Rating Update: Moody's affirms Ypsilanti, MI's A2 GOLT; removes negative outlook

Global Credit Research - 10 Apr 2014

A2 applies to $14.9M of GO debt

YPSILANTI (CITY OF) MI
Cities (including Towns, Villages and Townships)
MI

Opinion

NEW YORK, April 10, 2014 --Moody's Investors Service has affirmed the A2 rating on the City of Ypsilanti, MI's outstanding General Obligation (GO) Limited Tax debt. Concurrently, Moody's has removed the negative outlook on the rating. The city has $23 million in outstanding GO debt, of which $14.9 million is Moody's rated. The city's outstanding rated debt is secured by its GO limited tax pledge, which is subject to constitutional, statutory, and charter tax rate limitations.

SUMMARY RATINGS RATIONALE

The A2 rating reflects the city's modestly sized tax base, healthy reserves despite ongoing operating deficits, and weak debt profile. Removal of the negative outlook is based on our expectation that management will continue to implement the necessary expenditure reductions in order to restore operational balance by fiscal 2016 and that reserve declines in the interim will be manageable.

STRENGTHS

- Institutional presence of Eastern Michigan University (A1 / stable)

- Ample reserves

- History of implementing significant expenditure reductions

CHALLENGES

- Modestly sized tax base has experienced substantial valuation declines

- Ongoing budgetary pressure stemming from debt service payments on limited tax debt and revenue declines

- Above average debt and pension liabilities

DETAILED CREDIT DISCUSSION

MODEST TAX BASE LOCATED ADJACENT TO ANN ARBOR, VALUATIONS STABILIZING FOLLOWING SUBSTANTIAL DECLINES

The city's modestly sized $605 million tax base is stabilizing following substantial recent declines. Located adjacent to Ann Arbor (Aa1), the city's tax base is comprised of a diverse mix of residential and commercial properties. The city's full value declined by a substantial 43% from its peak in 2007 to its low in 2012 driven by tax appeals, foreclosures, and general depreciation. Favorably, the tax base has begun to stabilize with a 0.6% increase in 2013 and modest growth projected going forward.

The city benefits from the stabilizing presence of Eastern Michigan University with an enrollment of 23,000 and a workforce of nearly 2,000. Residents also have easy access to employment opportunities in neighboring Ann Arbor, home to the University of Michigan (Aaa / stable). The unemployment rate in Washtenaw County (Aa1) is below average at 5% compared the state average of 8.1% and the national average of 7%, as of January 2014. Resident income levels are below average with per capita income and median family income at 61.5% and 89.5% of US medians, respectively, from 2006 to 2010 as estimated in the American Community Survey.

ONGOING OPERATING DEFICITS MANAGEABLE IN COMPARISON WITH AVAILABLE RESERVES

We expect the city will continue to post operating deficits, but that reserves will remain satisfactory as officials target a return to structural balance by fiscal 2016. The city accumulated ample reserves in anticipation of the cost to support debt service on the city's Series 2006 bonds, with the General Fund balance reaching a peak of $9.5 million, or 66.7% in fiscal 2010. The 2006 bonds were used to refund an issuance that financed infrastructure improvements for Water Street, a 38-acre redevelopment project. The city had originally planned to utilize tax increment receipts to pay debt service, but the anticipated development has not yet materialized. Starting in fiscal 2010, annual debt service payments of $1.3 million have been financed through General Fund transfers. Adding to the city's budgetary pressures, property tax receipts declined by $1.8 million from 2009 to 2013 and state revenue sharing was cut. Officials responded to these challenges by making substantial expenditure reductions including significant staffing reductions, changes to health care benefits, and reduced transfers to the Motor Pool Fund. While the General Fund balance declined on an absolute basis by approximately $936,000 from 2010 to 2013, it remained stable on a relative basis as the city's operations shrunk. The General Fund closed fiscal 2013 with a fund balance of $8.5 million, or a still healthy 66.8% of revenues.

While the city continues to implement expenditure controls, officials estimate that at worse the General Fund balance will be drawn down by $750,000 per year in fiscal 2014 and fiscal 2015. If the operating deficits are fully realized, available Operating Fund reserves would decline to $6.7 million, or a solid 43% of revenues. Management is targeting a return to balanced operations by fiscal 2016 primarily through two large expenditure reduction strategies. First, officials hope to refinance the 2006 bonds when they are callable in 2016, which they believe could accrue significant interest rate savings. Second, the city implemented a lower tier of wages and benefits in 2012 for new employees, which will accrue significant savings as the workforce turns over. The city also plans to restore some public safety positions reducing over time expenses.

Property taxes are the city's largest revenue source comprising 61% of fiscal 2013 revenues. Growth in property tax receipts is restricted by statutory and constitutional limitations on increases in taxable values and total receipts. Officials report that they are expecting modest increases in property tax receipts going forward due to stabilization of taxable values. The second largest revenue source for the city is state aid, which comprised 20% of fiscal 2013 receipts. Following years of cuts, the state has increased funding for revenue sharing for fiscal 2015.

ELEVATED DEBT BURDEN IS SOURCE OF BUDGETARY PRESSURE

We expect the district's high debt burden will continue to be a source of budgetary stress for the city. The city's direct debt burden and overall debt burden are elevated at 4.2% of full valuation and 9.2%, respectively. Principal amortization is slow at 59% of GO debt retired within ten years. While debt service as percentage of total operating revenues is average at 17.5%, it has become a source of budgetary pressure for the city. Approximately 74% of the city's outstanding GO debt is not supported by an unlimited levy including the aforementioned 2006 bonds, requiring the city to fund debt service from operating revenues. All of the city's debt is fixed rate and long term, and the city is not a party to any derivative agreements.

Ypsilanti has a manageable pension burden based on liabilities for its single defined benefit employer police and retirement system. The system had a report unfunded liability of $14.7 million as of June 30, 2012. The city also participates in the Michigan Employees Retirement System (MERS), a multi-employer agent plan. That plan was overfunded on a reported basis by $5.6 million as of June 30, 2012. Pension driven budgetary pressures are modest. The city has not contributed to MERS for a number of years due to its reported overfunded status. Contributions for the city's police and fire pensions totaled $1.2 million, or a manageable 8% of operating revenues in fiscal 2013 and the city is able to fund payments through an unlimited pension levy. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $36.9 million, or a somewhat above average 2.41 operating revenues. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

WHAT COULD MOVE THE RATING UP

- Expansion of the tax base or strengthening of the demographic profile

- Reduction in the debt burden

WHAT COULD MOVE THE RATING DOWN

- Continued depreciation of the tax base

- Substantial decline in reserves

- Material increase in the city's debt burden

KEY STATISTICS

2013 Full valuation: $605 million

2013 Estimated full value per capita: $30,811

2006-2010 American Community Survey median family income: $56,400 (90% of US)

Fiscal 2013 Available Operating Fund balance: $8.2 million (52.9% of revenues)

5-Year Dollar Change in Operating Fund Balance as % of Revenues: 8%

Net operating net cash balance: $9.2 million (58.9% of revenues)

5-Year Dollar Change in Cash Balance as % of Revenues: 11.7%

Institutional Framework: "A"

Operating History: 5-Year Average of Operating Revenues / Operating Expenditures: 1.02

3-Year Average of Moody's ANPL / Full Value: 6.1%

3-Year Average of Moody's ANPL / Operating Revenues: 2.4x

Net Direct Debt / Full Value: 4.2%

Net Direct Debt / Operating Revenues: 3.5x

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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