

City of Detroit



Downtown Development Authority

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**DOWNTOWN DEVELOPMENT AUTHORITY
FINANCE COMMITTEE MEETING
MONDAY, AUGUST 20, 2018 – 3:00 P.M.**

COMMITTEE MEMBERS PRESENT:

Sonya Delley
John Naglick, Chair
Steve Ogden

COMMITTEE MEMBERS ABSENT:

David Blaszkiewicz

OTHERS PRESENT:

Gay Hilger (DEGC/DDA)
Malinda Jensen (DEGC/DDA)
Paul Kako (DEGC/DDA)
Glen Long (DEGC/DDA)
Rebecca Navin (DEGC/DDA)
Sarah Pavelko (DEGC/DDA)

VIA TELEPHONE:

Steve Kantor (Hilltop Securities)

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**MINUTES OF THE DOWNTOWN DEVELOPMENT AUTHORITY
FINANCE COMMITTEE MEETING
MONDAY, AUGUST 20, 2018
DETROIT ECONOMIC GROWTH CORPORATION
500 GRISWOLD STREET, SUITE 2200 – 3:00 P.M.**

GENERAL

Call to Order

Noting that a quorum was present, Chairman Naglick called the meeting of the Downtown Development Authority Finance Committee to order at 3:07 p.m.

Approval of Minutes of May 23, 2018 Meeting

Mr. Naglick asked if there were any additions, deletions or changes to the minutes of the May 23, 2018 Finance Committee meeting.

Hearing none, the Committee took the following action:

On a motion by Ms. Delley, seconded by Mr. Ogden, the minutes of the May 23, 2018 Finance Committee meeting were unanimously approved.

PROJECTS

Proposed Amended and Restated Parking Lease Agreement for Parking Facilities Located at 150 Michigan Avenue

Ms. Pavelko advised that the DDA and 1145 Griswold Street LLC, 1212 Griswold Street LLC, and 1249 Griswold Street LLC, (hereinafter referred to collectively as "Developer") entered into certain development agreements relating to 1145, 1212, and 1249 Griswold, all located in Capital Park ("Development Agreements"). Pursuant to the terms of the Development Agreements, the DDA entered into a lease agreement with the Developer (the "Original Lease Agreement") on December 30, 2013 for the lease of up to 100 parking spaces for the exclusive use by Developer and its assignees on a parking facility located at 150 Michigan Avenue (the "Parking Facility"). Developer commenced utilizing the Parking Facility in April 2017.

For several months, DDA staff and representatives from the Developer have discussed amending the terms of the Original Lease Agreement in order to accommodate Developer's future financing needs and DDA's need for increased certainty in rent projections. DDA staff recommends that the Board approve an Amended and Restated Lease Agreement, in the form of Exhibit A (the "AR Lease Agreement") which was included with the memorandum to the Finance Committee. The AR Lease Agreement includes the following key terms:

Term: 20 years following Board approval, renewable for consecutive 10-year periods

Rent:

- \$100 / space / month, with 3% annual increases each year until 31st anniversary of the effective date.
- 31st anniversary: 10% increase, with 3% annual increases thereafter until the 41st anniversary of the effective date.
- 41st anniversary: 10% increase, with 10% increases thereafter
- Rent shall never exceed market rate, defined as the average lease rate in the Parking Facility, excluding the lease rates charged to the Developer and Book Cadillac Hotel

Notice of offer: DDA will provide Developer notice of any offer to sell the Parking Facility in order to provide Developer an opportunity to submit an offer to purchase.

Subsequent to a discussion, the Committee took the following action:

On a motion by Ms. Delley, seconded by Mr. Ogden, the Committee unanimously approved recommending approval of the Lease Agreement to the Board.

2018 Bond Underwriter Recommendations

Mr. Naglick advised that Steve Kantor was on the phone to walk the Committee through the decision to select Jeffries.

Mr. Kantor stated that the Detroit Downtown Development Authority ("DDA") received 9 submissions in response to its Request for Proposals to provide underwriting services in connection with the remarketing/refunding of the Michigan Strategic Fund Limited Obligation Revenue Bonds Series 2014A (Event Center Project) (the "2014 Bonds") and the City of Detroit Downtown Development Authority Subordinate Tax Increment Revenue Bonds Series 2017 (Development Area No. 1 Projects) (the "2017 Bonds") (together, the "Outstanding Bonds"). The DDA elected to interview four of the respondents: Bank of America Merrill Lynch (BAML); JP Morgan Chase ("JP"); Jefferies; and UBS. Based upon the written proposals and oral presentations, it is Hilltop Securities' recommendation that DDA select Jefferies as the underwriter for the new DDA Series 2018 Bonds (the "2018 Bonds").

DDA issued the Outstanding Bonds as long term fixed rate bonds, with an option to call the Outstanding Bonds at par from July 1, 2018 to January 1, 2019. Failure to call the Outstanding Bonds would result in a substantial increase in the interest rate paid on the Outstanding Bonds. DDA has engaged the services of bond counsel, municipal advisor and revenue consultant with the expectation of issuing the 2018 Bonds, which will replace the Outstanding Bonds, prior to January 1, 2019.

DDA is faced with several options regarding the structuring of the 2018 Bonds. The first decision is the initial interest rate period. DDA received several proposals from underwriters offering to market 30-year bonds at a fixed rate of interest. The advantage of this approach is that DDA would be locking in its interest rate until 2046 and would not need to remarket bonds in the future. The disadvantage is that there is a cost to locking in interest rates today. Most proposals estimated the interest rate paid by DDA to issuing 30-year fixed rate bonds today to be about 6 %, while interest rates for 3-4-year interest resets are between 3.50% and 4 5/8%.

We believe that DDA should issue the 2018 Bonds with a 3-4-year interest reset for the following reasons. First, we believe that the tax receipts collected in the Downtown Development District will continue to increase and diversify. DDA will be in a much stronger position to apply for a credit rating and possibly receive an investment grade rating. If and when received, an investment grade rating will lower the interest costs substantially. Second, having a lower interest rate today will increase the ability of DDA to pay down principal on the 2018 Bonds, making the next remarketing/

refinancing to be at a lower amount. The demands on DDA are greatest over the next several years; having a lower interest rate during that period alleviates the financial pressures on DDA. The Outstanding Bonds were not rated by any credit rating agency. The respondents had different opinions as to whether DDA should apply for a credit rating for the 2018 Bonds. Some respondents said that any rating was better than no rating, as some investors cannot purchase bonds without a rating. Some respondents said that no rating was better than a non-investment grade rating, as investors in the non-investment grade space preferred to complete their own credit analysis and not rely on the rating agencies.

Hilltop Securities does not believe that the 2018 Bonds will obtain an investment grade credit rating from credit rating agencies. We think that DDA would be better served by not applying for a credit rating at this time. We are not convinced that the costs and time needed to educate the rating agencies on the special characteristics of the 2018 Bonds would result in a savings over a non-rated issue. Given the sophistication of the high yield sector investors and the proven demand for the Outstanding Bonds, we believe the 2018 Bonds will receive sufficient investor interest without a rating.

Both JP and Jefferies submitted proposals consistent with the above recommendations. Neither of their proposals require DDA to apply for a credit rating. JP proposed a private placement with JP Morgan Chase, and Jefferies proposed an unrated public sale. Jefferies proposal relies upon selling unrated bonds to a number of high yield investors while JP's proposal requires the bank to complete its own credit approval. Based upon our analysis of the proposals, we will believe that the Jefferies plan will result in a lower interest rate, as we expect that Jefferies will have multiple investors ready to purchase the 2018 Bonds, as opposed to just one investor in the JP proposal. Creating competition for the 2018 Bonds will help drive the interest rates down.

There are a number of investors who own the Outstanding Bonds who have already approved the credit of the 2018 Bonds. We would expect a great number of these current holders of Outstanding Bonds to participate in the sale of 2018 Bonds. Given that many investors have already approved the credit, we do not believe the DDA should assume the risk of working with one firm that may not have yet approved the credit.

Based upon the revenues collection assumptions as provided in the RFP, Jefferies proposed an initial 4-year period with an interest rate of 4%. Based upon the same assumptions, JP proposed an initial 3-year period with an interest rate range from 4 1/8% to 4 5/8%. Using the midpoint, we have used 4 3/8 % for our analysis.

Detroit Downtown Development Authority

	<u>JP</u>	<u>Jefferies</u>
Term of Initial Period	3 years	4 years
Par	\$291,675,000	\$284,165,000
Interest Rate	4.38%	4%
Debt Service for 3 years	\$ 40,364,200	\$ 39,394,277
Principal Repaid over 3 years	\$ 8,110,000	\$ 10,005,000
Total Debt Service		
Assuming 5% takeout	\$ 555,395,871	\$ 544,349,076
Upfront Transaction Costs	None	\$ 1,834,656

As the above chart indicates, Jefferies proposed financing plan would produce a lower cost financing for DDA in 3 important areas: debt service savings over the initial 3-year period; principal repaid over the initial 3-year period; and overall debt service costs (assuming a 5% takeout at the end of the initial period). Assuming level interest rates, DDA would save approximately \$11 million over the life of the bond issue. However, JP's proposal involves no upfront transaction costs, while

Jefferies would request a fee of approximately \$1.8 million. Jefferies plan issues approximately \$7.6 million less in bonds, due to the difference in funding of the debt service reserve funds.

We believe that the benefits of going to public markets, and its accompanying transparency, will result in a lower overall financing rate and more advantageous credit provisions. The transaction costs associated with the going to the public market (Jefferies) are greater than a private placement (JP). While a private sale offers lower transaction costs, the higher interest rate associated with a private placement ends up being more expensive to DDA. Now that DDA is an established credit, we believe that the best approach is to create competition among investors by offering public sale.

While we believe that any of the firms interviewed would be able to sell the 2018 Bonds, we are convinced that Jefferies is the best choice to manage the issue. Jefferies has significant experience in marketing unrated debt and is a leader in the tobacco securitization field, which engages investors who are willing to purchase unrated bonds. The senior person from Jefferies assigned to the DDA was extensively involved with the structuring of the 2014 Bonds and 2017 Bonds. We are confident that Jefferies will work with the financing team to bring the 2018 Bonds at favorable interest rate and in advance of the January 1, 2019 deadline.

Mr. Kantor responded to Committee members questions.

Subsequent to the discussion, the Committee took the following action:

On a motion by Ms. Delley, seconded by Mr. Ogden, the Committee unanimously approved recommending approval of engagement of Jefferies to the Board.

ADMINISTRATION

OTHER MATTERS

PUBLIC COMMENT

ADJOURNMENT

With there being no other business to be brought before the Committee, Mr. Naglick adjourned the meeting at 3:40 p.m.