

RatingsDirect®

Summary:

Detroit, Michigan; Miscellaneous Tax

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Table Of Contents

Credit Highlights

Outlook

Related Research

Summary:

Detroit, Michigan; Miscellaneous Tax

Credit Profile

Michigan Finance Authority, Michigan

Detroit, Michigan

Michigan Fin Auth (Detroit)

Long Term Rating

BBB/Positive

Upgraded

Michigan Finance Authority, Michigan

Detroit Public Lighting Authority, Michigan

Michigan Fin Auth (Detroit Pub Lighting Auth)

Long Term Rating

BBB/Positive

Upgraded

Credit Highlights

- S&P Global Ratings raised its long-term rating to 'BBB' from 'BBB-' on the Michigan Finance Authority's Local Government Loan Program bonds (City of Detroit financial recovery income tax revenue and refunding local project bonds), series 2014F-1 and F-2. The bonds were issued on behalf of the City of Detroit and are secured by a first lien on its municipal income taxes.
- We also raised our long-term rating to 'BBB' from 'BBB-' on the authority's Local Government Loan Program bonds (Public Lighting Authority, or PLA, local project bonds), series 2014B. The bonds were issued for the Detroit PLA and are secured by the city's utility users tax (UUT).
- The outlook is positive.
- The rating actions correspond to our rating action and positive outlook on Detroit's GO debt. (See our report published April 26, 2023, on RatingsDirect).

Credit overview

The 'BBB' rating reflects the application of our priority-lien tax revenue debt criteria, which factors in both the strength and stability of the pledged revenue, as well as the general credit quality of the municipality where taxes are distributed and/or collected (the obligor's creditworthiness). The priority-lien rating on both pledges is limited by our view of Detroit's creditworthiness (BB+/Positive). Therefore, the one-notch positive rating action and positive outlook on the GO rating on Detroit resulted in the same actions on these income- and UUT-secured obligations.

For the income tax pledge, we consider economic fundamentals weak-to-very-weak, volatility as moderate-to-low, and coverage and liquidity very strong. All city residents plus nonresidents who work in the city are subject to the income tax, but nonresidents whose work is based in the city but are working remotely from outside of it are entitled to refunds. Resident income is taxed at 2.4% and nonresident income at 1.2%. There is also a 2% tax on corporate earnings, which made up 10% of pre-refund collections last year. The city collected \$368.9 million in recurring income tax revenue in fiscal 2022, up 9.1% from fiscal 2019. This is after accounting for a \$26 million loss from nonresident remote work. Excluding a small portion of revenue not pledged to the bonds (and nonrecurring revenue), fiscal 2022

collections covered maximum annual debt service (MADS; \$33.3 million) by a very strong 10.8x. MADS declines to \$22.2 million following fiscal 2023, and coverage will increase further. The city projects a 1.5% increase in net revenue after refunds for fiscal 2023 and a 4.8% increase for fiscal 2024, reflecting ongoing but slowing payroll growth. The city's forecast assumes 16% of commuters will work remotely in 2023, compared with an estimate of 20% in fiscal 2022. The city receives income taxes at fairly level amounts throughout the year and does not rely heavily on tax return filings. Unemployment benefits are not subject to the city's income tax. The additional bonds test is 2x and there are no plans for additional parity debt.

For the UUT pledge, we consider economic fundamentals weak-to-very-weak, volatility high-to-moderate, and coverage and liquidity strong. UUT is generated from a 5% tax on the consumption of electricity, gas, steam, and telephone services. Revenue has seen less decline during the pandemic than have income taxes, reflecting the essential nature of the services. Gross revenue has increased 29.4% since 2020 and is projected to increase again in fiscal 2024. Fiscal 2022 collections covered MADS by 4.3x, and monthly collections remained strong. We view monthly revenue as important given that there is a maximum monthly collection limit that could disrupt coverage or limit an ability to replenish the debt service reserve fund (DSRF), should monthly collections ever fall below requirements. There is effectively no ability to issue additional parity debt. There is risk as a few large utilities collect most of these taxes and set rates, but no collection disruptions of note have occurred.

Both revenue streams are diverted first to bond trustees to fill monthly deposit requirements, and then are remitted to the city. Each of the bonds additionally has a debt service reserve fund.

The two-notch rating distinction for both pledges reflects our view that the pledged revenue and the flow of funds (under both state law and bond documents) are sufficiently removed from the city's control so as to substantially, but not completely, mitigate operating risk.

Environmental, social, and governance

We view Detroit as facing elevated social risks, specifically social capital risks. Commuting patterns changed significantly through the pandemic, and more than 30% of nonresidents continue to work remotely. This translates to revenue losses directly from refunds, but also slowed recovery of jobs that rely on a regular course of business and leisure activity in the city. Detroit's population trend remains a risk, as do its high poverty levels, as these can limit revenue-raising abilities and increase service needs. The city's leadership views building up its residential tax base as fundamental to its future and invests significant resources in these efforts. Successes to date are reflected in increasing property values, improved public safety metrics, and reduced poverty rates, and substantial new job creation within the city likely reflects the private sector's recognition of an increasingly skilled labor force. Detroit's poverty rate fell to 30% in 2021, a decline of 12 percentage points since 2012.

We see governance as a strength, with strong fiscal controls, formal long-term forecasting, well-framed policies that are consistently met, and commitment to long-term goals that keeps the city's rebound moving forward. We see no high environmental risk. Detroit is building a sustainability plan and continues to seek solutions to fight flooding of the Detroit River in certain pockets of the city. It also anticipates that federal infrastructure act funding will yield substantial investment in lead pipe removal, road repair, and broadband expansion.

Outlook

The positive outlook signifies at least a one-in-three likelihood that we will raise the rating over a one- to two-year outlook horizon. A higher rating is contingent upon improvements to Detroit's underlying credit quality.

Downside scenario

Alternatively, we could revise the outlook to stable or take a negative rating action in case of negative rating actions on Detroit's GO debt. In addition, if either pledged revenue declined significantly or experienced large collection disruptions we could lower the rating.

Upside scenario

We would take a positive rating action on both pledges in case of a positive rating action on Detroit's GO rating, combined with continued very strong coverage.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

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