S&P Global Ratings

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Summary:

Franklin, Tennessee; General Obligation

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Credit Profile		
US$28.97 mil GO bnds ser 2019A dtd 05/02/2019 due 04/01/2039		
Long Term Rating	AAA/Stable	New
US$23.035 mil GO rfdg bnds ser 2019B dtd 05/02/2019 due 03/01/2029		
Long Term Rating	AAA/Stable	New
Franklin GO		
Long Term Rating	AAA/Stable	Affirmed
Franklin GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating to Franklin, Tenn.'s series 2019A general obligation (GO) bonds ($28.97 million) and 2019B GO refunding bonds ($23.035 million). At the same time, we affirmed our 'AAA' rating on the city's existing GO bonds. The outlook is stable. The direct debt outstanding is approximately $204 million.

Security and use of proceeds

The city's full-faith-and-credit pledge, payable from the levy of an unlimited ad valorem tax on all taxable property within Franklin's incorporated city limits, secures the bonds.

The 2019A bond proceeds will be used to fund various capital projects (road improvement, police and fire departments' equipment purchase, and sanitation facility improvements).

The 2019B bond proceeds will be used to refund a portion of existing GO debt for interest savings (series 2009).

Franklin's GO bonds are eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the nation can in a stress scenario. Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, on RatingsDirect, the city has a predominately locally derived revenue source, with 60.1% of governmental activity revenue derived from local property and sales taxes, providing independent taxing authority and treasury management from the federal government.

Credit overview

The city participates in the largest metropolitan statistical area (MSA) in the state, Nashville-Davidson—Murfreesboro—Franklin. The city's strong economic growth and robust management practices and policies led to strong budgetary performance and financial stability in the last three years. Based on the city's comprehensive, forward-looking, long-term financial and capital improvement plan, combined with positive economic growth, we expect the credit quality to remain at the current level for the next two years.

The ratings reflect our assessment of the city's:

- Very strong economy, with access to a broad and diverse MSA;
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 75% of operating expenditures;
- Very strong liquidity, with total government available cash at 71.9% of total governmental fund expenditures and 5.2x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability profile, with debt service carrying charges at 13.7% of expenditures and net direct debt at 136.6% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 66.0% of debt scheduled to be retired in 10 years; and
- Very strong institutional framework score.

Very strong economy

We consider Franklin's economy very strong. The city, with an estimated population of 70,908, is located in Williamson County in the Nashville-Davidson--Murfreesboro--Franklin, Tenn., MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 162% of the national level and per capita market value of $229,027. The city's market value grew by 3.5% over the past year to $16.2 billion in 2019. The county unemployment rate was 2.7% in 2017.

The city is located roughly 15 miles south of Nashville, and serves as a regional retail and banking center and has a large commercial presence, including retail outlets, a regional mall, and several corporate headquarters (Community Health Systems, Nissan North America, Verizon Wireless, Jackson National Life, and Ford Motor Credit). Residents have local employment opportunities in the health care, government, advanced automotive-manufacturing, and biomedical sectors.

Consistent with the historical trend, the city experienced strong tax base growth in the last three years. Assessed valuation increased by roughly 30.0% for fiscal 2017 due to positive property reappraisal, followed by growth of 5.0% for fiscal 2018 and 3.5% for fiscal 2019 due to various commercial and residential developments. The city's four-year annual average building permits include roughly 1,000 residential permits and 361 nonresidential permits. Notable developments include several new hotels, various corporate headquarters, expansions from existing businesses, and various retail stores. Considering the available land within the city limits, officials project roughly 3%-4% annual growth for the next two years, which we view as realistic.

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The city's very strong management practices and policies and conservative budget assumptions led to surpluses in the general and total governmental fund for the last three fiscal years. In preparation of its annual budget, the city's finance and administration staff uses three years and five years of historical revenue and expenditure trends and outside sources to support annual budget assumptions. Budget projections, where available, can incorporate up to 25 years of historical information for major revenue categories; management produces a budget manual for all departments that consolidates assumptions, laws, timelines, and guidance into one master document. This guidance ensures each department uses consistent assumptions for cost increases--such as utilities, inflation, and fuel--while the city's finance and administration staff calculates revenue estimates, benefits, and wage costs. City departments submit service-level budgets to identify what level of resources they need in the following year to provide the same service as in the current budget year. In addition, departments can submit program-enhancement requests that would expand or modify service levels.

Furthermore, management reviews budgetary performance regularly and delivers monthly and quarterly budget-to-actual reports to the Franklin Board of Mayor & Aldermen. The board can amend the budget as needed. In addition, the city has adopted an investment policy; management provides monthly investment earnings and holdings reports to the board.

Franklin adopts a 10-year capital improvement program (CIP) it updates annually as part of budget adoption. The comprehensive CIP identifies projects by department and various internal and external funding sources for all capital projects. Management also prepares a long-range financial forecast annually that evaluates future costs and needs across a three-year period for departments supported by the general fund, as well as a five-year projection for enterprise-related activities.

In addition, Franklin's formal fund balance policy requires management to maintain a minimum reserve target at 33% of general fund expenditures to provide financial stabilization funds in the event of emergencies or to meet cash flow needs. Management, however, has an informal goal of maintaining more than 45% of general fund expenditures to fund capital expenditures. Historically, the city has met and sustained reserves exceeding the policy's minimum target. Management also maintains a comprehensive debt management policy that limits variable-rate debt to no more than 20% of debt outstanding. The policy also sets forth certain measurable benchmarks and debt affordability ratios.

Strong budgetary performance

Franklin's budgetary performance is strong, in our opinion. The city had operating surpluses of 9.8% of expenditures in the general fund and of 21.9% across all governmental funds in fiscal 2018. Our assessment accounts for our expectation that budgetary results could moderate somewhat in the near term.

Our view of the city's budgetary performance reflects adjustments made to include recurring transfers out to the sanitation and transit funds from the general fund, which provides annual operating subsidies from the general fund and exclude one-time expenditures funded with the bond proceeds.

The city reported operating and total governmental surpluses in fiscals 2017 and 2018, and based on the fiscal 2019 projections, we expect the budgetary performance to remain strong. Reflective of healthy economic growth, the city's operating budget increased annually, by roughly 5% for fiscals 2017 and 2018. Consistent with historical performance, the city reported operating surpluses of 6.8% of expenditures in fiscal 2017 and 9.8% of operating expenditures in fiscal 2018, which officials attribute to higher-than-budgeted property tax revenues and lower-than-budgeted expenditures due to delayed capital projects. Additionally, after the recurring transfers out and the one-time capital expenditures, the city reported surpluses in the total governmental funds in fiscals 2017 and 2018.

Although the city reported very strong budgetary performance for fiscal years 2015-2018, we expect budgetary performance could moderate somewhat in near term. As part of Franklin's long-term capital improvement plan, the city intends to use excess available reserves, drawing down approximately $1.6 million annually through fiscal 2028 to support the projects. In addition, we expect macro-economic growth to slow, which could soften the city's primary operating revenue source (sales tax revenue, which account for 49% of operating revenue). For additional information on North America's credit condition, see our report "Credit Conditions Are Mixed As Fed Pauses", published March 28, 2019.

Based on the latest budget-to-actual report, the city expects a minor operating deficit. However, budget assumptions are conservative and the city historically outperforms its budget. The city is in the preliminary stages of formulating the fiscal 2020 budget. The budget includes the assumptions of 2.0% property tax revenue growth (versus projected 3.0%-4.0% growth), 4.0% sales tax growth (versus year-over-year actual growth of 4.8%), hall income tax revenue of $500,000 due to the hall income tax phase out, and increases in pension contributions and capital projects. At this time, officials expect to adopt a balanced budget, with a $1.6 million use of available reserves.

The city's primary revenue sources include local sales tax revenue (49%) and state-shared revenue (21%), followed by property tax revenue (13%). In adherence to the Improve Act, the Hall income tax--a law that levies a 6% tax on personal income from all taxable interest and investment dividends exceeding $1,250 per person--will be eliminated by tax year 2020. As a result, the city budgets for a $250,000 reduction in revenue annually. As of fiscal 2018, hall income tax revenue represents only 2.4% of the operating revenue, and officials expect the local revenue growth to offset this revenue loss.

Very strong budgetary flexibility

Franklin's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2018 of 75% of operating expenditures, or $47.4 million. We expect the available fund balance to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

Given the city's historically strong budgetary performance, the city historically exceeded its formal reserve policy of maintaining 33% of operating expenditures. In the last three years, the available reserves remained above 65% of operating expenditures. Although the city plans to draw down roughly $1.6 million annually for the next 10 years, we expect its budgetary flexibility to remain very strong, given the current reserve level.

Very strong liquidity

In our opinion, Franklin's liquidity is very strong, with total government available cash at 71.9% of total governmental fund expenditures and 5.2x governmental debt service in 2018. In our view, the city has exceptional access to external liquidity if necessary.

Our opinion that Franklin maintains exceptional access to external liquidity reflects its history of issuing GO, revenue (enterprise), variable-rate, and refunding bonds over the past 15 years. Franklin holds investments in certificates of deposit, money market, and government-sponsored agency securities.

The city entered into two variable-rate loan agreements in 2005 and 2007, hedged with synthetic fixed-rate interest rate swaps. The combined notional amount is $21.1 million, or 10.00% of direct debt, with the interest rates of 3.65% and 3.59%, respectively. In accordance with variable- rate loan agreements, none of the city's variable-rate debt has cross-default or acceleration provisions. However, the SWAP agreements contains an acceleration provision in an event of default or termination, where total principal and interest would come due immediately following the event. Currently, the counterparties and city share the same termination event--the lowering of a rating below 'BBB+'.

Although we view exposure to this contingent liquidity or termination as remote within the next 12 months, if the loan is accelerated, the city would need to pay the remaining principal and interest due on the loan, approximately $30.9 million. Furthermore, the mark-to-market-value of the 2005 swap was approximately $19,682 and the mark-to-market-value of the 2007 swap was $3.62 million as of March 2019. However, we believe the city would maintain sufficient liquidity of $71.3 million, or 2.3x debt service coverage, if an acceleration event were to occur. We believe the city has enough liquidity on hand to support an acceleration event. Therefore, we do not expect liquidity to deteriorate over the next two fiscal years.

Strong debt and contingent liability profile

In our view, Franklin's debt and contingent liability profile is strong. Total governmental fund debt service is 13.7% of total governmental fund expenditures, and net direct debt is 136.6% of total governmental fund revenue. Overall net debt is low at 2.7% of market value, and approximately 66.0% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Based on the city's 10-year capital improvement plan, the city intends to issue new-money bonds every two years. The city intends to issue between $25 million and $35 million in 2021 to support the capital improvement projects. However, we expect the debt profile to remain strong, based on anticipated economic growth. Additionally, we note that the 2005 loan will mature within the next two years (July 2020), and officials are exploring options to refinance the 2007 loan in late summer or early fall of 2019 as the interest rates reset in December 2019.

Franklin's combined required pension and actual other postemployment benefit (OPEB) contributions totaled 4.9% of total governmental fund expenditures in 2018. The city made its full annual required pension contribution in 2018.

The city participates in the City of Franklin Employee's Pension Plan and Trust and the Tennessee Consolidated Retirement Plan (TCRS). The city closed its single-employer, defined-benefit pension plan as of Dec. 31, 2016, and the eligible new hires enroll in the state-administered TCRS, an agent-multiple-employer pension plan. The city's contributions are actuarially determined and the city historically met its full required contributions. As of June 30, 2017, latest actuarial valuation date, the city's pension funds are 82% funded, with the net pension liability of roughly $23.7 million. The City of Franklin Employee's Pension Plan features an assumed rate of return of 7.4% and the TCRS plan assumes rate of return of 7.25%, which are slightly below the national average. Given the conservative assumed rate of return, we do not expect an acceleration of fixed costs related to the plans and believe that the city's pension contributions will remain manageable.

Lastly, the city provides OPEBs. As of June 30, 2017, the OPEB liability equated to roughly $5.5 million, which we consider manageable. In order to manage the liability, the city established an OPEB reserve policy in 2009 that equates to 2% of the general fund budgeted expenditures, which we view as a positive credit factor.

Very strong institutional framework

The institutional framework score for Tennessee municipalities is very strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that the city's strong and embedded financial management policies and practices will likely allow it to sustain at least strong budgetary performance, and very strong budgetary flexibility. It also reflects our expectation that Franklin, which benefits from its presence in the broad and diverse Nashville MSA, will likely experience continued economic development and tax base growth. For these reasons, we are unlikely to change the rating during the two-year outlook period.

Although we view it as unlikely within the two-year outlook time frame, we could lower the rating if budgetary performance were to deteriorate significantly, leading to a substantial weakening of reserves to levels we no longer consider commensurate with those of Franklin's 'AAA' rated peers, and if Franklin's debt-and-liabilities profile were to increase materially.

Related Criteria And Research

2018 Update Of Institutional Framework For U.S. Local Governments