FITCH AFFIRMS SOUTH BEND REDEVELOPMENT AUTHORITY, (IN)'S LEASE REVS AND IDR AT 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-04 October 2016: Fitch Ratings has affirmed the 'AA+' rating on the following South Bend Redevelopment Authority, Indiana bonds:

--$3 million taxable lease rental revenue refunding bonds series 2011A (College Football Hall of Fame Project);
--$1.2 million lease rental revenue refunding bonds series 2011B (Century Center Project);
--$1.5 million lease rental revenue refunding bonds series 2009 (Morris Performing Arts Center).

In addition, Fitch has affirmed the city of South Bend's Issuer Default Rating (IDR) at 'AA+'.

The Rating Outlook is Stable.

SECURITY

The lease revenue bonds are payable from semiannual lease payments payable to the trustee two days prior to debt service payment on the bonds.

The lease payments are secured by an unlimited ad valorem tax levied by the South Bend Redevelopment Commission, on all taxable property in the City of South Bend Redevelopment District, an area coterminous with the city. Lease payments are not subject to annual appropriation.

If the leased property is damaged or destroyed, the Commission shall abate the lease payments for the period of time the leased property is unfit for use or occupancy. To mitigate the abatement risk, the Commission is required to carry physical loss insurance equal to the greater of 100% of the replacement cost of the property or the amount needed to redeem the outstanding bonds and rental interruption insurance equal to two years. The leased properties consist of the College Football Hall of Fame, the Morris Performing Arts Center, and the Century Center Complex.

The College Football Hall of Fame, for which the series 2011A bonds were issued, vacated its building in South Bend at the end of 2012 and moved to Atlanta. The city is in the process of selling the building to a developer who is building a hotel adjacent to that site. The last lease rental payment is Feb. 1, 2018. At that point, the city will stop levying the special property tax rate for the associated debt service and the developer will own the building outright. Fitch believes there is minimal risk of lease payments not continuing as there is no appropriation risk; a special property tax levy is used to pay debt service without tapping into general fund revenue or local option income tax revenue.

KEY RATING DRIVERS

The city's 'AA+' 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 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.

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. After decreasing from 2000 to 2010, population has stabilized, 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+' rating is sensitive to Fitch's expectation of continued solid revenue growth, exceeding the pace of inflation, over time. A slower revenue growth prospects assessment would create negative pressure on the current rating.

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

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, about $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 ten years through 2014, largely due to the implementation of the circuit breaker property tax caps, which caused a decrease in property tax revenue in FY 2009 and FY 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 going forward, the city has seen increases in the income tax revenue streams of 9%, 3%, and 5% respectively over the last three fiscal years. FY 2017 income tax revenue is trending 10% over FY 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.

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% 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 FY 2015 at approximately 20% of governmental expenditures, the city expects costs to decline beginning in FY 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 TIF 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. Fitch expects that available general fund and other operating fund reserves (66% of expenditures in fiscal 2015 and no less than 68% of spending dating back to fiscal 2009) would remain well above the 'aaa' reserve safety margin level, even in an unaddressed moderate recessionary period. Moreover, Fitch expects that the city would make use of its expenditure controls and thereby minimize use of its available reserves in response to revenue deterioration.

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

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478