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Ratings

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Summary:

Alcoa, Tennessee; General Obligation

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Summary:

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Credit Profile		
US$25.0 mil GO bnds ser 2022A due 06/01/2052		
Long Term Rating	AA-/Stable	New
Alcoa GO		
Long Term Rating	AA-/Stable	Affirmed
Alcoa GO bnds (federally taxable)		
Long Term Rating	AA-/Stable	Affirmed
Alcoa GO rfdg bnds (bank qualified)		
Long Term Rating	AA-/Stable	Affirmed
Alcoa GO (ASSURED GTY)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating and stable outlook to the City of Alcoa, Tenn.'s $25 million series 2022A general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA-' rating and stable outlook on the city's previously rated GO bonds.

The GO bonds are secured by the city's full faith and credit pledge, payable from Alcoa's levy on an unlimited ad valorem tax on all taxable property within the city. We understand that bond proceeds will be used to build an extension to the city's middle school and to finance other improvements.

Credit overview

Alcoa is a growing city, with a robust economy, located in the eastern portion of Tennessee. Its financial profile remains strong despite the budget's reliant on sales tax revenues. We do not expect the city's financial profile will weaken given strong economic prospects and ongoing population growth. If Alcoa were to face unexpected revenue declines or volatility, its strong liquidity could help provide some insulation against potential drops in revenue.

The 'AA-' rating reflects our opinion of Alcoa's:

- Strong growing economy in the extreme eastern portion of Tennessee;
- Strong budgetary performance and very strong reserves and liquidity;
- Strong management; and.
- Very weak debt and contingent liability profile.

Environmental, social, and governance

We analyzed Alcoa's social and governance risks relative to the city's economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard. The city's environmental risk is elevated--a large aluminum smelting plant is located within the city limits and accounts for 22% of the tax base. Although the plant could raise waste and pollution concerns it appears that air quality in the city is similar to the U.S. average levels. This risk could accelerate if it deters demographic growth.

Stable Outlook

Upside scenario

Diversification in the economic profile coupled with consistently positive financial operations could lead to a higher rating.

Downside scenario

A material reduction in Alcoa's reserves, or ongoing declines in budgetary performance, could result in a downgrade. In addition, should increased debt from future issuances further weaken the city's debt profile to levels no longer comparable with those of peers at the current rating level, we could lower the rating.

Credit Opinion

Strong growing economy in the extreme eastern portion of Tennessee

We consider Alcoa's economy strong. The city, with an estimated population of 10,695, is in Blount County, eastern Tennessee, in the Knoxville metropolitan statistical area, which we consider to be broad and diverse. Blount County borders Great Smokey Mountains and its terrain is hilly and mountainous. Historically the city was a small city dominated by farmland and Aluminum Co. of America, formerly known as Alcoa Inc. In recent years, its profile started to change rapidly as the city became a draw to new residents and businesses attracted by its beautiful terrain, access to outdoors, safety, robust economy, and low cost of living. The city's population has increased 30% since 2010 and is expected to continue to rise in the future. Income levels in the county are below average, at just 81% of U.S. average levels; however, they continue to improve. Wealth levels are solid at $172,000 on a per capital basis. Overall, the city's market value grew by 2.0% over the past year to $1.8 billion in 2022.

The top 10 taxpayers represent 33% of the property tax base. The largest taxpayer for the city, accounting for about 22% of assessed value, is Arconic (formerly Alcoa Inc.), which owns and operates a large aluminum smelting plant in the city. Although the aluminum sector makes up a large percent of the tax base in Alcoa, employment opportunities in the city and surrounding Blount County are diverse. City officials believe development will continue. Current projects include the construction of nearly 2,500 new residences and apartments, a 3-million-square-feet Amazon distribution facility, and many other developments.

After a spike in April 2020 due to the widespread economic effects of the pandemic and stay-at-home order, the unemployment rate in Blount County has steadily improved over the past nine months. It was just at 2.6% in November 2021.

Strong management

We view the city's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

The city applies strong revenue and expenditure assumptions in the budgeting process by using up to 10 years of historical data and by consulting with the local appraisal district. In addition, the city reports budget-to-actual performance monthly to the council and can amend the budget as needed throughout the year. Alcoa does not maintain a formal long-term financial plan; it has recently created a comprehensive five-year capital improvement plan with sources and uses identified. It has a formal debt management policy, as required by state statute, which limits variable-rate debt holdings to 50% of the debt profile, and additional swaps are prohibited. Officials adhere to an informal policy to maintain 30% of operational expenditures, which is tied to the city's cash flow needs and the timing of taxes received. Alcoa's reserves are currently in compliance with this target.

Strong budgetary performance and very strong reserves and liquidity

Alcoa's budgetary performance is strong in our opinion. We have adjusted the city's general fund revenues and expenditures to account for recurring transfers into and out from the general fund. Local sales taxes are the primary general fund revenue source, making up 38% of the total general fund revenues in fiscal 2021 followed by property taxes (30%).

In fiscal years 2018 and 2019 (June 30), the city saw a major reduction in sales taxes due to errors the state made in allocation of airport properties. Alcoa had been collecting revenues related to airport properties that should have been collected by Blount County. Instead of increasing property taxes in those years, the commission chose to compensate for those losses with a use of fund balance followed by a planned property tax increase in fiscal 2020. Revenue reconciliations and one-time capital expenditures affected the city's operating performance in both years.

Nearly 31% property tax increase took effect in 2020. Before the COVID-19 pandemic, revenues were generally running on target or above budget estimates. Higher revenues, coupled with extensive spending measures that were implemented during the peak of the stay-at-home orders, led to actual results outperforming the budget estimates—therefore, actual revenues increased 15%. Higher-than-expected revenues and steady expenditures led to a large surplus in fiscal 2021: The city added $4.5 million (50%) to general fund reserves.

Officials report that the city's 2022 budget calls for a $377,000 draw on reserves but that revenue collections are $500,000 above budgeted levels and that they expect to add to the reserves again in 2022.

Alcoa's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2021 of 50% of operating expenditures, or $12.8 million. The city has historically demonstrated conservative expenditure and revenue forecasts that contribute to better-than-expected budgetary performance. We believe reserves will remain very strong in the foreseeable future.

The city's total liquidity is also very strong at about $49 million in 2021 after excluding unspent bond proceeds and millions reserves for landfill closure and post-closure expenses. Alcoa's strong market access is supported by a history of issuing GO and utility revenue-supported debt. The city does not invest aggressively; its investments are primarily in

certificates of deposit or the state of Tennessee local government investment pool.

Alcoa has two direct purchase loans, the E-5-B loan placed with Regions Bank and the 2009 letter of credit placed with BB&T Bank, which have nonstandard events of default, cross-default, and acceleration provisions. However, given the cure period of 180 days to remedy an event of default, there is sufficient time to access the capital markets to remedy such an event. Therefore, we do not expect these contingent liabilities will likely result in a call on the city's liquidity position.

Very weak debt and contingent liability profile

The city has $170 million in total debt outstanding of which $67 million is self-supporting. Officials do not have definitive debt issuance plans currently.

City officials terminated the D-5-C and D-7-A swaps with the series 2020B and series 2020C bonds. The last remaining swap, IV-B-5, was terminated in 2021 and a small loss of $66,000 was realized.

Total debt includes approximately $54 million directly placed with Regions Bank and BB&T Bank, through a loan agreement with the Public Building Authority of Blount County, which represents about 32% of Alcoa's total debt. The direct purchase debt has a cross-default provision and includes an acceleration provision in an event of default, where the total principal and interest would come due with a cure period of 180 days following the event date. The cross-default provision does not include default of obligations of the city outside of agreements with Regions Bank; therefore, we do not view this as an additional default risk. The terms contain no other nonstandard events of default.

Although Alcoa does not have enough liquidity on hand to support an acceleration event, the cure period is long enough to allow it to address an acceleration event by accessing the capital markets. The variable rate on the Regions Bank loan (E-5-B) is Bloomberg Short-Term Bank Yield (BSBY) plus 40 basis points. It is good through June 1, 2025.

Although we do not view the city's position as close to the collateral or termination triggers, we believe that Alcoa's debt profile has exposure to instrument provisions for the direct purchase variable-rate loan that could result in higher debt service payments. With the direct purchase debt, there are some risks associated with certain provisions in the events of default; however, due to the city's strong credit quality, we do not view it as likely that these nonstandard events of default will be breached in the near future.

Pension and other postemployment benefits

The city participates in the following plans:

- The largest pension plan is the Employees' Retirement System of the City of Alcoa; 70% funded, with an unfunded liability of $11.5 million in 2020.
- Certain participants of the city school system are members of Tennessee Consolidated Retirement System; 96% funded, with an unfunded liability of $1.9 million.
- The city provides medical benefits to certain retirees until they become Medicare eligible; the other postemployment benefit (OPEB) liability was equal to $5.9 million.

Alcoa's pension costs are on the high side and have been for quite some time; therefore, we think the city is facing moderate pressures from pension liabilities.

Significant funding progress was made in relation to both pension plans in the most recent year, with contributions above our minimum funding progress metric. We believe that the plan's closed, level-dollar amortization of less than 20 years will support a stable contributions schedule. However, the plan's 7.25% assumed discount rate leaves some risk of rising pension costs due to exposure to market volatility.

The city's OPEB plan is not funded; however, the exposure to retiree health care costs is mitigated because employees hired after 2015 are not eligible.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Alcoa, Tenn.--Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Strong economy				
Projected per capita EBI % of U.S.	82			
Market value per capita ($)	171,684			
Population			10,765	10,695
County unemployment rate(%)			6.4	
Market value ($000)	1,848,173	1,812,207	1,741,557	
Ten largest taxpayers % of taxable value	32.6			
Strong budgetary performance				
Operating fund result % of expenditures		17.3	8.5	(6.7)
Total governmental fund result % of expenditures		2.2	2.3	(6.8)
Very strong budgetary flexibility				
Available reserves % of operating expenditures		49.2	31.4	20.3
Total available reserves ($000)		12,746	8,254	5,393
Very strong liquidity				
Total government cash % of governmental fund expenditures		77	83	78
Total government cash % of governmental fund debt service		967	808	757
Strong management				
Financial Management Assessment	Good			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		7.9	10.3	10.3
Net direct debt % of governmental fund revenue	160			
Overall net debt % of market value	6.7			
Direct debt 10-year amortization (%)	47			
Required pension contribution % of governmental fund expenditures		5.6		
OPEB actual contribution % of governmental fund expenditures		0.6		
Very strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits. Data points and ratios may reflect analytical adjustments.

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