South Bend, Indiana

Full Rating Report

Ratings

Issuer Default Rating	AA+

Outstanding Debt

Lease Rental Revenue Refunding Bonds	AA+
Taxable Lease Rental Revenue Refunding Bonds	AA+

Rating Outlook

Stable

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South Bend's 'AA+' Issuer Default Rating (IDR) reflects a below-average revenue framework that is offset by strong expenditure controls, a low long-term liability burden, and very strong operating performance. Fitch Ratings expects that the city will maintain strong reserve levels throughout an economic cycle. Fitch also believes that the insurance provisions sufficiently mitigate abatement risk to maintain the same rating on the lease revenue bonds and the IDR.

Key Rating Drivers

Economic Resource Base: South Bend is the fourth largest city in Indiana, located in the north central part of the state, approximately five miles south of the Michigan border and 90 miles east of Chicago. The University of Notre Dame is adjacent to the city. Population has stabilized after decreasing from 2000 to 2010, totaling 101,516 in 2015. Recent growth has indicated strengthening in economic prospects that Fitch expects to continue.

Revenue Framework ('a' factor assessment): Fitch expects the city's revenue growth to be solid. The city has limited independent legal ability to raise revenue.

Expenditure Framework ('aa' factor assessment): The city's expenditures should grow at a rate generally in line with revenue growth. Flexibility is supported by moderate costs for servicing debt and other long-term liabilities.

Long-Term Liability Burden ('aa' factor assessment): South Bend's long-term liability burden including pension liabilities and overall debt is moderate relative to personal income.

Operating Performance ('aaa' factor assessment): The city has exceptionally strong capacity to manage through an economic downturn through a combination of expenditure control and financial cushion and has maintained reserves at a very high level through the current economic recovery.

Rating Sensitivities

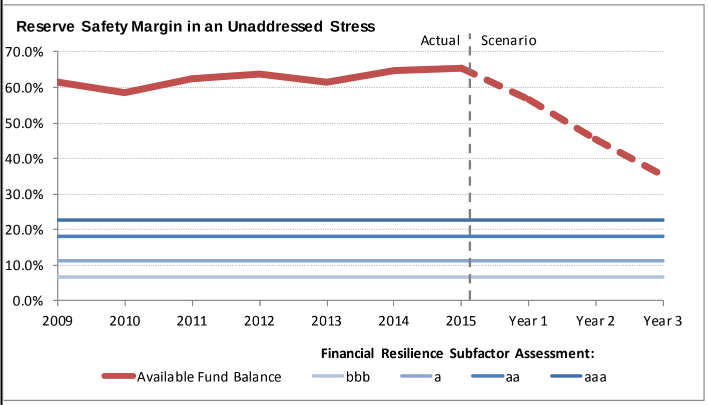
Continuing Solid Revenue Growth Prospects: The 'AA+' IDR is sensitive to Fitch's expectation of continued solid revenue growth over time, exceeding the pace of inflation. A slower revenue growth prospects assessment would create negative pressure on the current rating.

Continued Decline in Carrying Costs: The 'AA+' IDR is contingent on carrying costs of direct debt and pension contributions continuing to decline in the medium term.

South Bend (IN)

Scenario Analysis

v. 1.10 2016/06/22



Analyst Interpretation of Scenario Results:

This text must be entered in the Committee Memo and then captured by CreditBook.

Open the Committee Memo, add your commentary for "5.1 Financial Resilience Through Downturns", and if applicable, to "5.2 Scenario Analysis Comment". Then, click "Capture Text" on the CreditBook menu.

CreditBook will put both comments in the chart, 5.1 in the RAC, and the first sentence of 5.1 in the body of the research report.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(4.5%)	(0.8%)	2.8%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	72,628	90,680	83,645	87,710	81,951	86,651	86,414	82,498	81,803	84,134
% Change in Revenues	-	24.9%	(7.8%)	4.9%	(6.6%)	5.7%	(0.3%)	(4.5%)	(0.8%)	2.8%
Total Expenditures	64,526	88,261	85,170	84,289	82,853	87,474	82,002	83,642	85,315	87,021
% Change in Expenditures	-	36.8%	(3.5%)	(1.0%)	(1.7%)	5.6%	(6.3%)	2.0%	2.0%	2.0%
Transfers In and Other Sources	250	5,530	8,666	9,772	12,627	4,671	4,282	4,088	4,054	4,169
Transfers Out and Other Uses	4,677	8,136	8,996	11,953	15,548	8,615	9,782	9,977	10,177	10,380
Net Transfers	(4,427)	(2,606)	(330)	(2,181)	(2,921)	(3,943)	(5,500)	(5,889)	(6,123)	(6,211)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	3,676	(188)	(1,855)	1,239	(3,822)	(4,766)	(1,087)	(7,033)	(9,635)	(9,098)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	5.3%	(0.2%)	(2.0%)	1.3%	(3.9%)	(5.0%)	(1.2%)	(7.5%)	(10.1%)	(9.3%)
Unrestricted/Unreserved Fund Balance (General Fund)	23,103	26,913	26,489	27,837	27,012	27,029	30,130	23,097	13,463	4,365
Other Available Funds (Analyst Input)	19,333	29,411	32,478	33,637	33,534	35,042	29,947	29,947	29,947	29,947
Combined Available Funds Balance (GF + Analyst Input)	42,436	56,324	58,967	61,474	60,546	62,071	60,077	53,044	43,410	34,311
Combined Available Fund Bal. (% of Expend. and Transfers Out)	61.3%	58.4%	62.6%	63.9%	61.5%	64.6%	65.5%	56.7%	45.5%	35.2%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	72.5%	36.3%	22.7%	13.6%	9.1%
Reserve Safety Margin (aa)	54.4%	27.2%	18.1%	11.3%	6.8%
Reserve Safety Margin (a)	36.3%	18.1%	11.3%	6.8%	4.5%
Reserve Safety Margin (bbb)	13.6%	9.1%	6.8%	4.5%	2.3%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	10/4/16
AA+	Affirmed	Stable	10/26/10
AA+	Revised	Negative	4/30/10
AA	Assigned	—	5/17/96

Credit Profile

Manufacturing is still a major component of the area economy but the city also has strong service-based sectors with the University of Notre Dame, which is adjacent to the city, providing stability as the largest employer. Other major employers include Beacon Health System, South Bend Community School Corporation, and AM General.

City income levels are below average and poverty levels are almost double those of the state and nation. Low income levels are likely reflective, in part, of a large student population. Taxable assessed valuation of approximately $2.2 billion improved slightly for 2015 after declining almost 10% from 2010 to 2014.

Revenue Framework

The city's operating revenue comes from several main sources, with the largest, property tax revenue, at 43% of the city's operating funds revenue (the general fund, county option income tax [COIT] fund, economic development income tax [EDIT] fund, and public safety local option income tax [LOIT] fund). State payments on behalf of the city toward the 1925 Police Officers' Pension Plan and the 1937 Firefighters' Pension Plan make up 13%. Other large revenue sources include charges for services (7%) and intergovernmental revenue (5%). Approximately 29% of revenue comes from the various income taxes.

The city has very little ability to independently raise operating revenues. The city's property tax was capped under the state's 2008 Property Tax Cap (Circuit Breaker) legislation. This cap guarantees that property tax rates in overlapping districts cannot exceed a certain percentage of the parcel's gross assessed value, with homestead properties capped at 1%, other residential and agricultural land at 2%, and commercial and industrial property at 3%. As per legislation implemented on July 1, 2016, the city can increase the local option income taxes to a maximum of 3.75%, an increase from the prior 1.75%. This would require the support of one other governmental unit in the county (either the city of Mishawaka or Saint Joseph County), and is therefore not in the independent legal control of the city.

Fitch expects total operating fund revenue to grow going forward at a rate above historical revenue growth, above the level of inflation. General fund revenue has grown at a slow 0.4% compound annual growth rate (CAGR) over the 10 years through 2014, largely due to the implementation of the circuit breaker property tax caps, which caused a decrease in property tax revenue in fiscal years 2009 and 2010. That legislation limited property tax growth in the general fund, but allowed for revenue growth in the city's other operating funds where income taxes are collected. The 10-year CAGR through 2014 including the COIT, EDIT, and LOIT funds is a stronger 2.1%.

While the city is conservatively projecting 1% property tax growth and 2% income tax revenue growth in the near term, the city has seen increases in the income tax revenue streams of 9%, 3%, and 5% respectively over the past three fiscal years. Fiscal 2017 income tax revenue is trending 10% over fiscal 2016 levels due to the strength and stability in the local economy that includes the impact of the University of Notre Dame and the increasingly strong local job market. Fitch expects that the strengthening of the job market in the local economy will continue.

Related Criteria
U.S. Tax-Supported Rating Criteria (April 2016)

Expenditure Framework

The city's main expenditure item is public safety, which accounts for approximately 75% of the city's operating fund expenditures. Other expenditures include capital projects (13%) and debt service (3%).

Fitch expects that the city's natural pace of expenditure growth will be in line with the expected revenue growth rate. The largest drivers in the city's expenditure items include costs related to the labor force, which are expected to grow at 2.0% for the police force and 2.2% for firefighters, which combined make up the largest portion of the city's workforce.

The city maintains a solid degree of expenditure flexibility. While carrying costs were somewhat high for the rating category in fiscal 2015 at approximately 20% of governmental expenditures, the city expects costs to decline beginning in fiscal 2017 due to decreasing debt service payments. This is also due to approximately $1.7 million in annual debt service payments that management has moved from the city's operating funds to Tax Increment Financing funds, where the city has large cash balances that provide flexibility. City management also has a large degree of control over staffing levels and implementing workforce reductions.

Long-Term Liability Burden

The city's long-term liability burden is moderate, with debt and pension liabilities at 12% of personal income. As is typical in Indiana, due to stringent restrictions on the issuance of general obligation debt, the city relies upon the use of lease rental revenue bonds payable from ad valorem taxes. No new debt is expected in the medium term. Approximately $191 million of the total $421 million liability burden is in the form of pension liabilities.

The city participates in the state-run Public Employees' Retirement Fund (PERF). This provides pensions for all full-time employees other than police officers and firefighters, who are covered under the 1977 Police Officers' Pension and Disability Fund and the Firefighters' Pension and Disability Fund. PERF is a cost-sharing multiple-employer defined benefit pension plan, to which the city makes 100% of the required contribution. Indiana statute requires funding of the pension plans for police officers and firefighters to be funded on a pay-as-you-go-basis, which has caused a very low funded ratio. As a result of the circuit breaker legislation, the state assumed responsibility of the funding of these plans. Fitch calculates the ratio of assets to liabilities of the three plans to be a weak 47% assuming a 7% discount rate.

Operating Performance

The city has maintained an exceptionally high level of available fund balance throughout the recession and subsequent recovery relative to potential revenue declines depicted by the Fitch Analytical Sensitivity Tool (FAST) in a moderate economic downturn. For details, see "Scenario Analysis" on page 2.

The city has made consistent efforts to maintain a high level of available reserves in the recent economic recovery. Management projects to end fiscal 2016 with a surplus of over $1 million out of an $82 million budget. The city plans to adopt the fiscal 2017 budget later this month.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.