S&P Global
Ratings

RatingsDirect®

Michigan Finance Authority Revenue Sharing, Local Project Bond Ratings Revised To 'A+'; Outlook Positive

Primary Credit Analyst:
John Sauter, Chicago (1) 312-233-7027; john.sauter@spglobal.com

Secondary Contact:
Carol H Spain, Chicago (1) 312-233-7095; carol.spain@spglobal.com

CHICAGO (S&P Global Ratings) April 25, 2018--S&P Global Ratings has resolved its CreditWatch on various Michigan Finance Authority revenue sharing bonds, and on one series of Authority local project bonds (issued for Dearborn Heights), by raising the ratings to 'A+' from 'A'. The outlook is positive. The bonds were all issued on behalf of one or multiple local governments (LGs).

The 'A+' ratings are based on our State Credit Enhancement (SCE) criteria, and reflect the benefit each LG receives from strong Authority (and state of Michigan) oversight as well as the strength and availability of distributable state aid (DSA), which would be diverted to the Authority if a LG cannot make its full and timely debt service payment.

We placed these bonds on CreditWatch with developing implications on Dec. 22, 2017 to review our understanding of certain provisions in the Authority's Local Government Loan Program (LGLP) master resolution and to consider whether we had appropriately applied our criteria in prior reviews. We have determined that we incorrectly assessed provisions in the LGLP master resolution that relate to performance dependency among participating LGs in the Authority's Revenue Sharing Program. We have also concluded that we incorrectly applied our criteria in prior reviews.

In connection with these reviews, we also revised our ratings on additional local project bonds issued by the Authority, on behalf of three different LGs (Detroit, River Rouge, and Allen Park), to 'A+', with a positive outlook. These bonds are referred to herein as the Local Project Bonds.

This rating action reflects the application of our SCE criteria, following the determination that we incorrectly applied our Special Tax Criteria in previous reviews. The specific rating actions are discussed in further detail below.

On issuance and at each review until 2014, we applied our SCE criteria to all of the Authority's revenue sharing bonds and to the Dearborn Heights local project bonds, and rated them all 'A' with a stable outlook. However, pursuant to the SCE criteria, intercept or withholding programs that meet certain requirements are rated at a level one notch off of the state general obligation (GO) rating. In these cases, the ratings should have been directly linked to Michigan's GO rating, and should have moved in tandem with the state's GO rating. Additionally, in 2014, we reviewed and affirmed all of our 'A' ratings, but in that review under the Special Tax criteria rather than our SCE criteria. We have determined that the ratings should have consistently been rated under SCE criteria, with a direct linking to the state's GO rating.

Separately, we have also determined that we incorrectly applied our Special Tax criteria in prior reviews to analyze certain Local Project Bonds issued by the Authority on behalf of three different LGs (Detroit, River Rouge, and Allen Park), when we should have applied our SCE criteria, and directly linked the ratings to the state's GO rating. These obligations each benefit from enhancements similar to those of the revenue sharing and local project bonds described above, but with additional benefit of direct withholding of pledged DSA revenues. The ratings of the Local Project Bonds prior to this rating action were as follows: Detroit (previously rated 'AA' (first lien), 'AA-' (second lien), 'A+' (third lien), and 'A-' (fourth lien); River Rouge ('A'); and Allen Park ('A-'). The outlook on all these bonds had been stable. These Local Project Bonds are now each rated 'A+' with a positive outlook.

The SCE criteria application takes into consideration strong state and Authority oversight and strong structural features, notably the ability for the state treasurer to intercept and advance the entire amount of a LG's DSA that has been appropriated for distribution during the state's fiscal year, to the extent necessary to pay debt service on these bonds, regardless of the original distribution schedule. For the revenue sharing bonds and Dearborn Heights local project bonds, advance notification requirements under the bond documents enhance the likelihood that payments will be made on time and in full in the event of a shortfall. For the Local Project Bonds, DSA is directly deposited with the trustee to make set-aside payments before it is distributed to the LGs, and can be similarly clawed forward if there is any payment shortfall when obligations become due. In our view, these characteristics are common with other programs rated under our SCE criteria, and link the credit quality of the pledged revenues more closely to that of the state relative to other statewide tax-shared revenue bonds.

Additionally, in prior reviews of the revenue sharing bonds, we did not account for the fact that a default on any loan within a program "Type" (as defined in the Authority's LGLP master resolution) would constitute a default for all bond issues of that Type regardless of the particular bond issuance that financed the particular loan. This is based on the fact that all loans issued through a specific program Type are pledged and assigned to a common trustee, for the equal and ratable benefit of all holders of that Type. The loans issued through a program Type are not specifically pledged to any individual bond issuance, rather, they are pledged to all bond issuances of the Type. Thus, if there was a payment shortfall on one loan, it would cause a payment default on each of the Authority's bonds relating to that Type.

In the case of the Authority's revenue sharing bonds, this means that if one LG defaults on its loan (and there is insufficient DSA available for intercept and advancement to the LG), there would be a payment default on all revenue sharing bond issuances. As a result, we have determined that our analysis of each of the Authority's revenue sharing bond issues should be based on an assessment of the credit quality of all LG loans issued under the Revenue Sharing program Type in the LGLP master resolution, as opposed to reviewing each revenue sharing bond issue on an individual basis factoring only the LG loan(s) it financed, as we have done with previous ratings. Our analysis for all of the Authority's revenue sharing bond issues now is based on a weak-link approach.

However, given we are assessing each LG's loan under our SCE criteria, each loan is rated 'A+' (with a positive outlook). Accordingly, the rating on each revenue sharing bond issuance is an 'A+' with a positive outlook.

Each LG pledges 100% of its DSA to its loan obligations. LGs are eligible to receive DSA payments from the state pursuant to the Michigan State Revenue Sharing Act (Public Act 140 of 1971, as amended [MCL 141.901]), and as permitted by the Shared Credit Rating Act (Public Act 227 of 1985), can pledge their DSA to municipal loans issued to the Authority.

The positive outlook on these 'A+' ratings reflects S&P Global Ratings' positive outlook on the state of Michigan's GO debt. In general, it is also based on our assessment of the strength of the DSA intercept and withholding framework. In addition, it reflects our view that annual DSA for these LGs will continue to provide sufficient coverage, as well as our expectation that the state will remain committed to funding LGs and to adopting budgets in a timely manner. The rating and outlook moves in tandem with the state GO rating and outlook.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.