

DeKalb County Muni Bond Downgrade

By: SEI Fixed Income Portfolio Management

SEI Fixed Income Portfolio Management manages fixed-income strategies for SEI's Managed Account Program (MAP).

There have been many headlines describing the recent credit rating downgrades of DeKalb County, Georgia. Its General Obligation backed debt, rated AAA not very long ago, is now rated BBB. While this is still investment-grade quality, it is a far cry from the county's pristine rating of a few years prior.

The main reasons for the downgrades are the County's deteriorating finances and diminishing general fund levels. In its fiscal year 2005, the County's general fund balance was \$31.9mm, or 13.3% of revenues, which is very strong for local government finances. This robust fiscal position provided the county with adequate debt service coverage and liquidity, and helped it maintain its AAA rating. However, the county's general fund balance has deteriorated significantly over the past two years. Fiscal 2009 results show a negative general fund balance of \$24 million, and the county reported that it had no cash on the balance sheet for its general fund or special tax district funds. Preliminary results for 2010 (audited figures are not yet available) indicate that further deterioration may have occurred.

The issue of declining revenues and rising expenditures is clearly evident when looking at 5 year trends for DeKalb County (see Exhibit 1 below). Typically, when a municipality is facing these kinds of pressures, it invokes its ability to raise taxes; that's the backbone of the General Obligation pledge. However, the county CEO's proposed 2011 budget, which included a 14% tax increase, was voted down by county commissioners. This is the second consecutive year that DeKalb County commissioners have rejected a proposed millage increase.

Exhibit 1: DeKalb County Finances, Fiscal 2005-2009

	Historical Operating Results				
	FY	FY	FY	FY	FY
	2005	2006	2007	2008	2009
Revenues					
Taxes	\$182,898	\$206,223	\$201,814	\$197,260	\$186,915
Fines and Forfeitures	15,414	15,821	14,398	12,029	12,003
Intergovernmental	12,663	12,181	16,141	6,052	16,287
Charges for Services	22,980	21,073	28,238	31,265	26,638
Other	5,447	7,893	6,662	6,125	11,881
Total Revenues	\$239,402	\$263,191	\$267,253	\$252,731	\$253,724
Expenditures	\$218,308	\$259,183	\$272,783	\$277,801	\$263,134
Revenues over Expenditures	\$21,094	\$4,008	(\$5,530)	(\$25,070)	(\$9,410)
Other financing sources	(\$10,562)	(\$4,070)	(\$4,245)	(\$6,848)	(\$5,185)
Revenues and other sources over (under) expenditures	\$10,532	(\$62)	(\$9,775)	(\$31,918)	(\$14,595)
Beginning Fund Balances	\$21,401	\$31,933	\$31,871	\$22,096	(\$9,822)
Ending Fund Balances	\$31,933	\$31,871	\$22,096	(\$9,822)	(\$24,417)
Fund Balance as % of Revenues	13.34%	12.11%	8.27%	-3.89%	-9.62%
Debt Service	\$26,125	\$39,767	\$41,245	\$41,933	\$41,607
Debt Service as % of Expenditures	11.97%	15.34%	15.12%	15.09%	15.81%

The situation in DeKalb County is still developing at this point. Standard and Poor's rating service has stated their belief that a mid-year tax increase could still be an option in the form of a budget amendment. If this were to happen, it would certainly put the county on the path toward getting its fiscal house in order.

While we are not currently seeking to add to this name in our municipal portfolio, we are maintaining our current positions in it as we assess the unfolding situation (the market value of our position is approximately \$80,000 or 0.00006% of our \$1.2 billion municipal bond portfolio). By mid-June 2011, the county's audited 2010 results will be available and a decision should be made as to whether to pass a mid-year tax increase. At this point in time, we do not believe that this will develop into a bankruptcy-type situation, although with increased noise in the news, holders of the debt will see increased volatility until a resolution is reached.

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