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Detroit Boosts Disclosure in Effort to Build Investor Confidence.

As the city of Detroit works to rebuild its investor relationships, it got good credit news in the form of a one-notch upgrade from a second rating agency in as many months.

The ratings remain deep in junk-bond territory.

S&P Global Ratings upgraded the city's issuer credit rating to B-plus from B Dec. 21. The outlook is stable. Moody's Investors Service upgraded Detroit to B1 from B2 in October.

The S&P upgrade follows the city's soft launch of a new web portal to improve investor access to its financial data and bond offerings.

"The road to recovery is a long one and I think that Detroit is doing the right things," said Stephen Winterstein, managing director and chief municipal fixed income strategist at Wilmington Trust Investment Advisors, Inc. "I am really optimistic about what they have been doing in terms of disclosure and the investor website is definitely a move in the right direction."

Winterstein said that for municipal bond investors the notion of transparency and the ability of local governments to be quick to respond with timely disclosure has become increasingly important.

Government Finance Officers Association best practices recommend that governmental bond issuers consider developing an investor relations program. The centerpiece of such a program is a commitment to provide full and comprehensive disclosure of annual financial, operating, and other significant information in a timely manner consistent with federal, state and local laws.

Detroit's site is provided through BondLink, an investor relations and disclosure platform for municipal bond issuers.

"We were impressed with the platform and thought it was a good way to increase market understanding of the City's debt issues that are outstanding," said John Naglick, Detroit's chief deputy chief financial officer and finance director. "We did not do it with any particular bond issue in mind, just found that it fits with our desire to be more transparent."

The city has been slowly returned to the market, but only with paper carrying investment-grade state aid backing.

Since exiting bankruptcy in December 2014 Detroit has tapped the public bond market twice: in August 2015 with \$245 million of local government loan program revenue bonds and in August 2016 with a \$615 million general obligation/distributable state aid backed bond sale. Both deals were issued through the Michigan Finance Authority.

The 2015 debt was enhanced with a statutory lien and intercept feature on the city's income taxes, which landed an A rating from S&P Global Ratings. The city also privately placed \$125 million to pay

for projects aimed at revitalizing the city's neighborhood commercial corridors.

Naglick said that the city is also close to deciding on the underwriting team for a request for proposals it launched in October to find banks to lead a tender offer and refunding of its unsecured financial recovery bonds with the aim of lowering its costs and easing a future escalation of debt service.

"Disclosure can be the canary in the coal mine," said Colin MacNaught, CEO & co-founder of BondLink. "If a credit gets distressed, often-times they stop disclosing, or their disclosure is stale. If you have an investor website, you can provide current information on a timely basis, in a very user-friendly format. I think what Detroit's doing is a big positive step as they rebuild market access."

Detroit's investor website lists financial team members, the latest financial reports on the city and district, ratings information, offering documents, and links to information on the Municipal Securities Rulemaking Board's EMMA website.

"The city is doing a very good job managing the things that are within their control," said Tom Schuette, co-head of investment research and strategy at Gurtin Municipal Bond Management. "The City's BondLink disclosure efforts coupled with the recent adoption of a formalized and realistic strategy to handle accelerating pension payments in future years are signs of a management team that appears committed to both prudent, forward-looking fiscal policies as well as going the extra mile in terms of transparency with the investor community. "

S&P, in its upgrade, cited positive momentum the city is building with regard to stabilizing its operations and being better prepared to address future significant increases in pension contributions.

"We believe the city's financial position is now more transparent compared with recent years, as is Detroit's long-term financial strategy, which relies on fairly conservative growth assumptions," S&P said. "We also believe that the city has a stronger capacity to service its debt obligations than in years past."

In its October upgrade, Moody's assigned a positive outlook to reflect the possibility of further upward movement if current economic and financial trends persist and enhance the city's capacity to fund long-term liabilities.

The city's ratings are the highest since March 2012, before its July 2013 bankruptcy filing. Schuette said the upgrades should help Detroit's market access and support the city's assertion that its credit quality is improving.

In December, Moody's also raised the city's assigned new Aa2 enhanced ratings to bonds issued by the Michigan Finance Authority and secured by various liens on distributable state aid to the city. All bonds secured by a pledge of the city's DSA fall under this program. The outlook on the program rating is stable.

Previously, Moody's (MCO) assigned different underlying ratings to bonds secured by separate liens on Detroit's DSA. Bonds with a first lien on DSA were rated Aa2. Bonds with second, third and fourth liens were rated Aa3, A1 and A2, respectively. Moody's (MCO) has withdrawn these underlying ratings and assigned new Aa2 enhanced ratings to all bonds, regardless of lien.

Naglick said the upgrades further reward the purchase decision of holders of the City's bonds that were issued as part of the 2016 refunding in the summer of 2016.

Schuette said the DSA upgrade should not really change the market's view of the outstanding bonds.

"There are still different liens to the DSA backed bonds, and the state's support for some of the liens is still subject to appropriation risk," said Schuette. "This is why we believe investors need to make sure they understand what they are buying and what risks they are taking on as we do not believe that all of these bonds share the same risk characteristics. If you're not doing your homework and just relying on the ratings or an assumption that enhancement mechanics will work when you need them then you may be setting yourself up for surprises down the road."

Positive developments shouldn't obscure the fact that city's credit rating remains deep in junk territory and vulnerable to another recession, say market participants.

"We still believe Detroit faces a long path that will require years of prudent decision making from management and the avoidance of major economic shocks before its debt makes sense for investors looking for high-quality municipal exposure." Schuette said. "The city still has an abundance of extremely high-risk characteristics and speculative-grade qualities that investors should be very cognizant of and understand what they are taking on."

Detroit's post-bankruptcy finances have improved to the point where the city may be able to exit state oversight this year. The city has presented deficit-free budgets for two consecutive years and is on the path that would allow it to exit Financial Review Commission oversight. Although the city ended fiscal 2016 with a \$63 million surplus its general fund revenues came in lower than anticipated owing to lower than expected intergovernmental aid. The city's four-year forecast shows an annual growth rate of only about 1%.

The plan to address pension obligations is aimed at shoring up the city's long-term fiscal health. Detroit developed a long-term funding model with the help of actuarial consultant Cheiron, obtained City Council approval for changes to the pension funding ordinance that established the Retiree Protection Trust Fund, and deposited \$105 million into this IRS Section 115 Trust. This fund will grow to over \$335 million by 2024 and will provide a buffer to increased contributions beginning then.

Mayor Mike Duggan claimed during his 2016 State of the City speech that consultants who advised the city through bankruptcy had miscalculated the pension deficit by \$490 million.

By Nora Colomer

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