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Nashville and Memphis: Similar Credit Quality, Different Outlooks

A Comparison of Tennessee's Two Largest Cities

Summary

Nashville (Aa2 stable) and Memphis (Aa2 negative) are both strong credits that capitalize on large and regionally important economies, while demonstrating similar reserve levels and above-average debt profiles. Despite these similarities, Tennessee's (Aaa stable) two largest cities maintain different growth patterns, socioeconomic profiles and fiscal pressures.

Key findings in our comparison include:

» **Nashville and Memphis benefit from large, diverse economies but with different growth patterns and socioeconomic profiles.** Nashville enjoys a stable economic base as the state capital and Memphis relies on a durable transportation sector led by FedEx Corporation (Baa1 stable). Despite 100,000 fewer residents, Nashville's $64 billion tax base is 67% larger than Memphis'. Nashville also has more favorable unemployment and wealth levels.

» **Financial strength looks similar on the surface, however each city grapples with different fiscal pressures.** At first glance, the Nashville and Memphis financial positions appear very similar when considering reserve levels and cash positions. However, Memphis continues to struggle with high fixed costs, including debt service, pension and retiree healthcare obligations, while Nashville is hampered by an annual subsidy to a hospital authority and a voter-approved initiative that theoretically curtails their ability to raise the property tax rate beyond a certain level.

» **Debt levels for both cities are above average compared to other municipalities in Tennessee and across the nation.** Nashville's debt burden (5.3% of full value) tops Memphis' (4.2%), with both well above state (0.9%) and national (1.0%) medians. Going forward, Nashville's projected tax base growth puts the city in a stronger position in terms of debt affordability over the medium term.

Rating Outlooks on Nashville and Memphis

Nashville's stable outlook reflects our expectation that the city's regional tax base will continue to grow at a healthy rate and provide the necessary revenue growth to support ongoing governmental operations, including annual financial transfers to the city's hospital authority.

Memphis' negative outlook reflects our expectation that the city's financial position will remain challenged, primarily because fixed costs, including debt service, pensions, and retiree healthcare obligations, represented a substantial 45% of operating expenditures in fiscal 2013.

RATINGS

Nashville

General Obligation	Aa2 stable
Non Ad-Valorem	Aa3 stable

Memphis

General Obligation	Aa2 negative
Non-Ad Valorem	Aa3 negative

KEY INDICATORS

Nashville

	2011	2012	2013
Full Valuation ($ billions)	$63.3	$63.1	$63.3
General Fund Reserves as % of Revenue	8.4%	8.6%	11.5%
Net Direct Debt Burden as % of Full Value	3.2%	3.5%	3.8%

Source: Nashville's Comprehensive Annual Financial Reports

Memphis

	2011	2012	2013
Full Valuation ($ billions)	$38.8	$38.1	$37.8
General Fund Reserves as % of Revenue	13.6%	14.8%	11.4%
Net Direct Debt Burden as % of Full Value	3.3%	3.3%	4.0%

Source: Memphis' Comprehensive Annual Financial Reports

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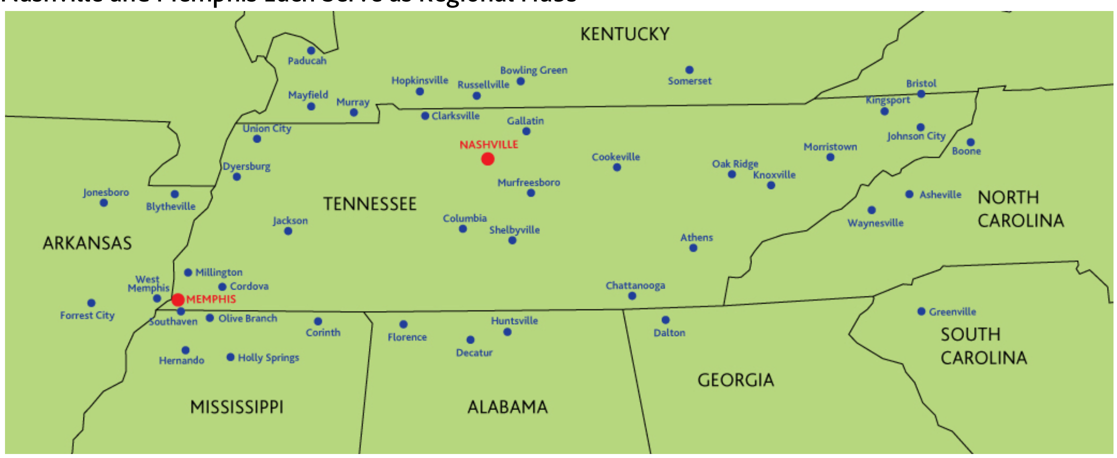
Large, diverse economies offer economic engines for Nashville and Memphis, but with different growth patterns and socioeconomic profiles.

Nashville and Memphis are the largest cities in Tennessee as measured by assessed value and population. Both benefit from their roles as regional economic centers and the diverse nature of their respective tax bases. Located in the north central portion of the state, Nashville's growth pattern over the last five years is considerably stronger than Memphis', which is situated in the southwestern part of the state adjacent to Mississippi (Aa2 stable) and Arkansas (Aa1 stable) (see Exhibit 1). Nashville's \$63.3 billion tax base is 67% larger than Memphis' \$37.8 billion base. The advantage comes despite Memphis' larger population of 646,889, compared to 545,524 in Nashville.

EXHIBIT 1
Nashville and Memphis Each Serve as Regional Hubs



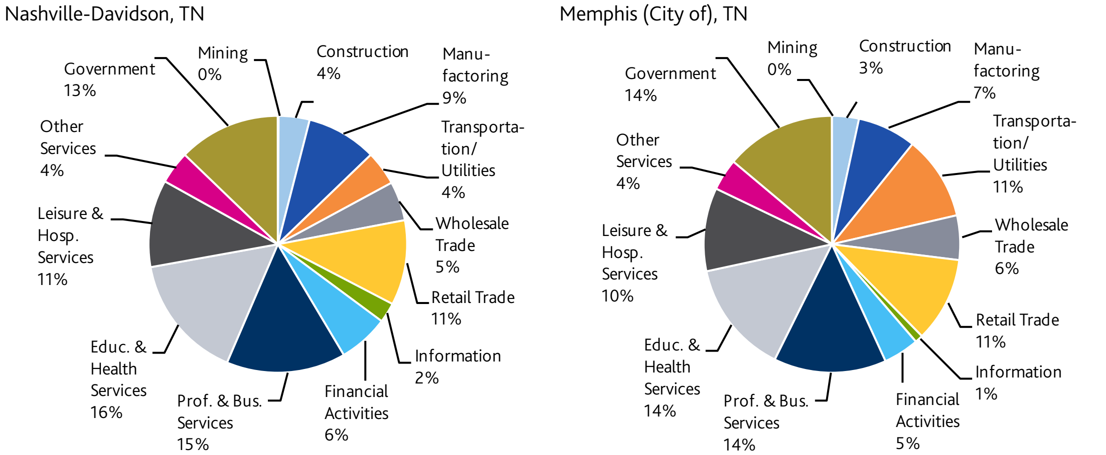
Source: Moody's

Nashville is a combined city and county government created by charter in 1962. The city services a 14-county metropolitan statistical area (MSA), the largest metro region in a five-state area. Nashville's growing economy gains stability from its status as the state capital, while it benefits from a very diverse employment base that includes federal, state and local government, financial and other professional business services, healthcare, education and manufacturing and tourism. No sector comprises more than 16% of the economy (see Exhibit 2). Additionally, Nashville's property taxpayers are diverse, with the 10 largest comprising less than 6% of total assessed value (see Exhibit 3). The lack of dependency on any one specific industry or taxpayer helped insulate Nashville from the impact of the recession and offers stability during general business cycles.

Memphis also boasts a large economy with similar diversity. Together with Shelby County, Memphis is the economic center of an eight-county tri-state MSA, which includes surrounding areas in Arkansas (Aa1 stable) and Mississippi (Aa2 stable). Education and healthcare services, transportation, tourism and financial services as well as government offer a diverse base. No single sector accounts for more than 14% of the economy and Memphis' 10 largest property taxpayers comprised less than 8% of total assessed value in fiscal 2013. However, Memphis faces considerable exposure to the fate of FedEx (Baa1 stable), which is headquartered in the city. FedEx is the city's largest employer (31,000 employees) and largest property taxpayer (4.6% of total assessed value in 2013), and various manufacturing and distribution centers benefit from proximity to the company's operations. In comparison, the next largest employer, Methodist Healthcare, has approximately 22,000 fewer employees. In recent years, FedEx reduced its workforce due to recessionary pressures, but has recovered and is in the process of constructing additional facilities in Memphis.

EXHIBIT 2

Nashville and Memphis Benefit from Diverse Economies



Source: Moody's Economy Metro Precis

EXHIBIT 3

Nashville and Memphis Benefit from Low Concentration Among Top-10 Taxpayers

Nashville, TN

Taxpayer	Rating	% of 2013 Assessed Valuation
HCA, Inc.	B3 positive	1.6%
RHP Hotel Properties, LP	B1 stable	1.5%
AT&T Inc.	A3 Ratings Under Review	0.9%
Opry Mills Co.	Not Rated	0.5%
Vanderbilt University, TN	Aa2 stable	0.4%
Green Hills Mall	Not Rated	0.3%
Verizon Communications Inc.	Baa1 stable	0.3%
Walmart Stores, Inc.	Aa2 stable	0.3%
Piedmont Natural Gas Company, Inc.	A2 stable	0.1%
Electric Power Board[1]	Not Rated	-
Top Ten Total	-	5.9%

Memphis, TN

Taxpayer	Rating	% of 2013 Assessed Valuation
FedEx Corporation	Baa1 stable	4.6%
BellSouth Corporation	A3 Ratings Under Review	0.8%
Wolfchase Galleria	Not Rated	0.5%
Valero Energy Corporation	Baa2 stable	0.3%
St. Francis Hospital	Not Rated	0.3%
BNSF Railway Company	Aa2 stable	0.3%
Archer-Daniels-Midland Company	A2 stable	0.2%
Kellogg Company	Baa2 stable	0.2%
AT&T Inc.	A3 Ratings Under Review	0.2%
Simon Property Group, Inc.	(P)A3 stable	0.2%
Top Ten Total	-	7.6%

[1] Represents payment in lieu of taxes and is not based on assessed valuation.
Source: Nashville and Memphis' Comprehensive Annual Financial Reports (CAFRs)

Tax base expansion in terms of assessed values and population have grown at very different rates in Nashville and Memphis. Nashville continues to enjoy a more stable base due in large part to the institutional presence of various governments, healthcare facilities and educational institutions (Vanderbilt University and Medical Center, Aa2 stable). The city benefits from relatively stable and high-paying jobs as well as good schools and affordable housing options. Its unemployment rate was a low 6.4% in 2013 and population saw a 32.8% increase from 1990 to 2012. These factors, combined with rising household incomes[1] and the strength of industrial production and retail sales, have led to

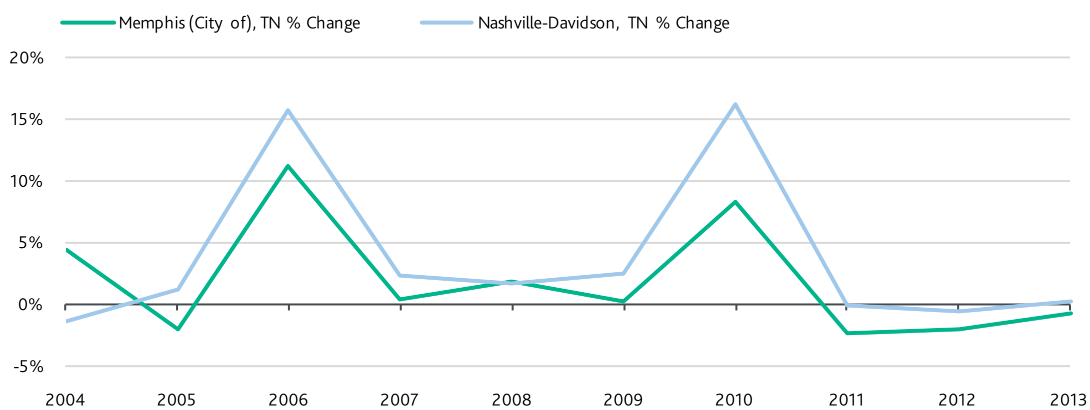
[1] Per capita income is $26,545 (111.9% of Tennessee and 97.1% of US medians). Median family income of $55,163 (103.6% of Tennessee and 87.6% of US medians). Source: 2010 American Community Survey.

rising tax base values. Assessed values within the tax base saw only minor declines throughout the recession (0.6% decline in 2011 and 2012) and began to increase modestly in 2013 (0.3% increase). Over the last five years, assessed values have grown at an average annual rate of 3.5% (2009-2013) (see Exhibit 4). Nashville's recovery is expected to continue with ongoing housing, commercial and retail development.

Memphis, in comparison, has experienced a more muted recovery. Important city industries such as manufacturing and trade have experienced only modest growth in the last several years, a trajectory that we expect will continue in the near term. In addition, unemployment levels remain elevated at 9.3% compared to the rest of the state at 8.2% and the nation at 7.4% in 2013 (see Exhibit 5). The city's lackluster labor market is its major source of economic weakness in the near term, although hourly earnings are rising.[2] Wealth levels in Memphis continue to be below average with a per capita income of $20,471, or 88% of the state and 76% of the national median. The city also has a median family income of $42,341, or 81% of the state and 68% of the national median.

Memphis' population experienced some moderate declines in the 1980s and early 1990s, but has grown lately as the city gains regional importance. Most recently, the city's population grew by approximately 1.6% from 2010 through 2012. Assessed value growth for Memphis has been relatively stagnant over the last five years, increasing by an average of 0.7% annually from 2009 to 2013, including a 0.8% decline in fiscal 2013. While the city is expected to grow at a slower rate than most of the Southeast due to the lagging labor market, assessed value is expected to stabilize in the near term as residential construction and consumer spending begin to accelerate.

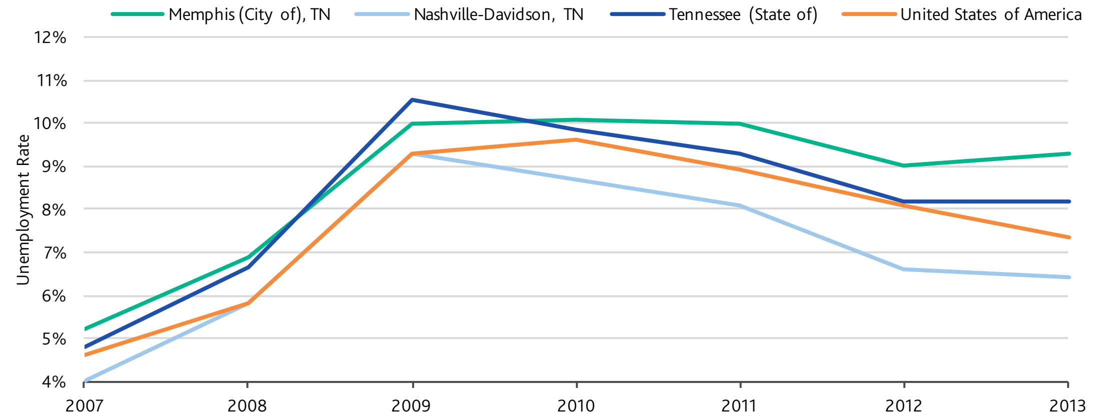
EXHIBIT 4
Growth in Assessed Value Is More Robust in Nashville



Source: Nashville and Memphis' CAFRs

2 Moody's Economy.com report on Memphis, March 2014

EXHIBIT 5
Nashville's Unemployment Lower Than Memphis and the US Since 2007

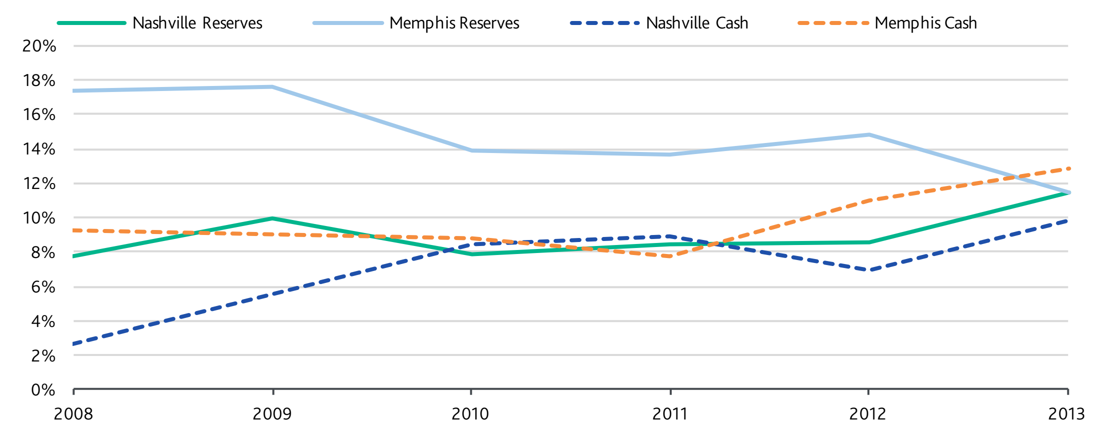


Source: Moody's Economy Metro Precis & Bureau of Labor Statistics

Financial strength appears similar, however each city grapples with different fiscal pressures

At first glance, Nashville's and Memphis' financial positions look very similar when considering reserve levels and cash positions at the end of fiscal 2013 (See Exhibit 6). Total General Fund balance levels finished at 11.5% of annual revenues for Nashville and 11.4% for Memphis, and cash positions were 9.8% and 12.9%, respectively. However, significant challenges present a divergence. These include sizable fixed costs for Memphis and an annual hospital subsidy and unchallenged property tax limit for Nashville.

EXHIBIT 6
Nashville and Memphis Maintained Similar Reserves in Fiscal 2013



Source: Nashville and Memphis' CAFRs

During the 2008-13 period, Nashville successfully increased its overall reserve and cash positions. As the national and regional economies began to recover, the city enjoyed a relatively quick return to revenue growth, especially in local sales, business, income and liquor taxes. Through fiscal 2014 and into fiscal 2015, we expect Nashville's reserve and cash levels to remain similar to historical levels with management continuing to budget revenues conservatively and maintaining tight expenditure controls.

Nashville is challenged by some unusual circumstances: an annual subsidy to the local hospital authority (which has declined 30% since 2008) and an unchallenged 2006 voter initiative that theoretically limits the government from raising property taxes beyond a certain amount (see below for more detail). The subsidy to the local hospital authority provides additional support for Metro General Hospital, Bordeaux Nursing Home and Knowles Assisted Living. To further reduce Nashville's annual subsidy to the hospital authority, the metro council approved a plan in March to privatize both the nursing home and assisted living facility. Nevertheless, the annual subsidy of $35 million still places some additional strain on Nashville's finances, accounting for 4.6% of its annual fiscal 2013 General Fund budget. It is expected to decrease to $30 million in fiscal 2016, providing the city with some added financial flexibility.

In November 2006, voters approved a ballot initiative prohibiting Nashville from raising real property tax rates above a set maximum level without voter approval. Nashville's legal department issued a memo stating that the initiative violates the Tennessee Constitution however, the matter has not yet been legally challenged. As a result, future necessary tax rate increases may be limited by the charter amendment, leading to constrained financial flexibility, if upheld in a court challenge. Nashville's tax rate is currently 17 cents below the charter amendment cap of $4.69 per $100 of assessed value.

Unlike Nashville's growth, Memphis' reserves declined 28.6% between fiscal 2008-13. This overall reduction in reserves was primarily due to lower-than-expected revenues, the city's annual contribution for Memphis City Schools (MCS), and unbudgeted costs for non-compliant interfund loans. At the same time, Memphis' cash position improved 34% due a reduction in receivables. While the city originally funded MCS operational costs from a portion of its property taxes, Memphis' state-required local maintenance of effort[3] spending was eliminated in fiscal 2014 with the transfer of MCS to the Shelby County school system. Although the city's annual maintenance of effort has ceased, the city has an outstanding $57 million liability to the school system for the 2008-09 school year, which the city is challenging in court. If the city's efforts are unsuccessful, it will seek to establish a payment plan with the schools; a lump-sum payment would represent 71% of the city's current cash position in fiscal 2013. Overall, the elimination of the annual local maintenance of effort expenditure provided the city with approximately $50 million in budget relief in fiscal 2014 and, as a result, the city is expecting to increase general fund balance by approximately $14.0 million to $84.0 million, or 13.2% of general fund revenues (unaudited) at year-end.

Memphis' financial position will remain challenged as fixed costs (including debt service, pensions and other post-employment benefits, OPEB) represented a very large 45% of operating expenditures in fiscal 2013. In contrast, Nashville's more moderate fixed-cost profile was 19% of operating expenditures. Memphis only contributed 21% of its pension Annual Required Contribution (ARC) in fiscal 2013, resulting in a $73 million funding gap. While pension contributions are expected to remain around the 20% level in fiscal 2014, the city plans to fully fund the ARC by fiscal 2020.

The newly adopted fiscal 2015 budget reflects the implementation of various efficiencies including healthcare reform that would produce $23 million in savings. A portion of these savings would be used to increase pension contributions by $27.4 million (50% of ARC in 2015) and reduce the overall pension funding gap to $48 million. Overall, Memphis' adjusted net pension liability (ANPL),[4] a high 2.46 times operating revenues, is well above that of Nashville's at 1.15 times.

[3] Requires local governments to fund local school systems by at least the same amount each year.

[4] Moody's ANPL reflects certain adjustments made to improve the comparability of reported pension liabilities.

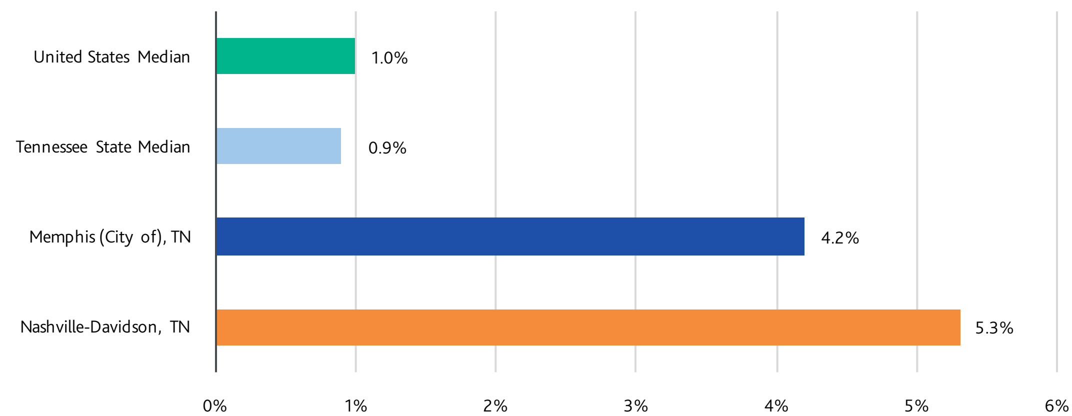
Debt levels for both cities are above average when compared to other municipalities in Tennessee and across the nation

Nashville and Memphis both have higher debt levels when compared to other municipalities in Tennessee and across the nation. Yet, Nashville's growing tax base provides greater debt affordability as tax base expansion typically results in increased revenues to offset debt costs. Nashville's 5.3% net direct debt burden[5] is well above the state median of 0.9% and the national median of 1.0% (see Exhibit 7). This disparity is the result of the city addressing the capital needs of an expanding and growing local and regional economy.

In addition to general infrastructure demands and high capital costs related to growing school funding, Nashville strengthened its tax base with projects that will continue to support the tourism sector, including the construction of a new convention center and several updates to local sports facilities. These projects were completed with debt financing and many are supported by specific revenues associated with the facilities as well as a pledge of the government's non-property tax revenues (Aa3 stable – see Exhibit 8). While Nashville maintains a sizable $3.1 billion Capital Improvement Plan (CIP) and a debt burden expected to remain above average for the near term, continued growth and economic expansion will provide it with ongoing revenue strength, which in turn improves the city's ability to afford the debt service, even for less essential projects.

EXHIBIT 7

Nashville and Memphis Have Above-Average Debt Burdens



Source: Moody's Municipal Financial Ratio Analysis

While Memphis' 4.2% debt burden is below Nashville's, it remains high and could grow due to a sizable CIP. The city currently maintains a $1.1 billion CIP for fiscal 2015-19, of which 40% is expected to be supported by additional bonds. The large CIP will primarily support the replacement and expansion of Memphis' older infrastructure in hopes of generating additional economic development. Although development has started to rebound, Memphis' debt burden is expected to remain above average in the near-term as growth within the city is expected to occur at a slower rate than in the remainder of the Southeast region . Debt service alone comprised a significant 19.6% of operating expenditures in fiscal 2013.

[5] We calculate debt burden as total net debt divided by full market value.

Similar to Nashville, Memphis also continues to leverage its non-property tax revenues by issuing bonds (Aa3 negative – see Exhibit 8) for non-general government projects such as basketball and baseball stadiums, a Bass Pro Shop and a port project. Non-property tax debt comprises 19% of the city's debt profile. While the investments in economic development are focused on revitalizing growth that could ultimately increase the tax base and lower the city's debt burden, the continued leveraging of non-property tax revenues could result in an overall decrease of financial flexibility since the pledged revenues are also used to support government operations.

EXHIBIT 8
Overview of Outstanding Debt for Nashville and Memphis

	Nashville, TN	
Security	**Rating**	**Amount Outstanding ($Millions)**
GOULT	Aa2 stable	$2,127.0
Non Ad-Valorem [7]	Aa3 stable	$196.1
	Memphis, TN	
Security	**Rating**	**Amount Outstanding ($Millions)**
GOULT	Aa2 negative	$1,240.1
Non Ad-Valorem	Aa3 negative	$293.3

[7] Secured by all legally available non-tax revenues excluding ad valorem revenues

Source: Nashville and Memphis' CAFRs

Moody's Related Research

Rating Updates:

» Moody's downgrades Metropolitan Government of Nashville & Davidson County, TN's GO bonds to Aa2 from Aa1; outlook is stable

» Moody's assigns Aa2 to Memphis, TN's $312.2M General Improvement Refunding Bonds, Series 2014A and 2014B; outlook is negative

Rating Methodology:

» US Local Government General Obligation Debt, January 2014 (162757)

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