S&P Global Ratings

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Summary:

Ecorse, Michigan; General Obligation

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Long Term Rating	BB-/Stable	Affirmed

Rating Action

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

The bonds are secured by a judgment millage statutorily dedicated solely to these bonds, as well as the city's limited-tax full faith and credit general obligation (GO) pledge. We rate the bonds using our "Issuer Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018, on RatingsDirect). Therefore, the 'BB-' rating is set on par with our view of the city's general creditworthiness, reflecting the shared tax base and availability of fungible resources for debt service.

Bond proceeds were used to pay various judgements against the city, all of which have been resolved and paid in full.

Credit overview

Ecorse has a history of distress, stemming largely from a shrinking tax base that relies on volatile, industrial taxpayers (thereby limiting revenue-raising abilities) and, in our view, weak institutional oversight. The city was under various stages of state oversight for most of the last decade (it has operated independently, without state oversight, since December 2017), providing it additional resources to eliminate its deficits and liabilities and build up reserves. However, without new revenue growth (a scenario we see as likely, or even optimistic in worst-case scenarios), the city is already projecting a return to deficits this year and does not currently have a plan in place to address that problem. In our view, there are significant uncertainties that could make matters much worse, factoring in the sustainability of the U.S. Steel facility in Ecorse and reliance on state aid that may be vulnerable to cuts in the state's next budget. Considering the city's very high fixed costs and limited ability to reduce expenditures, and uncertainty regarding management's ability to correct course, we see strong potential for increasing financial stress in the years to come.

Under our local government GO criteria, we view management as very weak, which constrains the rating. Years of imbalance have resulted in deficit borrowing and large underfunded pensions, thus yielding very high fixed costs that will linger for years. We also consider there to be political instability that could delay the city's response to increasing budget pressure.

We note that ratings in the 'BB' category are differentiated from those in the 'B' category, based on our view that exposure to adverse business, financial, or economic conditions could impair an obligor's ability to meet financial commitments, but is not likely to. The stable outlook reflects the city's very strong reserve and liquidity position that we feel leaves it equipped and with time to absorb the potential adverse events and still meet obligations. Maintaining the rating will require close management of the city's revenues and expenditures, particularly considering its very high fixed costs. Should a structural imbalance develop or the city start to otherwise deteriorate, credit quality will likely be affected.

Additional factors reflected in the 'BB-' rating include our view of Ecorse's:

- Very weak economy, with a concentrated local tax base and population declines, yet access to a broad and diverse metropolitan statistical area (MSA);
- Weak budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2020, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Adequate budgetary flexibility, with fiscal 2020 available reserves at 59% of operating expenditures, but limited capacity to reduce expenditures or raise revenues;
- Very strong liquidity, with fiscal 2020 total government available cash at 132.8% of total governmental fund expenditures and 15.3x governmental debt service;
- Very weak management, despite standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Very weak debt and contingent liability position, with debt service carrying charges at 8.7% of expenditures and net direct debt that is 87.2% 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 the lack of a plan to sufficiently address it; and
- Strong institutional framework score.

Environmental, social, and governance factors

We feel Ecorse faces higher social risks than most in the sector, factoring in population declines and incomes that are well below national levels, both of which can limit revenue-raising abilities. A heavy reliance on a steel industry that is susceptible to political trade disputes and shifting consumer behavior is another risk not shared by most of the sector, as this leaves the budget in perpetual risk. Governance is also a risk, with a history of fraud investigations and tension between the mayor and city council affecting our views on effective oversight.

Stable Outlook

Downside scenario

We could take a negative rating action if deficits materialize in the next one-to-two years and lead to large draws on fund balance and liquidity, and we feel there is no plan or ability to bring the budget back to balance in time to preserve sufficient reserves to offset risks of the tax base.

Upside scenario

We could take a positive rating action if the city is able to navigate the next one-to-two years and protect its very strong reserves, and we feel there is governance stability and a plan in place that can sustain operational balance.

Credit Opinion

Very weak economy

We consider Ecorse's economy very weak, with projected per capita effective buying income of 54.7% of the national level and a very low per capita market value of $27,092. The city spans just under three square miles in Wayne County, about 10 miles south of downtown Detroit, and has 8,894 residents. We positively account for its participation in the broad and diverse Detroit-Warren-Dearborn MSA, but also negatively adjust for population declines. Wayne County's unemployment rate peaked at 26.5% this past April, and has since retracted to 8.2% as recently as October.

Ecorse historically has had a very concentrated, volatile tax base. The current taxable value (TV) of $106.1 million is down 63% from 2009 levels. The decline reflects the state's elimination of personal property from tax rolls (which was almost half the base) and significant appeals being awarded to U.S. Steel. The plant remains the largest taxpayer, at 16.7% of TV, down from prior highs of 42%. The top ten taxpayers still combine to 44%, with the top three alone at 34%. When the state phased out personal property taxes, it replaced the revenue with state aid, softening the blow from the TV declines.

U.S. Steel announced in December 2019 that it would idle its Great Lakes Work site, which includes facilities in Ecorse and River Rouge, affecting about 1,550 jobs. The industry has been hampered by declining demand and challenges related to tariffs and international trade disputes. Most of the jobs were at facilities in River Rouge that have already shut down, but the Ecorse site, a finishing facility, is remaining open for now. According to management, there were not many Ecorse residents working at the shuttered River Rouge plant. If the site in Ecorse were to close, this would likely result in substantial property tax losses and intensified financial pressure. Property taxes made up 39% of general fund revenues in fiscal 2020, and at 17% of TV, we estimate U.S. Steel accounted for about 7% of revenues.

Weak budgetary performance

Ecorse recorded strong general fund surpluses in excess of 5% of expenditures each of the past three fiscal years (including a 7.8% surplus in 2020), but results are likely to weaken in the near term, and depending on events out of the city's control, could weaken substantially. The city annually budgets for break-even results, but has been reporting surpluses due mostly to the state paying personal property tax reimbursements (referred to as Local Community Stabilization Authority [LCSA] revenues) at levels well above formula. These LCSA overpayments exceeded $2.5 million each of the last three years. Management has been using them to make pension contributions above scheduled amounts (by $1 million each of the last three years) and to pay down its emergency loans and recovery bond ahead of schedule. Without the overpayments, operations would have still been balanced, but progress on pension funding likely would have slowed.

The fiscal 2021 general fund budget totaled $12.4 million and relied on a $627,000 appropriation of fund balance (negative 5% deficit). This was the first budget for several years in the red, but also does not assume any LCSA overpayments from the state. Given the weakened position of the state's budget (due to the pandemic), it could be more likely that the overpayments subside, and without them, positive progress on pension funding could vanish. Property taxes and special assessments accounted for 51% of budgeted revenues, followed by state LCSA (22%) and distributable state aid (DSA, 14%). The state held DSA funding for local governments flat in fiscal 2021 budget.

The city's five-year forecast assumes flat revenue and growing expenditures, and therefore increasing annual deficits. At this time, it does not have a plan in place to address projected deficits, which are before potential reductions in DSA or losses that could occur from future U.S. Steel closures. With a very weak pension plan that is only 42% funded, we see risk that these already very high costs could grow more than projected (particularly if plan assumptions are not met or the city does not find ways to continue overfunding) and further stress the budget. Required payments on the city's emergency loan do not begin until fiscal 2025.

Adequate budgetary flexibility

Ecorse grew its unassigned general fund balance to $8.1 million, or 59% of expenditures, to close fiscal 2020, which is very strong. Across 2010 and 2011, it issued $5 million in emergency loans and $9.5 million in recovery bonds to eliminate a deficit fund balance position and pay off claims and judgement. The amount outstanding on these balances was $8.9 million at the close of the fiscal year, still higher than the current available fund balance.

The adequate assessment reflects our view of a limited capacity to either raise revenues or reduce expenditures. Based on the city's most recent five-year projection, increasing deficits could absorb the entire available fund balance within five years. This does not include any losses that could occur related to U.S. Steel or state aid cuts. The city already eliminated a large number of staff positions while under emergency management, and about 40% of its annual expenditures are locked in with debt and retirement liabilities. According to management, if deficits materialize, its only avenue to address them would be to eliminate services or outsource them if cost effective. We do not see much ability or likelihood for the city to significantly increase revenues, factoring in tax limitations and the nature of the tax base.

Very strong liquidity

In our opinion, Ecorse's liquidity is very strong, with $22.4 million in total government available cash at 133% of total governmental fund expenditures and 15x governmental debt service in 2020. We anticipate liquidity declining, accounting for projected deficits in the operating and water/sewer enterprise funds, but still remaining very strong. U.S. Steel is projected to use substantially less water due to the closures, which will pressure the enterprise fund operations that are already in need of capital repair.

We consider the city to have satisfactory access to external liquidity if necessary. It has issued little debt on its own, rather, much of the debt was sold to the State of Michigan or was issued through the Downriver Utility Wastewater Authority. The 2011 financial recovery bonds were sold by the city, with an enhancement in the form a statutorily dedicated judgement millage. Still, we expect that if the city needs access to external liquidity, it could gain it at an acceptable price. Other than state emergency loans, the city does not have direct-purchase debt. We do not consider its investments to be aggressive.

Very weak management

We view the city's financial policies and practices under our FMA methodology as standard, indicating the finance department maintains adequate policies in some, but not all, key areas, but the management assessment is limited to very weak. The city has a history of managerial concerns. A former mayor was arrested in 2009 and in 2019, the FBI began an investigation of the police department. This past month, the city council passed a motion requesting the re-elected mayor to resign, alleging wrongdoing related to a 2016 vehicle purchase. However, we understand many of the councilmembers who voted for the motion have already been replaced by newly elected members and that the new council has since rescinded the motion. In totality, we feel there is political instability and lack of oversight, which could impair the city's ability to quickly respond to increasing pressures. The very weak assessment also factors the very high fixed costs and past going concern opinions in audits. City auditors cited its ability to function as a going concern as recently as 2017, though the 2018, 2019, and 2020 audits did not contain such an opinion.

Highlights of the city's financial management practices includes monthly budget-to-actual and investment reporting to the council and strong revenue and expenditure assumptions that consistently prove conservative. The city annually updates a five-year projection, but its assumptions are not very robust and it is not clear how much this is used as a planning tool for maintaining balance. There is no formal capital improvement plan. The city has an investment policy, but no debt or reserve policy. The finance department targets a minimum a 17% general fund reserve, but this is not necessarily an agreed-on reserve goal of the city.

Very weak debt and contingent liability profile

Ecorse has approximately $21.5 million in direct debt outstanding, $5 million of which is secured solely by enterprise net revenues. Total governmental fund debt service was 8.7% of total governmental fund expenditures in fiscal 2020, and net direct debt totaled 87% of total governmental fund revenue. Including overlapping debt, the overall net debt burden is very high at 37% of market value, a negative factor on our assessment. The city does not have additional debt plans at this time. Currently, 62% of principal is scheduled to be repaid in the next ten years. The city paid down $2.3 million of the emergency loan balance over the last three years, though required payments do not begin until fiscal 2025. It also paid $1.4 million on the recovery bonds in excess of scheduled amounts during this time. By paying these balances down in advance, it is relieving pressure from future cost increases.

Pensions and other postemployment benefits

- We view pension liabilities as an ongoing source of credit pressure for Ecorse given the very low funded level, already very high costs as a percentage of the budget, and potential for costs to increase if plan assumptions are not met.
- OPEB costs are significant as well, but with the city stopping benefits for new hires and putting in place steep requirements for legacy staff to meet, these costs should in time moderate.

Ecorse participated in the following plans as of June 30, 2020:

- Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the Retirement Board of MERS; 42% funded with $24.1 million net pension liability.
- Single-employer defined-benefit health care plan that is 9% funded with a net liability of $11.7 million.

Combined pension ($3.5 million) and OPEB ($1.4 million) contributions totaled $5 million in fiscal 2020, or a very high 30% of total governmental funds expenditures. We note that $1 million of this was a voluntary payment above required amounts, and about $560,000 was funded from the enterprise funds, thus modestly inflating this ratio.

The city closed all but one division of MERS in 2017, with new hires since then joining a defined-contribution plan. Police remain in a hybrid plan. The latest MERS valuation reflects a lowering of the discount rate to 7.35% from 7.75%. Amortization employs a level percentage of payroll approach, assuming 3% salary increases, just lowered from 3.5%.

With the city paying contributions above required amounts, it well exceeded both our static and minimum funding progress ratios, indicating that combined employee and employer contributions covered service costs plus unfunded interest costs plus a portion of unfunded liabilities. Funded levels dropped to 32% in 2016, but have hovered at or above 38% the last three years, and increased this past year, despite the adoption of more conservative plan assumptions. The discount rate remains above levels outlined in our guidelines, and with a level percent of pay amortization approach, there are increased risks if assumptions are not met. If the city's staff is reduced and payrolls do not rise, it will likely miss assumptions. Another risk is that the plan is very mature, with only 25 active employees to 141 inactive, leaving less flexibility to address liabilities through active staff.

The city administers a single-employer defined-benefit health care plan providing health care OPEBs to certain retirees and their beneficiaries. It closed the plan to police hired after January 2012. Police and Fire members require 25 years of service before qualifying, and general union employees are eligible on retirement when meeting certain qualifications. The plan is mostly funded on a pay-as-you-go basis.

Strong institutional framework

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

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
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020