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Salem, Utah; Sales Tax

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Credit Profile		
US$4.8 mil municipal energy sales and sales tax and telecom fee rev bnds ser 2020 due 09/01/2040		
Long Term Rating	A+/Stable	New

Rating Action

S&P Global Ratings assigned its 'A+' long-term rating to Salem City, Utah's municipal energy sales and sales tax and telecommunications fee revenue bonds, series 2020. The outlook is stable.

The bonds are limited obligations of Salem City, payable from the city's available sales tax revenues, the municipal energy sales and use tax (MESUT) revenues, and net network revenues. The rating primarily reflects the strength of the city's MESUT tax revenue pledge and coverage is calculated using the city's tax revenue.

Bond proceeds will finance the construction and installation of advanced communication lines and related improvements and facilities in Salem City.

Credit overview

While the economic and financial pressures posed by the COVID-19 pandemic remain unknown, the rating reflects our view of strong maximum annual debt service (MADS) coverage, supported by a stable and adequate economy. We base the rating on the application of our "Priority-Lien Tax Revenue Debt" criteria, published Oct. 22, 2018, which factors in the moderate-to-low volatility and strong MADS coverage of the pledged revenue as well as Salem City's general credit quality. Our view of the obligor's creditworthiness does not currently limit the priority lien rating. While we continue to monitor events related to the COVID-19 pandemic, we do not expect them to affect the city's ability to pay debt service on the bonds or maintain its financial position. Despite the current economic downturn we do not expect coverage will fall below levels that we consider strong, and therefore expect the rating will remain stable. Although our outlook is generally for two years, we see significant downside risks as a result of the COVID-19 pandemic and developing recession over the next six-to-12 months. For S&P Global Economics' latest U.S. forecast, see "The U.S. Economy Reboots, With Obstacles Ahead " (published Sept. 24, 2020, on RatingsDirect).

The rating further reflects our view of:

- The city's adequate economic base;
- Historically moderate-to-low volatility in nationwide taxes tied to public utilities for gas and electricity; and
- The city's strong additional bonds test (ABT) at 1.5x MADS and very strong MADS coverage.

Environmental, social, and governance (ESG) factors

We analyzed the city's ESG risks relative to its economic fundamentals, revenue volatility, coverage and liquidity, and obligor's creditworthiness. Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. Absent the implications of COVID-19, we consider the city's ESG risk to be in line with our view of the sector standard.

Stable Outlook

Upside scenario

Should the city experience significant economic expansion, and pledged revenue demonstrate resilience throughout various economic cycles, we could raise the rating.

Downside scenario

Should declines in pledged revenue or additional debt issuance significantly dilute coverage beyond current expectations, we could lower the rating.

Credit Opinion

Economic fundamentals: Adequate

Salem City is approximately 13 miles south of Provo and 59 miles south of Salt Lake City, with an estimated population of 8,600. The local economy is primarily residential in nature, with some presence of commercial and industry. City officials estimate it is approximately 10%-15% built out with the anticipation of being fully built out in the next 40 years. Local incomes are good with median household effective buying income (EBI) at 136% of the national level, while EBI per capita is 83% of the national level. The disparity between per capita and median household EBI is due to the presence of large families in the area.

Volatility: Moderate to low

We assess the volatility of revenue to determine the likelihood of the availability of revenue during different economic cycles. We have two levels of volatility assessment: macro and micro.

In general, we consider public energy tax revenue to have a moderate-to-low historical volatility assessment given the essential nature of utility services, inclusive of gas and electric power over various economic cycles. Nationwide public utilities historically fluctuated less than total consumption of goods and services, even during severe economic downturns and price fluctuations, given the relative inelasticity of demand for public utilities. There are no internal or external influences that we believe improve or worsen the macro assessment of volatility of the tax on gas and electricity, and we do not expect price variations in the near or medium term to affect our view of the volatility of energy revenue in aggregate.

On a micro level, we believe the pledged tax has and will likely continue to demonstrate moderate-to-low volatility. Because the pledged revenue is tied to unit sales of gas and electricity, it will remain subject to short-term volatility given weather-related fluctuations. In addition, technological changes that improve energy efficiency may suppress energy demand over time, potentially constraining pledged revenue or offsetting demand growth from a growing population.

Coverage and liquidity: Strong

The city's pledged municipal energy tax revenue has increased 15% over the past three years, with a small decrease of

1% in fiscal 2020. The city is projecting flat energy tax in fiscal 2021. Sales tax revenues have also been increasing and have not declined due to recessionary pressures from COVID-19. However, as sales tax revenues only account for $180,000 of pledged revenue and this cannot be increased due to limitations from state law, we base our rating on the MESUT revenues. In fiscal 2020, excluding any sales tax revenues, which would not be available for debt service, MADS coverage is 1.5x. However, pledged revenue totaled $1.65 million, which would cover future MADS by more than 4x, reflecting that sales taxes could drop dramatically before they would be unavailable to pay debt service. MADS is scheduled to occur in 2029.

Additional parity bonds are permitted if revenue for any 12 months in the 24 months immediately preceding the proposed date of issuance of additional bonds are equal to at least 1.5x MADS. There is no reserve fund requirement for the bonds outstanding.

Obligor linkage: Close

In our view, Salem City does not benefit from limited operations or extraordinary expenditure flexibility, and we believe pledged revenue have some exposure to operating risk, leading to a one-notch upward limitation compared with the city's general creditworthiness. While pledged revenue is pledged to support debt service first, the flow of funds for the pledged revenue allows management to use excess revenue for operations, and we consider pledged revenue within the city's direct control and exposed to operating risk. Therefore, under our priority lien criteria, we believe there is a close relationship between the priority lien pledge and the obligor.

Rating linkage to Salem City

We assess Salem City's general operations, because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax.

Salem City has experienced recent economic growth, including a 17.5% increase in assessed value within the past two years. We view the city's budgetary performance as adequate as it has intentionally made transfers out of its general fund to remain in compliance with the state's maximum reserve 25% of general fund revenue. At the same time, the city's budgetary flexibility remains strong and liquidity has remained very strong. City management anticipates strong reserve and liquidity levels over the next several years.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020