



STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: December 1, 2017

TO: Governor Rick Snyder

FROM: Kevin Kubacki, Executive Director for City of Detroit
Financial Review Commission

SUBJECT: Detroit Financial Review Commission Biannual Report No. 6

This report is being filed on behalf of the Detroit Financial Review Commission (the “FRC”) by its Executive Director, pursuant to the requirements of Section 6(8) of Public Act 181 of 2014, the Michigan Financial Review Commission Act (the “Act”). A copy of this report is being delivered to the Senate Majority Leader and the Speaker of the House of Representatives, and it is being posted on the FRC’s Michigan Department of Treasury website. A copy is also being delivered to the Mayor and City Council President of the City of Detroit (the “City”).

Pursuant to Section 6(1) of the Act, the FRC’s oversight of the City began on the effective date of the City’s plan of adjustment, December 10, 2014. The FRC is responsible for determining the City is complying with the Act and with its plan of adjustment (POA). This is the FRC’s sixth report, following the previous report submitted on May 30, 2017. It reports on the FRC’s activities and significant developments in the City’s finances and restructuring.

Statutory Oversight Activities

Sections 6 and 7 of the Act include various powers and duties of the FRC in its oversight of the City. Those statutory requirements and compliance with them to date are noted below.

Requirement	Act Sec. No.	Compliance
Compliance with plan of adjustment, the Act, and other revised statutory requirements	6(2) and 6(3)	The City is implementing programs consistent with its plan of adjustment. The FRC provided its annual certification of the City’s statutory compliance on September 28, 2017.
FRC review and approval of annual four-year financial plan	6(4) and 7(b)	The City has submitted 3 four-year financial plans to date. FRC has approved both: <ul style="list-style-type: none"> • FY 2016-FY 2019 plan (approved April 20, 2015) • FY 2017-FY 2020 plan (approved April 18, 2016) • FY 2018-FY 2021 plan (approved April 17, 2017)
FRC review and approval of all applicable contracts	6(6)	The City has submitted 579 applicable contracts and amendments to date. The FRC has approved 578 of them.
City and CFO provide needed information and documents and attend FRC meetings when needed	6(7), 7(d), and 7(o)	The City and CFO have been responsive to requests for information and documents and have attended meetings when requested.

FRC review and approval of collective bargaining agreements	6(9)	The City has submitted 8 collective bargaining agreements and amendments to date. FRC has approved all of them.
Quarterly debt service certifications	6(11)	The City has provided all 11 quarterly certifications to date.
Consensus revenue estimates	7(a)	The City has held 6 consensus revenue estimating conferences, as required to date. The City provided its revenue estimates to FRC for review.
FRC review and approval of budget amendments	7(c)	The City has submitted a total of 242 amendments to date. The FRC has approved all of them.
FRC review and approval of requests to issue debt	7(e)	The City has submitted 5 debt issuance requests to date. The FRC has approved all of them.
FRC approval of Chief Financial Officer appointment	7(g)	The FRC approved the appointment of the City's current Chief Financial Officer on January 26, 2015.

FY 2016 Comprehensive Annual Financial Report

The City's audited FY 2016 CAFR was issued May 26, 2017. The CAFR shows the City ended its second consecutive year with a balanced budget, while reporting a General Fund surplus of \$62.9 million, and an unassigned fund balance of \$143 million. The restructuring of the Office of the Chief Financial Officer, with an increased focus on internal controls, has continued to lead to reduced audit findings.

Also, for the first time in over a decade the City shows \$0 in questioned costs in Federal grant spending. The table below highlights these results for the last five years:

Year	2012	2013	2014	2015	2016
Number of Audit Findings	98	75	41	33	19
Federal Award Spend	\$ 293,393,583	\$ 200,166,706	\$ 129,869,289	\$ 202,630,590	\$ 157,676,621
Amount of Questioned Costs	\$ 7,305,027	\$ 18,512,118	\$ 11,918	\$ 214,100	\$ -
Number of Indeterminable Questioned Costs	8	4	13	8	1

September 2017 Consensus Revenue Estimates

Under Section 4t of the Home Rule City Act (Public Act 279 of 1909), the City is required to hold two consensus revenue estimating conferences per year, one in February and another in September. On September 21, 2017, the City held its consensus revenue estimating conference that considered revenue estimates/projections for FY 2018 through FY 2022. For General Fund revenues for FY 2018, the consensus estimate reflected an increase of only 0.7% from the February 2017 consensus estimate (i.e., an increase from \$1,023.9 million to \$1,031.5 million). For FY 2018 through FY 2022, the General Fund revenue projections are as follows:

City of Detroit General Fund Revenues				
September 2017 Consensus Revenue Projections				
\$ millions				
<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>
\$ 1,031.5 ¹	\$ 1,043.0	\$ 1,056.4	\$ 1,068.6	\$ 1,079.9

FY 2017 and FY 2018 Financial Update

The City is currently undertaking its year-end closing and anticipates the FY 2017 audit will be completed no later than Q1 of 2018. Unaudited projections as of November 2017 forecast the General Fund will generate approximately \$38.5 million surplus for FY 2017. The City currently projects its General Fund unassigned fund balance will reach \$160 million at the conclusion of the FY 2017 audit.

Based on budget projections as of October 2017, the City estimates a General Fund operating surplus of about \$29.3 million for FY 2018. The surplus is primarily being driven by unfilled vacancies within the City and revenues trending above the adopted budget. The City has developed a ten year forecast that it expects to update at least annually. This is an important tool to ensure that long-term obligations are monitored and that short-term decisions are made in the context of appropriately balancing the City's many funding needs.

Retiree Protection Fund Update

Since our last report, the City has finalized its Section 115 trust, the Retiree Protection Fund (RPF). Under the City's bankruptcy plan of adjustment (POA), the City's required pension contributions to its legacy plans were based on a fixed schedule through FY 2023 and were funded primarily by third parties. Beginning in FY 2024, the City is required to contribute to its legacy plans. The amounts will be based on a funding policy to be established by the Retirement Systems to amortize the remaining unfunded actuarial accrued liabilities of each legacy plan. Under these requirements, the City's General Fund required contributions are currently estimated to increase from zero in FY 2023 to an estimated \$182.7 million² annually in FY 2024.³ To meet this challenge, the City Council has approved an irrevocable Section 115 trust solely for the purposes of making future contributions to the City's two legacy pension plans. To date, the City has transferred \$105 million plus interest earnings to the trust. The City's current plan calls for an additional \$230 million to be transferred between the start of FY 2019 and the end of FY 2023. The City's current four year plan includes annual appropriations from the General Fund to the RPF, thereby demonstrating the City's commitment to this additional funding. The City plans to update its RPF funding plan at least annually in order to make any necessary adjustments based on the Retirement Systems' investment returns and other variables.

¹ Excludes \$50 million of the City's previous year surplus that will be used to fund additional capital projects, blight remediation, and technology improvements.

² Based on the most FY 2016 actuarial valuation of both legacy plans. This estimate is based on a 30-year level dollar closed amortization.

³ FY 2017 investment returns were favorable and therefore reduced the anticipated FY 2024 contribution to \$150.1 million. FY 2017 valuations are not expected until sometime early 2018.

Credit Rating Increase

In October 2017, the City received its second credit rating upgrade in less than three years and its highest since March 2012. Moody's Investors Service upgraded Detroit's issuer rating to B1 from B2 and also assigned a positive outlook to reflect the possibility of future upgrades. Moody's report stated that Detroit has the following credit strengths:

- Very healthy fund balance and liquidity provide resources to invest in economic development or absorb a short-lived budgetary shock.
- Job growth is fueling rising income taxes, positioning the City for operating surpluses in the coming years.
- Very conservative fiscal management is intent on keeping general operating expenses below the current revenue intake in order to address long-term pension funding needs.
- Increased road funding from the State of Michigan will support Detroit's neighborhood revitalization initiative.

City's Waiver from FRC Oversight

With the anticipated release of the City's 2017 CAFR projected in Q1 of 2018, it is possible that the City will have met the required conditions of the FRC statute (P.A. 181 of 2014) such that the FRC's oversight of the City of Detroit is reduced. FRC staff and counsel are in the process of developing a protocol with the City so that the FRC has the information necessary to fulfill its duties, assuming an annual waiver is given. The FRC expects to continue to monitor the City's financial performance in order to: 1) determine annually whether to grant a waiver and 2) determine whether anything has occurred to cause the FRC to rescind the waiver.