

## CREDIT OPINION

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# Berrien (County of) MI

## Credit analysis following initial issuer rating

### Summary

[Berrien County's](#) (Aa2) credit profile is headlined by its strong full value per capita and robust operational fund balance and liquidity. These strengths are balanced against a relatively weak resident income profile, a declining population, restrictive revenue raising flexibility, and an elevated pension burden. The county's low debt burden helps to offset these credit challenges as it contributes to manageable fixed costs for debt service and post-retirement benefit contributions.

On October 18, we assigned an initial Aa2 issuer rating and an initial Aa2 general obligation limited tax (GOLT) rating to the county's \$1.8 million Hollywood Road Consolidated Drain #524 Drainage District Drain Refunding Bonds, Series 2018 (GOLT).

### Credit strengths

- » Sizable, recovering tax base with solid full value per capita
- » Very strong operational fund balance and liquidity
- » Modest debt burden contributes to manageable annual fixed costs

### Credit challenges

- » Relatively low resident income indices
- » Michigan's strict tax caps limit revenue growth
- » Elevated pension burden; moderate exposure to unfunded OPEB liabilities

### Rating outlook

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

### Factors that could lead to an upgrade

- » Continued economic and tax base expansion
- » Increasing resident incomes
- » Material reduction to the pension burden

### Factors that could lead to a downgrade

- » Material economic or tax base contraction as evidenced by falling incomes and outsized unemployment

- » Sustained narrowing of operational fund balance or liquidity
- » Significant increase to the debt, pension or OPEB burdens

## Key indicators

Exhibit 1

Berrien County, MI	2013	2014	2015	2016	2017
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$17,207,436	\$17,845,835	\$18,342,685	\$18,745,836	\$18,984,280
Population	156,290	155,992	155,565	155,134	154,259
Full Value Per Capita	\$110,099	\$114,402	\$117,910	\$120,836	\$123,068
Median Family Income (% of USMedian)	87.0%	87.7%	87.3%	86.6%	86.6%
<b>Finances</b>					
Operating Revenue (\$000)	\$58,951	\$61,075	\$63,421	\$64,818	\$66,426
Fund Balance (\$000)	\$53,483	\$52,273	\$55,900	\$56,937	\$60,071
Cash Balance (\$000)	\$51,249	\$43,351	\$47,267	\$49,541	\$53,830
Fund Balance as a % of Revenues	90.7%	85.6%	88.1%	87.8%	90.4%
Cash Balance as a % of Revenues	86.9%	71.0%	74.5%	76.4%	81.0%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$60,877	\$49,533	\$53,285	\$51,713	\$54,839
3-Year Average of Moody's ANPL (\$000)	\$166,678	\$158,003	\$146,572	\$172,318	\$189,415
Net Direct Debt / Full Value (%)	0.4%	0.3%	0.3%	0.3%	0.3%
Net Direct Debt / Operating Revenues (x)	1.0x	0.8x	0.8x	0.8x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.0%	0.9%	0.8%	0.9%	1.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.8x	2.6x	2.3x	2.7x	2.9x

Source: Moody's Investors Service, US Census Bureau, Berrien County audited financial statements

## Profile

Berrien County encompasses 580 square miles in the southwest corner of [Michigan's](#) (Aa1 stable) Lower Peninsula. The county is home to an estimated 154,259 residents. The City of St. Joseph is the county seat.

## Detailed credit considerations

### Economy and tax base: sizable tax base along Lake Michigan; weak resident income levels

Berrien County's economy and tax base is expected to strengthen as property valuation rises and unemployment has come in line with state and national levels. Located along Lake Michigan and the [Indiana](#) (Aaa stable) border, the county is a mix of urban and rural communities and has historically been the location for a significant number of second homes. The county's largest employer (4,000 employees) is [Whirlpool Corporation](#) (Baa1 stable). Other notable employers include Lakeland Regional Health (3,800 employees), which recently merged with [Spectrum Health](#) (Aa3 stable), Andrews University (2,100), and the Four Winds Casino (1,800).

Long term economic growth potential may be constricted by Berrien County's comparatively weak demographic patterns. The county's population has contracted 10% since peaking in 1980, and its labor force has experienced a similar drop over the last ten years. Furthermore, the county's average age has risen to a median of 42 years, and median family income is weak at 87% of the US. Industrial diversity of the region is low, with much of the manufacturing base dependent on the vitality of operations at Whirlpool.

While demographics are a moderate credit challenge, the county's large tax base and solid full value per capita wealth is a strength. Valued in 2018 at a sizable \$19.1 billion, the tax base grew at an average annual rate of 2.1% over the past five years. The presence of second homes, is reflected in a strong estimated full value per capita of \$123,672. Cook Nuclear Power Plant, which is operated by a

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subsidiary of [American Electric Power Company, Inc.](#) (Baa1 stable), comprises 15% of the county's taxable value. Favorably, the plant has a license to operate through 2037 and has no property tax appeals outstanding.

### **Financial operations and reserves: ample fund balance and liquidity; tax caps limit revenue growth**

The county's sustained trend of positive operations point to the continued maintenance of robust fund balance and liquidity. The county has routinely recorded general fund operating surpluses, including a surplus of \$1.3 million in fiscal 2017. The most recent surplus resulted in an ending fiscal 2017 available balance of \$20.7 million, or 35.5% of annual general fund revenue. In addition to the general fund the county maintained significant fund balances in other major operating funds financed by locally generated revenue sources. The combined total available fund balance stood at \$60.1 million at the close of fiscal 2017, equivalent to a very high 90.4% of combined revenue. A significant portion of fund balance, \$35.8 million, came from the county's Delinquent Tax Revolving Fund (DTRF), which is used to buy the delinquencies of underlying units of local governments, but may also be used to support general operations.

The county budget for fiscal 2018 (year-end December 31) is balanced. The budget calls for an increase of \$2.4 million in DTRF transfers to the general fund to support operations.

The county's main revenue sources are property taxes (68% of fiscal 2018 operating revenue), followed by state aid (13%), and charges for services (12%). In addition to the county's general operating millage, the county has four of supplemental millages dedicated to specific purposes, including law enforcement, 911 operations, parks, and senior citizens services. All taxes are currently levied at the maximum rate allowed under the state's constitutional rollback and assessment caps. Although the tax caps limit the county's ability to leverage tax base growth, the county's strong fund balance will allow it to withstand significant revenue pressure associated with revenue loss during periods of tax base declines.

### **LIQUIDITY**

The county's liquidity position is robust, and includes a significant amount of cash held outside of the general fund. At the close of fiscal 2017 the county held \$53.8 million in cash across its variety of operating funds, equivalent to 81% of revenue.

### **Debt and pensions: low debt burden; elevated pension burden**

The county's low debt burden will help keep annual fixed cost manageable, despite its exposure to significant unfunded pension liabilities. Outstanding debt backed by the county is equivalent to a modest 0.2% of full value and 0.5x operating revenue. The county's debt profile includes \$9.6 million of sewer and water bonds and \$17.4 million of drainage bonds that carry its GO full faith and credit pledge. While the obligations are secured by its GOLT authority, the vast majority of debt is serviced by underlying municipalities and property owners who benefit from the infrastructure financed through the county's issuance of debt. Management reports no additional debt plans at this time.

### **DEBT STRUCTURE**

The county's long-term debt is fixed rate and structured with relatively even annual debt service. Payout of outstanding principal is average with approximately 67% scheduled to be retired over the next ten years.

In addition to long term GO debt, the county has \$71 million in short-term delinquent tax anticipation notes outstanding. The county issues the notes for arbitrage purposes as the DTRF carries excess liquidity to make its annual delinquent tax purchases.

### **DEBT-RELATED DERIVATIVES**

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

### **PENSIONS AND OPEB**

The county administers the Berrien County Employees' Retirement Plan, a single-employer defined benefit pension plan. As of its most recent actuarial reporting date the plan had a net pension liability of \$91.4 million. The Moody's three-year average adjusted net pension liability (ANPL) for the county, which is our measure of a local government's pension burden that uses a market-based interest rate to value accrued liabilities, is a much higher \$191.9 million. The ANPL burden is equal to a low 1.0% of full value, but above average, 2.9x operating revenue.

The county has been in compliance with state law as it continues to annually contribute to the full amount of the plan's actuarially determined contribution. However, the county's single year ANPL has grown by 36% over the last three years. While recent market

returns may moderate the liability over the near term, the county likely must contribute above and beyond its required contribution rate to moderate the liability over the long-term.

In addition to the county's pension burden, the county has exposure to unfunded liabilities associated with its defined benefit post-employment healthcare benefit (OPEB) plan. The county has pre-funded a portion of this liability but overall the plan remains slightly less than 50% funded as of its most recent December 31, 2017 actuarial valuation. The current liability is sized at \$35 million. Favorably, the county closed plans to new hires was closed in previous years.

The county's all in leverage, including net direct debt, pension ANPL, and unfunded OPEB liabilities currently sits at \$231.2 million, or 1.2% of full value and 3.5x operating revenue. In fiscal 2017 the county's fixed costs totaled \$12 million, or a moderate 18% of annual operating revenue.

#### **Management and governance: conservative management, moderate institutional framework**

Berrien County's conservative management team has put the county in a position to withstand potential future financial pressures most likely to arrive in the form of either renewed tax base contraction or reductions to state aid. Management reports the county will continue to adhere to its policy of maintaining general fund reserves between 20% to 40% of the following years' budgeted expenditures. Additionally, the management intends to seek renewal of all expiring supplemental property tax millages when they come due. On the expenditure side the county negotiates with eight employee groups, four of which have contracts expiring at the end of fiscal 2018. Moderate salary increases for all groups are likely, though material increases to overall employee headcount is not expected.

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. Berrien County benefits from several voter approved supplemental millages which management expects to request reauthorization from voters prior to the expiration of each tax. 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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