

RatingsDirect®

Summary:

Lake County, Tennessee; General Obligation

Primary Credit Analyst:

Randy T Layman, Centennial + 1 (303) 721 4109; randy.layman@spglobal.com

Secondary Contact:

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

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Credit Profile

US\$6.665 mil GO rfdg bnnds ser 2020 due 06/01/2037

<i>Long Term Rating</i>	BBB+/Negative	New
Lake Cnty GO		
<i>Long Term Rating</i>	BBB+/Negative	Affirmed
Lake Cnty GO (AGM)		
<i>Unenhanced Rating</i>	BBB+(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'BBB+' long-term rating to Lake County, Tenn.'s 2020 general obligation (GO) refunding bonds. At the same time, S&P Global Ratings affirmed its 'BBB+' long-term rating and underlying rating (SPUR) on the county's GO bonds outstanding. The outlook is negative.

The 2020 bonds and the county's outstanding GO bonds are secured by its full faith and credit, including its ability to levy property taxes without limitation to as to rate or amount.

The 2020 bond proceeds will be used to refinance the county's 2012 and 2012B GO bonds for debt service savings with no extension of maturity.

Credit overview

Our view of Lake County's credit quality reflects its limited general fund liquidity position, with fiscal 2019 ending with a cash and cash equivalents balance of just \$195,746 following years of structural imbalance. While the county's unassigned fund balance is slightly larger at \$300,623 (7.7% of expenditures), the majority of this position consists of receivables that we consider questionable. The budgetary misalignment also extended to the county's debt service fund, requiring consistent use of reserves to meet debt service payments. We consider the receivables questionable given that the state's findings in the county's audit include an improper accounting of certain accruals. However, we understand that the county has made certain staffing adjustments and is utilizing its audit committee in an attempt to rectify bookkeeping issues. Additionally, after years of attempting to balance its budget, tax increases effective for fiscal 2020 will likely lead to positive results in the general fund, debt service fund, and solid waste fund. Furthermore, the Tennessee Valley Authority (TVA) recently selected a site within the county on which to contract an extensive solar farm to meet renewable energy requirements for one of its largest customers. The development is anticipated by county officials to generate additional property tax revenue for the county, improving its economic and financial trajectory.

With the county's limited, rural economy, the direct impacts from COVID-19 will likely be less severe than in other places nationally, though the county will not be entirely spared from the slowdown in economic activity.

The 'BBB+' long-term rating reflects our view of the county's:

- Very weak economy, with projected per capita effective buying income at 43.4% of the national level and market value per capita of \$49,360;
- Weak management, with vulnerable financial policies and practices under our financial management assessment methodology;
- Weak budgetary performance, with an operating deficit in the general fund and a slight operating deficit at the total governmental fund level in fiscal 2019;
- Weak budgetary flexibility, with an available fund balance in fiscal 2019 of 7.7% of operating expenditures but a nominally low \$301,000, as well as receivables included in the available fund balance that we do not expect to be collected in the near term;
- Very strong liquidity, with total government available cash at 29% of total governmental fund expenditures and 2.4x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 11.9% of expenditures and net direct debt that is 167.4% of total governmental fund revenue; and
- Very strong institutional framework score.

Although certain improvements have been enacted, the negative outlook reflects our view of the county's macroeconomic uncertainty and accounts for significant audit findings and a lack of financial controls that persist, in part, into fiscal 2020.

Negative Outlook

Our outlook period generally extends up to two years, but the significant risks that the local economy faces as a result of the COVID-19 pandemic mean our outlook period may extend only six to 12 months under a scenario in which credit conditions unexpectedly deteriorate.

All else equal, should the county's upcoming audit demonstrate an improvement in financial controls, 2020 results materialize as anticipated, and the new TVA project indicate that the county will return to long-term structural balance, we could consider revising the outlook to stable.

Credit Opinion

Very weak economy

We consider Lake County's economy very weak. The county has an estimated population of 7,016. The county has a projected per capita effective buying income of 43.4% of the national level and per capita market value of \$49,360. Overall, the county's market value grew by 8.6% over the past year to \$346.3 million in 2020. The county unemployment rate was 5.2% in 2018. Weakening Lake County's economy is its demographic profile, which includes persistent population decline coupled with a projected decline of 6% over the next five years, according to IHS Global Insight.

Lake County is located in northwestern Tennessee, along the Kentucky-Missouri-Tennessee border. The economic base of this predominantly agricultural and residential county is somewhat limited, centered on agribusiness, government, and manufacturing. The county's tax base has remained relatively stable in the past three years. Although the county expects to add several industrial businesses to the tax base, we view these as long-term developments, and the county will not see significant assessed value growth in the near term. Furthermore, the county's wealth and income levels remain well below state and national averages, and its 2019 average unemployment rate of 5.7% remained higher than the national and state averages.

On April 27, 2020, TVA officially entered into a 20-year power purchase agreement with a 177-megawatt solar facility (Ridgley Energy Farm) to be developed within the county. The development will result in material windfall property tax revenue for the county that may be enhanced if the facility is contracted for a second phase. Management reports that approximately \$100,000 in property tax revenue will be realized immediately as a result of rezoning property for utility purposes. The valuation associated with phase one of the project is anticipated to generate around \$300,000 in property tax revenue annually once complete.

The county's limited retail and hospitality sectors and rural setting provide some insulation against direct economic impacts associated with COVID-19. However, given the severity of the economic downturn, the county will likely be negatively affected to some degree. For more information, see S&P Global Economics' latest forecast, highlighting anticipated economic impacts from the pandemic, published April 16, 2020 on RatingsDirect.

Weak management

We view the county's management as weak, with vulnerable financial policies and practices under our financial management assessment methodology, indicating our view that the government lacks policies in many of the areas we believe are most critical to supporting credit quality.

Negatively influencing our view of management practices are the county's persistent structural imbalance in the past nine fiscal years coupled with historical significant audit findings raising questions about financial controls. The most severe findings included deficiencies in recording accruals and a lack of separation of duties. We understand the county has made certain staffing changes within its accounting and has benefited from a training program offered by the state. Should the county return to structural balance and should future audits be free of significant findings, our view of the county's financial management practices could improve.

In developing its annual budget, management consults one to two years of historical information to guide its revenue and expenditure assumptions. Officials work with the county audit committee to build recommendations for budget development, and consult the assessor's office for updated assessed value information. Budget-to-actual results are presented to the county commission on a monthly basis, and while amendments to the budget are possible as needed, they are rarely made. While the county lacks a formalized reserve policy, it has an informal reserve target of maintaining \$1 million in the general fund and \$1 million in the debt service fund. The county adheres to state investment guidelines and provides monthly investment reports to the county commission. In addition, the county has a formalized debt management policy that limits variable-rate debt to 35% of total debt outstanding and restricts the use of derivatives or swaps. The county lacks formalized long-term financial and capital plans.

Weak budgetary performance

Lake County's budgetary performance is weak, in our opinion. The county had a deficit operating result in the general fund of 5.3% of expenditures and a slight deficit result across all governmental funds of 1.4% in fiscal 2019.

Our view of the county's budgetary performance in 2019 excludes one-time expenditures funded with debt proceeds.

A trend of persistent operating deficits has prompted corresponding drawdowns in available reserves since fiscal 2010. Although officials have implemented measures to raise local revenue since fiscal 2015, they have not been able to maintain structural balance. The county narrowed the budget gap for fiscal 2017 and reported a minor surplus in fiscal 2018. Fiscal 2019 yielded negative general fund results largely as a result of ambulance-related charges coming in under budget. However, 2019 results were positive relative to the final budget amounts. The debt service fund also realized another drawdown, equal to 14.9% of expenditures, highlighting the ability of resources dedicated to debt service to meet annual carrying charges.

Local taxes (nearly all from property taxes) accounted for 50% of general fund revenue, followed by charges for current services (20%) and federal sources (13.4%).

In an effort to restore the county's finances, officials implemented austerity measures, cutting the county's operating budget and increasing the property tax rate for fiscal 2020. The cost reductions include cutting all travel expenditures, eliminating two personnel from payroll, and converting to LED lighting to save electricity costs. The county effectively increased the tax rate by 30 cents, after accounting for the rollback. The increase was spread across the general fund, the debt service fund, the solid waste fund, and others.

Officials report that general fund performance is approximately \$300,000 positive relative to the budget to date, which already included a \$44,000 addition to reserves. With recent refinancings and the tax rate increase, officials report that the debt service fund should start realizing surpluses of around \$75,000 annually, with a \$25,000 increase budgeted for fiscal 2020. The tax rate increase will also serve to rectify the negative position in the solid waste fund.

In addition, the windfall property tax revenue associated with the solar project should facilitate a return to long-term structural balance upon completion should the county continue to manage expenditures. The county is also anticipated to receive a grant of nearly \$1 million from the state dedicated toward capital projects given its economically distressed status, and this should alleviate pressure on general revenue to support capital spending.

We understand the county is seeking to hold the 2021 budget flat amid the current economic environment. Expenditure pressure could materialize if the state reduces education funding and the county is required to support school department revenue under local maintenance of effort requirements. Should 2020 actual results be positive, and should upcoming budgets show an alignment of recurring revenue and expenditures, our view of the county's budgetary performance could improve.

Weak budgetary flexibility

Fiscal 2019 ended with a general fund cash and cash equivalents balance of just \$195,746 following years of structural imbalance. The unassigned fund balance is slightly larger at \$300,623 (7.7%) expenditures, though the majority of this position consists of receivables that continue to accumulate. We understand the bulk of receivables consists of ambulance-related charges. Given the county's low incomes and high poverty rates, a significant portion of these are

likely uncollectible. Additionally, we consider the receivables questionable given that the state's findings in the county's audit concerning improper accounting of certain accruals. Our view of the county's flexibility position could improve if general fund cash positions improve and begin to form the majority of the county's unassigned fund balance as opposed to receivables.

Very strong liquidity

In our opinion, Lake County's liquidity is very strong, with total government available cash at 29% of total governmental fund expenditures and 2.4x governmental debt service in 2019. In our view, the county has strong access to external liquidity if necessary.

Despite multiyear deficits, the county maintains what we consider very strong liquidity when considering liquid investments and certificates of deposit held across total governmental funds. Although very strong on a percentage basis, the county's cash and liquid investments are relatively low at \$1.9 million. Management's expectations for positive results in fiscal 2020 should support liquidity in its operating and debt service fund. However, if budgetary pressures continue and lead to liquidity pressures, our view of the county's credit quality could deteriorate.

Weak debt and contingent liability profile

In our view, Lake County's debt and contingent liability profile is weak. Total governmental fund debt service is 11.9% of total governmental fund expenditures, and net direct debt is 167.4% of total governmental fund revenue.

Despite the revenue shortfalls in the debt service fund, the county met its debt service payments, relying on its debt service fund balance and transfers from the general fund in the past three years. While the county further reduced its debt service fund to \$246,000 in fiscal 2019, officials expect to report a small surplus and intend to increase the debt service reserve by around \$75,000 annually. We understand the county has no additional debt plans. The county does not maintain any direct purchase obligations that we believe could result in undue liquidity pressure.

Pension and other postemployment benefit (OPEB) liabilities:

- We do not believe pension liabilities pose a significant credit pressure for the county given the near fully funded status and manageable contributions relative to the budget.
- Required pension contribution contributions may increase as a result of negative asset performance thus far through fiscal 2020.
- The county does not provide OPEBs.

The county and noncertified employees of the discretely presented Lake County School Department participate in Public Employees Retirement Plan administered by the Tennessee Consolidated Retirement System. The plan is an agent multiple-employer plan. As of the latest valuation, the county's share of the plan was 98.3% funded with a net liability of \$155,988. Required contributions point to the ability to overfund the plan, though this largely depends on asset performance in 2020. We consider the discount rate slightly elevated at 7.25%, contributing to some cost volatility. The Lake County School Department carries a net asset position within its plan.

Lake County's pension contributions totaled 2.8% of total governmental fund expenditures in 2019. The county made its full annual required pension contribution.

Very strong institutional framework

The institutional framework score for Tennessee counties 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
- 2019 Update Of Institutional Framework For U.S. Local Governments

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