

RatingsDirect®

Summary:

Alcoa, Tennessee; General Obligation; General Obligation Equivalent Security

Primary Credit Analyst:

Anna Uboytseva, Chicago (1) 312-233-7067; anna.uboytseva@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:

Alcoa, Tennessee; General Obligation; General Obligation Equivalent Security

Credit Profile

US\$31.0 mil GO rfdg bnds ser 2020 due 06/01/2043

Long Term Rating

AA-/Stable

New

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating and stable outlook to the City of Alcoa, Tenn.'s \$31 million series 2020 general obligation (GO) refunding 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.

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

Credit overview

S&P Global Economics reports that the COVID-19 pandemic has sent the national economy into recession, which we think signals a strong likelihood of a strong local economic slowdown. (For further information, see "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect.) We expect any near-term budgetary pressure, particularly potential state-funding decreases, will likely become more apparent during the next six to 12 months.

Currently, we think the city is in a position to withstand some degree of revenue decline given its strong liquidity position; it had \$41 million in total liquidity at the end of fiscal 2019. The city's limited retail and hospitality sectors and somewhat remote setting provide some insulation against direct economic impacts associated with COVID-19. However, given the severity of the economic downturn, the city will likely be negatively affected to some degree. In the event the economic fallout continues for an extended period or the short-term shock provides a high degree of disruption, our view of the city's credit quality could deteriorate.

The rating reflects our opinion of the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2019, which closed with operating deficits in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 20% of operating expenditures;

- Very strong liquidity, with total government available cash at 78.1% of total governmental fund expenditures and 7.6x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 10.3% of expenditures and net direct debt that is 178.1% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and
- Very strong institutional framework score.

Environmental, social, and governance factors

We analyzed the city's environmental, social, and governance (ESG) risks relative to its economy, management, financial measures, and debt and liability profile and determined that all are in line with our view of the sector standard, absent any risks related to COVID-19, which we view as a health and safety risk.

Stable Outlook

Downside scenario

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

Upside scenario

All else remaining equal, a material improvement in the city's debt profile coupled with significant diversification in the tax base could lead to a higher rating.

Credit Opinion

Strong economy

We consider Alcoa's economy strong. The city, with an estimated population of 10,499, is located in Blount County in the Knoxville, TN MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 86.4% of the national level and per capita market value of \$167,993. Overall, the city's market value grew by 2.7% over the past year to \$1.8 billion in 2020. The county unemployment rate was 3.2% in 2019.

The top 10 taxpayers represent 31% of the property tax base. The largest taxpayer for the city, accounting for about 27% 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 in the city include several large mixed-use developments, a new hotel, a large restaurant, and a 300-unit upscale apartment complex.

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.

The city uses 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 capital or financial plan, but completes informal internal projections and plans for capital expenses on an as-needed basis. 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. Although Alcoa is currently below this level due to a one-time use of reserves, we expect it will return to compliance with this target in a few years.

Adequate budgetary performance

Alcoa's budgetary performance is adequate in our opinion. The city had operating deficits of 6.7% of expenditures in the general fund and of 6.8% across all governmental funds in fiscal 2019. Our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term.

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 41% of the total general fund revenues in fiscal 2019 followed by property taxes (25%).

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. The City of 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 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. Prior to the COVID-19 pandemic, revenues were generally running on target or above budget estimates; the city adopted a surplus budget for 2020. Positive results will be somewhat offset by the effects of COVID-19; officials confirmed that sales tax revenues were down 6% in March and are expected to be down again in April and May. Officials expect they will make up the losses, because business activity is picking up, and the collection of online sales tax will also offset some of the losses at physical stores.

We understand the city is seeking to hold the 2021 budget flat amid the current economic situation. Officials will monitor revenue collection progress and will amend the fiscal 2021 budget accordingly. While our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term due to the sales tax turn back, in our view, pressures resulting from the pandemic and recession will likely pose budgetary challenges in the near term. The budgetary performance score of adequate reflects our view of revenue uncertainty facing the city in the current economic climate, particularly given Alcoa's reliance on sales taxes, which we expect will weaken in the near term.

Very strong budgetary flexibility

Alcoa's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 20% of operating expenditures, or \$5.4 million.

General fund balance had been steadily growing before 2017 and 2018. While the city drew on its reserves to cover the expected fiscal 2018 deficit, due to strong results in the previous years and a recent property tax hike, we expect fund balance to remain very strong in the near term. Alcoa has historically demonstrated conservative expenditure and revenue forecasts that contribute to better-than-expected budgetary performance.

Very strong liquidity

In our opinion, Alcoa's liquidity is very strong, with total government available cash at 78.1% of total governmental fund expenditures and 7.6x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary.

The city'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.

The city 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

In our view, Alcoa's debt and contingent liability profile is very weak. Total governmental fund debt service is 10.3% of total governmental fund expenditures, and net direct debt is 178.1% of total governmental fund revenue. The city has \$150 million in total debt outstanding of which \$62 million is self-supporting. Officials are thinking about issuance \$4 million in GO secured debt to support a sewer system project in 2021, which we expect will be self-supporting as well.

Total debt includes approximately \$65 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 43% of the city'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 the city 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 bonds have been placed with the banks for a five-year term on index rates. To date Alcoa has not had any failed remarketing. The variable interest rate is 69% of LIBOR plus 59 basis points, and the maximum interest rate is prime plus 4% and the rate mode resets monthly. Historically, the city has conservatively budgeted for a variable interest rate of 5%. The LIBOR benchmark is set to retire at the end of December 2021. Officials indicate that they currently have no plans on the transition of LIBOR-based instruments to any fallback benchmarks beyond monitoring market trends and preliminary discussions with their counterparties. We believe this may pose transition pressure as the LIBOR expiration date approaches. For more information related to the impact to public finance issuers from the expiration of LIBOR, please see "Will The Expiration Of LIBOR Affect The Credit Quality Of U.S. Public Finance Issuers?" published Feb. 26, 2020.

About \$28 million or 19% of the total debt portfolio, of the city's variable-rate debt is synthetically fixed with swaps. Alcoa has three swap agreements outstanding, two with Depfa Bank and one with Morgan Keegan Financial Products Inc. (MKFP). The swap with MKFP has Deutsche Bank AG as credit support provider. The swap with MKFP was novated from Ambac Financial Services LLC in 2009. If Alcoa were to terminate all three swap agreements, the total termination payment would be approximately \$8 million as of May 2020. According to documents for the swap with MKFP as a counterparty, MKFP would have to post collateral if ratings were lowered to below 'A-' by S&P Global Ratings or 'A3' by Moody's. In addition, a termination event would occur for the swap with MKFP as counterparty if the rating on MKFP were to decrease below 'BBB+' (S&P) or 'Baa1' (Moody's), regardless of collateral posting requirements. For the two swaps with Depfa as the counterparty, Depfa has a collateral posting requirement if the rating on Alcoa were to decrease below 'A-' (S&P Global Ratings) or 'A3' (Moody's), as well as if the mark-to-market value of the swaps is a negative value for Depfa, which it is not currently.

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 swap and 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 OPEB highlights

The city participates in the following plans:

- The largest pension plan is the Employee's Retirement System of the City of Alcoa; 71% funded with an unfunded liability of \$10.7 million in 2019.
- Certain of the city school system are members of Tennessee Consolidated Retirement System; 95% funded with an unfunded liability of \$2.4 million.
- The city provides medical benefits to certain retirees until they become Medicare eligible; the OPEB liability was equal to \$5.5 million

The city's pension costs are on the higher side and have been for quite some time; therefore, we think the city is facing moderate pressures from pension liabilities. Alcoa's combined required pension and actual OPEB contributions totaled 7.8% of total governmental fund expenditures in 2019. Of that amount, 6.8% represented required contributions to pension obligations, and 0.9% represented OPEB payments.

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.

Related Research

- 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

Ratings Detail (As Of May 29, 2020)

Alcoa GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Alcoa GO		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
Alcoa GO (ASSURED GTY)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Blount Cnty Pub Bldg Auth, Tennessee		
Alcoa, Tennessee		
Blount Cnty Pub Bldg Auth (Alcoa) GO Equiv (ASSURED GTY)		
<i>Unenhanced Rating</i>	NR(SPUR)	

Many issues are enhanced by bond insurance.

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGS DIRECT are registered trademarks of Standard & Poor's Financial Services LLC.