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Ratings

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Summary:

Ecorse, Michigan; General Obligation

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Table Of Contents

Credit Highlights

Outlook

Credit Opinion

Related Research

Summary:

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Credit Profile		
Ecorse		
Long Term Rating	BB-/Stable	Affirmed

Credit Highlights

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

Security

The bonds are secured by a judgment millage statutorily dedicated solely to these bonds, as well as by the city's limited-tax full faith and credit general obligation (GO) pledge. We rate the bonds using our "Issue 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.

Credit overview

Ecorse's concentrated tax base and population continue to shrink, which limits its ability to raise revenue and leaves it susceptible to events outside of the city's control. In addition, its history of financial distress, high fixed costs, and weak institutional oversight makes the city reliant on the overpayment of state-shared revenue to maintain fiscal operations. In 2009, Michigan declared a fiscal emergency in Ecorse, appointing an emergency financial manager who remained in place through fiscal 2013 (and has been operating independently without state oversight since December 2017). In 2010 and 2011, the city 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 city received additional resources to eliminate its deficits and liabilities and build up reserves and continues to receive state revenue beyond what it is entitled to.

The city's general fund performance, while positive, is due to the continued state appropriations that are above Ecorse's formula allocation. Without these, the city would likely have reported deficits in fiscal 2020 and 2021 and, in our view, there is no plan in place to address the structural deficit. Significant uncertainties remain, including the possible closure of a U.S. Steel facility and reliance on state aid that may be vulnerable to cuts in the state's next budget or if politics in Lansing change. Considering the city's very high fixed costs—over 40% of the budget in fiscal 2021—and limited ability to reduce expenditures or increase revenue, we see strong potential for increasing financial stress in the years to come. Maintaining the rating will require close management of the city's revenues and expenditures.

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, yielding very high fixed costs that will linger for years.

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 'BB-' rating also reflects our view of the city's:

- Limited economy with a declining population and falling market values in the Detroit metropolitan statistical area (MSA);
- Very weak management, with standard FMA and strong institutional framework;
- Reliance on additional state funding to maintain budgetary balance despite surplus operations and very strong reserves; and
- Very weak debt burden with poorly funded pensions and very high fixed costs.

Environmental, social, and governance

We have evaluated the city's environmental risks and view them as neutral within our credit rating analysis. We consider the city's social risks moderately negative compared with those of the sector, with population declines and incomes that are well below national levels, which can limit revenue-raising abilities. A heavy reliance on a steel industry that is susceptible to economic demand, political trade disputes, and shifting consumer behavior is another risk not shared by most of the sector and leaves the budget at perpetual risk. In our view, the city's governance risk is moderately negative compared with that of the sector, with a history of fraud investigations and tension between the mayor and city council that affect our views on effective oversight, though we note that political tension has abated in recent years.

Outlook

The stable outlook reflects our opinion that Ecorse's very strong reserve and liquidity position leaves it equipped, at this time, to absorb any potential adverse events and still meet obligations. However, should a structural imbalance develop and the political environment or the city start to otherwise deteriorate, credit quality will likely be affected.

Downside scenario

We could take a negative rating action if deficits materialize over the outlook period, resulting in draws on fund balance and liquidity, and we believe there is no plan or ability to bring the budget back to balance in time to preserve sufficient reserves to offset tax-base risks.

Upside scenario

We could take a positive rating action if the city maintains its very strong reserves and we believe there is governance stability and a financial plan in place that can sustain operational balance.

Credit Opinion

Suburb of Detroit with a limited economy, declining market values, and falling population

Ecorse has a population of 8,680 located in just under three square miles in Wayne County, about 10 miles south of downtown Detroit, which has an economy we consider to be broad and diverse. The city's population was once double what it is today but over the last fifty years has been declining steadily and with no sign of abating, which we view as a negative credit factor.

U.S. Steel announced in December 2019 that it would idle its Great Lakes Steel 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. While most of the jobs were at the River Rouge facility (which neighbors Ecorse), the Ecorse site, a finishing facility, remains open due to strong automotive demand. However, its future is uncertain and closure of the plant is possible if demand declines, which would likely result in further substantial property tax losses and intensified financial pressure. Property taxes made up 37% of general fund revenues in fiscal 2021, and, with U.S. Steel's share of taxable value (TV) at 17%, we estimate that it accounted for about 6% of revenues.

Ecorse historically has had a very concentrated, volatile tax base. The current TV of $100.1 million is down $88.5 million, or 46.9%, since 2016, and was in steady decline prior to that. The decline reflects the state's elimination of personal property from tax rolls (which was almost half the base) and significant tax appeals being awarded to U.S. Steel. The plant remains the largest taxpayer at 17% of TV, down from prior highs of 42%. The top ten taxpayers still account for 39%. When the state phased out personal property taxes, it replaced the revenue with state aid, softening the blow from the TV declines.

According to management, residential, commercial, and industrial development is limited. However, the city used a portion of its American Recovery Plan Act (ARPA) funds to purchase land to complete a direct access truck route connecting the expressway to an approximately 60-acre site that will likely be developed for warehouses. The city, working with the county, expects to have the road project completed by next summer and hopes that the sale of the site will soon follow. The city would realize $2.2 million in revenue once the site is sold, and while the city expects to grant tax abatement for the potentially redevelopment of the site, it also hopes the completed site will bring a number of jobs to the city.

Very weak management with standard FMA

The city has a history of managerial concerns. A former mayor was arrested in 2009 and, in late 2020, the city council passed a motion requesting the recently re-elected mayor to resign. The council's actions were unsuccessful as many of the council members who voted for the motion were leaving office and the new council members rescinded the motion. Over the last 18 months, the mayor and city council have, for the most part, been able to reach agreement to maintain operations. The very weak assessment factors in the very high fixed costs and past going concern opinions in audits; the 2017 audit cited the city's ability to function as a going concern, although no audit since contain such an opinion.

FMA highlights include:

- The city's revenue and expenditure assumptions are cautious, as the city does not budget for any additional revenue from the state and officials using a line-item budgeting approach that factors in historical revenue and expenditures data to forecast trends;
- Monthly budget-to-actual performance is provided to the council, with the budget amended quarterly;
- No formal fund balance policy is maintained, and while the finance department has internal targets, these have historically not always been agreed upon by the council;
- The city maintains a formal investment policy that follows state guidelines, and officials report investment holdings and earnings annually; and
- The city's long-term financial forecast has not been updated in recent years, and it currently lacks formalized long-term capital plans and does not maintain a debt policy that goes beyond state guidelines.

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

Despite surplus operations and very strong reserves, the city remains reliant on additional state funding to maintain budgetary balance

Ecorse reported positive general fund performance in the past five audited years, although this is 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 $3.5 million in fiscal 2021 (June 30), a roughly $1 million increase from the prior three years. Management continues to use the LCSA overpayment to make the city's full required pension contributions and to pay down its emergency loans and recovery bond ahead of schedule. The city would have reported general fund deficits of approximately 3.5% and 2.3%, in fiscal 2020 and 2021, respectively, without the overpayments.

While the audit is not yet complete, the city expects to report near balanced operations in fiscal 2022, though there may be a slight general fund deficit due to capital projects related to the road project. The city received an LCSA overpayment of $3.7 million, which it used to pay down a portion of its financial recovery bonds and once again make its full pension contribution. Ecorse also received $1.0 million in ARPA funds, which it is using for the road project as well as for capital needs.

The fiscal 2023 budget includes a $5.0 million, or 27.7%, general fund deficit, but this does not include any state overpayment in LCSA funds. Michigan recently passed its fiscal 2023 budget, and it is likely that the city will once again receive the revenue overpayment, though management does not know the final figure at this time. However, even if the LCSA overpayment is in line with the prior two years, the city's general fund deficit is projected to be about $1.1 million, or 6.0%. The city has reduced its millage rate (Ecorse's property tax rate is among the highest in the state), which further reduced revenue. Meanwhile, expenditures are expected to increase due to rising fixed costs as well as to one-time capital projects, with officials planning to replace a number of playgrounds in the city, although ARPA funds will cover some of this cost.

Based on its positive financial results, the city's fund balance was nearly $9.3 million, or 64.7%, at the end of fiscal 2021. However, our adequate assessment of the city's flexibility reflects our view of its limited capacity to either raise revenues or reduce expenditures. The city's property tax rate is among the highest in the state and management has informed us that there are not many opportunities to cut expenditures without severely affecting services at this time.

The city eliminated a large number of staff positions while under emergency management and 42% of its annual expenditures are fixed costs. According to management, if deficits materialize, its only avenue to address them would be to eliminate services or outsource them if this is cost effective. Factoring in tax limitations and the nature of the tax base, we do not think it likely that the city will be able to significantly increase revenues.

Since the city is reliant on state overpayment of LCSA funds, its reserve position could deteriorate rapidly if these funds were to be reduced or cut entirely, potentially reaching zero in less than three years. Furthermore, if U.S. Steel were to close its plant, the city's general fund revenue and utility systems would be adversely affected.

Ecorse's cash position is very strong, in our view. The city has issued little debt on its own; instead, 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 do so at an acceptable price. Other than state emergency loans, the city does not have direct purchase debt. As a result, we expect that its liquidity will remain very strong over the outlook period.

Very weak debt burden and very high fixed costs

Ecorse has approximately $21.2 million in direct debt outstanding, $4.5 million of which is secured solely by enterprise net revenues. Including overlapping debt, the overall net debt burden is very high at 35.5% of market value, a negative factor in our assessment. The city does not have additional debt plans at this time. Amortization is above average, with 61.9% of principal scheduled to be repaid in the next ten years. The city has paid down $2.5 million of the emergency loan balance over the last five years, though required payments do not begin until fiscal 2025. Including fiscal 2022, the city has also paid $3.0 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.

Net water and sewer revenues for the debt supported by the utility systems did not provide coverage in fiscal 2020 or 2021. Management said the city's general fund did not have to cover any of the debt service payments, however. Debt service coverage declined due to significant decline in water consumption at the US Steel facility starting in 2019 as well as to the city council pausing rate increases during the pandemic. The city increased utility rates by $2 million year-over-year in March 2022 and will continue to increase rates over the next four years. Management is aware that further consumption declines at the US Steel facility will affect utility revenue and plans to be proactive with rates as a result.

Poorly funded pension and other postemployment benefits (OPEB) liabilities

We view pension liabilities as an ongoing source of credit pressure for Ecorse given the very low funded level, 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 and the city has not made its fully required contribution in a number of years, although it no longer provides benefits for new hires.

Ecorse participated in the following plans as of Dec. 31, 2020:

- Municipal Employees Retirement System of Michigan (MERS), a defined benefit, agent multiple-employer plan, 48.1% funded with $21.8 million net pension liability.

- Single-employer defined-benefit health care plan that is 14.6% funded with a net liability of $11.1 million.

Combined pension ($4.5 million) and OPEB ($1.1 million) contributions totaled $5.6 million in fiscal 2021, or a very high 33.1% of total governmental funds expenditures, though we note that about $570,000 was funded from the enterprise funds, thus modestly inflating this ratio. The city only made 93.7% of the required contribution to its OPEB plan. Management confirmed that the city would not be able to make its actuarially determined pension contribution without LCSA overpayments from the state.

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 MERS plan has a discount rate of 7.35%, while employing a level percentage of payroll approach, assuming 3% salary increases. The city 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 funding progress remains steady as both the funded ratio and net liability improved in recent years 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 that provides 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.

Ecorse, Mich.: Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Very weak economy				
Projected per capita EBI % of U.S.	48.3			
Market value per capita ($)		27,973		
Population		8,680	8,674	8,894
County unemployment rate (%)		8.0		
Market value ($000)		242,802	228,820	218,426
Ten largest taxpayers % of taxable value	38.5			
Weak budgetary performance				
Operating fund result % of expenditures		8.1	7.8	7.4
Total governmental fund result % of expenditures		13.9	12.6	12.9
Adequate budgetary flexibility				
Available reserves % of operating expenditures		64.7	59.2	53.9
Total available reserves ($000)		9,293	8,113	6,885

Ecorse, Mich.: Key Credit Metrics (cont.)				
	Most recent	**Historical information**		
		2021	**2020**	**2019**
Very strong liquidity				
Total government cash % of governmental fund expenditures		112.5	132.8	122.9
Total government cash % of governmental fund debt service		1,429.3	1,530.0	690.5
Very weak management				
Financial Management Assessment	Standard			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		7.9	8.7	17.8
Net direct debt % of governmental fund revenue	104.3			
Overall net debt % of market value	35.5			
Direct debt 10-year amortization (%)	61.9			
Required pension contribution % of governmental fund expenditures		26.7		
OPEB actual contribution % of governmental fund expenditures		6.4		
Strong institutional framework				
EBI--Effective buying income. OPEB--Other postemployment benefits.				

Data points and ratios may reflect analytical adjustments.

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 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022