



City of Ann Arbor
Treasury Services Unit
Matthew V. Horning, Treasurer

TO: TOM CRAWFORD, CFO
FROM: MATTHEW V. HORNING, TREASURER
SUBJECT: DEBT COVERAGE
DATE: THURSDAY, APRIL 16, 2009

The City is subject to legal debt margins, ascribed by State law. The City may not issue qualifying debt in excess of 10% of the SEV of its assessment roll. Some forms of bonds, such as Revenue bonds for Water and Sewer, do not qualify. The calculation of our legal debt margin follows:

2008 SEV	\$6,077,168,500
Debt Limit (10%)	607,716,850
Debt Subject to Limit	<u>108,740,000</u>
Additional Debt Which Could Legally be Incurred	\$498,976,850

The City is currently at 17.9% of its legal debt capacity. Even if all non-qualifying issues were included in the calculation, the City would be at 36.7% of its legal debt capacity.

Debt coverage ratio is one metric typically used to assess the financial health of a company. It is the ratio of net income before debt to debt service requirements. This metric is not typically used to assess municipalities in their entirety, as they have a multitude of funds, which operate like distinct entities. However, we do look at this metric in performance of our internal due diligence prior to issuing bonds. A ratio below 1.0 is a sign of weakness: it indicates negative cash flow and an inability to fund both operations and debt service. A ratio in excess of 1.0 indicates positive cash flow. Below is a sample of some of the City's debt coverage ratios.

<u>Unit</u>	<u>Ratio</u>
Water Supply System	1.7
Sewage Disposal System	4.5
Stormwater Sewer System	15.9
DDA Parking	1.9

The most recognizable metric to gauge the financial soundness of an entity is a credit rating issued by a credit rating agency. Below is a summary of the ratings currently assigned to the City:

	<u>Water</u>	<u>Sewer</u>	<u>City</u>
Standard & Poor's	AA-	AA+	AA+
Moody's	Aa3	Aa3	Aa2

There are ten rating classes above investment grade (see exhibit next page). The City's rating of AA+ by Standard & Poor's is one grade below the highest rating of AAA. Our rating of Aa2 by Moody's is two grades below the highest rating of Aaa. In both cases, the rating agencies have determined that the City's securities are firmly set amongst the highest quality investment grade securities. These ratings would be unattainable without adequate verifiable debt coverage.

COMPARISON OF BOND RATING SCALES

	Fitch Investors Service	Moody's Investors Service	Standard & Poor's
INVESTMENT GRADE RATINGS	AAA	Aaa	AAA
	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
	A+	A1	A+
	A	A2	A
	A-	A3	A-
	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-

INVESTMENT GRADE LINE -->

SPECULATIVE GRADE RATINGS	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-
	CCC	Caa	CCC
	CC	Ca	CC
	C	C	C