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Invested in America

July 18, 2013

Governor Rick Snyder
P.O. Box 30013
Lansing, Michigan 48909

Mr. Andy Dillon
Michigan Department of Treasury
Austin Building
430 W. Allegan Street
Lansing, MI 48922

Dear Governor Snyder and Treasurer Dillon:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is writing this letter to you regarding the City of Detroit's outstanding municipal securities obligations. We urge you to act deliberately and be aware that your actions relating to Detroit's outstanding municipal securities obligations could have potentially significant, negative municipal securities market implications, and could increase the cost of borrowing for all Michigan municipalities.

SIFMA and its members feel investor trust and confidence in the capital markets is the cornerstone to the viability of the municipal bond market. Investors in municipal bonds are largely retail investors[2]; people saving for their retirement and other needs. Investors in Michigan bonds are largely Michigan residents, who are looking to the traditional safety of the municipal bond market in order to meet their investing needs and goals. Without those investors who are the cornerstone to a vibrant municipal bond market, municipalities could face serious challenges when they need to raise money to finance important infrastructure projects such as schools, bridges and health care facilities. Detroit will also likely need to borrow money in the capital markets to aid in the restructuring of Detroit's outstanding obligations. In these times when some local governments are facing financial challenges and the country's infrastructure construction needs are so great, SIFMA feels it is important to the financial stability of local governments for them to be able to access the municipal bond market at favorable rates.

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] "Individuals, or "retail" investors, directly or indirectly hold more than 75% of the outstanding principal amount of municipal securities." SEC Report on the Municipal Securities Market, found at http://www.sec.gov/news/studies/2012/munireport073112.pdf.

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Detroit has issued a number of different types of municipal securities with different sources of repayment and security, as described in the offering documents for each transaction. Market expectation is there would be different treatment for holders of different types of securities. It is generally the expectation of market participants that holders of general obligation unlimited tax bonds would be paid principal and interest as it comes due, based on a pledge of the debtor's "full faith, and credit" to repay the bonds, in addition to the characterization of the bonds as "first budget obligations, including the proceeds of annual ad valorem property taxes, which must, to the extent necessary, be levied on all taxable property". This pledge is seen by the capital markets to be an obligation to raise property taxes to the level necessary to pay the principal and interest in the bonds as they come due. The Michigan Constitution also provides that repayment of voter approved bonded indebtedness is guaranteed.[3]

Holders of general obligation limited tax bonds also expect to be paid principal and interest as it comes due, based on the pledge of the "full faith, and credit" to repay the bonds, in addition to the characterization of the bonds as "first budget obligations, including the proceeds of annual ad valorem property taxes, which must, to the extent necessary, be levied on all taxable property" and the promise to levy additional taxes as necessary to repay the these bonds; however, the obligation to raise taxes to meet debt service obligations is subject to constitutional, statutory and charter tax limitations.

Holders of certificates of payment are generally aware that this type of debt doesn't carry the pledge of the "full faith, and credit" to repay the bonds. Detroit's offering documents for its certificates of participation state that the obligation to repay the certificates are unsecured contractual obligations that "are not general obligations of the City, and neither the faith and credit, taxing power nor any specific revenues of the City are pledged" thereto.

Any action that would permit general obligation bonds to be treated on a pari passu basis with unsecured contractual obligations that are not backed by a full faith and credit pledge ignores the appropriate priority that should be given to these bonds. We believe any such treatment will have a long lasting negative impact on the ability of Michigan's municipalities to obtain financing on favorable terms. Bond holders may attempt to sell current holdings and market participants may be reluctant to purchase Michigan general obligation unlimited tax bonds and general obligation limited tax bonds in the future, causing the cost of financing infrastructure projects to rise.

Additionally, actions to diminish, or impair or alter the rights of bond holders and their expectation to receive monies described as pledged in offering documents could have material consequences by creating uncertainty and confusion in the entire municipal securities market. This uncertainty would likely increasing costs for municipal borrowers. We feel these effects could be particularly acute for Michigan municipalities.

We understand that Detroit has serious financial issues. However, we believe that any impairment of outstanding municipal securities may have a minor, temporary positive effect on Detroit's financial condition, but that should be weighed against a potentially significant future increase in borrowing costs. We ask you to respect the different security interests pledged to repay the municipal securities issued by Detroit.

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[3] MICH. CONST. art. IX, § 25 (finance and taxation).

The largest city of any state has never, to date, filed Chapter 9. There are concerns about the time, cost, expense and long term impact on a municipality that files for Chapter 9. Other states have considered various alternatives to aid distressed municipalities, including enacting laws regarding local government debt, to ensure that the markets' perception of what investors are due matches the outcome. Also, some distressed municipal issuers have worked with their taxpayers and their creditors to come to a reasonable resolution of disputes without taking action that would have negative consequences. We believe there are different ways of addressing these concerns and actions you can take to protect the investors in local government debt in Detroit and across Michigan. We implore you to be sensitive to the potential impacts of your actions on the investors in the various classes of Detroit's municipal securities, municipalities in Michigan and their future borrowing ability, and taxpayers in Michigan. We believe it is possible to navigate this financial crisis without hurting the credibility of Michigan municipal bond issuers in the market in the future.

SIFMA would be pleased to discuss any of these comments in greater detail, or to provide any other assistance that would be helpful. Thank you for your consideration.

Sincerely,

Ira Hammerman
General Counsel