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Summary:

South Bend, Indiana; Miscellaneous Tax

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Credit Profile		
US$5.595 mil econ dev income tax bnds ser 2015 due 08/01/2035		
Long Term Rating	AA-/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' long-term rating to South Bend, Ind.'s series 2015 economic development income tax (EDIT) bonds. The outlook is stable.

Securing the bonds is a pledge of South Bend's distributive share of St. Joseph County's county EDIT revenues. A debt service reserve fund (DSRF), which is to be cash funded at closing through bond proceeds, provides additional security. The DSRF requirement is equal to the standard three-prong test, which the city expects to be at maximum annual debt service (MADS).

The 'AA-' rating reflects our view of the city's:

- Stable EDIT revenues, which we expect will remain stable or strengthen in the near term;
- Very strong MADS coverage by pledged EDIT revenues; and
- Stable countywide tax base, anchored by South Bend and the University of Notre Dame.

Offsetting credit factors include:

- An adequate additional bonds test (ABT);
- Only adequate income levels; and
- The allocation formula, which presents minor risk to the percentage share of countywide revenues that the city receives.

Officials intend to use bond proceeds to begin funding a long-range plan for park and park facilities improvements.

EDIT revenues pledged to the series 2015 bonds are also pledged on a parity basis to the city's existing series 2006A and 2006B bonds, both of which mature in February 2017. The city also pledged EDIT revenues in an amount equal to 29.03% (about $200,000) of annual debt service on St. Joseph County's series 2014 EDIT revenue bonds. Pursuant to an interlocal agreement between the county and city, once the series 2015 bonds close, the city will use existing cash on hand (from its EDIT fund) to prepay its share of the county's series 2014 bonds that is due through maturity on the city's series 2006A and 2006B bonds. This means through February 2017, the city will collect 100% of its distributive monthly share of EDIT revenues, which will all be available for payment on the series 2006A, 2006B, and 2015 bonds. Following maturity of the 2006A and 2006B bonds, the county will begin to withhold a portion of monthly distributions due to the city, in amounts equal to one-twelfth of the city's annual share of the county's series 2014 bonds. Though the EDIT pledge for the county's series 2014 bonds is not legally superior, it is structurally senior (beginning in

February 2017) given that EDIT revenues the city receives will be net of portions paid toward the county's series 2014 bonds. However, given the minimal size of revenue pledged to the county's series 2014 bonds, compared with total pledged EDIT revenues, we do not consider this a weakness.

St. Joseph County levies its EDIT on the adjusted gross income of county residents and on those who maintain their principal place of business in the county and who are not subject to county income tax elsewhere in Indiana. The EDIT rate was increased to 0.4% from 0.2% in 2010. Combined with the 0.6% county option income tax, the two taxes are at the maximum permitted combined rate of 1%. There is no maturity on the tax, and it cannot be rescinded while the bonds are outstanding.

EDIT revenues are distributed by the state monthly to the county (and then to each taxing unit) and certifications for each calendar year are based on income tax returns filed in the state's previous fiscal year.

South Bend's distributive share of countywide EDIT revenues is based on the city's total property tax levy in proportion to the aggregate property tax levies of all civil taxing units in the county. Thus, EDIT receipts could decline if the city lowered its property taxes or if property tax levy growth in other taxing jurisdictions throughout the county outpaced the growth of South Bend's property tax levy. Given circuit-breaker limitations, rapid swings in property tax levies are not very common, which somewhat tempers the allocation risk. South Bend's distributive share of total county EDIT revenues has typically ranged between 35% and 40%, including between 39.6% and 39.9% each of the past three years. We do not expect the percentage share to deviate much from this trend.

After declines in 2011 and 2012, which were due to a combination of delayed recessionary impacts and errors in state-distribution methods, EDIT revenues have been on a steady rise. The city's EDIT revenues were up 8.9% in 2013 and 7.6% in 2014, and certified 2015 revenues are up 4.4% to $9.18 million. Certified countywide EDIT revenues are $23.08 million for 2015.

The city's certified 2015 EDIT revenues cover MADS by a very strong 6.2x. Including the series 2006A and 2006B bonds, and the pledged annual amount for the county's series 2014 bonds, MADS is $1.48 million and occurs in 2016. Once the series 2006A and 2006B bonds mature in February 2017, debt service (and MADS) will decline dramatically to $597,000. Holding revenues flat at 2015 certifications, MADS coverage would improve to 15.4x in 2017.

Outside of debt service, the county uses EDIT revenues mostly to support ongoing capital and economic development type costs, including subsidizing streets department budgets, department of community investment administrative costs, and removal of vacant/abandoned properties. EDIT revenues are not collected in the general fund nor are they used to support general fund operations; however, the expenses being covered are recurring, as opposed to one-time capital projects.

To issue additional parity debt, EDIT revenues to be received by the city (according to the most recently state-certified annual distribution amount) must provide at least 1.5x MADS coverage of existing and proposed additional debt. However, annual EDIT revenues used in the formula can include cash in a DSRF that secures existing debt. It can also include estimated interest earnings on the certified annual EDIT revenues. While the permitted use of a DSRF or estimated interest earnings in the ABT calculation is not likely to have a material effect on overall coverage, it does weaken our view of the ABT.

The city indicates it has no plans to issue additional parity debt at this time, despite the large amount of debt rolling off in 2017. Officials intend the series 2015 bonds to finance the beginning phase of a proposed $25 million to $30 million long-term parks master plan. Officials indicated the entire plan ultimately may not be fully funded, and that the plan is designed to be funded over a 20-year period. Given the 1.5x ABT and underlying purpose of the EDIT revenues, which are not for general fund purposes but rather for recurring expenditures, we anticipate that coverage could become diluted in the future due to additional debt, but we do not expect it would be significantly diluted.

South Bend is 90 miles east of Chicago in St. Joseph County. The county's estimated 2014 population is 265,770, with South Bend at 100,347. Countywide incomes are stronger than those of the city, yet are still only adequate, with both median household and per capita effective buying incomes at 87% of national levels. St. Joseph County unemployment dropped to a 6.7% average in 2014, which is now below state and national levels. South Bend is home to several colleges and universities, most notably the University of Notre Dame, which employs about 5,920 and has a student body of about 12,000. This presence is a stabilizing factor for the economy, and suppresses, to an extent, city and county incomes. South Bend serves as a regional economic center for the area. We do not consider the tax base concentrated.

Outlook

The stable outlook reflects our expectation that pledged EDIT revenues will remain steady and continue to provide very strong DSC through the two-year outlook period. Given the adequate incomes, nongeneral fund operating use of EDIT revenues, and the adequate ABT, we do not expect to raise the rating. On the other hand, if the city were to significantly dilute coverage through additional debt (or if EDIT revenues fall precipitously, which is less likely than the issuance of additional debt, in our view), we could consider a lower rating.

Related Criteria And Research

Related Criteria

- USPF Criteria: Special Tax Bonds, June 13, 2007
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Institutional Framework Overview: Indiana Local Governments

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