the pandemic and its impact on certain revenue streams. Unaudited 2020 general fund results, on a cash basis of accounting, highlight a surplus of \$650,000 (approximately 16% of expenditures) that indicates the result of a tax increase implemented the year before and management's ongoing commitment to cost control measures. Although we expect that debt service costs will be covered by a tax increase first collected in fiscal 2020, we believe the additional revenue will be more than sufficient to cover debt service costs over the life of the bonds, and therefore, we expect budgetary performance will remain at least strong outside of one-time expenditures.

Although management is making prudent adjustments, revenue declines and other disruptions could negatively affect operations. Smithville's primary source of income is sales taxes, accounting for 38% of general fund revenues in 2019 when combining state and local collections, followed by property taxes at 25% of general fund revenues. While we expect property revenues will remain relatively stable in the near term, sales taxes have historically been more volatile during recessions, although management has indicated that sales tax collections continue to exceed those in the previous year as more people spend locally rather than travelling to large cities during the pandemic. Management has adjusted for this by adopting a fiscal 2021 budget that has a flat assumption across sales taxes, despite the city realizing an increase in sales tax through fiscal 2020.

For fiscal 2021, Smithville has proposed a \$44,000 surplus general fund budget, which management has indicated is attainable. It received approximately \$360,000 annually from the increase in the property tax rate in fiscal 2020 and expects a slight increase from assessed value growth in fiscal 2021. We believe Smithville's limited exposure to immediate revenue stress will provide relative budgetary stability in the coming year. However, should the pandemic continue to result in closures that affect revenue collection, the city could face prolonged budgetary pressures.

### **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.

Management makes conservative budget assumptions based on historical trend analysis and the most recent year; it

provides the city board with quarterly budget to actual reports. The formal investment policy reflects state guidelines, and management provides the board with reports on earnings as part of ongoing monitoring from the certified municipal finance officer. In accordance with state law, Smithville has adopted a debt management policy; however, it lacks formal long-term capital and financial plans, although management is in discussions to develop both. The city has not implemented a formalized reserve policy, or set an informal target to maintain cash levels at a certain amount, though it does have a cash management policy outlining best practices.

### **Very strong budgetary flexibility**

Smithville's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 107% of operating expenditures, or \$3.9 million. Despite our belief that revenue receipts could deteriorate slightly from previous years because of the pandemic, we believe the city's budgetary flexibility will remain what we consider very strong. The very strong level of available reserves offsets risks associated with the pandemic or the recession because it will provide a cushion against any temporary or permanent loss of tax revenue, as well as any unexpected increases in expenditures as the city responds to community health needs. We expect the available fund balance to remain above 75% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

### **Very strong liquidity**

In our opinion, Smithville's liquidity is very strong, with total government available cash at 2.7x total governmental fund expenditures and 359.0x governmental debt service in 2019. In our view, the city has satisfactory access to external liquidity if necessary. Furthermore, although Tennessee allows for what we view as somewhat permissive investments, we do not consider the city's investments aggressive. Investments are eligible to be held in the state's highly liquid investment pool, U.S. government securities, or deposit accounts at state and federal chartered banks and savings and loan associations.

Through its enterprise funds, the city has several revenue and tax deficiency bonds outstanding that total approximately \$300,000. All are fixed rate through their respective maturities and none of the agreements contains provisions that would lead to immediate acceleration or contain events of default or covenant violations that we deem nonstandard pursuant to our contingent liquidity criteria.

### **Strong debt and contingent liability profile**

In our view, Smithville's debt and contingent liability profile is strong. Smithville did not have any net direct debt outstanding, but total governmental fund debt service is less than 1% of total governmental fund expenditures prior to this issuance. Upon issuance of the series 2020 bonds, net direct debt on a fiscal 2021 proposed budgeted basis would equal approximately 60% of total governmental revenue and total governmental fund debt service will increase to 4.1% of total governmental fund expenditures. Overall net debt will increase from 0.4% of market value to 0.9%, which we still consider low and is in our view a positive credit factor. Beyond this issuance, the city does not have any additional debt plans at this time.

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

- We do not believe the city's pension liabilities will pose a significant credit pressure, despite the relatively underfunded position of the Electric System's Central Service Association Employee Retirement Plan (CSAERP) as we understand that the plan is funded solely by system revenues. The system has sufficient revenues and has historically covered our minimum funding progress and thus, we do not believe this will have a direct impact on the

city's budgetary operations

- The electric system provides medical benefits to certain retirees until they become Medicare eligible; the other postemployment benefits (OPEB) liability was equal to \$637,000
- We also do not believe the city's defined contribution plan poses any significant credit pressure. The city does not provide direct OPEB benefits to its employees

Smithville participates in the following pension plan:

- Defined contribution plan to all full-time city employees outside of the electric system, where the city matches up to 3% of employee contributions.
- CSAERP, an agent multiple-employer, defined-benefit pension plan that is 73% funded, with a proportionate share of the plan's net pension liability of \$1.0 million.

The city has no liability for the losses under the defined contribution plan; however, there is a required duty of care on investments. This plan is not available unless the employee faces termination, retirement, or financial hardship and will also be available to employee beneficiaries in case of death. Considering the city's contribution of \$30,200 in fiscal 2019, we do not believe this plan will cause budgetary stress to the city's operations.

In the most recent year, Smithville's electric system CSAERP plan slightly worsened with an increase in pension liability despite contributions in excess of our minimum funding progress metric. We believe that the plan's closed, level-dollar amortization will lead to timely paydown of unfunded liabilities. However, the plan's aggressive payroll growth assumption and 7.00% assumed discount rate leave some risk of rising pension costs due to market volatility. Smithville's combined required pension and actual OPEB contributions totaled 5.5% of total governmental fund expenditures in 2019. Of that amount, 4.6% represented required contributions to pension obligations, and 1.0% represented OPEB payments.

### **Very strong institutional framework**

The institutional framework score for Tennessee counties is very strong.

## **Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 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
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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