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Summary:

Ecorse, Michigan; General Obligation

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Long Term Rating	BB-/Stable	Downgraded

Rationale

S&P Global Ratings lowered its long-term rating on Ecorse, Mich.'s series 2011 financial recovery bonds to 'BB-' from 'A'. The outlook is stable.

The downgrade is due to our analytical error where we are now analyzing this transaction under our "Issuer Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" (ICR) criteria (published Jan. 22, 2018) and our "Local Government GO Ratings Methodology and Assumptions" (Local GO) criteria (published Sept. 13, 2013) instead of our "Special Tax Bonds" criteria (published June 13, 2007).

At issuance in 2011 and in subsequent reviews, we applied our Special Tax Bonds criteria to analyze the bonds. We applied these criteria because of the various property taxes pledged to support the bonds, some of which are limited. On June 2, 2015, however, the Special Tax Bonds criteria were updated to include a section clarifying the characteristics of property tax-secured bonds that may allow the obligation to be evaluated as special tax bonds. Specifically, the criteria indicate that property tax-secured bonds may be analyzed as special tax bonds when "bondholders are not pledged access to available balances of the obligor." Given the series 2011 bonds contain a dedicated judgement millage and a limited-tax general obligation (GO) pledge of the city, the source for which includes all legally available funds of the obligor, based on the updated criteria, we have now determined that the property tax pledge is not a special tax as described in the Special Tax Bond criteria, and therefore those criteria do not apply.

By applying our Local GO criteria, the rating is constrained, in our opinion, by weak management conditions driven by recent opinions delivered by the city's auditor, who has stated that the city is a going concern due to a declining tax base and increases in expenditures. It is our opinion that these conditions could negatively affect the city's ability to meet its financial commitments.

In the fall of 2009, the city was appointed an emergency financial manager (EM) by the Governor of Michigan through a recommendation by the state treasurer. In April 2013, the financial emergency was declared rectified and the Receivership Transition Advisory Board (RTAB) was appointed to oversee the city's transition back to its own control. In December 2017, the RTAB released the city from its receivership and the city is now back under local control.

During the financial emergency time period, the city issued its series 2011 bonds financial recovery bonds whereby those bonds are secured by a pledge of property taxes from the city of Ecorse with millage from two separate levies: A judgement millage, which is statutorily dedicated solely to these bonds, and its operating millage, a limited tax GO pledge.

The city has built up its available general fund reserves over the past three years after being in a negative position for a number of years. It also has a five-year financial plan that depicts future general fund deficits and the reserves will be able to offset these deficits. The property tax values have declined materially over the past five years, along with a declining population-although over the past year the resident count did increase by a small amount. The funding level for its pension obligation remains very low, in our opinion, but over the past few years the city has been able to allocate additional monies to move that funding percentage up.

These recent developments have led to the RTAB releasing its control back to the city. Ecorse has a new controller and a new administrator who have financial and economic plans in place to further enhance the city's financial and economic profile. We believe the city still faces challenges but we do feel that the current status of the city is stable and we expect this to continue over our two-year outlook period.

While we recognize the city's recent improvement, further upgrades are predicated on management sustaining its advancement on its own authority since being released by the RTAB in December 2017.

The rating reflects our opinion of the city's:

- Very weak economy, with a concentrated local tax base and significant population decline, yet access to a broad and diverse metropolitan statistical area (MSA);
- Very weak management, despite standard financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with an operating surpluses in the general fund and at the total governmental fund level in fiscal 2017;
- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 39% of operating expenditures, but limited capacity to reduce expenditures;
- Very strong liquidity, with total government available cash at 87.3% of total governmental fund expenditures and 10.2x governmental debt service;
- Very weak debt and contingent liability position, with debt service carrying charges at 8.6% of expenditures and net direct debt that is 100.6% of total governmental fund revenue, as well as high overall net debt at greater than 10% of market value and a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Very weak economy

We consider Ecorse's economy very weak. The city, with an estimated population of 8,852, is located in Wayne County in the Detroit-Warren-Dearborn, Mich. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 55.8% of the national level and a low per capita market value of $25,194 in 2018, which, in our view, indicates a limited tax base supporting the debt and is a negative credit factor. Overall, the city's market value fell by 4.1% over the past year to $232.0 million in for 2017-2018. Weakening Ecorse's economy are a concentrated local tax base, with the 10 largest taxpayers accounting for 48.6% of the total tax base and its demographic profile, which includes significant population decline of negative 6%. The county unemployment rate was 6.4% in 2016.

The city of Ecorse covers 2.98 square miles and is in the southeastern portion of Wayne County and is approximately 10 miles southwest of Detroit. The city's current mix of tax base consists of approximately 37% residential; 36% industrial, and 20% commercial.

The city's residential values have declined by approximately 37% since fiscal 2015 and the industrial values were negatively affected by the change in personal property tax laws implemented by the state a few years ago. City officials believe the assessed values (AV) have hit bottom and should be at least flat for the next few years. It is our opinion that values will continue to fall, although maybe not as severe as it has occurred the last few years, for at least our outlook period.

The city's main tax payer--U.S. Steel--has been stable over the past few years and it remains the largest employer. Over the past four decades the company (formerly National Steel Co) has experienced financial distress, in part because its product is primarily used by customers in the automotive industry, which has negatively affected the overall economy for Ecorse. Currently, U.S. Steel has been stable and is expected to remain at least stable over the next few years.

Further stress to the economy has been the city's declining population, which has fallen over 30% since the 1980s. Since 2000, the population has dropped 21%, although we estimate an actual increase in its residents in 2016 from 2015.

The population declined 7% for Wayne County from 2008--2018 and we expect a 5% decline for the next 10 years %, which indicates improvement from our previous reviews of the county when both actual and predicted reductions were about 2% higher. So there are signs that the county's population maybe heading for more stability; however, we will monitor whether the one-year turnaround in population becomes a trend for the city while recognizing that any future downturn in the automotive sector could again negatively impact the city's overall economy.

The city has a new administrator who has experience working with other distressed economies in the state of Michigan and has a plan for economic development over the next two years, which is expected to stabilize and grow property values as well as expand commercial and residential activity. The directives are embedded and we will monitor the implementation of the future plans for economic development.

Very weak management

We view the city's management as very weak, despite standard financial policies and practices under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

We have applied a qualitative factor (auditor's going concern opinion) with a negative impact on the initial score, which caps the management score as weak, as previously mentioned. It is our opinion, that we will probably apply this adjustment at least through our two-year outlook period or however long the auditors continue to give it a going concern opinion.

Other highlights of our FMA score

The city performs a line-by-line, incremental approach for its budgetary process and relies on five years of historical information. The budget can be amended anytime, if needed, and is amended every three months and there is a monthly budget to actual report, which is distributed to its council members.

The city did develop a long-term financial plan in fiscal 2017 that projects out to fiscal 2021, but this is not updated annually. It does not have a formal long-term capital plan but is working on a water capital asset plan that is required by state law.

The city has its own investment policy and reports on an annual basis the holdings and performance of its investments. There is no formal debt management policy but the city adheres to state guidelines. There is no formal reserve policy.

Strong budgetary performance

Ecorse's budgetary performance is strong in our opinion. The city had operating surpluses of 6.4% of expenditures in the general fund and of 11.1% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2017 results in the near term, meaning a lower surplus projected in the general fund for fiscal 2018.

We expect the city's budgetary performance to remain at least strong over the next two years as it expects to adopt a balanced budget for fiscal 2019 (June 30) for the general fund and the latest amended budget for 2018 projects a surplus of approximately 1% of operating expenses.

Included in the amended budget for 2018 is additional monies received by the city from the state in "excess" of 100% of personal property taxes reimbursement (these monies are referred to as Local Community Stabilization Authority or LCSA revenues). , which will assist in the projected surplus. (The state of Michigan changed tax laws associated with personal property taxes a few years ago-which is a significant portion of the Ecorse tax base-and essentially the city is made whole by the state for what it was expecting to receive from its personal property tax base) The city does not account for these "excess" LCSA monies received and will not include it for future budgets. It is our understanding that there is some legislation to possibly eliminate these excess LCSA amounts but as mentioned the city does not and will not budget for these amounts, so we expect the city's budgetary performance to remain strong. It is our understanding that the city will use this excess revenue to pay down debt and other long-term obligations, including pension and/or post-employment benefits.

For fiscal 2017, the city also received additional LCSA revenues, which enabled it to post the general fund surplus as well as coming in under budget on its general and safety expenses. According to the 2017 audit, revenues from intergovernmental represent 45% of the total general fund revenues (as a result of the reallocation of LCSA revenues) while property taxes represents 44% of total general fund revenues.—

The city's tax base is small and has been declining and based on the projection of AV growth, we feel that the city's budgetary performance will continue to be pressured over our two-year outlook period but beyond this time period there could be growth in the tax base if the economic development plan is successful and leads to commercial and residential expansion.

In addition to the tax base being small, the city's budgetary performance will be pressured by its pension and OPEB liabilities, which are materially underfunded, although the actuarial determined contribution (ADC) amounts, based on current assumptions, have been declining but as mentioned the city has been using the additional LCSA revenues to make payments above the ADC requirement to lower the overall pension liability.

Between the declining tax base and the underfunded pension and OPEB liabilities, the city's recent audits have been prepared assuming it will continue as a going concern. This going concern opinion will most likely appear in future audits and we will continue to monitor the budgetary performance, which has been strong for the past three audits but could be challenged further if future legislative action removes the additional LCSA revenues that the city has been receiving because the city does not have any further room to cut expenses from its budget, which had already been done by directives from the EM and RTAB.

Strong budgetary flexibility

Ecorse's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 39% of operating expenditures, or $4.6 million. Negatively affecting budgetary flexibility, in our view, is Ecorse's limited capacity to reduce expenditures.

We expect the city's budgetary flexibility to remain strong over the two-year outlook period as fiscal 2019 is projected to be a balanced budget in the general fund and the expectation for fiscal 2018 to be at least balanced.

While we recognize the city's improved budgetary flexibility we still have applied a negative qualitative adjustment related to, in our opinion, the city's limited capacity to cut spending. This is because for the eight-to-nine years the city has been under the control of both the EM and RTAB, which directed material spending cuts, hence it is our opinion that the expenditure base is currently operating at a level whereby if further cuts are needed it would most likely impact the available reserves that the city has currently built and recently maintained at a very strong level.

Very strong liquidity

In our opinion, Ecorse's liquidity is very strong, with total government available cash at 87.3% of total governmental fund expenditures and 10.2x governmental debt service in 2017. In our view, the city has satisfactory access to external liquidity if necessary. We expect should the city need access to external liquidity it could gain it at a price acceptable to them.

We do not believe its cash position will improve or deteriorate within the two-year outlook horizon. Also, it has no direct-purchase or variable-rate debt that could pose a liquidity risk, and we expect the liquidity profile will remain very strong.

Very weak debt and contingent liability profile

In our view, Ecorse's debt and contingent liability profile is very weak. Total governmental fund debt service is 8.6% of total governmental fund expenditures, and net direct debt is 100.6% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt of 37.1% of market value.

There are no debt plans for the city over our two-year outlook period.

The city was able to pay off a majority of its stabilization bonds when it paid $2.3 million in 2017 from restricted monies that were released to the city once it was able to have balanced budgets. The remaining $325,000 will be paid in 2018. As mentioned, if the city is able to receive additional LCSA revenues it will continue to pay additional debt, which include its pension and OPEB liabilities.

In our opinion, a credit weakness is Ecorse's large pension and OPEB obligation. Ecorse's combined required pension and actual OPEB contributions totaled 42.6% of total governmental fund expenditures in 2017. Of that amount, 33.9% represented required contributions to pension obligations, and 8.6% represented OPEB payments. The city made its full ADC for pension in the last three audited years. The funded ratio of the largest pension plan is 37.8%. The city plans to use additional LCSA revenues to bolster pension contributions. However, if potential legislation removes these additional LCSA revenues or if the city decides to use these additional monies for something other than its pension liability, it could place pressure on funding levels and reverse our view that the city has a credible plan to address pension funding requirement.

The city participates in the Municipal Employees' Retirement System (MERS) of Michigan, a defined-benefit pension plan providing certain retirement, disability and death benefits to plan members and beneficiaries.

There were 136 retirees and beneficiaries receiving benefits as of the most recent audit (2017), and 24 members are currently vested.

The defined-benefit plan, as of Dec. 31, 2016, was funded at 37.8% with a net liability of $25.9 million. This was an improvement over the prior year where the liability was $28.5 million or 31.9% funded.

The city provides postemployment health care benefits to certain retirees and their beneficiaries, which are provided on a pay-as-you-go basis. The plan is a single-employer defined-benefit health care plan administered by the city.

As of the Dec. 31, 2014, valuation, the OPEB unfunded actuarial liability was $22.6 million and not funded. We understand the city will continue to fund its OPEB liability on a pay-as-you-go (PAYGO) basis. In fiscal 2016, the OPEB ADC was $1.5 million and the city's PAYGO contribution was $1.25 million, or about 83.6% of the ADC.

We will continue to monitor the city's pension and OPEB liabilities as we believe this will be a budgetary pressure for the city for years to come.

Strong institutional framework

The institutional framework score for Michigan municipalities with a population between 4,000 and 600,000 is strong.

Outlook

The stable outlook reflects our opinion that the city will maintain balanced budgets by making the necessary adjustments to maintain at least an adequate budgetary performance so as to maintain at least a strong flexibility profile. As such we do not expect the rating to change over our two-year outlook period.

Upside scenario

We could consider raising the rating if the city sustains its strong budgetary performance and flexibility profile while continuing to increase the funding percentage of its pension liability and as long as the city's economic metrics (market value per capita and per capita EBI) does not materially deteriorate from its current levels.

Downside scenario

We could consider lowering the rating if the city's budgetary performance falls to adequate or weak and is sustained at this level for at least two years while negatively affecting the budgetary flexibility profile.

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 the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.