

# RatingsDirect®

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## Summary:

# Providence, Utah; Sales Tax

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## Summary:

# Providence, Utah; Sales Tax

### Credit Profile

US\$7.38 mil franchise and sales tax rev bnds ser 2021 due 03/01/2048

*Long Term Rating*

A-/Stable

New

## Rating Action

S&P Global Ratings assigned its 'A-' long-term rating to Providence, Utah's anticipated \$7.38 million series 2021 energy sales and sales tax revenue bonds. The outlook is stable.

The bonds are limited obligations of the city secured by a first-lien pledge of the city's franchise tax revenue, together with a first-lien pledge, subject to an approximately \$198,000 annual cap (one-half of annual aggregate debt service), of the city's sales and use tax revenue. The franchise tax revenue is derived from the city's 6% municipal energy sales and use tax (MESUT) levied on taxable natural gas and electricity sales within the city. The sales tax revenue is derived from a 1% sales and use tax. The Utah State Tax Commission collects the 1% local sales and use tax and disburses the revenue monthly to the city. The amount of disbursements for the local levy is based on a formula: 50% of sales tax collections based on population and 50% based on point of sale. Bond proceeds will be used to develop fiber telecommunication infrastructure within the city.

### Credit overview

The rating reflects the city's somewhat limited economic fundamentals, specifically in a relatively small population, though we note population growth has been significant within the city during the past 20 years. Additionally, MESUT revenues have exhibited volatility over the past few years, due in part to warmer winters. We expect pledged revenue coverage to improve, as the MESUT tax rate will increase to 6% from 4% in fiscal 2022 as debt service payments become due. With this rate increase, maximum annual debt service (MADS) coverage will be an estimated 1.3x, which we consider adequate.

S&P Global Ratings believes uncertainty remains high regarding the evolution of the coronavirus pandemic. While the early approval of several vaccines is a positive development, countries' approval of vaccines is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by mid-2021. We use this assumption in assessing the economic and credit implications associated with the pandemic. For more information on our view of the U.S. economy, see the report "Economic Outlook U.S. Q2 2021: Let The Good Times Roll", published March 24, 2021, on RatingsDirect.

Key credit considerations include:

- An adequate-to-strong economic base, with access to the Logan, UT, economic area;
- Historically moderate-to-low volatility in taxes tied to public utilities for gas and electricity; and

- Adequate debt service coverage and an additional bonds test (ABT) requiring at least 1.5x MADS.

### **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.

## **Stable Outlook**

### **Downside scenario**

Should the city's revenue exhibit continued volatility, resulting in a drop in pledged revenue to levels we no longer consider adequate, we could lower the rating.

### **Upside scenario**

We could raise the rating should pledged revenue grow and sustain coverage at levels we would consider strong to very strong.

## **Credit Opinion**

### **Economic fundamentals: Adequate-to-strong**

Providence is in Cache County, in northern Utah, within the broad and diverse Logan, Utah metropolitan statistical area (MSA). Our view of the city's economic fundamentals is driven by its relatively small population of 7,780. The city's per capita effective buying income (EBI) was 87% of the national level in 2019, though we note median household EBI is much higher at 121% of the national level, due in part to large families in the area. City residents have access to diverse employment opportunities throughout the county, including Utah State University within Logan. Though the city is approximately 80% built out for residential use, city officials note multiple developments underway that they believe will contribute to continued population growth.

Our analysis considers the additional breadth and diversity lent to the pledged revenue stream due to the sales and use tax revenue stream's allocation, with 50% of sales and use tax revenue derived from the state's total sales and use tax collections, flowing to the city based on its share of the total state population. We believe this additional breadth and diversity is notable, though just 18% of total pledged revenue flows from the state's total sales and use tax collections, with 63% of the fiscal 2021 pledged revenue stream comprising of MESUT franchise tax revenue.

### **Revenue volatility: Low-to-moderate**

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-level and micro-level.

In general, we consider public utility tax revenue to have a low historical volatility assessment, given the essential nature of utility services and demand for natural gas and electricity over time. In our view, the essentiality and price inelasticity of energy demand offset the role of commodity prices and pressures from technological innovations like

energy efficiency in influencing the demand for, and delivered value of, energy in the long run.

On a micro level, we've analyzed local energy tax revenue since 2012 and noted local franchise tax revenue has demonstrated moderate volatility, with declines in revenue in 2015, 2017, and 2019. City officials note these declines are due to warmer winters.

**Coverage and liquidity: Adequate**

Sales tax revenues that are available to be used to pay debt service on the bonds are capped at approximately \$198,287 annually, which represents about half of average aggregate debt service. Due to the state shared formula, one-half of the sales tax originates from the state. The city's MESUT tax represents the largest portion of total pledged revenues, making up approximately 58% of total pledged revenues in fiscal 2020. Overall, total pledged revenue grew by an annual average rate of less than 1% during the past five years, with declines reported in 2017 and 2019. For fiscal 2020, pledged revenue grew to \$468,287 (an increase of 1.6% compared to the previous year) and would cover MADS on the bonds by 1.1x, which we would consider weak. However, the tax rate on the MESUT tax is set to increase to 6% from 4% on natural gas and to 6% from 5% on electricity in fiscal 2022, when debt service payments are scheduled to begin. With this 6% rate, the city projects total pledged revenues would increase to \$539,651 and would cover annual debt service by 2.7x, which we consider strong, and MADS by 1.3x, which we consider adequate. City officials note there are no current plans to issue any parity debt.

Bond provisions require that pledged revenue for any consecutive 12-month period in the 24 months immediately preceding the date of issuance provides 2.0x coverage of MADS on all bonds, including the additional bonds. There is no reserve fund requirement for the outstanding bonds.

**Obligor linkage: Close**

In our view, Providence 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 to 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 Providence**

We assess Providence'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.

We consider Providence's economy to be strong based on the area's income levels and market value, with access to the Logan, UT MSA. We note that the county's taxable value has been increasing steadily during the past few years and we believe the economy is likely to remain at strong levels with its increasing market value per capita figures. The county's budgetary performance is adequate in our view, which reflects both increasing sales tax revenue and stable property tax revenue with a potential spend down in reserves in fiscal 2021 as the city plans to repair roads and support a growing population, though we anticipate the city's available reserves will remain very strong, in line with the city's informal goal of reserves of 20% of revenue.

## **Related Research**

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

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