

CREDIT OPINION

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Update

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South Bend (City of), IN

Rating Update - Moody's Downgrades South Bend, IN's Lease Revenue Bonds to Aa3

Summary Rating Rationale

Moody's Investors Service has downgraded the rating on the City of South Bend, IN's lease revenue bonds to Aa3 from Aa2. The Aa3 rating applies to the Lease Rental Revenue Refunding Bonds of 2008; Lease Rental Revenue Refunding Bonds of 2009 (Morris Performing Arts Center Project); Taxable Lease Rental Revenue Refunding Bonds, Series 2011A (College Football Hall of Fame Project); and Lease Rental Revenue Refunding Bonds, Series 2011B (Century Center Project). This action concludes a review undertaken in conjunction with the July 2016 publication of the Lease, Appropriation, Moral Obligation, and Comparable Debt of US State and Local Governments Methodology.

The Aa3 lease revenue rating is one notch lower than Moody's internal assessment of the city's hypothetical general obligation unlimited tax (GOULT) rating. The city's fundamental credit characteristics include a moderately-sized tax base that is home to Notre Dame University (Aaa stable); low resident income indices; ample operating reserves; and somewhat elevated debt and pension obligations.

The notching from the hypothetical GOULT rating reflects the lease revenue bonds' legal structure, in which lease payments are subject to abatement risk if the properties are unable to be used. The Aa3 lease revenue rating also incorporates the nature of the assets financed with the lease revenue bonds. The pledged assets for the Series 2008 bonds are infrastructure improvements, which we consider more essential to municipal operations. The pledged assets for Series 2009, 2011A, and 2011B bonds are a performing arts center, a museum, and a convention center, respectively, which we consider less essential to municipal operations. Finally, the Aa3 lease revenue rating reflects the city's pledge to use its ad valorem taxing authority to fund lease payments, a pledge which is not subject to Indiana's Circuit Breaker taxing limitations.

Credit Strengths

- » Moderately-sized tax base that is home to Notre Dame University
- » Ample operating fund balances and liquidity

Credit Challenges

- » Low resident income indices
- » Somewhat elevated debt and pension obligations

Rating Outlook

Outlooks are typically not assigned to local government credits with this amount of debt.

Factors that Could Lead to an Upgrade

- » Significant tax base growth and/or improvement in resident income indices
- » Moderation of debt levels

Factors that Could Lead to a Downgrade

- » Declines in tax base valuation and/or weakened resident income indices
- » Draws on operating fund balances and/or liquidity
- » Increases in debt levels

Key Indicators

Exhibit 1

South Bend	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 4,991,866	\$ 4,910,736	\$ 5,091,221	\$ 4,842,882	\$ 4,837,490
Full Value Per Capita	\$ 49,080	\$ 48,486	\$ 50,477	\$ 48,225	\$ 47,816
Median Family Income (% of US Median)	66.7%	66.0%	65.8%	63.9%	63.9%
Finances					
Operating Revenue (\$000)	\$ 105,537	\$ 108,141	\$ 93,940	\$ 84,793	\$ 80,992
Fund Balance as a % of Revenues	66.0%	65.6%	74.2%	83.5%	80.1%
Cash Balance as a % of Revenues	66.2%	66.2%	76.4%	83.8%	85.1%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 133,140	\$ 127,583	\$ 122,393	\$ 113,722	\$ 131,737
Net Direct Debt / Operating Revenues (x)	1.3x	1.2x	1.3x	1.3x	1.6x
Net Direct Debt / Full Value (%)	2.7%	2.6%	2.4%	2.3%	2.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	0.7x	1.0x	1.3x	1.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	1.5%	1.8%	2.2%	2.2%

Source: Moody's Investors Service, Audited Financial Statements, US Census data

Detailed Rating Considerations

Economy and Tax Base: Moderately-Sized Tax Base Anchored by Notre Dame University

Despite recent declines in valuation, we expect South Bend's tax base to remain relatively stable due to the institutional presence of higher education institutions. Located approximately 140 miles north of [Indianapolis](#) (Aaa negative) and 90 miles east of [Chicago](#) (Ba1 negative), South Bend serves as a regional economic hub and the seat for [St. Joseph County](#) (Aa3). South Bend is home to several colleges and universities, including the [University of Notre Dame](#) (Aaa stable), which lends considerable stability to the regional economy. The city's \$4.8 billion tax base has experienced average annual declines of 0.9% over the past five years, though valuations are expected to stabilize given new development and recovery in residential home values. Resident income levels are weak, with median family income at 64% of the US. As of July 2016, the county's unemployment rate of 5.3% was above both the state (4.4%) and nation (5.1%).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Financial Operations and Reserves: Strong Financial Profile with Ample Reserves

The city's financial operations are expected to remain stable due to conservative fiscal management and plans to maintain reserve levels. Following a modest General Fund deficit in fiscal 2014, the city closed fiscal 2015 with a General Fund surplus of \$3 million due to increased tax revenues. Available fund balance across all operating funds (General, Debt Service, County Option Income Tax, County Economic Development Income Tax, and Rainy Day Funds) totaled \$64.9 million, or 80% of operating revenues, at the close of fiscal 2015. Management reports positive operations in the current year, and anticipate recording a fiscal 2016 surplus of \$500,000. For fiscal 2017, the city has budgeted for balanced operations.

LIQUIDITY

The city closed fiscal 2015 with a net cash position in its operating funds of \$68.9 million, or an ample 85% of operating revenues.

Debt and Pensions: Somewhat Elevated Debt and Pension Obligations

South Bend's direct debt burden is elevated at 2.7% of gross assessed value and 1.6 times operating revenue. The debt burden is mitigated somewhat by alternate revenue support for a portion of debt service and lease payments. Such revenues include economic development income tax (EDIT) and county option income tax (COIT) revenues. Fiscal 2015 fixed costs, which include debt service and pension contributions, comprised 16.3% of operating revenues.

The outstanding lease revenue debt is not subject to appropriation but is subject to abatement if the pledged assets are unable to be used. The city has issued lease revenue bonds for a variety of purposes, including construction of a performance arts center, the College Football Hall of Fame museum, and a convention center, projects which we consider less essential to city operations, and for infrastructure improvements, which we consider more essential. The city pledges its unlimited ad valorem taxing power for the lease payments on all outstanding series, which provides some uplift to the lease revenue ratings but does not entirely remove abatement risk.

DEBT STRUCTURE

All of the city's outstanding debt is fixed rate and amortizes over the long term.

DEBT-RELATED DERIVATIVES

The city has no exposure to any debt related derivatives.

PENSIONS AND OPEB

City employees participate in four separate pension plans: the Public Employees Retirement Fund (PERF), the 1925 Police Officers' Pension Plan, the 1937 Firefighters' Pension Plan, and the 1977 Police Officers' and Firefighters' Pension and Disability Fund. PERF is a multi-employer agent plan administered by the Indiana Public Retirement System (INPRS). Moody's three year average adjusted net pension liability (ANPL) for the city through fiscal 2015, under our methodology for adjusting reported pension data, was \$107.2 million, or an above average 1.3 times annual operating revenue and 2.2% of full valuation. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended replace the city's reported contribution information, but to improve comparability with other rated entities. We determined the city's share of liability for their plans in proportion to its contributions to the plan and covered payroll.

The city's other post employment benefits (OPEB) liability is funded on a pay as you go basis, and the city contributed \$719,000 in fiscal 2015. The total unfunded liability is \$21.5 million as of January 1, 2015, the most recent update to the valuation report.

Management and Governance: Moderate Institutional Framework

Indiana cities have an institutional framework score of "A," or moderate. Cities have moderate revenue-raising ability. Circuit Breaker legislation limits property tax levies to a percentage of gross assessed value, but cities can seek voter approval for additional tax revenue. Unlike most of the [State of Indiana](#) (Aaa stable), South Bend benefits from a provision of the legislation which allows for debt service on obligations issued or lease rentals for leases entered into before July 1, 2008, payable from ad valorem taxes in counties with an estimated loss of property taxes equal to at least 20% of the levy (currently only Lake and St. Joseph Counties), be exempt from Circuit Breaker calculations through 2019. Indiana cities rely on income taxes for 30% to 40% of revenues. Cities have low revenue predictability, as the state has adjusted income tax distributions in the past. Cities have a high ability to adjust expenditures, which mostly consist of public safety and health services. Expenditures are highly predictable and manageable given limited public sector union presence and moderate pension costs.

Legal Security

South Bend's lease revenue debt is secured by rental payments from the South Bend Redevelopment Commission to the City of South Bend Redevelopment Authority. The Redevelopment District pledges its ad valorem property taxing power to the lease payments, but the pledge is subject to abatement risk if the property is unable to be used. The pledge is not subject to Indiana's Circuit Breaker taxing limitations. The boundaries of the Redevelopment District and the City of South Bend are coterminous.

Use of Proceeds

Not applicable.

Obligor Profile

The City of South Bend is located 90 miles east of Chicago, and serves as the seat for St. Joseph County. It encompasses 42 square miles, and is the fourth largest city in Indiana with an estimated population of 101,000.

Methodology

The principal methodology used in this rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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