Office of the Chief Financial Officer
CITY OF DETROIT

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MEMORANDUM

TO: Council Member Scott Benson

FROM: David Massaron, Chief Financial Officer, City of Detroit
Arthur Jemison, Group Executive for Planning, Housing and Development

DATE: October 21, 2019

RE: Responses to Questions about Blight Removal Bond

The following are answers to questions you submitted in your October 16 memo.

1. **Please solidify the bond number at $225m or $250m. The mixing of numbers is confusing to the public and leads to distrust**.

We are asking the public for $250 million in bond authorization. To be conservative, we have shown City Council various scenarios (attached) based on the economic situation that would meet the City's needs. We believe under all scenarios, we can borrow $225 million without raising taxes on Detroiters and conserving capacity for future capital needs. In scenario 2 where there is an improvement in taxable values, we would be able to borrow $250 million without raising taxes and conserving capacity for future capital needs. Scenario 2 would give us a greater contingency to meet Detroit's blight removal needs and reduce future pressure on the General Fund.

2. **Please prepare a diagram that illustrates the stress test results on the final bond offering scenario selected by the administration.**

In the attachment, Scenario 4 of the bond sizing scenarios was prepared to consider the impact of a recession. This scenario assumed a 25% decrease in state equalized values beginning in tax year 2020, spread over three years before recovering. This scenario forecasted a decrease in total City taxable value of over $465 million. The results of this stress test indicate that $225 million in blight bonds would still be issued and the debt millage would remain at 9 mills, but that the capacity to issue future capital bonds would decrease to $384.7 million as compared to $443.5 million in the base case.

3. **Please respond to the recommendation that all demolition activities be located and managed by one office for efficiency purposes. Does the administration plan to implement this recommendation?**

The Administration has proposed the creation of a new Demolition Department to oversee the demolition program. Under this proposal, the Detroit Building Authority will no longer be part of demolition. The new Demolition Department will work with OCFO divisions (OCP, ODFS, OB, and Treasury) to budget, procure, pay for and monitor use of bond proceeds for demolitions. The Buildings, Safety Engineering and Environmental Department (BSEED) will continue to inspect. The Administration will propose an Executive Organization Plan change prior to the end

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of City Council's session in November, and will propose the funding change with the FY2020-2021 Budget Recommendation.

4. **Please detail how the administration plans to comply with all IRS regulations around the tax exempt status of the bonds. I.e. Who will be responsible for the compliance, where will the records be held, how will this compliance process be carried out over the 30 years of the bonds, which departments will be involved in compliance, etc?**

The OCFO (specifically the Debt Management Branch within Treasury) is responsible for monitoring compliance with all IRS regulations. The procurement for the demolition projects will occur through the Office of Contracts and Procurement and the invoices will paid through the Oracle ERP system, so records of bond expenditures will be maintained there.

The Land Bank will continue to use Salesforce to track investment and long-term disposition in each of the properties. While Treasury could create a new database for this, we thought it was more prudent to use an existing system that already tracks demolition and disposition of properties. As part of the Land Bank's tax compliance certificate, they will agree to provide regular exports from the system to the City. The OCFO will store the data from the extracts so that if Salesforce information is not available for any reason, the OCFO will have up to date data to rely on.

On a quarterly basis, the OCFO will review the exports to measure compliance with the de minimis limitation for the private payment test described under the IRS regulations.

5. **The LPD report indicates every parcel which receives an investment of blight bonds will have to be tracked for compliance purposes. Is this an accurate portrayal of the level of monitoring required for these bonds to comply with IRS tax exempt regulations?**

It is correct that the OCFO will monitor the disposition of each parcel to track any amounts received from the sale or lease (if any) of the property as described in the response to Question 4 above.

6. **Please describe a worst case scenario, where the City cannot maintain compliance with the blight bonds and the IRS removes the tax exempt status. How would this situation impact the:**
    a. **Detroit taxpayers**
    b. **City of Detroit**
    c. **Purchasers of the bonds**

Compliance with the IRS rules is not as onerous as it would seem. If tax exempt bond proceeds were initially spent on a demo, and then money was recovered by other means (selling the property), there is a "replacement" for tax purposes. To "cure" the replacement, the City would need to use the amounts received from the private property owner on other eligible costs and treat those new expenditures as the ones actually made with bond proceeds. The "new" expenditure from the amounts received from private property owners would then need to be tracked, in the same way that expenditures from bond proceeds are tracked. That is, the

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expenditure made from amounts received from private property owners "replaces" the one originally paid from bond proceeds and needs to be tracked as such. The City is very accustomed to tracking spending using tax exempt bond proceeds and this is already part of the debt management branch of the OCFO Treasury operation.

7. **After 2025 the administration indicates the City should experience the need for 100-200 demolitions per year. Justify this estimate?**

As we looked at similar cities like Pittsburgh, we found that they have a steady state demolition rate of about 100-200 demolitions per year.

8. **The LPD report provides a narrative of how the City's debt policy is impacted by the bond proposal and debt affordability. A series of metrics/ratios is indicated as the measurements to verify if the bonds comply with our debt policy. Please prepare infographics to illustrate visually how these metrics/ratios are calculated, so the layperson can understand how they work. Ex. I.85X is indicated as a reasonable ratio on page 14 of the LPD report.**

We are proposing that in June 2020 the City issues $175 million in blight UTGO bonds and $52.245 million in capital UTGO bonds (the latter was authorized by the City Council in October 2018). We considered the impact on key debt ratios of this proposed June 2020 borrowing by comparing these debt ratios to the same ratios at the end of fiscal year 2019 (i.e., June 30, 2019). We found that there would be no impact.

Specifically, we calculated how the City's total debt as a percent of its annual general fund revenue would change. At June 30, 2019, the City's total debt as a percent of its general fund was 171%. This means that, with the proposed June 2020 borrowing, the City's outstanding debt will be 1.71 times higher than the annual revenues coming into the City's general fund. We then reviewed how that ratio is evaluated by major rating agencies - which look at many local units across the country.

The chart below shows how Moody's rating agency might view our debt ratios. (In the chart, Aaa is the best score.) As shown below, a "Debt As % of General Fund Revenues" percentage of 171 (or 1.7X) falls in the "A" category.

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City of Detroit at June 30, 2019: 1.7X ("A" category)

City of Detroit Projected at June 30, 2020: 1.85X ("A" category)

Moody's Rating Agency Scorecard Sub-factors	Aaa	Aa	A	Baa	Ba	B & Below
Debt as % of General Fund Revenues	33% or 0.33x	67% or 0.67x	300% or 3.00x	500% or 5.00x	700% or 7.00x	1500% or 15.00x
Debt as % of Full Value	0.75%	1.75%	4%	10%	15%	20%

City of Detroit at June 30, 2019: 12.74% ("Ba" category)

City of Detroit Projected at June 30, 2020: 10.55% ("Ba" category)

The ratio of "Debt as % of Full Value" (full value generally refers to the market value of all the property located within the City of Detroit) remains in the Ba category. While this category is not as high as an A, we note that the proposed June 2020 borrowing does not negatively impact that ratio. In fact, there is a slight improvement from 12.74% (June 30, 2019) to 10.55% (projected June 30, 2020) due to the projected increase of property values in the City of Detroit.