City of Detroit, Michigan

Economic Strength	Financial Condition	Debt & Long-Term Liabilities	Management & Operating Environment	Overall Score
Poor	Poor	Poor	Poor	Poor

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Analysis as of 2 Jul 2012

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Issuer Profile

The city of Detroit, Michigan's largest city, is located in Wayne County in the southeastern section of the state's Lower Peninsula. Home to more than 700,000 people, the city covers approximately 140 square miles and accounts for nearly half the population of Wayne County. Detroit is internationally known for automotive manufacturing and trade and also serves as the international headquarters for General Motors.

County	Wayne County
State	State of Michigan
Sector	Local
Subsector	City

Key Statistics

Population (2010)	759,340
Full Market Valuation (MV) (2011) ($000s)	$20,246,209
MV Per Capita	$26,662
Per Capita Personal Income % US Average	55.1%
Median Household Income % US Average	54.6%
% Unemployment (2011)	19.9%
Total Fund Balance % of Spending (2011)	-11.5%
Overall Debt Burden ($000s)	$4,611,913
Overall Debt Burden as % of Taxable Assessed Valuation (2011)	49.0%
Principal Amortization (10 years)	42.2%

Credit Perspective

• The city's financial profile is exceedingly challenged and its liquidity is weak. Total General Fund balance equaled a negative 11.5% of General Fund spending at the end of fiscal 2011.

• State officials recently entered into a consent agreement with the city establishing increased oversight of Detroit's finances. This could add some stability, but a tremendous amount of uncertainty remains.

• The city's economic and demographic profile is extremely weak, reflected in large population losses, high unemployment, and elevated poverty rates over the last decade.

• The city's debt burden is high. Its debt profile includes a large OPEB liability and a significant swap portfolio at risk for termination.

Credit Forecast

Credit quality will remain very weak through at least the next two years. We have significant concerns regarding the stability of the city's economic base, its financial operations, and its ability to pay obligations. Bondholders should pay close attention to developments regarding current state review and oversight in the coming months as volatility will remain high.

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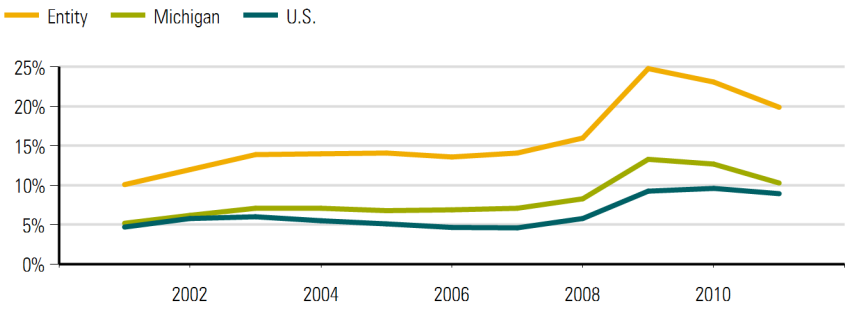
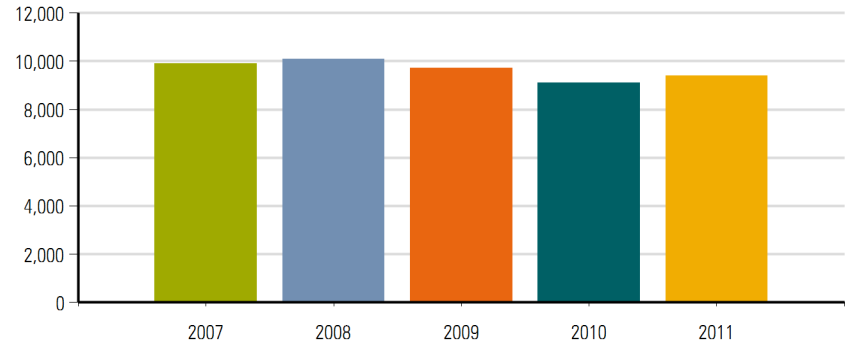
Historical Unemployment



Taxable Assessed Value ($Millions)



Economic Strength

Despite a substantial full market value of $20.2 billion and some diversification of industry in recent years, Detroit's economic profile remains extremely weak. The relatively recent expansion of the healthcare and gaming sectors was important in providing some stability and diversity to the local base, yet the long-term challenges of the domestic auto industry continue to dominate the economy. Together, Chrysler and General Motors comprised a total of 4.8% of the city's taxable valuation in 2011. Both emerged from protection from creditors under Chapter 11 in 2010 with signs of improved operations, yet substantial cutbacks in employment and operations have weighed heavily on economic growth.

Over the past decade, Detroit's population has fallen by nearly 25% bringing it to its lowest level since 1910. Although this means the labor force has declined in number, unemployment rates remained exceptionally high. Detroit's unemployment rate averaged 24.8% in 2009 and 22.7% 2010, trending well above the state and national rates. As of February 2012, Detroit's rate was improved yet still stood at a substantial 17.8%; more than one-third of residents were living below the poverty line.

Further evidence of economic challenge can be seen in low wealth indicators, which have generally declined since 1970; current per capita personal income equaled nearly 60% of the state average. The city also has a historically high rate of home foreclosure and decreasing market valuations. Although still substantial in 2011, the city's full valuation declined a significant 28% since 2007. Further declines are expected albeit at a

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Economic Snapshot

Full Market Valuation (MV) (2011) ($000s)	$20,246,209
5 Year Average Annual Change (2007-2011)	-7.9%
MV Per Capita	$26,662
Taxable Assessed Valuation (TAV) (2011) ($000s)	$9,411,302
5 Year Average Annual Change (2007-2011)	-1.2%
TAV Per Capita	$12,394
Top Industry (Employment)	Trade, Transportation, and Utilities
Top Industry (Production)	Manufacturing
Top Employer	City of Detroit
Top Taxpayer	Detroit Edison
Top Taxpayer as % of TAV (2011)	3.2%
Top 10 Taxpayers as % of TAV (2011)	17.3%
% Unemployment (2011)	19.9%
% Unemployment (May 2012)	17.7%
Population (2010)	759,340
Median Age: (US:36)	33
Dependency Ratio	65.3%
% of Persons Below the Poverty Line	34.5%
Median Household Income (MHI) (2010)	$28,357
MHI % State Average	58.6%
MHI % US Average	54.6%
Per Capita Personal Income (PCPI) (2010)	$15,062
PCPI % State Average	59.9%
PCPI % US Average	55.1%

Economic Strength (continued)

more moderate pace, as officials report that residential housing values are stabilizing. With an estimated 33,000 vacant homes in 2009, however, robust improvements in valuations are not likely in the near term.

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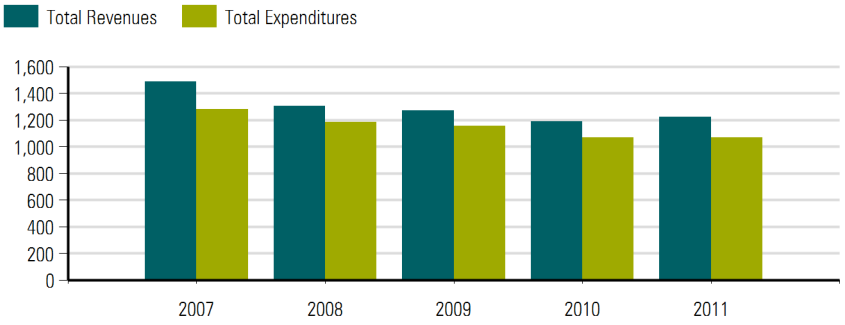
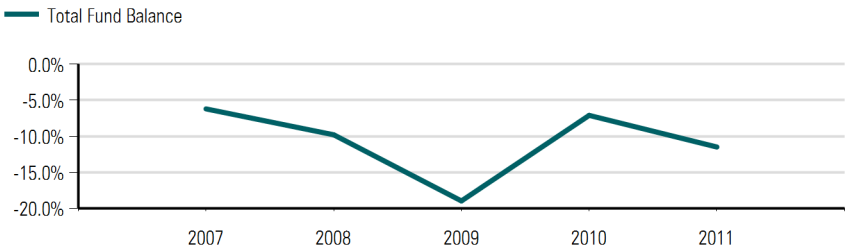
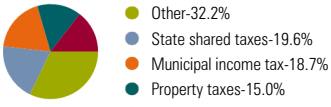
Historical Revenues and Expenditures ($Millions)



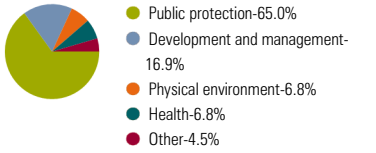
Total Fund Balance as Percentage of Spending



Top Sources of General Fund Revenues



Top Sources of General Fund Expenditures



General Fund ($000s)

Fiscal Year	2011
Total Assets	$707,167
Total Liabilities	$438,249
Total Revenues	$1,220,258
Total Expenditures	$1,070,181
Excess (Deficiency) of Revenues Over (Under) Expenditures	$150,077
Operating Surplus (Deficit) After Transfers	-$56,870
Net Change in Fund Balance	-$56,870
Total Fund Balance	-$148,072
Net Cash & Investments as % of Spending	5.7%
Total Fund Balance as % of Spending	-11.5%

Financial Condition

The city's financial position is very weak. Detroit has a history of significant structural budget gaps due to years of spending beyond budgeted levels and declines in major revenue streams. This resulted in negative General Fund balances and significantly limited financial flexibility. Detroit's total General Fund revenues (before transfers) decreased for several years before stabilizing somewhat in fiscal 2011. Management's inability to reduce expenditures to match revenues resulted in large operating deficits. From fiscal 2002 through fiscal 2009, the audited General Fund balance declined from a positive $206 million, or 13% of General Fund spending, to negative $267 million (or negative 23.6% of General Fund spending). At the end of fiscal 2009, the unreserved, undesignated General Fund balance stood at negative $331 million. A substantial portion of the reserve deficit was eliminated in fiscal 2010 due to the issuance $250 million of long-term general obligation limited tax debt payable from the Distributable State Aid (DSA) the city expects to receive from the state of Michigan. The city still recorded an operating deficit in that year and the next, resulting in a General Fund balance of a negative $148 million (negative 11.5% of General Fund spending) at the end of fiscal 2011.

In an effort to restore structural balance and rebuild reserves, officials implemented one-time budget solutions and made organizational changes. These included pension savings, general cuts to operations, layoffs, and salary and healthcare concessions from staff. Many of these actions were offset by unfavorable budget variances, including the failed sale of city assets and the lack of

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Financial Condition (continued)

timely changes to staffing levels and benefit offerings.

To fund operations with limited resources, the city issued both Revenue Anticipation Notes (RANs) and Tax Anticipation Notes (TANs) for cash flow purposes in fiscal 2005 through fiscal 2010. The amount of combined borrowing for cash flow proposes grew from $54 million in fiscal 2005 to $224 million in fiscal 2009. Officials reduced short-term borrowing in fiscal 2010 due to the long-term issuance of the city's Series 2010 DSA bonds which funded a portion of its accumulated and projected operating deficit. The city again issued short-term debt for cash flow needs in March 2012 through a private placement. This financing allowed the city to delay some debt payments for several months and provided funds for self-insurance claims which are usually paid out of the General Fund. Liquidity will remain a concern and a focus of our reviews because Detroit's current liquidity and its access to credit markets are generally limited and its needs are substantial.

As required by state statute, Detroit filed a Deficit Elimination Plan (DEP) with the Michigan Department of Treasury in September 2011. The city's DEP eliminates the accumulated deficit in 2014 (as required) and depends on: substantial reductions in employee pension and medical costs negotiated with the city's unions; increasing revenues, including income tax collections; vendor concessions; and reducing General Fund operating subsidies to other funds. In place of an approval, in December 2011, the state commenced a review of

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Financial Condition (continued)

Detroit's finances to determine the need for an ordered consent decree or a state-appointed emergency manager. The emergency manager has broad powers to impose organizational and financial changes that may be necessary to avoid a Chapter 9 bankruptcy. Such an appointment could add stability to Detroit's financial profile, but it also brings the city closer to bankruptcy. Under state law only the emergency manager can recommend that a municipality file for Chapter 9 or disband.

In April 2012, the governor and the city agreed on a consent decree that lays out financial reforms, establishes an advisory board to oversee most of the city's fiscal matters, and avoids the appointment of an emergency manager for now. This development should improve the city's fiscal crisis, yet a great deal of uncertainty remains. Please see the "Management and Operating Environment" section of this report for more details on the state's Public Act 4 (P.A. 4) and oversight of the city.

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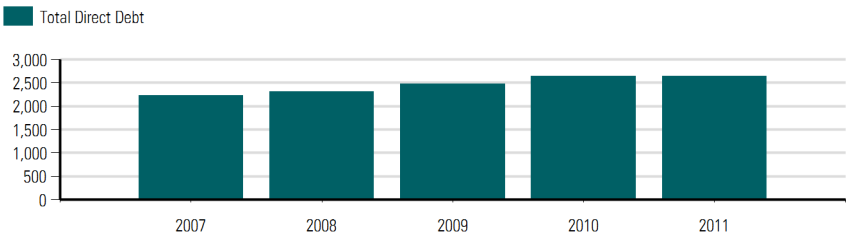
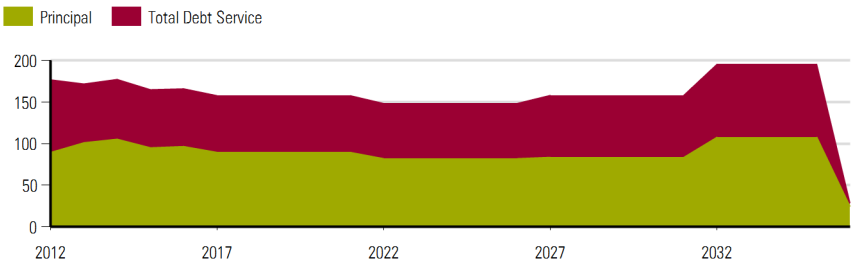
Direct Debt Snapshot ($000s)

Security	Amount Outstanding
General Obligation Unlimited Tax	$553,085
General Obligation Limited Tax	$480,148
Pension Obligation Certificates	$1,468,780
Notes Payable	$88,926
Loans Payable	$36,595
Capital Leases	$16,588
Analyst Adjustments	N/A
Less: Self-supporting	N/A
Net Direct Debt	**$2,644,122**
Overlapping Debt	$1,967,791
Total Overall Debt	**$4,611,913**
Direct Debt Burden:	
Per Capita	$3,482
As % of Taxable Assessed Valuation (TAV)	28.1%
Overall Debt Burden:	
Per Capita	$6,073
As % of TAV	49.0%

Historical Debt Burden ($Millions)



Projected Principal and Total Debt Service ($Millions)



Debt and Long-Term Liabilities

The city's debt burden is high and its overall debt profile is extensive. The city generally issues both general obligation unlimited tax (GOULT) and general obligation limited tax (GOLT) debt to support capital plans and operating needs. When considering the general obligation debt alone, the overall debt burden is high at 15.5% of full market valuation and its direct debt burden is above average at 5.8% of full market value. Debt as a percentage of taxable market value is much higher. Contributing to these figures was the city's issuance of approximately $250 million of GOLT Distributable State Aid Bonds in 2010, which funded a portion of its accumulated and projected operating deficit. The GOLT tax debt has an aggressive amortization through fiscal 2016, which could provide for some operating relief, as the limited tax debt effectively competes (on a first lien basis) with operating expenditures. When accounting for the city's $1.48 billion pension certificates of participation (COPs) issued in 2005 and 2006, the overall debt burden increases to 22.8% of full market valuation, although this partly reflects a shift from an unfunded accrued actuarial liability (UAAL) to fixed obligations.

The Detroit Retirement Systems Funding Trusts issued the COPs to fund the city's UAAL for its two pension systems. The certificates are payable solely from all COP service payments, pursuant to service contracts with the city. The city has an unconditional obligation to pay all COP service payments per a contractual agreement, and that obligation is not subject to appropriation. In the event of an insufficient payment on the obligation, the judicial system can compel Detroit to finance the payment of any judgment against the

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Other Long-Term Liabilities

Pension

Defined Benefit/Defined Contribution	Hybrid
Type of Plan	Single Employer
% Funded (2011)	N/A
Pension Costs as % of Spending	16.0%
Increase in pension costs over past 3 years	88.1%
Fully funding Actuarially Required Contribution (ARC)	Yes

Other Post-Employment Benefits (OPEB)

Pay-go Funding or ARC Funding	Pay-go
Presence of OPEB Trust	No
Pay-go Funding as % of ARC	51.0%
OPEB as % of Spending	13.0%
Funded Ratio (2011)	0.0%

Debt and Long-Term Liabilities (continued)

city through the unlimited levy of property taxes. The COPs are floating rate notes for which the city pays an adjustable interest rate tied to the LIBOR index to certificate-holders and for which there is no put option. With the issuance of the COPs, Detroit entered into floating to fixed rate insured swap agreements with UBS AG and Siebert, Brandford, Shank & Co. (and guaranteed by Merrill Lynch) for $800 million amount outstanding. The swap payments are currently insured by Syncora Guarantee Inc. and Financial Guaranty Insurance Co.

The original swap agreements allowed the counterparty to terminate the agreements early should the credit rating of the COP debt be withdrawn, suspended or downgraded below Baa3 by Moody's or BBB- by either S&P or Fitch. These conditions were met in January 2009 when the estimated payment to counterparties upon termination would have been approximately $400 million. The terms of the original swap agreements were amended in June 2009, avoiding the large termination payment originally due. As part of the amended agreements, the city directs the revenue received from wagering taxes on a daily basis to a trustee for collateral for the quarterly payment to counterparties and agreed to new termination events. An additional rating downgrade in March, 2012, on the COPs would allow the counterparties to again terminate the swaps, although currently the city is negotiating to avoid this. If they do terminate, the city will likely have up to seven years to make a termination payment. Additional required payments will undoubtedly stress budgets as liquidity and flexibility are low.

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Debt and Long-Term Liabilities (continued)

Adding to the city's debt profile are its two pension systems, the General Retirement System (GRS) and the Police and Fire Retirement System (PFRS). Each pension system is a single-employer plan composed of a defined benefit and a defined contribution annuity plan. With financing from the offering of the COPs in 2005 and 2006, Detroit contributed to the outstanding UAAL for both systems. Along with annual payments, this resulted in funding ratios of 87% for the GRS and a strong 96.6% for the PFRS as of June 30, 2011. The cost for both systems, not including debt service, was $134 million in fiscal 2011, which represents 10% of General Fund spending. Including debt service and swap payments for the COPs, the cost represents 16% of General Fund spending in fiscal 2011.

The city also offers benefits through Employee Health and Life Insurance Benefit Plan (Benefit Plan), a single-employer defined benefit plan, and a Supplemental Death Benefit Plan for retirees (Supplemental Plan). The Benefit Plan is funded as a pay-as-you-go plan resulting in a 0% funded ratio and a massive UAAL of $4.97 billion at the end of fiscal 2009. The Supplemental Plan is a pre-funded plan with a more modest $11 million UAAL as of June 30, 2010. Costs for both plans in fiscal 2011 were $166.3 million, which represents 13% of General Fund spending. Reducing costs for both the pension and OPEB liabilities will be a continued focus for management as these liabilities are significant and will most likely require large portions of the city's budgets moving forward. The city expects concessions from unions to limit these liabilities, but they will

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Management and Operating Environment

State oversight of this distressed city is high. In December 2011 the state began an in-depth review of city finances per Michigan's Public Act 4. Passed in March 2011, it establishes procedures for state intervention of financially stressed municipalities, including requirements for deficit-elimination plans, in-depth reviews a municipality's financial profile by state officials, and the appointment of an emergency manager (EM) if it is deemed necessary. The new legislation allows for earlier intervention than previous legislation and greatly increases the authority of EMs to make organizational and financial changes that may be necessary to avoid a Chapter 9 bankruptcy. An EM now also has the power to implement financial and operating plans; suspend the authority and compensation of managers and elected officials; modify or terminate collective bargaining agreements; and sell, lease, or transfer the assets or responsibilities of the municipality. Importantly, the EM can also recommend to the governor that the municipal government file for Chapter 9 bankruptcy or disband. The new legislation does require the governor's approval before the EM is authorized to file for Chapter 9.

In April 2012, the governor and the city agreed on a consent agreement under P.A. 4 that establishes a nine-member advisory board to review financial operations, multi-year budgeting, revenue-estimating conferences, spending limits, and calls for the elimination of the reserve deficit in five years. If the city does not comply, state revenue sharing payments could be withheld or an EM assigned. Developments regarding the consent agreement in the coming months will

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Management and Operating Environment (continued)

likely lead to credit volatility.

Success in the near term will rely upon management's ability to restructure the organization, further cut expenditures, and balance budgets. Important to this effort will be the outcome of the city's negotiation with its unionized employees. The city had nearly 11,820 FTEs as of June 30, 2011, with the vast majority covered under one of several collective bargaining agreements; negotiations are currently underway for future salary levels and benefit offerings that will afford Detroit some financial sustainability moving forward. This is important as the city, like the vast majority of local municipalities in the state, has very limited revenue raising capacity due to taxing limits.

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