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Moody's: Detroit's Income Tax Revenue Bonds Offer Better Credit Quality than City's GO Pledge.

New York, August 12, 2015 — The City of Detroit's (B2 positive) $245 million in income tax revenue bonds will be publicly reoffered by Barclays and now include structural enhancements that make them stronger than the city's general obligation rating, but are not guaranteed to eliminate bondholder risk in any future economic downturn or bankruptcy, Moody's Investors Service says in "Detroit's New Income Tax Revenue Bonds Provide Greater Credit Protection Than the City's General Obligation."

The income tax revenue bonds are not rated by Moody's, but we believe the bonds would be rated in the low Baa to high Ba range. This is due to the meaningful, but untested, bondholder protection and Detroit's ongoing fiscal and credit challenges.

"Default risk with these income tax bonds is much lower than the city's general obligation debt, which carries no special statutory protections and was significantly impaired during the city's recent bankruptcy," author of the report and Moody's VP — Senior Credit Officer Hetty Chang says.

However, Moody's says no guarantee can be made that pledged revenue would not be subject to an automatic stay during bankruptcy proceedings, which raises the possibility of technical or payment default in that scenario.

The income tax bonds share some of the same protection qualities as the city's distributable state aid (DSA) bonds. The state makes DSA payments directly to the DSA bond trustee, who is responsible for allocating funds for debt servicing. The DSA bonds were not included in Detroit's recent Chapter 9 proceedings. But Moody's notes there are differences in bondholder securities between these bonds.

"We perceive greater security for DSA bondholders because distributable state aid is a state revenue appropriated for local government purposes. The state levies and collects sales tax revenue and has issued bonds for Detroit secured by a lien on that revenue. The DSA's higher degree of state control protects bondholders and warrants the higher rating," Chang says.

Moody's also says Detroit's credit quality continues to be weighed by persistent economic challenges, which directly impact income tax collections. Recent improvements in income tax collections have not recovered to historical levels. Employment remains below pre-recession levels, and population is not rebounding.

Although the risk of default or bankruptcy has lessened for Detroit, the potential for another economic downturn continues to be reflected in the B2 issuer rating. Another recession would elevate financial pressure on the city.

The report is available to Moody's subscribers here.