DETROIT DEBT DEFAULT

JUNE 2013

Given the recent announcement by Detroit's Emergency Manager Kevyn Orr, stating that the city would default on some debt, we would like to address concerns regarding the credit standing of Detroit, MI for our clients. First and foremost, Appleton Partners does not approve Detroit debt for purchase in client accounts. Below are a few points detailing the current situation.

At a meeting with a number of the city's creditors last Friday, Kevin Orr, Detroit's appointed emergency manager, announced that the city would selectively default on unsecured debt obligations, including a $39.7 million payment on Certificates of Participation (COPs) due June 15th. Although recent bond pricing and analyst commentary assumed a restructuring of Detroit's debt was highly likely, the timing of the default comes as a bit of a surprise. As recently as May, the emergency manager indicated Detroit had sufficient cash to make all debt service payments remaining in fiscal 2013, which ends on June 30th. The decision to default on the COPs may be a negotiating tactic on the part of the manager, as Detroit does not have another debt service payment due until October 1st.

Additionally, the emergency manager publicly announced his turnaround proposal for Detroit, including a headline-grabbing statement to pay unsecured creditors less than 10 cents on the dollar for outstanding liabilities. We caution that the emergency manager's definition of "unsecured" may be nontraditional and that this proposal is in fact only a proposal. For example, the emergency manager has labeled almost $411 million of unlimited tax general obligation (GO) bonds to be "unsecured" and commingled the GO debt with other bonds that have a distinctly weaker security structure. Based on the strong security pledge and lack of precedent, we would expect the generalizing of general obligation debt as an unsecured claim to be met with significant bondholder pushback.

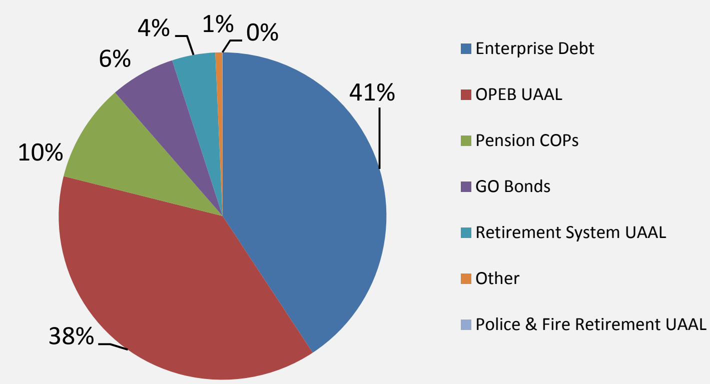
DETROIT'S DEBT PROFILE

Obligation	Amount ($mm)
Enterprise Debt	5,850.00
Pension COPS	1,430.00
MTM Swaps related to COPs	344.00
Unlimited & Limited GO	1,130.00
Others	300.00
Total	9,054.00

Source: Detroit Emergency Manager's Creditor Proposal, June 2013

According to the state of Michigan's latest review, the city of Detroit has almost $15 billion in long term liabilities, including a little over $9.0 billion in bond-related debt. This consists of $511 million in unlimited tax general obligations, $576 million in limited tax general obligations, and $1.4 billion in pension COP bonds. We believe the most "at-risk" debt, based on the security structure, would be the pension COPs, which are an obligation of the general fund, but lack a specific tax revenue pledge. Detroit also has approximately $6 billion in water and sewer debt outstanding that is secured by a separate revenue stream. A significant portion (80%) of the city's debt outstanding is guaranteed by bond insurers, including National Public Finance Guarantee and Assured Guaranty.

DETROIT'S LONG TERM LIABILITIES



Source: Michigan State Review Board Report, JP Morgan

As pointed out directly by the emergency manager, Detroit's long term distressed situation has been driven by a declining population, weakening tax base, growing pension and retirement liabilities, and financial mismanagement that have collectively resulted in significant deficits. We would expect, based on the emergency manager's proposal and Detroit's current financial profile, a drawn out discussion with creditors over the restructuring of the city's liabilities. With approximately $15 billion in long-term liabilities and over 100 different creditors, there are a number of moving parts. ***Importantly, we also view Detroit's situation to be specific to the city and not an example of the broader municipal market. Detroit has not been an approved credit at Appleton based on deteriorating fundamentals, a weak underlying economy, and significant long term liabilities.***

APPLETON PARTNERS, INC ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM