

CREDIT OPINION

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 Rate this Research

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Alpena (County of) MI

Update to credit analysis

Summary

Our credit view of [Alpena County](#) (Aa3) is influenced by its robust operational fund balance and liquidity, which will allow the county to absorb future budgetary challenges, including rising fixed costs or potential revenue loss associated with tax base declines. However, the county's credit upside may be restricted by its remote location in northern [Michigan](#) (Aa1 stable), and related small population and limited economic base. Upcoming capital borrowing will increase the county's debt burden, though we expect annual fixed costs to remain moderate. The county's pension burden is also moderate relative to both the tax base and the county's budget.

Credit strengths

- » Robust operational fund balance and liquidity
- » Moderate debt, pension and fixed costs burdens

Credit challenges

- » Remote location and limited economy restrict tax base growth potential
- » Below average resident income and wealth
- » Michigan's strict tax caps limit revenue growth

Rating outlook

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

Factors that could lead to an upgrade

- » Significant economic and tax base expansion
- » Materially improved demographic trends and socioeconomic indicators

Factors that could lead to a downgrade

- » Notable economic and/or tax base contraction
- » Sustained declines in operating fund balance or liquidity
- » Material growth in the county's debt or pension burdens

Key indicators

Exhibit 1

Alpena (County of) MI	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$2,012,874	\$1,932,933	\$2,035,574	\$2,030,238	\$2,083,488
Population	29,399	29,242	29,068	28,929	28,462
Full Value Per Capita	\$68,467	\$66,101	\$70,028	\$70,180	\$73,202
Median Family Income (% of US Median)	74.6%	72.6%	72.5%	74.8%	74.8%
Finances					
Operating Revenue (\$000)	\$9,775	\$10,068	\$10,356	\$10,550	\$10,790
Fund Balance (\$000)	\$13,717	\$13,890	\$14,184	\$14,501	\$14,570
Cash Balance (\$000)	\$12,978	\$13,187	\$13,579	\$13,932	\$14,015
Fund Balance as a % of Revenues	140.3%	138.0%	137.0%	137.5%	135.0%
Cash Balance as a % of Revenues	132.8%	131.0%	131.1%	132.1%	129.9%
Debt/Pensions					
Net Direct Debt (\$000)	\$2,048	\$3,375	\$2,635	\$1,388	\$1,302
3-Year Average of Moody's ANPL (\$000)	\$13,350	\$14,679	\$15,887	\$16,799	\$18,723
Net Direct Debt / Full Value (%)	0.1%	0.2%	0.1%	0.1%	0.1%
Net Direct Debt / Operating Revenues (x)	0.2x	0.3x	0.3x	0.1x	0.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.7%	0.8%	0.8%	0.8%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.4x	1.5x	1.5x	1.6x	1.7x

The county plans to issue \$13 million of bonds in November 2018 to finance capital projects. As a result, its net direct debt burden will rise to 0.7% of full value and 1.3x operating revenue. Source: Moody's Investors Service, US Census Bureau, Alpena County audited financial statements

Profile

Alpena County encompasses 640 square miles along Lake Huron in the northeastern portion of the state's Lower Peninsula. The county operates under an elected Board of Commissioners and provides county services to a population of 28,462. The City of Alpena is the county seat.

Detailed credit considerations

Economy and tax base: modestly populated county in northern Michigan

We expect the county's economy and tax base will remain stable, albeit with modest prospects for long-term growth given its geographical location and limited local economy. Tourism has long been an important component of the area's regional economy given the considerable amount of shoreline along Lake Huron. The county is home to just one city, the City of Alpena, where roughly 40% of residents reside and where much of its economic activity is centered. The county's largest employers are a mix of healthcare providers, local government units and retailers. The county's total workforce declined by 12% over the past decade. This, along with low population density and a median age of 47 suggests future economic growth will be slow. At 4.6% in August 2018 unemployment was above average, though not significantly elevated as compared to the state and nation. Median family income is a low 74.8% of the US.

Currently valued at \$2.1 billion the county's tax base is smaller than sector medians in similar rating categories. Although the tax base grew on average 0.8% annually over the last five years, full value remains roughly 15% below its 2008 peak. The majority of the tax base consists of residential property (70% of 2018 taxable value), followed by commercial (11%), personal (8%), and agricultural (7%) property. The number of seasonal homes help to prop up the county's solid 2018 full value per capita of \$73,446.

Financial operations and reserves: robust reserves provide cushion against potential budgetary pressures

Alpena County's strong financial position will allow it to withstand a high degree of budgetary pressure. The county recorded general fund operating surpluses in each of the past fourteen audited fiscal years, including a modest \$185,000 surplus in fiscal 2017. The

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surplus increased year-end available balance to \$4.9 million, or 52.5% of general fund revenue. In addition to the general fund we consider the county's core operating funds to consist of sizable non-capital funds primarily supported by recurring local and state revenues. These funds include the county's debt service, delinquent tax, ambulance, older persons act, and youth and recreation funds. Total available operating fund balance stood at \$14.6 million, or an ample 135% of combined operating fund revenue. For fiscal 2018 county officials expect to draw down \$524,000 in general fund reserves to help partially cash finance a one-time capital project.

The sizable reserves mitigate the county's restrictive revenue raising environment related to the state's constitutional rollback and assessment caps. The tax caps will limit the county's ability to leverage tax base growth, while also leaving the county vulnerable to revenue loss during periods of tax base declines. Property taxes are the county's largest revenue source, accounting for 41% of fiscal 2017 total governmental revenue. In addition to the general operating millage, the county has a variety of supplemental millages dedicated to specific purposes, including recreation, services for senior citizens, and ambulance services. Additionally, in November 2017 county voters approved a supplemental jail millage which will help pay debt service costs associated with a new jail facility described in the debt section below. Other major revenue streams include state aid (23%) and charges for services (21%).

LIQUIDITY

The county's liquidity is very healthy, and includes a significant amount of cash held in the delinquent tax revolving fund (DTRF). At the close of fiscal 2017 the county held \$14 million in cash across its variety of operating funds, which includes \$7.7 million in the DTRF. The county utilizes the DTRF to purchase the delinquent taxes of underlying local governments, collecting fees and interest expenses on the taxes that are subsequently received. Unlike many counties which may borrow through delinquent tax anticipation notes, Alpena County cash finances all of its delinquent tax purchases.

Debt and pensions: growing but manageable debt burden, moderate pension burden

While set to rise, the county's debt burden will remain moderate. Alpena County plans to sell \$13 million in general obligation limited tax (GOLT) bonds for capital projects. Projects include a local funding match for various capital upgrades at the county airport, as well as the construction of a new county jail and sheriff's office sized at \$11.6 million. Debt service on the bonds will be funded through the county's general operations, with payments on the jail debt aided by the recently approved 20-year jail millage. The county also expects to provide a \$1.0 million capital contribution from the general fund to pay towards the airport projects. The capital contribution is the main reason for the general fund's expected draw in fiscal 2018 which is not indicative of structural imbalance. Though the county's annual fixed costs are set to rise \$900,000 beginning in fiscal 2019, the new costs will be covered by the jail tax.

Following the sale of the upcoming bonds the county's debt burden will rise to a moderate 0.7% of full value and 1.3x operating revenue. In addition to the county's debt burden, the county has a similarly sized pension burden. The Moody's three-year average adjusted net pension liability (ANPL) is \$18.7 million, equal to an additional 0.9% of full value and 1.7x operating revenue.

DEBT STRUCTURE

Once the jail and airport bonds are issued the county's debt will consist of \$14.3 million in fixed rate GOLT bonds that amortize over the long term. The upcoming bonds will be structured with relatively even debt service through final maturity in 2038. Payout of outstanding principal is relatively slow, with 47% retired within the next ten years. The slow retirement schedule should match the useful life of the capital projects being constructed.

DEBT-RELATED DERIVATIVES

The county is not a party to any derivative or interest rate swap agreements.

PENSIONS AND OPEB

The county participates in a defined benefit pension plan administered by the Michigan Municipal Employees' Retirement System (MERS). As of December 31, 2017 the county had a total of 222 inactive and active employees that are receiving or are scheduled to receive pension benefits. Benefits for certain employee groups have been closed to new hires. The county has been in compliance with state law as it continues to annually contribute the full amount of the plan's actuarially determined contribution. At the same time, the county continues to discount its accrued liabilities at 8%, a rate that is high compared to that of many other public pension plans. While recent market returns may moderate the liability over the near-term, the county's costs will likely rise going forward.

The county carries no other post-employment benefit (OPEB) liabilities as it does not offer healthcare benefits to its retirees.

Management and governance: moderate institutional framework

Michigan counties have an institutional framework score of "A," or moderate. Counties rely on property tax and state aid revenues, which in combination are moderately predictable. Counties have moderate revenue-raising ability, since they face limits on taxable valuation growth (Proposal A) and revenue growth (Headlee Amendment). The Headlee Amendment also creates a permanent reduction in the millage rate, although voters can approve an override. Alpena County benefits from several voter approved supplemental millages which sunset over a varying period of time. Expenditures for Michigan counties primarily consist of public safety, court, and healthcare expenses, which are moderately predictable. Counties have a moderate ability to reduce expenditures. While Michigan's constitution provides protections for accrued pension benefits, changes can be made to future benefits.

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