

Fitch Affirms Pontiac TIFA #2, MI Bonds at 'CCC'; Outlook Stable



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NEW YORK--(BUSINESS WIRE)--

Fitch Ratings has affirmed the 'CCC' rating for the following Pontiac Tax Increment Finance Authority, Michigan (TIFA) bonds:

-- \$2.3 million TIFA (development area #2) tax increment revenue and refunding bonds, series 2002.

In addition, Fitch affirms the implied unlimited tax general obligation (ULTGO) rating for the city of Pontiac (the city) at 'B-'.

The ratings have been removed from Negative Watch. The rating Outlook is Stable.

SECURITY

The bonds are limited obligations of the TIFA payable solely from tax increment revenues collected in the development area. There is a cash-funded debt service reserve to the IRS standard.

KEY RATING DRIVERS

WATCH REMOVAL ON WASTEWATER TRANSACTION COMPLETION: The city has completed the transaction with Oakland County monetizing the excess capacity at its regional wastewater treatment plant, as planned. Restoration of general fund liquidity relieves near-term negative pressure on the ratings and allows the city to continue operations while pursuing solutions for structural balance.

SPECULATIVE GRADE ULTGO RISK FACTORS: The 'B-' implied ULTGO rating reflects the city's poor financial performance, rooted in its lack of revenue-raising flexibility, high fixed cost structure, and weak economic profile. The authority of the state-imposed emergency financial manager (EFM) to rein in certain costs is a credit positive, but structural balance has not yet been restored.

TIFA BONDS RELIANT ON CITY SUBSIDY: The 'CCC' rating on the TIFA bonds reflects the city's demonstrated willingness to subsidize debt service on the bonds from available non-pledged funds as pledged revenues are insufficient.

TAX INCREMENT ELIMINATED: Due to severe tax base declines taxable value (TV) in the TIF district has dropped below the base amount, creating a negative incremental value and eliminating tax increment revenues.

CREDIT PROFILE

INCREMENT INSUFFICIENT TO SUPPORT DEBT SERVICE

Primary support for the bonds is derived from the city's continued willingness to subsidize debt service, given the erosion of the pledged revenue stream; TV in TIF #2 is now lower than the base value. An 80% drop in TV was recorded in fiscal 2012, largely due to a successful General Motors Corporation (GM) tax appeal. Meaningful recovery of the tax increment revenue stream is unlikely in the near or medium term given the depths of the real estate downturn, the projection of continued tax base erosion for the next several years, as well as state-wide limits on annual growth of the property tax levy.

Likely sources of debt repayment include approximately \$1 million on deposit in the TIF #2 fund and approximately \$985,000 in the cash-funded debt service reserve. Additionally, the city has identified excess revenues from TIF #4, whose bonds have been fully repaid, as a potential source for subsidy of TIF #2 debt service. The city does not anticipate subsidization from the general fund.

WEAK TAX COLLECTIONS

Citywide property tax collections have hovered around 75% for the past two years. As with all local entities within Oakland County, the city is made whole via the county revolving delinquent tax fund. However, there is a charge back to the city after two years for uncollected taxes. The county also may decide to terminate the revolving fund at any time.

ASSET MONETIZATION RESTORES GENERAL FUND BALANCE

The agreement with Oakland County to monetize the excess capacity of the wastewater treatment plant generated \$55 million for the city. Proceeds were allocated to put money aside for water and wastewater system improvements (\$5 million), retire revenue bond debt associated with the system (\$4.1 million), retire the 2006 fiscal stabilization bonds (\$16.5 million), retire 2006 tax increment finance authority/building authority bonds (\$9.6 million), and to pay the property tax appeal refund due to GM (\$2 million). The remaining \$17.8 million is allocated to deficit elimination.

STATE OVERSIGHT

Fitch believes Pontiac will continue to struggle economically and financially as it works to transition away from its traditionally manufacturing-based roots. The city has operated with a state-appointed EFM since March 2009. The EFM is employed by the state to re-establish structural integrity and eliminate the accumulative deficit within five years, with authority over labor negotiations, hiring, spending, and most other financial concerns.

Last month Michigan voters overturned Public Act 4, the emergency manager law that granted the EFM broad powers to address the city's substantial fixed cost burden. The EFM is now operating under the prior law, Act 72. Newly passed legislation, which has not yet been signed into law, would restore many of the broader powers lost by the repeal of Public Act 4. The legislation would also allow the city council to remove the EFM as early as April 1, 2014, but provides some limits on how quickly the city council could reverse the EFM's decisions.

FUNDAMENTAL EXPENDITURE CHANGES

The state-appointed EFM has employed extraordinary expenditure reduction methods, including outsourcing police responsibilities to Oakland County, privatizing several governmental functions, dramatically reducing staff, selling assets, streamlining health care costs, and monetizing excess capacity at the regional wastewater treatment plant.

As a result of the expenditure reductions - coupled with the omission of certain payments - the city generated a \$4.6 million general fund operating surplus after transfers (14% of spending) and ended fiscal 2011 with a \$554,732 balance or 2% of expenditures and transfers out. The positive ending general fund balance was the first since fiscal 2002. Fitch notes the operating results were partially achieved by omitting a \$4.0 million pension and benefits payment and a \$1.9 million property tax refund owed to General Motors Corporation.

Unaudited results for fiscal 2012 show a \$3.7 million operating deficit turning the general fund balance back to a negative \$3.1 million, equivalent to a negative 7.3% of spending. The city anticipates returning the general fund to positive territory in fiscal 2013 with the proceeds of the wastewater transaction. Projections for fiscal 2013 call for adding \$13 million to general fund balance, which would put the total ending general fund balance at \$9.9 million or 15.5% of spending. The city reports that the structural deficit has narrowed, but still persists, with recurring expenditures exceeding recurring revenues by \$6 million for fiscal 2013.

The city is exploring ways to reduce or eliminate its costs for retiree health care as a way to achieve structural budgetary balance. Currently, the city pays approximately \$5.6 million annually for retiree health care. Eliminating this payment would close the structural gap between recurring revenues and recurring expenditures. The EFM and mayor have proposed using the overfunded portion of the pension fund to pre-fund the other post-employment benefit (OPEB) liability which would reduce the city's annual costs.

Previously, the board governing the pension system has been unwilling to study this plan. However, the EFM recently reconstituted the board and the new members are expected to be more favorable toward studying the option. Fitch expects the proposal will be met with legal challenges and will monitor any progress the city makes toward achieving structural budgetary balance through this or other means.

CHALLENGING ECONOMIC PROFILE

Pontiac has been adversely impacted by the decline of the auto industry. At one point GM employed 15,000 people and accounted for 25% of aggregate taxable property value. But

employment declined to 3,000 after the closure of both its truck and assembly plants in 2009, and GM now accounts for less than 2% of TV.

Citywide unemployment rates have improved from 31% in October of 2009. However, rates are still extraordinarily high at 21.8% in September 2012. The individual poverty rate is more than double the state average, and median household income equals 64% of the state mean. The current property tax collection rate is extremely low at 75%. Oakland County makes the city whole through its delinquent tax revolving fund, but the city is liable for charge-backs for uncollectible amounts after two years.

MANAGEABLE LONG-TERM OBLIGATIONS

Overall debt levels are moderate, totaling \$1,290 per capita and 3.8% of market value. Principal amortization is above average, with 70% repaid within 10 years. The city provides pension benefits to its employees through two single-employer defined benefit pension plans. The city made one-half of its required contribution in fiscal 2010, and none of the fiscals 2011 or 2012 amounts. One of the plans is well over-funded, even after adjustment by Fitch to reflect a 7% discount rate, and the other is nearly fully-funded.

The city also provides OPEB benefits, as mentioned, which the city currently funds on a pay-as-you-go basis. As of December 2011, the OPEB unfunded actuarial accrued liability (UAAL) totaled \$180 million or a relatively high 8.8% of market value. Fitch notes that staffing reductions and changes to health care benefits have reduced the OPEB UAAL dramatically from the \$306 million recorded in the previous actuarial study.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors.

Applicable Criteria and Related Research:

- 'Tax-Supported Rating Criteria' (Aug. 14, 2012);
- 'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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