

Bendzinski & Co.



municipal finance advisors

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CITY OF TROY
CITY MANAGER'S OFFICE

July 27, 2005

Mr. John Szerlag, City Manager
City of Troy
500 West Big Beaver Road
Troy, Michigan 48084-5285

RE: Standard & Poor's Annual Review of "AAA" U.S. Municipalities

Dear John:

Enclosed is a report from Standard and Poor's Rating Agency entitled "Annual Review of "AAA" Rated U.S. Municipalities", showing that the City is only one of three Michigan Municipalities and 66 cities in the entire United States which have been granted a "AAA" rating by Standard & Poor's Corporation. As we indicated it to you and the City Council, the rating represents strong fiscal policies, administration and leadership by the City's legislative body. We are proud to be the City's Financial Advisors and encourage you to continue your outstanding work.

As usual, if you should have any questions, or require any additional information, please do not hesitate to call.

Sincerely,

BENDZINSKI & CO.
Municipal Finance Advisors

Robert C. Bendzinski, CIPFA

RCB/cam
Enclosure
cc: John Lamerato
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Annual Review Of 'AAA' Rated U.S. Municipalities

How 'AAA's Managed Through The Recession

How Management Coped With The Effects Of The Recession

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Outlook

Since the last review of 'AAA' rated U.S. municipalities in September 2003, there have been five additions to the GO rated municipalities list -- and for the first time in recent memory -- two municipalities were deleted. The list of municipalities now stands at 66, compared with 45 four years ago.

Additions to the list include Glastonbury, Conn., and Lincoln, Mass., which are issuers using Standard & Poor's Ratings Services ratings for the first time. Both of these municipalities achieved the 'AAA' rating right out of the gate. Three other issuers achieved the 'AAA' rating through upgrades, with Madison Borough, N.J., and West Des Moines, Iowa upgraded from 'AA+', while Coral Springs, Fla. was raised two notches from 'AA'.

For the first time, two issuers -- Dallas, Texas and Coral Gables, Fla. were downgraded from 'AAA', but still maintain a lofty 'AA+' rating. Dallas's rating was lowered in November 2003 reflecting ongoing budget and financial pressures and significant infrastructure challenges faced by the city. Coral Gables Issuer Credit Rating (implied GO rating) was lowered in December 2003 based on diminishing financial reserves over a multi-year period, inconsistent budget results and an over reliance on enterprise fund transfers.

The recent additions all displayed strengths in the key rating factors leading to their 'AAA' ratings:

- Pro active management;
- Low-to-moderate debt levels;
- Economies that have outperformed the region in recessions and expansions;
- Higher wealth levels; and
- Strong and well elucidated financial and debt policies combined with historically comfortable financial positions, which provide a safety net protecting against virtually all uncertainties.

How 'AAA's Managed Through The Recession

The stability of 'AAA' ratings is due in part to the following factors:

- 'AAA' revenue streams tend to be less economically cyclical -- for instance, less dependent on economically sensitive revenues compared to states, which are heavily dependent on personal and corporate income taxes; business; sales taxes and capital gains taxes, which feel the effects of an economic slowdown almost immediately.
- Municipal revenue streams, with a reliance on the more stable property tax and locally derived fees and charges, have shown remarkable resilience through the recent recession. The less economically sensitive revenue sources provide a significant share of operating budget revenues. The property tax, supported by a surprisingly strong housing market, was not affected to any noticeable degree by the recent recession. Tax collections remained quite high through the recession, averaging in excess of 99% in Standard & Poor's 'AAA' rated municipalities, and in most cases tax collections provided better-than-budgeted results while continuing to grow.
- The strong pace of new housing construction, fueled by low mortgage rates, combined with residential valuation appreciation and tax base growth, has in most cases provided better-than-budgeted revenues in areas such as permits, fees and charges. This has allowed municipalities to offset declines or stagnation in other revenue areas such as interest income, state aid cuts and sales tax caused by the recession.
- Due to their relative high wealth and income, and well above average property valuations, most 'AAA' rated municipalities receive very little state aid and therefore weren't materially hurt by state aid cuts.
- Generally, sales tax revenues performed better than expected through the recession, with collections in many instances experiencing modest declines of only a few percentage points over

prior years.

- Most 'AAA' rated communities' reserve levels, on a percentage basis, were quite strong going into the current slowdown.

How Management Coped With The Effects Of The Recession

As previously mentioned, management is a key rating component in the rating process. Management of the 'AAA' rated communities has demonstrated a proactive approach historically in managing through all economic cycles.

Here are some of the many actions Standard & Poor's has observed:

- To absorb the loss of revenue, increased financial pressure and rising health care and public safety costs, a combined approach was undertaken by balancing budgets from a combination of staff reductions, hiring freezes, use of reserves, and some minor fee adjustments.
- There is little evidence pointing to wholesale or large tax increases. While in some instances property taxes and certain fees and charges are increasing, large tax increases alone were not viewed as a solution.
- Discretionary spending and in some instances capital spending was scaled back.
- Very few budget-balancing efforts involve use of one-shot revenues of any magnitude.

A Case Study: Glastonbury, Connecticut

Located in the greater Hartford area about 10 miles south east of Hartford, the state capital, Glastonbury is primarily a residential community with a nice mix of business and commercial development. Management continuity is evident. There has been a strong focus on long-term planning, with a seasoned management team that has carefully managed resources through growth spurts as well as national and regional slowdowns. Well established policies and procedures for debt, budgeting, finances, reserves and capital spending, complemented by multi-year financial forecasting have aided the town in managing growth. Management has been diligent in guiding the town's economic development, resulting in a high quality, diverse residential, commercial balance. The town's revenue structure relies on the stable property tax, which comprises nearly 90% of general fund revenues. Through the recession, management has been able to maintain property tax collections at 99%. The town receives limited state aid, and most aid is grant related. Given the difficulties Connecticut has experienced in recent years balancing its own budget, state aid cuts have been easily accommodated within the town's operating budget.

Table 1 'AAA' Rated Municipalities By State And Region

Northeast	No.	Midwest	No.	West/Southwest	No.	Southeast	No.
Connecticut	8	Minnesota	5	California	6	North Carolina	5
Massachusetts	7	Illinois	4	Texas	2	Florida	3
New Jersey	6	Michigan	3	Arizona	1	Virginia	2
New York	2	Ohio	2	Washington	1	Georgia	1
Pennsylvania	1	Nebraska	2			Tennessee	1
		Kansas	1				
		Missouri	1				
		Indiana	1				
		Iowa	1				

Behind The 'AAA' Ratings

Close examination of 'AAA' rated communities' ratios shows that population size does not matter, nor does geographic location. Indianapolis has nearly 800,000 residents, while Bloomfield Hills, Mich. has fewer than 5,000 residents. However, both large and small population 'AAA' communities share important attributes, such as low unemployment rates and above-average wealth levels. Grouping the municipalities by size and region reveals for instance, that per capita market values and wealth levels tend to be higher in the northeast than in other regions. The fact that these two statistics move in tandem indicates a direct link between the wealth of a community and property values. Even though large cities generally have lower wealth levels, it is not impossible for them to achieve the highest rating category.

Standard & Poor's emphasizes four factors when assigning a 'AAA' rating to a municipality:

- Strong and proactive administrations;
- Effective debt management policies with moderate to low debt ratios;
- A vibrant and diverse economy or participation in one; and
- A strong track record of managing financial position supported by sufficient reserves and established policies that guide management practices.

These factors combine both qualitative and quantitative factors.

Qualitative data includes:

- The presence of an experienced management team with a history of conservative budgeting and successful management through all economic cycles;
- The scope and extent of financial responsibility for municipal services shared with other levels of government; and
- The extent to which a municipality can draw on alternative sources to finance operations.

Quantitative factors, however, provide the numbers and ratios helpful to financial analysis. These reveal:

- The relative ability to repay principal and interest (but not willingness to pay, which is a qualitative factor);
- Sufficiency of reserves; and
- The strength of the economy and its growth trend.

Together, the qualitative and quantitative factors provide insight into a community's ability to support its debt.

Administration

One of the most important factors in rating a community is the community's financial management team. In order to achieve a 'AAA' rating, management must have strong, interactive relations with elected officials, favorable budgeting results, and a proven track record of managing through good as well as bad economic periods. The management team must also have a strong grasp of its finances and an explicit plan for future capital outlays and tax base development. Conservative and accurate budgeting is another important attribute of 'AAA' rated communities. 'AAA' rated communities' management demonstrate the ability to manage resources, recognize potential revenue and or expenditure pressures, and react during the fiscal year to ensure maintenance of financial position. Superior management is never passive.

Debt

'AAA' rated communities carry affordable and easily manageable debt ratios. The average net debt per capita for the 66 'AAA' rated communities is \$2,794. Seven of the smaller municipalities exceed \$4,500 debt per capita. As a result of these smaller communities incurring higher debt per capita ratios, the 'AAA' average debt per capita has grown in recent years. Compared to five years ago, however, the median debt per capita for all 'AAA's' has grown from \$1,700 five years ago to \$2,604 currently.

Smaller municipalities generally provide fewer services or services on a smaller scale that require less debt financing than larger communities. The fact that Standard & Poor's assigns 'AAA' ratings to eight municipalities with populations greater than 250,000 illustrates that issuers are not penalized by their size or for providing those extra services, assuming the services fit within the budget. High debt-per-capita

levels can also be offset by other factors. Manhattan Beach, California's debt-per-capita level is above average at \$4,695 but its per capita effective buying income is well above the national average, at 272%.

The 'AAA' municipalities have a very low debt-to-market value average of 2.1%, and aggressively pay off approximately 70% of their long-term debt within 10 years. While such aggressive debt retirement schedules can increase fixed costs by accelerating repayment faster than need be, 'AAA' municipalities exhibit the economic strength and financial capability to support the rapid amortization. Typically, less than 10% of the 'AAA' rated communities' general fund and debt service budgets are dedicated to debt service.

Economy

A municipality does not necessarily need to have a dynamic economy in order to achieve a high-grade rating. Predominantly residential communities such as Massachusetts' Sudbury, Weston, Dover, and Wellesley benefit from their close proximity to the technology-intensive Route 128 corridor, the growing Route 495 commercial sector, and participation in the strong and diverse Boston economy. The larger 'AAA' municipalities tend to support their own diverse economies. Stamford, Conn., and Raleigh-Durham, N.C., have strong corporate headquarters presence. The diversity of these economies provides the assurance that they will be able to weather a downturn in any one sector.

Some of the key ratios demonstrating a municipality's economic health include unemployment, the market value and trend of property valuations, and the relative wealth levels measured by effective buying income. High per capita property valuation represents a significant investment in property. In economic downturns, higher-valued properties typically retain valuation and exhibited strong growth through the recession. Bloomfield Hills, Mo., has a very high \$543,788, market value per capita as does Greenwich, Conn., \$466,184, and Weston, Mass., has \$406,057. The larger population 'AAA's tend to have much lower per capita market values, such as Columbus, Ohio, at \$42,599, and Indianapolis, Ind., at \$52,818. The average per capita market value for all 'AAA' rated communities is \$177,658, up a strong 37% over the last 18 months.

Table 2 AAA' Rated Municipalities Key Ratios

Municipality	State	Population	PC EBI % U.S.	Tot MV (\$)	PC MV (\$)	Gen FB % Exp.	Unres FB % Exp.	Overall debt % MV	Overall debt PC (\$ mil.)
Alexandria	Va.	134,000	174	22,757,185	169,830	17	17	1.1	1,907
Avon	Conn.	16,709	211	2,952,353	176,692	9	7	1.0	1,685
Bedford Twn	N.Y.	18,670	163	5,174,656	277,164	46	45	1.4	3,848
Bernards Twp	N.J.	26,268	250	5,115,934	194,759	53	50	0.3	574
Birmingham	Mich.	19,360	283	4,999,228	258,225	23	19	3.2	8,178
Bloomfield Hills	Mich.	3,811	536	2,072,377	543,788	29	19	1.0	5,238
Bloomington	Minn.	85,172	136	10,106,693	118,662	34	33	2.8	3,268
Boca Raton	Fla.	76,043	233	14,913,519	196,120	30	30	1.5	2,934
Cambridge	Mass.	101,355	141	21,348,001	210,626	32	29	0.6	1,268
Cary	N.C.	107,973	151	11,494,877	106,461	62	52	2.6	2,757
Cerritos	Calif.	53,100	111	4,900,000	92,279	233	211	1.1	1,019
Charlotte	N.C.	614,330	123	62,692,001	102,049	27	16	2.6	2,602
Charlottesville	Va.	40,999	72	3,538,307	86,302	14	13	1.4	1,204
Columbus	Ohio	711,470	96	42,599,172	59,875	11	8	3.9	2,330
Coral Springs	Fla.	126,711	124	6,675,464	52,683	45	44	0.8	416
Dover	Mass.	5,558	147	1,718,511	309,196	24	18	0.8	2,476
Durham	N.C.	209,420	100	14,773,879	70,547	22	12	3.3	2,342
Edina	Minn.	47,425	237	7,133,201	150,410	49	47	1.6	2,387
Fairfield	Conn.	57,340	226	10,403,152	181,429	10	9	2.5	4,517
Germantown	Tenn.	40,203	221	4,006,706	99,662	79	70	3.6	3,608

Annual Review Of 'AAA' Rated U.S. Municipalities

Glastonbury	Conn.	28,832	168	4,102,819	125,128	9	9	1.6	2,490
Glencoe Vill	Il.	8,762	429	1,663,293	189,830	29	20	3.6	6,731
Greensboro	N.C.	235,262	103	20,759,571	88,240	32	16	3.5	3,048
Greenwich	Conn.	61,101	295	28,484,297	466,184	7	5	0.2	693
Harrison Village	N.Y.	25,150	206	7,204,616	286,466	20	18	1.4	3,978
Hinsdale	Il.	17,940	289	3,735,941	208,246	33	31	2.1	4,313
Indianapolis	Ind.	791,926	105	41,827,846	52,818	40	36	5.6	2,973
Irving	Texas	196,750	111	13,959,039	70,948	14	12	8.6	6,111
Lincoln	Neb.	235,565	98	12,744,105	54,100	35	31	2.1	1,169
Lincoln	Mass.	8,111	149	1,830,623	225,696	16	12	0.2	486
Lower Merion Twp	Pa.	59,850	288	10,626,224	177,548	18	17	2.4	4,300
Madison Boro	N.J.	16,500	171	2,929,330	177,535	47	45	0.2	410
Manhattan Beach	Calif.	36,600	272	8,216,801	224,503	51	49	2.1	4,695
Millburn Twp	N.J.	19,765	288	4,311,445	218,135	33	18	1.9	334
Minneapolis	Minn.	382,618	104	34,544,631	90,285	24	24	4.2	3,768
Mountain View	Calif.	72,000	176	11,329,212	157,350	125	98	2.1	3,288
Naperville	Il.	138,802	165	14,487,771	104,377	35	33	2.2	2,331
Needham	Mass.	28,911	182	6,285,225	217,399	13	7	0.6	1,392
Northbrook Vill	Il.	33,435	221	5,667,660	169,513	55	48	2.8	4,782
Norwalk	Conn.	84,170	152	15,576,344	185,058	9	9	1.0	1,923
Omaha	Neb.	399,357	110	19,438,092	48,673	14	12	4.5	2,207
Overland Pk	Kan.	163,319	152	15,125,579	92,614	54	52	3.0	2,755
Palm Beach Twn	Fla.	9,676	440	8,152,038	842,501	47	45	0.5	4,242
Palo Alto	Calif.	60,246	258	15,020,454	248,564	71	64	0.4	947
Plano	Texas	245,000	188	20,869,735	85,183	27	24	4.9	4,208
Princeton Twp	N.J.	16,027	113	3,282,939	204,838	7	6	1.2	2,535
Raleigh	N.C.	328,880	122	29,380,152	89,334	44	32	3.0	2,675
Ridgefield	Conn.	24,054	263	5,789,129	240,672	11	8	2.4	5,717
Ridgewood Vill	N.J.	24,936	237	4,724,961	189,484	18	13	1.5	2,862
Rochester	Minn.	93,037	113	6,908,453	74,255	35	34	1.8	1,299
Roswell	Ga.	79,334	174	8,105,687	102,172	60	43	1.9	1,908
Santa Monica	Calif.	87,954	195	15,786,981	179,491	97	24	1.9	3,453
Scottsdale	Ariz.	222,500	185	35,156,385	149,017	28	27	1.8	2,710
Seattle	Wash.	572,600	172	83,938,096	146,591	17	6	1.9	2,778
St Paul	Minn.	288,000	91	27,646,797	95,996	22	19	2.3	2,233
Stamford	Conn.	120,107	163	15,560,354	129,554	5	3	1.9	2,484
Sudbury	Mass.	16,841	234	3,753,911	222,903	10	5	0.5	1,097
Summit	N.J.	21,131	271	4,203,149	198,909	37	26	1.3	2,500
Town & Country	Mo.	10,894	322	2,281,929	209,467	136	135	1.6	1,524
Troy	Mich.	84,841	165	11,911,394	140,397	41	34	1.6	2,236
Wellesley	Mass.	26,613	218	8,211,972	308,570	6	2	0.6	1,821
West Des Moines	Iowa	52,884	135	4,338,384	82,036	27	27	5.5	4,482
West Hartford	Conn.	61,045	174	5,198,364	85,156	7	7	2.8	2,341
Westlake	Ohio	31,719	163	3,736,300	117,794	102	71	2.4	2,762
Weston	Mass.	11,469	333	4,657,065	406,057	10	5	1.1	4,582

Winston-Salem	N.C.	185,776	101	14,897,732	80,192	22	13	3.3	2,615
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There are some differences among the municipalities depending on population and location. Larger cities (those with more than 250,000 residents) have average per capita values of about \$73,000; smaller communities (those with less than 15,000 people) show a very high average per capita value of \$390,000. This dramatic difference can best be explained by the relative homogeneity of smaller communities. Larger municipalities, by contrast, contain a mix of wealthy and poorer areas that tend to moderate per capita values. For instance, Madison Boro, N.J., with a per capita market value of \$177,535, is a wealthy residential suburb of New York City.

In contrast, Indianapolis, Ind., is a diverse city with a per capita market value of \$36,341. Northeast municipalities have higher per capita valuations reflecting the generally higher housing values in, New Jersey, Connecticut, and Massachusetts, as well as higher incomes. The relationship between per capita effective buying income and market value per capita indicates that higher incomes are associated with higher property values.

Additionally, most 'AAA' municipalities share strong employment and income figures, which can offset other areas of weakness. Charlottesville, Va., has an unemployment rate well below the national average, which helps offset a per capita wealth level that is 93% of the U.S. average. The presence of the University of Virginia also assures Charlottesville of relatively strong employment in economic expansions as well as contractions. In our analysis, Standard & Poor's often uses the three-year average unemployment figure, which tends to smooth one-year aberrations and provides a better indication of an economy's health.

The average wealth levels of Charlottesville and Columbus, Ohio, are also offset by the presence of large and well-regarded state universities. While the large student population depresses wealth levels, the intellectual capital helps create jobs and a dynamic economy. Just as the large university presence in the areas of Palo Alto, Calif. (Stanford), and Cambridge, Mass. (Harvard and MIT), help generate new businesses and jobs in those areas, Charlottesville (University of Virginia) and Columbus (Ohio State University) reap the benefits of significant university presence. Raleigh and Durham have higher-than-average wealth levels, but also benefit from the presence of Duke, Wake Forest, and the University of North Carolina. These three prestigious universities form an important base for the "Research Triangle" and a fast growing regional economy with high-paying jobs.

Finances

The fourth important factor is a municipality's finances, which are closely tied to the strength of the management team and the tax base's ability to generate revenue. Strong financial management with the ability to accurately plan and develop significant reserves is a common characteristic of highly rated municipalities. Average unreserved general fund balance as a percentage of operating expenditures for all 'AAA' rated municipalities is very strong, at 28%, which remained virtually unchanged compared prior to the recession. Reserves of this magnitude provide local governments great flexibility in dealing with unforeseen events such as an unexpected shortfall in revenues or rise in expenses. At the top of the list are four communities including, Town & Country, Mo., with an unreserved general fund balance of 135%; Mountain View, Ca. (98%); Westlake, Ohio (102%) and Germantown, Tenn. (70%). The strong financial profiles have allowed the 66 'AAA' rated communities to weather the current national economic slowdown.

Outlook

While the number of new entrants to the 'AAA' rated list slowed, on a net basis, as a direct result of the most recent economic slowdown, we believe that now that growth is again accelerating, continued growth in the 'AAA' list is inevitable. This is not to say that there are no challenges ahead. While revenue growth is again occurring on the local level, mixed signals on state aid, unfunded mandates, rising health care costs, homeland security, pension performance and multi-year wage contracts will continue to challenge management. Standard & Poor's will continue to focus on how officials manage these budget issues, but given the track record of this exclusive group, practices in place and management skills will continue to ensure strong performance. Mastery of these issues will likely result in further additions to the 'AAA' list.

Table 3 Explanation Of Table Column Headings

Although all municipalities are arranged in the same table, direct comparison is problematic because not all municipalities provide the same services — some support school systems, others do not. Ratios, by themselves, do not address the subtleties and diversities of the municipalities.

Population: The number of residents in the community or county. Source: Bureau of the Census.

PC EBI (Per capita effective buying income) % of U.S.: PC EBI of the municipality as a ratio of the nation's PC EBI. Source: Market statistics.

Tot MV (Total market value): The value of the municipality's taxable property. Source: Official statements of the municipalities.

PC MV (Per capita market value): This ratio measures total taxable value of all property in a jurisdiction divided by the number of residents. A higher ratio usually translates into more resources available to meet obligations.

Gen FB (General fund balance) % expenditures: This ratio measures the total general fund balance as a percentage of operating expenditures. Higher percentages are a sign of financial strength.

Unres FB (Unreserved general fund balance) % expenditures: Similar to total general fund balance, but more restrictive because only those funds not reserved for some specific purpose are included. Source: Audits of the municipalities.

Overall net debt % MV: A ratio of the dollar value of debt to the value of the underlying tax base. This number provides insight into how heavy the debt burden is on taxable property.

Overall debt PC (per capita): Measures direct and overlapping debt responsibility on an entity on a per capita basis. It measures how heavy a debt burden is on an individual basis.

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