Sevierville (City of) TN
Update to credit analysis

Summary
Sevierville, TN (Aa3) benefits from healthy financial operations resulting in strong reserve and liquidity levels. While the city's debt burden is elevated, conservative budget practices and continued economic growth partially mitigate this risk.

Credit strengths
» Moderately-sized and growing tax base
» Strong reserve levels
» Tourism-based economy has proven resilient in the face of recent wild fires and in the face of the 2008 recession

Credit challenges
» Elevated debt burden with variable rate exposure
» Exposure to economically sensitive revenues
» Residential wealth levels are below average

Rating outlook
Moody’s does not usually assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade
» Material reduction in debt burden
» Substantial increase in tax base size

Factors that could lead to a downgrade
» Any additional increase in debt burden
» Material decrease in cash or reserve levels
» Large, prolonged tax base contractions
Key indicators

Exhibit 1

<table>
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<tr>
<th>Sevierville (City of) TN</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tr>
<td><strong>Economy/Tax Base</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Total Full Value ($000)</td>
<td>$2,276,478</td>
<td>$2,285,241</td>
<td>$2,302,256</td>
<td>$2,322,228</td>
<td>$2,468,073</td>
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<td>Population</td>
<td>15,259</td>
<td>15,592</td>
<td>15,903</td>
<td>16,213</td>
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<tr>
<td>Full Value Per Capita</td>
<td>$149,189</td>
<td>$146,565</td>
<td>$144,769</td>
<td>$143,232</td>
<td>$152,228</td>
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<td>Median Family Income (% of US Median)</td>
<td>65.1%</td>
<td>61.5%</td>
<td>61.0%</td>
<td>58.7%</td>
<td>58.7%</td>
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<tr>
<td><strong>Finances</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>$26,781</td>
<td>$33,009</td>
<td>$32,654</td>
<td>$36,164</td>
<td>$38,038</td>
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<tr>
<td>Fund Balance ($000)</td>
<td>$11,554</td>
<td>$12,481</td>
<td>$13,998</td>
<td>$16,076</td>
<td>$18,479</td>
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<tr>
<td>Cash Balance ($000)</td>
<td>$8,899</td>
<td>$9,214</td>
<td>$11,069</td>
<td>$13,159</td>
<td>$15,486</td>
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<td>Fund Balance as a % of Revenues</td>
<td>43.1%</td>
<td>37.8%</td>
<td>42.9%</td>
<td>44.5%</td>
<td>48.6%</td>
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<tr>
<td>Cash Balance as a % of Revenues</td>
<td>33.2%</td>
<td>27.9%</td>
<td>33.9%</td>
<td>36.4%</td>
<td>40.7%</td>
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<td><strong>Debt/Pensions</strong></td>
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<tr>
<td>Net Direct Debt ($000)</td>
<td>$196,368</td>
<td>$218,455</td>
<td>$215,085</td>
<td>$211,995</td>
<td>$208,605</td>
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<td>3-Year Average of Moody's ANPL ($000)</td>
<td>$26,574</td>
<td>$30,759</td>
<td>$36,863</td>
<td>$40,658</td>
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<td>Net Direct Debt / Operating Revenues (x)</td>
<td>7.5x</td>
<td>6.6x</td>
<td>6.6x</td>
<td>5.9x</td>
<td>5.5x</td>
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<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>8.6%</td>
<td>9.6%</td>
<td>9.3%</td>
<td>9.1%</td>
<td>8.5%</td>
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<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>1.0x</td>
<td>0.9x</td>
<td>1.1x</td>
<td>1.1x</td>
<td>1.2x</td>
</tr>
<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>1.2%</td>
<td>1.3%</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.9%</td>
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</table>

Source: Moody's Investors Service

Profile

Sevierville is located in eastern Tennessee, approximately 24 miles east of Knoxville (Aa1) and 14 miles north of the Great Smoky Mountains National Park. The city serves a population of approximately 14,800.

Detailed credit considerations

Economy and Tax Base: Tourism-based economy remains stable

The city’s $2.5 billion tax base will experience steady growth over the near-term given retail and residential development projects. The city’s economy benefits from participation in the Knoxville MSA and its location near the Smoky Mountains. The local economy is a popular domestic tourist destination, with multiple and diverse attractions that tend to draw tourists and seasonal residents even amid economic downturns. These include the Dollywood theme park and resort, the Great Smoky Mountains National Park, the Ripley’s Aquarium of the Smokies, and numerous related entertainment and retail venues. Despite the 2016 forest fires, tourism in the area continues to increase. In addition to its tourism components, the county economy includes the Mountain Home VA Medical Center, a 29,610-square foot Sevier County Health Department facility, and an East Tennessee State University satellite campus. The city’s tax base is slightly concentrated with the ten largest taxpayers accounting for 20.6% of total assessed value. Concentration continues to decrease as the tax base grows and diversifies. Anticipated future developments includes a couple restaurants and new residential lots.

Five-year average annual full value growth has been sound at 2.9%, and full value per capita is a robust $152,228. The county unemployment rate was 2.9% in December 2017 which compares well to both state (3.1%) and national (3.9%) averages. Wealth indices remain below average with a median family income that is 69% and 58.7% of the state and nation respectively.

Financial operations and reserves: Strong operating history with solid reserve levels

The city’s financial position is expected to remain strong given solid reserve levels and conservative budgetary practices including a formalized fund balance policy. The city generated a $2.5 million General Fund surplus in fiscal 2017, marking the second consecutive

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In the past six years, the city has increased its available General Fund reserves from $11.2 million (43.5% of revenues) in 2012 to $18.5 million (46.7% of revenues) as of 2017. The city’s Central Business Improvement District (CBID) Fund, which can be used to support TDZ related debt service, ended the year with a $1.3 million surplus increasing reserves to $10.3 million (140% of revenues). Surplus operations resulted from growth in sales tax and property tax revenues.

The fiscal 2018 budget reflects a sizable surplus that will increase General Fund reserves to $21 million or 46.3% of fiscal 2018 revenues. The budget represents a 14.5% increase over fiscal 2017 due primarily to the receipt of bond proceeds.

The city's economy is primarily tourism based and, as such, city tends to maintain very low property tax rates and instead imposes a variety of consumption and transient use taxes in an effort to shift the cost of services to non-resident visitors. The result is an operating budget with a high degree of exposure to economically sensitive revenues, however the city has historically maintained healthy levels of liquidity and reserves to buffer potential revenue declines as well as liquidity risks associated with its demand debt and swaps. Conservative budgeting and a formalized fund balance mitigate this volatility. Under the formal fund balance policy, reserves must be above 25% of expenditures.

Liquidity
The city maintains sound liquid reserves. In fiscal 2017 the city had $15.5 million or 39.1% of revenues in its General Fund alone. Including the CBID Fund, total cash and investments was $25.8 million at the end of fiscal 2017.

Debt and Pensions: Elevated debt burden with variable rate exposure
The city's net direct debt burden of 8.9% of full value, after self-supporting electric system debt is backed out, is high. However, 66.4% of the city's outstanding debt is related to the tourism development zone (TDZ), which the city is able to use dedicated sales tax revenues to pay debt service. The city has structured the TDZ-related debt for interest-only debt service while the zone continues to develop. TDZ revenues, approximately $7.4 million in fiscal 2017, do not currently permit the permanent financing of all TDZ debt. Accordingly, much of the debt remains in short-term or interest-only modes, and the related payout of principal is very slow. The city's capital improvement plan includes debt issuance to fund a wastewater plant expansion, which will be secured through water and sewer revenues. Because the city's debt burden is already high, any additional borrowing could put downward pressure on its credit rating.

Debt Structure
Of the $184 million in direct city debt, approximately 58% is in variable rate mode and is largely hedged by three interest rate swaps.

Debt-related Derivatives
The city’s three swaps (excluding the swap on self-supporting electric debt) are with Morgan Keegan Financial Products as counterparty and Deutsche Bank AG (A3) as Credit Support Provider (CSP). As of a March 30, 2018 valuation, the three swaps had a combined mark-to-market value of $16.4 million in favor of the CSP. While collateral thresholds are infinite with the city’s credit rating above A3, and only the city has optional termination, we do note that there are potential termination risks should the Deutsche Bank rating fall below A3 and the bank fail to deliver collateral under the CSA, or should the Deutsche Bank rating fall below Baa1 coupled with failure by the bank to find a replacement CSP. The risk is somewhat mitigated because the mark-to-market value is in favor of Deutsche Bank. The city’s five variable rate issues are currently in index rate mode bank placements, with the nearest term expiration in June 2019. Other than for various events of default, the issues cannot be tendered prior to the term expiration date.

Pensions and OPEB
The city participates in the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit plan administered by the Tennessee Consolidated Retirement System (TCRS). Annual required contributions (ARC) totaled $2.4 million for the plan. The city’s payments to the plan constituted 100% of the ARC in fiscal 2017. The city’s adjusted net pension liability, under Moody’s methodology for adjusting reported pension data, is $47.5 million, or a below average 1.25 times operating revenues.

Management and Governance: Fiscally conservative management team
Sevierville benefits from fiscally conservative management, evidenced by its healthy reserve levels, trend of surplus operations and formalized fund balance policy.

Tennessee Cities have an Institutional Framework score of Aaa, which is high compared to the nation. Institutional Framework scores measure a sector’s legal ability to increase revenues and decrease expenditures. The sector has one or more major revenue sources
that are not subject to any caps. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Tennessee is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.
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