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Ratings

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Summary:
Ecorse, Michigan; General Obligation

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Long Term Rating	BB-/Stable	Current

Credit Highlights

- S&P Global Ratings' long-term rating on Ecorse, Mich.'s series 2011 financial recovery bonds is 'BB-'.
- 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. The 'BB-' rating is set on par with our view of the city's general creditworthiness, reflecting availability of fungible resources for debt service.

Credit overview

Ecorse, a historically industrial-based suburb of Detroit, remains financially challenged after decades of disinvestment driven by the decline of the steel industry along southern stretch of the Detroit River. The city's taxable value fell by half to $106.6 million by 2024 from $219.7 million just 10 years ago. Its ability to self-fund essential services, debt, pensions, and needed capital investments is hampered by this tax base decline. Furthermore, weak individual wealth levels led to over 20% tax collection delinquency in 2023, statutorily limiting the city's ability to issue debt. High fixed costs have chronically overburdened the budget, and financial solvency is heavily dependent on discretionary state funding.

While management is focused on financial independence from U.S. Steel, it remains its top taxpayer at 15% of assessed value. The city and U.S. Steel are scheduled to go to trial in December 2024 to resolve an assessment dispute over four years of taxable value. An adverse ruling would likely require the city to return collected revenues. While officials do not expect the appeal to be successful, we view this as a severe continent liquidity risk that could impair its financial position. 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 are not likely to. The strong reserve and liquidity position could help soften an initial loss, but the city would likely need to implement sustainable adjustments quickly to remain solvent.

If the appeal is resolved in the city's favor, there is potential for rating improvement. Management has proactively taken steps to redevelop industrial sites and diversify away from steel, which has overshadowed its tax base. It continues to aggressively pursue grants to improve critical infrastructure and has focused on repurposing space into parkland and enhance geographic amenities to improve quality of life. The city's finances have improved, and positive general fund performance from 2017 to 2021 allowed the city to grow reserves to $9.2 million. Debt and pension liabilities remain a credit pressure, making up 25% of governmental spending; however, fixed costs have moderated from much higher levels, over 40% prior to 2019. While fixed costs are moderating, we expect performance in the general fund could weaken given the city's intent to cash-fund $6 million to $7 million in reinvestment projects over time. Management's ability to maintain budgetary flexibility while funding general operating costs and achieving its vision for capital improvements remain important factors in considering a higher rating.

The 'BB-' rating also reflects our view of the following:

- We consider the local economy very weak, given high tax base concentration and weak incomes and property wealth. The city is 2.98 square miles, about 10 miles south of downtown Detroit. The city's population declined 4% to roughly 9,000 residents over the last two decades following a much longer trend of outmigration starting in the 1970s when population was over 19,000. Average per capita income is just $18,282 annually, roughly half of the national average, despite residents' access to employment opportunities throughout the metro area. There are some signs of improvement, however, as market value grew by 45% since 2019, reversing more than a decade of decline (though this growth is not fully realized in the levy given the Headlee limit). Ongoing development, including a 64-unit mixed-use housing project and the 64-acre Mill Street light industry site readiness project, will likely support continued market value growth.
- The city has standard financial management policies and practices, though we characterize management as weak, given its challenging operating environment and history of fiscal distress. The city rehired its previous administrator, who ultimately directs all budgeting for the city, with approval from its council. The city reports quarterly budgetary performance to its council along with investments in accordance with its investment policy. It lacks formal debt management and reserve policies, though management targets 15%-25% of expenditures.
- The city's annual operating performance has been positive, but ultimately propped up by state funding. The city received $4.3 million in unbudgeted Local Community Stabilization Authority (LCSA) overpayments, which supported 24.5% of its general fund budget for 2023. 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. Grants and contributions made up 53% of the city's general fund revenue in 2023, followed by property taxes at 33%. Officials have raised water rates and special assessment millage in recent years to keep up with inflation and public works costs. Future tax increases are unlikely given management is actively working to improve its collection rate and its 2024 budget includes an 8.7% millage reduction. Despite the millage reduction, property tax revenue is budgeted to increase 34.4%. The city received roughly $4.5 million in American Rescue Plan funding, which was directed to roadway improvements. Performance in 2023 weakened after a stretch of positive results; the 7.3% deficit in the general fund was purposeful and capital related. The city's 2024 budget includes a $2.275 million draw on reserves to fund continued capital investments, but management expects the result to be closer to $1 million, or 5.3% of current general fund.
- The city's debt and contingent liability position is very weak, driven by high debt relative to the tax base and extremely high fixed costs. Ecorse has approximately $16.4 million in direct debt outstanding, $4.6 million of which is secured solely by enterprise net revenues. Including overlapping debt, the overall net debt burden is very high at 25% of market value, a negative factor in our assessment. The city has accelerated the payoff of its 2011 judgment bonds, paying off $4.1 million in principal early, and reducing the expected total payoff period by 20 years. Pension costs make up roughly 20% of the city's budget; however, its overall funding position will improve with the receipt of $5 million in Protecting Michigan Pension Grant awards. The city's funded ratio in its Municipal Employees' Retirement System of Michigan defined-benefit pension plan increased to 73% in 2023 from 58% in 2022 because of the award.

Environmental, social, and governance

We have evaluated the city's environmental risks and view them as elevated within our credit rating analysis. The city frequently encounters flooding from heavy rains and poor stormwater infrastructure feeding into the Ecorse Creek. The ongoing financial impact of environmental risk factors has largely been addressed by a number of grant-funded restoration projects to mitigate flooding. 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 the steel and automotive industries, which are 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 currently very strong reserve and liquidity position would help it absorb any potential adverse events and still meet obligations during the outlook time frame.

Downside scenario

We could take a negative rating action if rising operating costs, capital spending, or an adverse decision in the U.S. Steel case begin to limit financial flexibility and weaken overall liquidity, and we believe there is no plan or ability to bring the budget back to balance and restore reserves to offset the declining and concentrated tax base.

Upside scenario

We could take a positive rating action if the appeal against the city is resolved, reducing uncertainty, and city maintains structurally balanced operations and its very strong reserves in accordance with its 25% target.

This report does not constitute a rating action.

Related Research

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