Summary:

Warren, Michigan; General Obligation

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Credit Profile		
US$6.5 mil cap imp rfdg bnds (GO ltd tax) ser 2019A due 04/01/2031		
Long Term Rating	AA/Stable	New
Warren GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' rating and stable outlook to Warren, Mich.'s series 2019A limited-tax general obligation (GO) refunding bonds and affirmed its 'AA' rating, with a stable outlook, on the city's existing limited-tax GO debt.

The city's full-faith-and-credit limited-tax-GO pledge secures the bonds and existing debt. We think Warren possesses the financial stability and flexibility to sustain identical ratings on its unlimited- and limited-tax GO bonds.

Officials intend to use series 2019A bond proceeds to refund the city's series 2010 refunding bonds for level savings during the bonds' life, totaling roughly $227,000.

Despite a planned spenddown 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. 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, the city has strong management practices; we believe it has taken actions to help address costs, which, in addition to already very strong budgetary flexibility, should help absorb increasing costs while maintaining budgetary balance and very strong reserves. 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 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;

- Strong debt-and-contingent-liability profile, with debt service carrying charges at 1.8% of expenditures and net direct debt that is 48% of total governmental-fund revenue, as well as rapid amortization, with 71.4% 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 135,031, is just north of Detroit in Macomb County; therefore, 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 effective buying income of 75.3% of the national level and per capita market value of $60,657. 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. (20,000 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 the city, 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 jobs. While no single employment sector accounts for more than 30% of the county's workforce, it relies heavily on manufacturing, which presents a risk. County unemployment averaged 4.3% in 2017, 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 increased by 4.6% to $3.3 billion in fiscal 2018. The 10 leading taxpayers account for 15.4% 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's investment policy mirrors state guidelines. Its financial plan includes the current budget year plus three years, including projected revenue, expenditures, and fiscal year-end fund balance. When budgeting, the city uses three years' historical data to form revenue and expenditure assumptions. Management performs monthly reports on budget-to-actual results and makes monthly reports on investment holdings and earnings to the city council.

The city's five-year capital plan identifies estimated costs and funding; management updates the plan annually and shares it with the council. The city's formal fund-balance policy calls for maintaining 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 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 in fiscal 2018. The adequate assessment reflects our expectation that results could deteriorate slightly but remain mostly balanced.

When removing one-time revenue and expenditures, the city has posted positive operations annually since fiscal 2013. Officials attribute positive performance to conservative budgeting and the five-year police-and-fire millage, which they renewed for another five years starting in fiscal 2018. Property taxes generate 64.6% of revenue while state aid accounts for another 18.6%.

Fiscal 2018 audited results closed with a $22.2 million general fund deficit. Management attributes this to its planning to fund legacy costs by $18.6 million more than required and taking on a $4 million capital project to revamp the 911 system. When removing those two one-time expenses, general fund revenue outpaced expenditures by $403,000.

Fiscal 2019 budgeted general fund expenditures total $111.6 million, using $3.1 million of fund-balance appropriation to balance the budget. Warren has historically budgeted for an appropriation of reserves to balance the budget as part of conservative budgeting. Officials report that so far they received $4.4 million more in state revenue than expected and that expenses are tracking the budget closely. Therefore, barring any unforeseen revenue or expenditures throughout the remainder of the fiscal year, officials expect to finish anywhere from breakeven results to slightly less than a 1% general fund surplus. Total governmental-fund performance is also currently consistent with previous-year operating results.

Officials expect to pass the fiscal 2020 budget on May 12. The mayor's proposed general fund budget, however, totals $115.7 million with a $3.8 million fund-balance appropriation, which is part of conservative budgeting. Officials do not see any significant deviations to budgetary assumptions heading into fiscal 2020. Warren does not currently plan to increase or spend down available reserves significantly.

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. This cost pressure contributes to our expectation budgetary performance will likely remain adequate during the next few fiscal years rather than strong.

Very strong budgetary flexibility

Warren's budgetary flexibility is very strong, in our view, with available fund balance in fiscal 2018 of 50% of operating expenditures, or $51.7 million. We expect available fund balance will likely remain above 30% of expenditures for the current and next fiscal years, which we view as a positive credit factor.

When considering budgetary flexibility, we adjusted general fund expenditures for recurring transfers into nonmajor funds to support operations and debt service. The city does not have any taxing flexibility under the Headlee limit.

Despite the $22.2 million use of reserves in fiscal 2018, budgetary flexibility remains well above 30% 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.

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. Warren purchased new sanitation trucks in September 2018 for $7.4 million through a capital lease with Comerica. The lease contains terminology that could lead to cross-default acceleration. However, Warren has 17.8x coverage on the lease. Therefore, we do not consider this a liquidity risk. However, we consider investments conservative. Therefore, we expect liquidity will likely remain very strong.

Strong debt-and-contingent-liability profile

In our view, Warren's debt-and-contingent-liability profile is strong. Total governmental-fund debt service is 1.8% of total governmental-fund expenditures, and net direct debt is 48% of total governmental-fund revenue. About 71.4% of direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor.

Warren has about $163 million in direct debt outstanding, including $104.5 million of enterprise-revenue-secured debt. Officials could issue $20 million of additional debt within two years for water infrastructure, but there are currently no definite plans.

In our opinion, Warren's large pension and OPEB obligation, which could cause accelerating payments and represents ongoing budget pressure, is a significant credit weakness. 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 provides two single-employer, defined-benefit pension plans: a general employees' plan and a police-and-firefighters' plan. Warren closed the general employees' plan to new hires in 2000, and new hires since are part of a defined-contribution plan. The general employees' plan has a net pension liability of $68.2 million with a 74.1% funding. The discount rate is close to the national median at 7.35%. The police-and-firefighters' plan remains open with a net liability of $176.5 million with a 75% funding. It has a lower discount rate of 5.96%, which is good; it, however, uses an open-percentage-of-pay-amortization method, which adds risk.

Warren has historically met its full actuarially determined contributions, and it has been overfunding these amounts recently; it substantially overfunded the actuarially determined contribution in fiscal 2017. While annual required contributions have been fairly stable recently, they are likely to increase during the next few fiscal years. Without paying above the required amounts to improve funding, near- and long-term increases could be significant.

Employees who are part of either pension plan are also entitled to receive retiree health and dental insurance. Warren established two single-employer, public- and voluntary-employee benefit associations to help manage and prefund these costs: Warren City Employees' Retirement Health, Life, & Disability Benefits Plan & Trust and Warren Police & Fire Retirement Health Benefits Pension Plan & Trust. Warren's total plan contributions were $22.2 million in fiscal

2017. The general plan is 38.1% funded with a $123 million unfunded liability, and the police-and-firefighter plan is 25% funded with a $148 million unfunded liability. The city continues to prefund these plans according to city ordinance, albeit not at full actuarial levels.

We recognize Warren has been taking steps to improve its plan funding and prepare for cost increases. Any pension or OPEB cost increases will present pressure because they already account for a major portion of the budget. At the same time, the city remains well managed; it maintains very strong reserves, which can offer some cushioning to address increasing costs and phase them into 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 Warren will likely maintain very strong budgetary flexibility and liquidity. 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 pension and OPEB liability funding does not improve, annual costs were to increase to levels that could weaken budgetary performance, or budgetary flexibility were to weaken significantly to levels we no longer consider commensurate with the current rating, we could lower the rating. Although Warren maintains very strong budgetary flexibility, high fixed costs could potentially pressure the rating beyond the outlook period.

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
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of May 8, 2019)		
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren GO (AGM)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Warren GO		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of May 8, 2019) (cont.)		
Warren GO		
Long Term Rating	AA/Stable	Affirmed
Warren GO		
Unenhanced Rating	AA(SPUR)/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.