FitchRatings

FITCH AFFIRMS WAYNE CO, MI GOS AT 'B' & REMOVES NEGATIVE WATCH; OUTLOOK STABLE

Fitch Ratings-New York-24 August 2015: Fitch Ratings affirms and removes from Rating Watch Negative the 'B' ratings on the following Wayne County, Michigan bonds:

--$186 million limited tax general obligation (LTGO) bonds issued by Wayne County;
--$51.3 million building authority (stadium) refunding bonds, series 2012 (Wayne County LTGO) issued by Detroit/Wayne County Stadium Authority;
--$200 million building authority bonds issued by Wayne County Building Authority;
--Wayne County unlimited tax general obligation (ULTGO) (implied).

The Rating Outlook is Stable.

SECURITY

LTGO bonds issued by the county carry the county's general obligation ad valorem tax pledge, subject to applicable charter, statutory and constitutional limitations.

Stadium authority and building authority bonds are backed by lease payments from the county to the respective authority. The obligation to make the rental payments is not subject to appropriation, setoff or abatement for any cause, and carries the county's LTGO pledge.

KEY RATING DRIVERS

CONSENT AGREEMENT IMPROVES PROSPECTS: Removal of the Negative Watch reflects elimination of the immediate uncertainty of which path the county might choose under Act 436. The county recently entered into a consent agreement with the state under Act 436 that affords to the county's executive and legislative branches many, but not all, of the emergency manager powers and which may improve expenditure flexibility.

SEVERE FINANCIAL DISTRESS: The 'B' rating reflects the county's substantial financial challenges which have resulted in persistent structural and accumulated deficits. Previous lack of significant revenue or expenditure flexibility has hampered efforts to address the imbalance.

RECOVERY PLAN EXECUTION RISK: The county has reported making progress towards structural deficit elimination, with the remainder of the plan reliant upon use of consent agreement powers. Successful execution of the plan hinges on cooperation between the county executive and the county commission, which have been jointly granted many of the powers under the consent agreement.

STRESSED ECONOMY SLOW TO RECOVER: The weak local area economy is reflected in elevated unemployment rates, population loss and below-average income levels.

RATING SENSITIVITIES

LIQUIDITY DETERIORATION: Inability to maintain adequate liquidity, either internally or by external borrowing, would lead to a cash flow crisis and trigger a further downgrade.

RECOVERY PLAN EXECUTION: Successful achievement of remaining recovery plan elements, with the expected savings, would indicate a positive change in the rating trajectory. An inability to achieve the needed savings could lead to negative rating action.

CREDIT PROFILE

RECOVERY PLAN KEY TO POTENTIAL CREDIT IMPROVEMENT

The county's recovery plan includes efforts to solve the recurring, structural operating deficit as well as eliminate the accumulated general fund deficit. Progress toward accumulated general fund deficit elimination has been largely due to transfers of unrestricted delinquent tax revolving fund (DTRF) balance. Additional transfers from this fund are expected to bring total general fund balance to a positive position by the end of the fiscal year (Sept. 30).

Achievement of structural budgetary balance will be key to maintaining a positive general fund balance over time. The plan identifies $52.7 million of measures to cure the structural deficit. The county reports that $28 million of these (54% of the plan) have been implemented.

CONSENT AGREEMENT IMPROVES PROSPECTS FOR STRUCTURAL BALANCE

The county recently negotiated and the county commission formally approved an Act 436 consent agreement with the state. The consent agreement affords the county tools that can improve its expenditure flexibility but only if the executive and legislative branches of government can cooperate on their execution. An inability of those two branches to work together, as was the case under Detroit's consent agreement, could lead the county to pursue one or more of the remaining avenues under Act 436: neutral evaluation, emergency manager, and Chapter Nine bankruptcy. Failure of the consent agreement would be a credit negative as neutral evaluation would likely be ineffective post-consent agreement, and emergency management and bankruptcy would likely be detrimental to bondholders.

The most important aspects of the consent agreement are those that deal with labor. Most of the county's collective bargaining agreements are expired and negotiations are ongoing. The recovery plan calls for significant savings ($22.9 million) from wages, benefits (including $13.3 million from pensions), outsourcing and layoffs. This represents the bulk of the remaining $24.7 million structural deficit. If the contracts remain unsettled after the consent agreement has been in place for 30 days (mid-September) the county will have the ability to impose terms, which should give the county significant leverage during negotiations.

Successful negotiation (or imposition) of the recovery plan elements would indicate a potential improvement in the county's rating, as would fiscals 2015 and 2016 audited results matching plan expectations.

REDUCED DEFICIT POSITION AIDED BY TRANSFERS

The county projects ending fiscal 2015 with a $3.3 million general fund operating surplus, which, along with a $78.7 million DTRF transfer should put the total general fund balance into, and the unassigned general fund balance close to, positive territory. Achievement of structural balance goals will be critical to maintaining or improving this status. Without the recovery plan savings, projections show a return to a general fund accumulated fund deficit position in fiscal 2016, with operating deficits causing the accumulated deficit to continue to grow, reaching -$200 million by the end of the projection period in 2019.

Fitch does not expect the DTRF to be an ongoing source for major deficit elimination. After this fiscal year, Fitch expects the fund to generate a more moderate amount of cash of around $30 million-$40 million annually for operating transfers to the general fund as delinquencies return to more of a steady state.

ECONOMY SHOWS PERSISTENT STRESS

The Detroit area economy remains pressured after severe weakening during the recent recession. Socioeconomic indices for county residents are below average overall, as the effect of impoverished city residents outweighs that of the relatively wealthier suburban residents. Median household income was 85% of the state and 78% of the nation. The individual poverty rate of 24.5% is well above the state and national averages of 16.8% and 15.4%, respectively. Market value per capita is also well below average at $50,000, reflecting the weakened housing market.

The county unemployment rate remained above the state and U.S. levels throughout the recession but is showing signs of improvement. The seasonally unadjusted June 2015 rate of 7.7% is lower than the 10.5% recorded a year prior and well below the peak of 17.9% recorded in July 2009. Total employment and the labor force have both contracted severely over the last decade although recent trends point toward stabilization.

ABOVE-AVERAGE DEBT BURDEN

The high debt burden of 8.2% of market value is largely attributable to considerable borrowing by overlapping governments but nevertheless presents a practical limitation on future debt issuance flexibility. The county's net direct debt is a modest 0.5% of market value. Future new money borrowing plans are uncertain, as plans for the jail construction are not yet settled.

The county recently halted the jail project, for which it borrowed $200 million in 2010, when cost projections rose from $300 million to $390 million. Management is evaluating its options for the site and the consent agreement requires the county to submit a new plan by January 2016. Fitch will monitor developments and evaluate the potential impact on operating and capital costs.

SUBSTANTIAL LEGACY OBLIGATIONS

The county maintains two single-employer pension plans, the smaller of which is currently fully funded from state contributions. The larger plan reported a low 45.1% funding ratio at the end of fiscal 2013 using the county's 7.75% return assumption, which equates to an even weaker estimated 41.7% funding ratio when adjusted by Fitch to reflect a 7% discount rate. The $910 million unfunded actuarial accrued liability (2013) was a moderate 1% of market value.

The pension actuarial required contribution (ARC) has more than tripled in recent years, from $18.4 million in 2008 to $51.7 million in fiscal 2012. The county contributed less than the ARC only in fiscals 2011 and 2012, relying upon transfers from the pension fund's inflation equity reserve to make up the difference. This strategy resulted in technical meeting of the ARC, but not an overall increase in pension assets. The state supreme court recently ordered the county to repay these amounts. The county has approved a one-year judgment funding levy to meet most of the payment. The recovery plans calls for changes to the pension plan which, if achieved, are described as generating $13.3 million of recurring budgetary savings as well as reductions to the unfunded liability.

The county currently funds its other post-employment benefits (OPEB) on a pay-as-you-go basis. The unfunded actuarially accrued liability is large at $1.3 billion or 1.5% of market value. A recent legal settlement regarding a certain class of retirees is projected to reduce annual OPEB costs as well as the unfunded liability significantly. If the county is successful in achieving further recovery plan savings, both annual costs and the unfunded liability would decline even more.

Carrying costs for debt service, pension ARC and OPEB pay-go are currently moderate at 16.7% of governmental spending; however, absent achievement of recovery plan changes to the pension and

OPEB plans, Fitch expects carrying costs to rise in the near term, given the projected trajectory of the pension ARC.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors.

Applicable Criteria
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
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