

Investment Summary

<i>General Obligation:</i>	<i>Caa3/D</i>
<i>Water & Sewerage Revenue:</i>	<i>B1/BB-</i>

- The City of Detroit filed for bankruptcy on July 18, 2013. After hearing arguments concerning the legality of the city filing for bankruptcy, the City of Detroit was allowed to enter bankruptcy protection under Chapter 9 on December 2, 2013.
- Governor Rick Snyder appointed Kevyn Orr as Emergency Financial Manager (EFM) last March under Public Act 436. Public Act 436 gives the EFM broad powers in receivership to work with the city to address financial emergency, restore financial stability, and ensure the continuity of services to public health, safety and welfare. The EFM has exclusive powers to make decisions concerning the city's operations and to have input into a plan of restructuring that ultimately will be presented to the court. In 2014, newly-elected Mayor Mike Duggan will control about two-thirds of city operations which include managing the city's economic development operations, blight removal and a slew of other departments, all functions that are not directly related to the city's bankruptcy. The EFM will oversee the finance department, contract negotiations and the Detroit Police Department.
- Creditors fall into several groups including: the pension plans, the unsecured general obligation note holders, the secured general obligation note holders. There are over \$17 billion in claims against the city of Detroit.
- The municipal bankruptcy code does not have established rules for the priority of creditor claims such as pensioners and unsecured bond holders. As a result, the judge has broad powers to establish the priority of claims between creditors.
- One of the major assets of the City of Detroit is the art collection housed at the Detroit Institute of Arts. A large portion of the 66,000 piece collection was purchased with public money and is estimated to be valued at over \$1.0 billion. An appraisal last year from Christie auction house valued the portion of the collection purchased with city money between \$454 million to \$867 million, but creditors insist the entire collection is worth billions. Part of the current negotiations with creditors is a plan to raise money to keep the art collection intact at the Detroit Institute of Arts.
- We expect the EFM will file a plan of reorganization with the court by the end of March, 2014.

WCM's Investment Thesis – City of Detroit General Obligation debt - Insured

- We believe the specific general obligation debt of the City of Detroit that is insured by Assured Guaranty Municipal Corporation (AGM: A3/AA-/NAIC 1), Assured Guaranty Corporation (AGO: A2/AA-/NAIC 1), and National Public Finance (NPF: Baa1/A-/NAIC 1) offers excellent relative value in the market today. S&P reaffirmed the ratings of AGM and NPF last week.
- In the event of a default the insurance company is obligated to make timely interest and principal payments.
- According to the AGM insurance company's most recent 8-K, they have a net par exposure of \$462 million to the city of Detroit, consisting mostly of \$257 million in sewer and water revenue bonds and \$30 million in general obligation bonds.

- Given our analysis of AGM, we believe the insurance company has the ability to sustain a potential default in the city of Detroit bonds in the near future.
- As of the end of the third quarter 2013, AGM has \$6.6 billion and AGO has \$3.6 billion in total claims-paying resources which could be used in the event that Detroit can no longer cover its debt payments.
- *We believe the bonds with a maturity date no later than July, 2016 and trade near or below par in the market offer excellent relative value. Our investment thesis is based on the AGM and NPF insurance companies paying principal and interest up until the point that the reorganization is confirmed by the bankruptcy court. We expect that will be late 2014 or early 2015 at the earliest. Thus, a bond insured by AGM that matures in July of 2023 will most likely be tendered for at par plus accrued interest at upon confirmation by the bankruptcy court and will not remain outstanding until its maturity date.*

WCM's Investment Thesis – City of Detroit Water & Sewer Revenue debt - Insured

- The debt issued for the water & sewer systems have initially been described as secured special revenue debt of the utility system by the EM and are expected to remain unimpaired in terms of principal repayment during the bankruptcy.
- The Detroit water & sewer system serves both the city of Detroit and the surrounding area. Roughly 45% of the participants are within the city of Detroit while the remaining participants are from outside of the City of Detroit.
- We view the Water & Sewer system as an asset of the city which will remain operational during the bankruptcy period.
- Moody's downgraded the senior debt of the water and sewer system from Ba1 to B1.
- Given the separation of the utility system from the operations of the city of Detroit, we expect it will be very difficult for unsecured creditors to attempt to impair the debt of the utilities which is classified as secured special revenue debt, to their benefit.
- *We believe the bonds with a maturity date no later than July, 2016 and trade near or below par in the market offer excellent relative value. While we are less concerned with the potential default of the water & sewer bonds, anything can happen in a bankruptcy restructuring. Thus, we are inclined toward the insured water & sewer bonds and again favor bonds that trade near or below par.*

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