S&P Global Ratings

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Summary:

Sault Ste. Marie, Michigan; Miscellaneous Tax

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Summary:

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Credit Profile		
Sault Ste. Marie (mich trans fd)		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AA' long-term rating on Sault Ste. Marie, Mich.'s series 2008 Michigan Transportation Fund (MTF) bonds, reflecting the city's first-lien pledge of state-collected annual gas and weight taxes. The outlook is stable.

The city's series 2008 bonds are secured by a first-lien pledge of state-collected annual gas and weight taxes returned to the city of Sault Ste. Marie from the MTF for highway and road purposes, pursuant to Act 51, Public Acts of Michigan, 1951, as amended. As additional security, the city has pledged its full-faith-and-credit general obligation to levy ad valorem taxes subject to statutory and constitutional limitations. We rate the series 2008 bonds based on the pledge of MTF revenues, which we view as the stronger pledge, based on our multiple revenue streams criteria.

(For information on the city's limited-tax general obligation rating and outlook, please refer to our article published Dec. 29, 2015, on RatingsDirect).

The 'AA' rating reflects our view of:

- The statewide collection of pledged revenue distributed to the city;
- The generally stable trend of gas and weight tax receipts, with the expectation of increases in the next few years; and
- The very strong maximum annual debt service (MADS) coverage, coupled with the city's lack of plans to issue additional MTF bonds.

Partly offsetting the above strengths, in our view, is the city's weak economic profile, as demonstrated by below-average income and market value per capita indicators. We note that certain economic characteristics could begin to affect population trends, which are a key factor in the distribution of MTF revenue to cities and villages.

The city issued its MTF bonds pursuant to the provisions of Act 51, Public Acts of Michigan, 1951, as amended, and Act 175, Public Acts of Michigan, 1952, as amended. According to Act 175, maximum annual principal and interest payments for MTF debt obligations cannot exceed 50% of the city's previous fiscal year distribution, providing minimum coverage of 2x. We feel this 2x coverage is a strength, and therefore, typically there are no debt service reserve fund requirements for MTF bond transactions; there is none for the 2008 series.

The Michigan Department of Transportation distributes MTF revenue to cities and villages each month, based on the prior month's actual MTF revenue and calculated distribution factors. The distribution of MTF major and local street funds is based primarily on two factors: the city's census population and the city equivalent major mileage or city local mileage. We believe below-average economic indicators such as income and market value per capita indicators could negatively affect population trends. Given that the city's population is part of the distribution formula for MTF revenue, we view this below-average trend as a limiting factor for the city. In our opinion, median household effective buying income (EBI) is low, at 62.6% of the national level, but per capita EBI is adequate, at 68.2%. At about $45,500, the estimated market value per capita is, in our opinion, adequate. While these economic metrics range from low to adequate, we believe each metric is materially lower than that of peers and as such can be a limiting factor for overall economic and population growth in the city.

The city received $1.85 million in MTF revenue in fiscal 2017 (June 30), generating very strong, 23.2x coverage on projected MADS of $79,000 (in 2021). Coverage has improved significantly in 2017 and 2018 due to a drop-off in the amortization schedule for the series 2008 bonds. MADS coverage of 6.5x had been maintained prior to 2017, when MADS was $269,000. The series 2008 bonds will mature in 2023, and debt service payments are level throughout the remaining life of the bonds. We understand the city has no additional plans for MTF revenue debt at this time.

The Michigan legislature increased vehicle registration fees and gas taxes in 2017, and we expect continued growth in MTF revenue given state projections. Given the typical inelasticity of demand for motor fuel, we believe that the state's forecast for each Michigan city should be reasonably accurate.

Outlook

The stable outlook reflects our expectation that the city's pledged revenue will continue to provide very strong MADS coverage. We do not anticipate changing the rating within the two-year outlook horizon, because we expect that the city's stable state gas and weight tax revenue (which is expected to increase) will sustain strong MADS coverage.

Upside scenario

If the city's low economic metrics improve to a level we no longer consider materially lower than those of peers, and if gas and weight tax revenue distributions continue to provide very strong MADS coverage, we could consider a higher rating.

Downside scenario

If the city issued additional debt secured and paid by MTF revenue, or if gas and weight tax revenues were to decline and MADS coverage weakens to a level that is no longer commensurate with that of similarly rated peers, we could lower the rating.

Related Research

Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015

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.