S&P Global
Ratings

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Summary:

Warren, Michigan; General Obligation

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*(**Editor's Note:** This summary, originally published Nov. 22, 2019, misstated the debt and contingent liability profile score as strong instead of adequate in the debt and contingent liability profile heading. A corrected version follows.)*

Credit Profile		
US$28.0 mil cap imp bnds ser 2019 due 01/01/2040		
Long Term Rating	AA/Stable	New
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Warren GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Warren, Mich.'s series 2019 limited-tax general obligation (GO) capital improvement bonds. At the same time, we affirmed our 'AA' long-term rating and underlying rating (SPUR) on the city's existing limited-tax GO debt. The outlook on all the ratings is stable.

Security and use of proceeds

The city's full-faith-and-credit limited-tax GO pledge secures the bonds and existing debt. The bonds are payable from ad valorem taxes levied on all taxable property, subject to statutory limitations. We rate the limited-tax GO debt at the same level as our view of the county's general creditworthiness given that ad valorem taxes are collected from the county's entire tax base and that there are no limitations on the fungibility of resources available for debt service.

Although not pledged, the city plans to also use revenues it receives from the sanitary sewer system towards the debt service payment on the bonds.

Officials intend to use series 2019 capital improvement bond proceeds to finance the construction of a sanitary relief sewer, a sanitary sewage retention basin, and related necessary, pumping capacity improvements at the existing Nine Mile Pump Station.

Credit overview

Despite the planned spend-down of 30% of available reserves in fiscal 2018 to help fund legacy costs and take on a one-time capital project, budgetary flexibility remains, in our opinion, very strong at 50.5% of expenditures. Furthermore, it has improved in fiscal 2019 as the city ended with positive general results based on an unaudited report. Warren still has exposure to a large pension and other postemployment benefits (OPEB) obligation that could cause accelerating payments and represent ongoing budget pressure. However, it has strong management practices;

we believe it has taken actions to help reduce the liabilities, which, in addition to already very strong budgetary flexibility, should mitigate the increasing costs. Economic development has continued in the city, and we believe this will help taxable value (TV) increase.

The rating reflects our opinion of the city's:

- Adequate economy, with projected per capita effective buying income (EBI) at 75.3% of the national level and market value per capita of $60,657, that benefits from access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, which closed fiscal 2018 with balanced operating results in the general fund and an operating surplus at the total governmental-fund level when removing significant one-time revenue and expenditures;
- Very strong budgetary flexibility, with available fund balance in fiscal 2018 of 50% of operating expenditures;
- Very strong liquidity, with total government available cash at 91.1% of total governmental fund expenditures and 49.5x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 1.8% of expenditures and net direct debt that is 101.8% of total governmental-fund revenue, as well as rapid amortization, with 70.2% of debt scheduled to be retired within 10 years, but a large pension and OPEB obligation; and
- Strong institutional framework score.

Adequate economy

We consider Warren's economy adequate. The city, with an estimated population of 133,965, is just north of Detroit in Macomb County. It participates in the Detroit-Warren-Dearborn MSA, which we consider broad and diverse and a positive assessment factor. The city has a projected per capita EBI of 73.6% of the national level and per capita market value of $65,402. Warren's property tax base is primarily residential (57% of TV), but it also has a large commercial and industrial presence.

Leading city employers are heavily automotive related. The three leading employers are:

- General Motors Corp. (23,000 employees),
- TACOM (8,400), and
- Fiat-Chrysler (5,243).

General Motors (GM) has a significant presence in the city. Although it recently announced layoffs at a plant in Warren, this plant did not have a large staff; the roughly 3,000 jobs GM is transferring to Warren from Pontiac should more than offset the lost positions. While no single employment sector accounts for more than 30% of the county's workforce, it relies heavily on automotive manufacturing, which presents a risk. County unemployment averaged 4.0% in 2018, below the state but on par with the national average.

Total TV increased by 4% from fiscal years 2012-2015 before it declined by 7% in fiscal 2016 and started exhibiting consistent increases through fiscal 2020, reaching $3.5 billion. The 10 leading taxpayers account for 15.7% of TV, which is diverse. Management cites several economic development projects underway, a majority of which are commercial, supporting growth expectations.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating that financial practices exist in most areas but that governance officials might not formalize or regularly monitor all of them.

Warren has its own investment policy that mirrors state guidelines. Its financial plan includes the current budget year plus three years, including projected revenue, expenditures, and fiscal year-end fund balances. When budgeting, the city uses three years of historical data to form revenue and expenditure assumptions. Monthly reports are performed on budget-to-actual results and investment holding and earnings are reported to the city council. The city's five-year capital plan identifies estimated costs and shows funding; management updates the plan annually and shares it with the council. Its formal fund balance policy is to maintain 10%-15% of expenditures in unassigned general fund reserves, a level it currently exceeds. The city's debt policy adheres to state guidelines.

Adequate budgetary performance

Warren's budgetary performance is adequate, in our opinion. The city has demonstrated a track record of maintaining stable operations due to its conservative and prudent fiscal practices and policies. This may also reflect the additional revenues the city receives due to the five-year police-and-fire millage, which it renewed for another five years starting in fiscal (June 30) 2018. It has operated with consistent positive operating results over the past three audited years, net of one-time expenditures, not only in the general fund but also across its total governmental funds. However, the city will continue to face cost pressures due to fixed costs associated with pensions and OPEBs. Therefore, we believe its budgetary performance will likely remain adequate during the next few fiscal years rather than strong.

Most recently, in fiscal 2018, Warren had balanced operating results in the general fund of 0.4% of expenditures and surplus results across all governmental funds of 3.7% of expenditures. These results take into account our adjustments to the city's general fund and across the governmental funds to reflect the effects of annual interfund transfers and one-time large capital expenditures.

Prior to adjustments, fiscal 2018 audited closed with a $22.2 million general fund deficit due to proactive steps taken to fund $18.6 million in legacy costs associated with pension and OPEB liabilities in excess of the required contribution. An additional $4 million capital project to revamp the 911 system was also spent. When removing those two one-time expenses, general fund revenue outpaced expenditures by $403,000.

Based on fiscal 2019 estimates, the general fund is expected to end with a net operating surplus of about $9.7 million despite the city's budgeted fund balance appropriation of $3.1 million. Warren has historically budgeted for an appropriation of fund balance to balance the budget as part of conservative budgeting. It has continued this trend based on its fiscal 2020 budget.

The fiscal 2020 adopted budget, up 3.4% year over year, totals $115.8 million and includes fund balance appropriation of $3.9 million. Property taxes accounts for generate 61.9% of revenue while state-shared accounts for another 18.2%.

Warren's pension and OPEB costs represent a significant portion of the budget, which will continue to present a challenge, limiting overall flexibility. The city has already begun to fund beyond the annual required amounts, and we expect management might have to continue this practice to prevent escalating costs.

Very strong budgetary flexibility

After spending down its fund balance due to legacy costs and one-time capital expenditures, the city's available fund balance ended at $51.7 million, or 50% of adjusted general fund expenditures in fiscal 2018, down from $74.5 million or 71.3% in fiscal 2017. Nonetheless, Warren's budgetary flexibility is very strong, in our view. Moreover, it has consistently maintained available fund balance above 30% for the current and next fiscal years and is expected to continue doing so, which we view as a positive credit factor. Unaudited results for fiscal 2019 reflects the available fund balance increasing to $58.4 million, or 53.6% of expenditures.

The city does not expect to use reserves during the next few fiscal years, which will be important because they provide a cushion against significant pension and OPEB costs. With combined fixed costs at more than 40% of governmental funds spending, we consider capacity limited to cut spending compared with its peers. Even if management draws on reserves to address pension and OPEB costs, we expect budgetary flexibility will likely remain very strong.

The city does not have any taxing flexibility under the Headlee limit.

Very strong liquidity

In our opinion, Warren's liquidity is very strong, with total government available cash at 91.1% of total governmental-fund expenditures and 49.5x governmental debt service in fiscal 2018. In our view, the city has strong access to external liquidity if necessary.

Warren issues GO debt frequently, supporting its strong access to capital markets. It purchased new sanitation trucks in September 2018 for $7.4 million through a capital lease with Comerica. There are no remedies that could lead to acceleration, only reposition of the equipment.

Adequate debt and contingent liability profile

In our view, Warren's debt and contingent liability profile is adequate. Total governmental fund debt service is 1.8% of total governmental fund expenditures, and net direct debt is 101.8% of total governmental fund revenue. About 70.2% of direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

Warren has over $200 million in direct debt outstanding with partial self-support given to its tax secured debt that is payable from water and sewer revenues. Officials could issue $20 million of additional debt in early 2020. We do not believe that this will cause a significant increase in its debt burden.

Pension and other postemployment benefits

- We view Warren's pension and OPEB liabilities to be large and fixed costs are very high, representing an ongoing budget pressure. We believe the city has a plan and is committed to improving the funding of these obligations by contributing above the ADC to improve plan funding status.
- Because the city's pension ADC is based on relatively aggressive assumptions, including open amortization schedules and discount rates of 7.35% and 7.45%, we believe there is a potential for future cost escalation. In the

near-term, we believe the city can absorb increased costs given their very strong financial flexibility, but if the city is unable to handle the increases we would likely lower the rating.

- The city has begun to prefund its OPEB liability, but given the significant size of the liability, it will take a significant period of time to lower the liability.

Warren participates in the following plans as of Dec. 31, 2017:

- Police and Fire Retirement System: 75% funded with a net liability of $100 million.
- Employee's Retirement System: 74.1% funded with a net liability of $47.7 million
- Police & Fire Retirement Health Benefits Pension Plan & Trust: 25% funded with a net liability of $134.8 million.
- City Employees' Retirement Health, Life, & Disability Benefits Plan & Trust: 38.1% funded with net liability of $92.8 million.

The combined required pension and actual OPEB contribution totaled 39.4% of total governmental fund expenditures in fiscal 2018: 14.8% represented required contributions to pension obligations and 24.6% represented OPEB payments. The city made 136% of its annual required pension contribution in fiscal 2018.

Warren has historically met its full ADCs, and it has been overfunding these amounts recently; it substantially overfunded the ADC in fiscal 2017. While annual required contributions have been fairly stable recently, we believe that cost escalation is likely given an aggressive rate of return assumption and that amortization is based on a level percentage of pay with assumed 4% payroll growth. If the city is able to continue to fund the plans above the ADC, costs may accelerate less quickly. However, any pension or OPEB cost increases will present pressure because they already account for a major portion of the budget.

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 S&P Global Ratings' opinion that Warren will likely maintain very strong budgetary flexibility and liquidity and continue to address its large pension and OPEB liabilities. We believe strong management provides further rating stability. Therefore, we do not expect to change the rating during the two-year outlook period.

Downside scenario

If the city is unable to maintain strong funding discipline for its pension and OPEB liability or if the annual costs increase significantly causing deterioration in reserves, we could lower the rating. In addition, a multiple notch rating downgrade is likely should fixed costs continues to grow and approaches 50% of total governmental expenditures.

Upside scenario

Barring any deterioration in other credit factors, we could raise the rating if economic indicators were to increase to levels we consider at least strong and management were to address pension costs.

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
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of November 25, 2019)		
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren Bldg Auth, Michigan		
Warren, Michigan		
Warren Bldg Auth (Warren) GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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