

FITCH AFFIRMS BERKLEY, MI, GOS AT 'AA'; OUTLOOK REVISED TO STABLE

Fitch Ratings-New York-08 August 2011: In the course of routine surveillance, Fitch Ratings has taken the following rating action on the city of Berkley, Michigan's (the city) bonds:

--\$4.4 million unlimited general obligation (GO) bonds, series 2006 affirmed at 'AA'.

The Rating Outlook is revised to Stable from Negative.

SECURITY

The bonds are general obligations of the city, secured by its full faith, credit and taxing power, without limitation as to either the rate or amount.

KEY RATING DRIVERS

Outlook Revised to Stable: The Outlook revision to Stable from Negative reflects the city's continued sound financial profile and strong reserve levels despite the ongoing pressured financial environment and limited revenue flexibility.

Strong Financial Management: Management is strong, highlighted by results continuing to end better than budget, prudent fiscal policies and multi-year financial forecasting.

Moderate Debt Levels: Debt levels are moderate with very rapid amortization while the pension plans remain well funded. However, funding costs for combined debt service, pension and other post employment benefits (OPEB) account for an above-average percentage of the budget, which may add to financial pressure going forward.

Residential Community: Berkley is a mature, residential community located near Detroit. Direct exposure to the auto industry is limited with government, engineering and nearby healthcare facilities making up the top employers. Employment contraction continues although at more moderate levels. Wealth levels are below average.

WHAT COULD TRIGGER A RATING ACTION

The city's ability to maintain its financial profile, given its above-average fixed costs and limited revenue flexibility, will be critical to preservation of the existing rating.

CREDIT PROFILE

Berkley is a mature, residential community of roughly 15,000 residents located 11 miles northwest of Detroit. Unlike many area communities, the city has limited exposure to the auto industry in its largest taxpayers or employers. Major employers include city government as well as the SHW Group, a global engineering firm, which has recently established itself in the city. Beaumont Hospital, located just outside of city limits, also employs a notable number of city residents and is expanding through a medical school partnership with Oakland University. The first class of students is expected to matriculate later this month. Total employment loss over the past 12 months has been minimal with a 0.1% decline as of May 2011. The 10.2% May 2011 unemployment rate, which remains comparable to that of the state and above that of the nation, has decreased from 12.1% a year prior as the city's labor force has contracted 2.2% over the same period. Wealth levels remain above state and national averages.

Tax-Base Contraction Moderating

The city's tax base has declined a total of 13% from its peak in fiscal 2008, with the largest annual decline of 6.8% occurring in fiscal 2011. Tax-base contraction has continued for the current year although to a lesser extent, with a 4.8% decline for fiscal 2012. The city is projecting a 2.5% decrease in taxable value for fiscal 2013 and a further 1% loss in fiscal 2014. The trending tax-base

declines constrain the city's financial flexibility due to state millage rate limitations. Foreclosures remain manageable at roughly 1.2% of properties.

Reserve Levels Sound Despite Pressures

Financial operations have been pressured in recent years from declining property tax and state aid revenues. However, management remains sound, evidenced by its conservative budgeting, multi-year financial forecasts, ongoing budget monitoring, and preservation of adequate reserve levels despite the pressured operating environment. The city budgeted some use of fund balance for the past few years leading to moderate operating deficits in fiscals 2009 and 2010. Nevertheless, actual performance has been more favorable, preserving the city's relatively favorable reserve levels on a percentage basis. Fiscal 2010 ended with a \$397,000 operating deficit, lowering the unreserved fund balance to \$1.9 million or a still healthy 20.4% of spending. For unaudited fiscal 2011, results are more favorable, with roughly a \$200,000 addition to fund balance expected despite budgeting a \$168,613 budget gap. The fiscal 2012 proposed budget is conservative calling for a \$137,000 use of fund balance, but does not include statutory state shared revenues, which the city expects to receive and which should alleviate budgetary pressure for the year.

Multi-year financial forecasts show moderate budget gaps in the out-years that would be solved by the passage of the Headlee override tentatively scheduled for a referendum vote this fall. If the override vote fails, the city still has considerable spending reduction flexibility as staffing levels have remained stable for the past few years. The city is committed to staying around its 15% undesignated, unreserved fund balance policy. Fitch believes the city's historical record of conservative budgeting, ongoing budget management and ample remaining expenditure flexibility will allow the city to retain adequate financial flexibility for the current rating level.

Moderate Debt with Lack of Borrowing Planned

Debt is moderate and consists mostly of overlapping debt. The proposed budget for fiscal 2012 includes a seven year-capital program totaling \$12.8 million and a seven-year \$2.8 million capital equipment replacement plan. Major capital needs include general road maintenance and quality of life related projects. No additional debt is projected over the next five years.

The city has managed its OPEB and pension well over the past few years. On an aggregate basis, the city's two pension plans are close to 79% funded as of their latest valuations using their respective investment returns. Using Fitch's more conservative 7% discount rate, aggregate funding remains healthy at nearly 73%. Additionally, the city continues to fund OPEB benefits above its required annual pay-go contribution and has successfully achieved employee healthcare concessions which will lower the annually required contribution going forward. However, current funding for the pension and OPEB benefits total roughly 22% of general fund spending for fiscal 2010, a relatively high degree of expenditures.

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In addition to the sources of information identified in the 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, Zillow.com and National Association of Realtors.

Applicable Criteria and Related Research:

'Tax-Supported Rating Criteria', dated 16 Aug. 2010.

'U.S. Local Government Tax-Supported Rating Criteria', dated 08 Oct. 2010.

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=564566

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