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Moody's: Detroit's DIP Proposal Differs Substantially From its Corporate Predecessors.

The new Debtor-in-Possession (DIP) financing proposal that the City of Detroit's Emergency Manager put forth on October 11, 2013 is unprecedented among municipalities, says Moody's Investors Service. Because of this and some key differences from more common corporate-based DIPs, the ultimate impact of the proposal on the city's finances and existing bondholders is uncertain, says Moody's in the report "Detroit: DIPing its Toe into a Corporate Bankruptcy Tool."

DIP financings are commonly used in the corporate sector to inject liquidity into a bankrupt entity, with the objective of paving the way for eventual recovery. Although structurally similar with respect to most terms, the proposed Detroit DIP has several key differences.

The most significant difference is the use of proceeds. Corporate DIPs are traditionally used to provide operating financing and liquidity, with limited draws on the DIP commitment at closing. Conversely, Detroit's proposed DIP financing plan would immediately deploy 100% of the transaction proceeds.

"The full utilization of all note proceeds highlights the city's ongoing narrow cash position that persists despite already ceasing all debt service payments on liabilities deemed unsecured by the state-appointed emergency manager, as well as deferral of the city's employer pension contributions," says Genevieve Nolan, a Moody's Assistant Vice President.

While corporate DIP financing plans can be a credit positive by providing liquidity that facilitates continued operations, the ultimate credit impact of Detroit's DIP financing proposal is not clear at this time.

"The impact of the proposal on the city's existing creditors, as well the city's near-term financial position and long-term financial recovery, are difficult to assess at this point given the number of contingencies that remain," says Nolan.

Ultimately, it is uncertain whether the judge overseeing the current bankruptcy hearings will permit the DIP financing to proceed.

For more information, Moody's research subscribers can access this report at https://www.moodys.com/research/Detroit-DIPing-its-Toe-into-a-Corporate-Bankruptcy-Tool-PBM_PBM160112.