S&P Global
Ratings

RatingsDirect®

Summary:

Manchester, Tennessee; General Obligation

Primary Credit Analyst:
Matthew T Martin, New York + 1 (212) 438 8227; Matthew.Martin@spglobal.com

Secondary Contact:
Stuart Nicol, Chicago + 1 (312) 233 7007; stuart.nicol@spglobal.com

Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

Summary:

Manchester, Tennessee; General Obligation

Credit Profile		
US$2.28 mil GO bnds ser 2020B due 06/01/2050		
Long Term Rating	AA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating and underlying rating to the City of Manchester, Tenn.'s $2.28 million series 2020B general obligation (GO) bonds. The outlook is stable.

The city's full-faith-and-credit secures the bonds. Officials plan to use bond proceeds to finance renovations and improvements of governmental buildings.

Credit overview

While the scope of the economic and financial challenges posed by the COVID-19 outbreak remains to be seen, given Manchester's fiscal stability, very strong reserves, and stable fixed costs, we believe the city is well-positioned to navigate the possible effects of the ongoing pandemic. Manchester will undoubtedly face pressures related to a yet-unknown decline in sales tax revenue, although the primary source of revenue for the city is property tax revenue. That said, the city does stand to lose revenue from various sources that typically benefit from its annual hosting of Bonnaroo Music Festival, one of the most popular music festivals in the country, which holds its permanent home in Manchester; this year, due to the pandemic, it has been cancelled entirely after several months of postponement. The city's budgetary performance has been aided by steady assessed value (AV) growth, and officials report development on both the commercial and residential front continues despite the ongoing pandemic. While our outlook generally covers up to two years, we believe that the next six-to-12 months will be critical when evaluating the impact on Manchester's revenues and any corresponding expenditure adjustments; therefore, rating stability will depend on the city's response to adjusting for any potential changes in tax revenues and lingering financial and economic effects from the pandemic and subsequent recessionary headwinds.

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

- Weak economy, with market value per capita of $70,691 and projected per capita effective buying income at 83.5% of the national level;
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Weak 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 52% of operating expenditures;
- Very strong liquidity, with total government available cash at 19.8% of total governmental fund expenditures and

3.9x governmental debt service, and access to external liquidity we consider strong;

- Adequate debt and contingent liability profile, with debt service carrying charges at 5.1% of expenditures and net direct debt that is 94.0% of total governmental fund revenue; and
- Very strong institutional framework score.

Environmental, social, and governance factors

The rating also incorporates 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 Manchester's social risks to be in line with those of the sector. We consider the city's environmental risk in line with our view of the sector as a whole. Governance risks are also standard when viewing the entirety of the sector, with management proactive when mitigating risks associated with potential cybersecurity attacks.

Stable Outlook

Downside scenario

All else being equal, we could consider lowering the rating if the ongoing economic uncertainty weakens the city's revenue collections substantially, resulting in material declines in reserves or liquidity that are no longer commensurate with the rating level.

Upside scenario

We currently think a higher rating is unlikely due to our expectation of current economic volatility from the pandemic-related recessionary headwinds. Over the longer term, however, we could raise the rating if economic indicators were to strengthen to levels we consider commensurate with higher-rated peers, while management maintains very strong liquidity and reserves and develops more robust financial policies.

Credit Opinion

Weak economy

We consider Manchester's economy weak. The city, with an estimated population of 11,038, is located in Coffee County. The city has a projected per capita effective buying income of 83.5% of the national level and per capita market value of $70,691. Overall, the city's market value was stable over the past year at $780.3 million in 2021. The county unemployment rate was 3.3% in 2019.

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 50,000-90,000 tourists annually, and provides an economic boost through direct local spending at city and county businesses, hotels, and restaurants. The festival has officially been cancelled after months of postponement, and we recognize the subsequent loss in these revenues for Manchester. However, the city is not overly reliant on these revenues for fiscal stability.

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 continues to see increased housing demand due to its comparative affordability to the region and proximity to surrounding employment and education opportunities. Even during the pandemic, officials note continued development and planning on both the industrial and residential front.

Adequate management

We have revised our view of the city's management to standard from good in analyzing Manchester's 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, Manchester 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. However, the debt policy does not provide quantitative guidelines in terms of debt affordability.

The city does not conduct formal long-term capital or financial planning, which also factored into our rating action.

Weak budgetary performance

Manchester's budgetary performance is weak in our opinion, attributable to the volatility surrounding sales tax and other related revenues because of the COVID-19 pandemic and recent recession. In our opinion, before the impact of recent events, the city's budgetary performance was considered strong, with surplus adjusted operating results in the general fund of 4.0% of expenditures and of 2.9% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could deteriorate from 2019 results in the near term. For analytical consistency, we adjusted fiscal 2019 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 had healthy growth in recent years, are the city's leading revenue source (41.6% of fiscal 2019 general fund revenues), followed by property taxes (41.5%). Altogether, the city's local revenue sources accounted for 84.2% of general fund revenues, followed by intergovernmental sources accounting for 12.9%.

Manchester adopted a $14.9 million general fund budget for fiscal 2020, which, including recurring transfers, calls for a deficit of approximately $585,000. Management planned for a slight increase in sales and property tax revenue, and conservatively budgeted for an approximate 12% increase in general fund expenditures over the previous year. Officials note that collections had been trending above expectations before the pandemic and ensuing recession. That said, revenues have been affected by the current environment, as well as expenses exacerbated by two new employees added this year; while the city was prepared to use some level of reserves to stabilize the budget, management is optimistic that it will see some positive variance to this figure based on fiscal year-end 2020 unaudited estimates indicating a surplus of approximately $1 million. Should the city demonstrate the necessary agility to maintain positive budgetary performance, we will revise our weak assessment.

The city's fiscal 2021 budget includes a planned drawdown of $1.9 million. It is unclear at present the degree to which the city's finances will be pressured due to the pandemic-induced recession. Manchester's budgets typically side with caution, and based on the minimal impact of the pandemic relative to other areas of the country, officials are cautiously optimistic that the effect will not be as bad as budgeted. However, the fiscal 2021 budget cuts total local tax revenue figures by approximately 8%, with property taxes and local option sales taxes being cut by approximately 5% and 13%, respectively. The city's generally conservative revenue and expenditure projections coupled with intrayear expenditure monitoring will be crucial moving forward, as we expect budgetary performance to hinge on management's ability to respond to recessionary headwinds 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 2019 of 52% of operating expenditures, or $6.9 million.

The city has an informal practice of maintaining a minimum unassigned fund balance at 25% of general fund expenditures. Because of management's budgeting for deficit performance in fiscal years 2020 and 2021, we believe

the city's historical maintenance of reserve levels above 30% of expenditures is likely to be tested. Even so, were the city to spend down available fund balances in accordance with budgetary figures, amounting to a combined $2.8 million over fiscal years 2020 and 2021, it would still sustain a very strong available balance of about $4.1 million, or 22.3% of expenditures.

Very strong liquidity

In our opinion, Manchester's liquidity is very strong, with total government available cash at 19.8% of total governmental fund expenditures and 3.9x governmental debt service in 2019. 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.

Adequate debt and contingent liability profile

In our view, Manchester's debt and contingent liability profile is adequate. Total governmental fund debt service is 5.1% of total governmental fund expenditures, and net direct debt is 93.9% of total governmental fund revenue.

Furthermore, the city has issued enterprise-related GO debt--which we do not rate--on behalf of the Duck River Utility Commission, 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. Therefore, we adjusted approximately $23.2 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.

Pension and other postemployment benefits

- We do not consider the city's pension liabilities as likely 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 so far through fiscal 2020.

Manchester participates in the following pension plan as of fiscal year-end June 30, 2019:

- Tennessee Consolidated Retirement System (TCRS) Public Employee Retirement Plan (PER), an agent multiple-employer, define -benefit pension plan that is 106.3% funded, with a proportionate share of the plan's net pension asset of $377,257.
- 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 $668,132.

The city participates in the state-administered PER plan, an agent multiple-employer plan. Significant funding progress was made in the most recent year for PER and TLPP, with contributions significantly in excess of our minimum funding progress metric. We believe that the PER plan's 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 (OPEB) for general and public safety employees, but its school system contributes to a self-insured, multiple-employer, defined benefit plan, which it funds on a pay-as-you-go-basis. Manchester's combined required pension and actual OPEB contributions totaled 3.4% of total governmental fund expenditures in 2019, with the city having made its full annual required pension contribution.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments