

RatingsDirect®

Summary:

**Decatur County, Indiana
Decatur County Jail Building
Corporation
Decatur County Hospital Association;
General Obligation Equivalent
Security**

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Summary:

Decatur County, Indiana

Decatur County Jail Building Corporation

Decatur County Hospital Association; General Obligation Equivalent Security

Credit Profile

US\$20.225 mil lse rental rev bnds (Decatur Cnty) (Jail) ser 2018 due 01/15/2038

Long Term Rating

A-/Stable

New

Decatur Cnty Hosp Assn, Indiana

Decatur Cnty, Indiana

Decatur Cnty Hosp Assn (Decatur Cnty) 1st mtg lse rent rev rfdg bnds

Long Term Rating

A-/Stable

Downgraded

Rationale

S&P Global Ratings lowered its long-term rating two notches to 'A-' from 'A+' on Decatur County Hospital Association's first mortgage lease rental bonds series 2011, issued on behalf of Decatur County, Ind. The downgrade reflects the weakened management conditions and vulnerable financial policies and practices under our Financial Management Assessment (FMA) methodology.

At the same time, S&P Global Ratings assigned its 'A-' long-term rating to Decatur County Jail Building Corp.'s \$20.225 million series 2018 lease rental revenue bonds issued on behalf of Decatur County. The outlook is stable.

Officials will use bond proceeds to build a new jail facility. The 2018 bonds are secured and payable from a 0.50% special purpose local income tax (LIT). To the extent the special purpose LIT revenues are insufficient, the bonds are payable from and secured by an ad valorem property tax levied against all taxable property in Decatur County. Special purpose LIT can only be used for the purposes of financing certain corrections facilities and related buildings, or the cost of additional projects described in the statute. The 'A-' long-term rating is based on the ad valorem property tax pledge, which we believe is a stronger pledge.

The 2018 bonds are issued pursuant to a trust indenture between the county and the trustee, and a lease between the Decatur County Jail Building Corp., as lessor, and Decatur County, as lessee. Lease rentals paid by the county directly to the trustee secure the bonds. The ad valorem property tax levy is not subject to annual appropriation under Indiana law. However, there is abatement risk, as the county is required to abate lease rentals in the event the leased premises are not available for use. This risk is mitigated, in our view, by the lease requiring the county to maintain at least two years of lease-interruption insurance as well as casualty insurance equal to full replacement cost. In addition, there is construction risk given that lease payments depend on project completion. The bonds have been structured so that the

first lease payments do not begin until six months after estimated completion; interest payments are capitalized through Jan. 15, 2020, and construction is expected to be completed by January 2020. Considering the nature of the project, we feel this provides a reasonable cushion against possible delays and mitigates construction risk.

The ad valorem property tax pledge is subject to state circuit-breaker legislation, which caps the property tax burden for taxpayers based on a percent of the real estate parcels' gross assessed value (AV). This can, and often does, reduce the total tax levy. The levy to cover debt service, however, is statutorily protected, allowing the county to distribute circuit-breaker losses first across non-debt service funds that receive property taxes. We rate the debt at the same level as our view of the county's general creditworthiness.

The series 2011 first-mortgage lease rental revenue-refunding bonds were issued for the Board of Trustees of Decatur County Memorial Hospital and Decatur County. Lease rental payments are payable from the hospital's net revenues and ad valorem property taxes. To the extent that hospital net revenues are insufficient to pay its lease rental payments, the county is obligated to levy ad valorem property taxes.

The 'A-' rating reflects the following credit characteristics of Decatur County:

- Very weak economy, with a concentrated employment base;
- Weak management, with "vulnerable" financial policies and practices under our FMA methodology;
- Adequate budgetary performance, with an operating deficit in the general fund but an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available cash reserve in fiscal 2017 of 37% of operating expenditures;
- Very strong liquidity, with total government available cash at 69.3% of total governmental fund expenditures and 7.0x governmental debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 9.9% of expenditures and net direct debt that is 153.9% of total governmental fund revenue; and
- Strong institutional framework score.

Very weak economy

We consider Decatur County's economy very weak. The county has an estimated population of 26,711. The county has a projected per capita effective buying income of 81.7% of the national level and per capita market value of \$90,268. The county unemployment rate was 2.9% in 2017.

Decatur County is in southeastern Indiana, approximately 50 miles southeast of Indianapolis and 55 miles northwest of Cincinnati. Weakening its economy is a concentrated employment base, with the manufacturing sector accounting for more than 30% of total employment. The county's principal manufacturing employers are Honda Motor Co. Ltd. (2,900 employees), Valeo Engine Cooling, Inc. (1,400), and GECOM Corp. (860). Honda opened an automobile assembly plant in Greensburg in 2008 and continues to invest in its production facilities. About 75% of Honda Civics sold in the U.S. are produced at the Greensburg facility; popular Honda CR-V models are manufactured there as well. In addition, the company recently announced that it would begin producing Honda Insights (an electric vehicle) at the Greensburg facility.

Overall, the county's economy has been stable in recent years, in our opinion. In the past two years, AV advanced 5.4% and will likely continue to improve as the major employers continue to invest in their production facilities.

Weak management

We view the county's management as weak, with "vulnerable" financial policies and practices under our FMA methodology, indicating the government lacks policies in many of the areas we believe are most critical to supporting credit quality.

We have revised the FMA to vulnerable from standard, following clarification of financial and accounting reporting practices.

Key practices include:

- Revenue and expenditure forecasting that relies largely on historical trend analysis, although with a history of negative budget-to-actual results in the self-insurance fund, suggesting that budget assumptions are not thoroughly validated; and
- The county has its own investment policy and reports on investments to the council on an annual basis.

The county does not maintain long-term financial and capital plans. It follows state guidelines on debt management but lacks a policy on reserves.

The auditor provides the council with appropriation reports that show year-to-date expenditures, month-to-date expenditures, and percentages of the budget spent during the annual budget process and at the end of the year so that the council can review its budgetary performance during the previous year. The reports do not include revenue information. No formal process exists for regular review and timely updating of the budget during the year after that budget is formed. We believe the weak financial reporting mechanisms lead to material restatements and create uncertainty. For example, in the 2017 annual report certain income tax revenues were incorrectly reported as miscellaneous revenues (the issue was subsequently corrected).

Adequate budgetary performance

Decatur County's budgetary performance is adequate, in our opinion. The county had deficit operating results in the general fund of 1.6% of expenditures, but a surplus result across all governmental funds of 1.9% in fiscal 2017.

We have combined the county adjusted gross income tax certified shares fund with the general fund for our analysis of general fund performance, given the basic operations of the departments. In addition, we adjusted the operating results to exclude revenue and expenditures associated with bringing back the tax increment revenue capital appreciation 2008 bonds to the county's books. The Indiana State Board of Accounts in 2015 instructed the county to remove this bond issue from its debt reporting and financial statement reporting despite the fact that the county was the issuer of the debt, and the sole source of security for this debt is tax increment revenues generated by the Honda Allocation Area. During the time when the county did not report the bonds or the bond-related funds in its financial statements, it continued to make its scheduled debt service payments in full. In 2017, the county convinced the State Board of Accounts that its initial view was incorrect and that the bonds were in fact an obligation of the county and should be reported as such. As a result, it returned to reporting this bond issue and the related funds. The large

revenue/expenditure variations in 2017 were related to the county "clearing" this fund, then returning it to its books.

Decatur County's budgetary performance has been mostly stable in recent years, and we expect performance will remain adequate. An ongoing budgetary challenge is the county's self-insurance fund. Decatur has been paying claims in excess of payroll withholdings, and has accumulated a \$1.2 million deficit in the fund. The deficit has been mostly covered through pooled cash (interfund transfers). To combat the deficit, Decatur County initiated a review of its self-funded plan in June 2017 and made several updates and changes to the plan provisions. Officials also raised the income tax rate and approved adoption of a new public safety income tax revenue in October 2017 in the form of a public safety LIT – about \$2 million in total new revenue beginning 2018.

We understand the county expects to report break-even or surplus operations in its key operating funds in fiscal years 2018 and 2019, although officials do not engage in long-term financial planning, so detailed projections are not available. Factoring historical results and projected revenue increases, we anticipate budgetary performance will remain at least adequate, although the deficit in the self-insurance fund could continue to pressure operations.

In 2017, the leading combined general fund revenue sources were property taxes (54%) and income taxes (27%). Both of these revenue sources are stable and growing.

Our analysis relies on unaudited, Dec. 31 fiscal-year-end cash reports that are submitted to the state. These reports prescribe to the state's uniform system of accounting and reporting that all local governments are required to follow, and based on previous-year comparisons with state-examined data, we consider them reliable to serve as a basis for our analysis.

Very strong budgetary flexibility

Decatur County's budgetary flexibility is very strong, in our view, with an available cash reserve in fiscal 2017 of 37% of operating expenditures, or \$3.1 million. We expect the available cash reserve to remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor. Negatively affecting budgetary flexibility, in our view, is the use of cash accounting, which reduces clarity about the amount of funds that are truly available.

The cash reserve includes \$1.2 million (14.4% of expenditures) in the general fund and \$1.9 million (23% of expenditures) that is outside the general fund but legally available for operations. In addition to the combined general fund, nongeneral fund available reserves include the rainy day, economic development local income tax, and cumulative capital development funds, each of which contains cash reserves with no restrictions on how they can be spent. We believe the available reserves will likely remain well above 30% of operating expenditures in 2018 and 2019 because of the higher income tax revenues.

Very strong liquidity

In our opinion, Decatur County's liquidity is very strong, with total government available cash at 69.3% of total governmental fund expenditures and 7.0x governmental debt service in 2017. In our view, the county has strong access to external liquidity if necessary.

While we view the state's investment policy as permissive, we do not consider Decatur County's investments aggressive; the county keeps money with local banks, according to officials. We understand that the county has no

plans to significantly reduce available cash balances, and therefore we do not expect the liquidity score to deteriorate in the near term.

The following debt obligations have been privately placed:

- Courthouse rehabilitation project loan issued in 2017; and
- Decatur County Redevelopment Commission tax increment revenue capital appreciation bonds series 2008.

The bond documents include standard provisions and do not include events of default or provisions that could pose contingent liquidity risk.

Weak debt and contingent liability profile

In our view, Decatur County's debt and contingent liability profile is weak. Total governmental fund debt service is 9.9% of total governmental fund expenditures, and net direct debt is 153.9% of total governmental funds. The county does not plan to issue additional debt at this time; however, the debt service metrics will likely weaken following 2018 debt issuance.

The county contributes to two state-administered retirement plans: Indiana Public Employees' Retirement Fund (PERF) and the 1977 Police Officers' and Firefighters' Retirement Fund ('77 Fund). These plans are cost-sharing, multiple-employer, defined-benefit plans (the plans share all risks and costs, including benefit costs, proportionately by the participating employers). Certain employees are also covered by legacy police and firefighter retirement plans (1925 Police Pension, 1937 Police Pension, and 1953 Pension Funds). While these plans' liabilities belong to the local entities, the state has assumed 100% of the cost and has been historically funding the benefits on a pay-as-you-go basis through its pension relief fund. Given the state's commitment to funding these costs, we do not consider them a liability of the local entities.

Decatur County's pension contributions totaled 2% of total governmental fund expenditures in 2017. The county made its full annual required pension contribution in 2017.

As of June 30, 2017, the PERF was 76.6% funded and the '77 Fund was 100.3% funded, in accordance with Governmental Accounting Standards Board Nos. 67 and 68. We view the plans' actuarial assumptions, including the assumed rate of return of 6.75%, as generally reasonable because they are slightly more conservative than the national average. Considering the plans' strong funded ratios, reasonable actuarial assumptions, and low historical contribution requirements for plan participants, we do not expect the county's required pension costs to increase significantly in the medium term.

Strong institutional framework

The institutional framework score for Indiana counties is strong.

Outlook

The stable outlook reflects our expectation that Decatur County's liquidity and budgetary flexibility will remain at least very strong in the near future. The county's vulnerable financial management conditions are a weakness. Considering

the county's current financial position, recent health insurance modifications, and new income tax revenues, we believe it will be able to maintain at least stable credit characteristics in the near term; therefore, we do not expect to change the rating in the next two years.

Upside scenario

If the county's financial management practices improve and remain consistent year over year (specifically if the county is able to demonstrate that officials conduct periodic budget and actual reviews during the years to track operating variances), and it shows meaningful progress in reducing the deficit in its self-insurance fund, we could raise the rating.

Downside scenario

If the county's financial performance starts to weaken, pressuring liquidity and budgetary flexibility, we could lower the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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