STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: November 9, 2011

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: Preliminary Review of the City of Inkster

I. Background

On October 10, 2011, the Department of Treasury commenced a preliminary review of the finances of the City of Inkster to determine whether or not a local government financial problem existed. Section 12(1) of Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, permits a preliminary review to be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the City of Inkster resulted from the conditions enumerated in subdivision (a) and (r) of Section 12(1) having occurred within the City. [1]

As summarized below, based upon information received and considered as part of the preliminary review -- including the inability of the City to operate within budgets and to avoid fund deficits, recurrent accumulated deficit spending, severe cash flow shortages resulting in an improper reliance on inter-fund borrowing and appropriations, the lack of funding of the City's other post-retirement benefits, and the increased costs to its pension plans -- I conclude that probable financial stress exists in the City of Inkster and recommend appointment of a financial review team. Appointment of a financial review team is a prerequisite step in the Act 4 process to the appointment of an emergency manager.

II. Preliminary Review Findings

The preliminary review found the following:

- The City has not distributed property tax collections timely. Through the latter part of August 2011, distribution of summer taxes were delayed. For example, from July 1 through August 31, $992,141 was collected on behalf of Inkster Schools, but only $337,392 was disbursed to the School District by September 15. During the same period, $15,389,798 in total was collected for all taxing jurisdictions, but only $7,140,530 was disbursed by September 15. In effect, the City borrowed property taxes collected on behalf of other taxing units of government and utilized

[1] Subdivision (a) provides that "[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this act." In this case, the request was made by the then City Manager. Subsection (r) provides that "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress."

them to fund its own operations. This borrowing resulted in an untimely disbursement of those taxes by the City to the other taxing units of government in violation of Public Act 206 of 1893, the General Property Tax Act. The City was able to make up some of the earlier shortfalls as of the date of this review. However, the property tax collection account is not reconciled and has a remaining balance of over $500,000.

- The City is experiencing significant cash management and cash deficit issues. The City utilizes a pooled bank account for the majority of its funds, which offered the City flexibility and efficiencies. However, if not properly monitored, use of a single bank account for multiple funds can cause complications such as unrecorded inter-fund borrowing. Table 1 depicts, as of September 30, 2011, the most significant negative- and positive-cash balances, by fund, in the pooled bank account. Each of the funds that carry a positive cash balance has a restriction on the use of that cash.

Table 1
Pooled Cash Account

Fund	**Balance**
General	$(1,101,654)
Community Development Block Grant	(195,862)
Brownfield	(263,985)
Water and Sewer	(1,060,531)
Communication Services	(308,485)
Garage	(546,065)
Restricted Funds:	
Major Streets	1,726,856
Local Streets	176,593
Parks	340,429
Tax Increment Finance Authority	1,426,437
Downtown Development Authority	137,500
Library	390,767
Justice Center Debt	142,579
Agency	443,771

The deficit cash position of the foregoing funds represents inter-fund borrowing that is not permissible, due to restrictions upon usage of extra-voted millage or grants from State and Federal agencies. The preliminary review was unable to determine which fund owed another and it is unlikely that City officials are able to do so either because checks were written from the pooled account without booking the corresponding liability to other funds. Since the cash is pooled, it account without booking the corresponding liability to other funds. Since the cash is pooled, it can be presumed that each negative balance has drawn a proportional amount from each fund with a positive balance. It is only by the impermissible use of cash from restricted sources that the City has been able to operate. Were the City to operate in compliance with those restrictions, the funds with negative balances would not have the cash to carry out the activities associated with those funds. For example, the general fund has a negative $1.1 million in the pooled account. It must use other restricted money or a different cash source in order to run the day to day operations of most of the City's departments.

- There is a projected operating deficit in the general fund for the remainder of the current fiscal year. In addition to the pooled bank account illustrated in Table 1, there was a general fund set aside of $1.2 million in a separate account. City officials intend to use this separate account to offset the negative balance in the pooled bank account leaving $148,000 in available cash for the general fund ($1,250,000 less $1,102,000). Aside from the additional borrowing of cash, this amount will not likely increase over the remaining months of the current fiscal year because the majority of the City's property taxes from its summer tax collection has already been used. A $1.8 million general fund deficit is projected for the 2011 fiscal year. There also is a projected $2.5 million general fund deficit in the 2012 fiscal year that would increase if additional debt proceeds are denied.

- Accounts receivable and accounts payable continue to increase. The City is delaying payment of its bills, as can be seen by increased accounts payable from 2010 to 2011. For example, in the general fund, accounts payable increased from $684,288 to $1,045,977 and water and sewer fund accounts payable increased from $787,217 to $2,407,066. During the same period, the City's ability to collect outstanding water and sewer billings suffered as reflected in the increase in accounts receivable from $338,000 in 2010 to $2,004,731 in 2011, which only intensified the cash flow problem.

- City officials have proposed unrealistic budgets and failed to make timely budget revisions. For example, for the current fiscal year, the City originally budgeted $2.3 million in fines from police activities (an increase of over $1.6 million from the previous year), even while reducing budgeted expenditures for police patrols and other police expenditure activities. This amount has been amended to $1.2 million, but still appears to be too optimistic. Similarly, the chargeback of uncollectable tax collections reduced tax revenues by over $1 million in 2011; however, no chargebacks were originally budgeted for the current fiscal year, thereby artificially inflating projected property tax receipts.

- The general fund continues to charge the water and sewer fund over $700,000 for indirect costs related to costs incurred by general government employees, which exacerbates the cash flow shortage in the water and sewer fund. These cash shortages originated in fiscal years 2008 through 2010 when cash flows due to capital purchases and related financing reduced cash by almost $6 million. Simultaneously, the City's ability to collect from its customers lagged. Only recently did the City Council adopt a shut-off policy for delinquent customers. In addition, while the City has put past due accounts on the tax rolls, many accounts remain unpaid because of the foreclosure and other economic problems facing the community. While the water and sewer fund has not experienced significant losses, such factors have resulted in a cash shortage.

- The City is experiencing increased pension related expenses. In order to reduce costs of salaries and benefits, the City offered general (non-police or fire) employees who were eligible to retire an incentive payment of $750 multiplied by their years of service to encourage early retirement. Ten employees agreed to the incentive and were to leave employment by the end of June 2011. The total amount of the incentive payments was $240,750. In addition, the City paid annual, sick, and longevity balances which amounted to $121,374. Combined, the total payments at the end of June 2011 were $362,124, which further reduced the City's cash.

  General employees of the City contribute 5 percent (dispatchers contribute 3 percent) toward their retirement. Upon retirement, their pension multiplier is 2.5 percent (2.0 percent for dispatchers). Therefore, an employee who earned $50,000 and worked 30 years would be eligible to receive a $37,500 annual pension. Police and fire employees contribute 6.75 and 6.0 percent respectively toward their retirement. Upon retirement, their pension multiplier is 2.75 percent of final average compensation for the first 25 years of service, 2.5 percent for the next five years of service and 1.0 percent for any further years of service.

  Early retirement incentives, along with relatively generous retirement benefits, have resulted in a billing from the City's retirement administrator, Prudential Retirement Insurance and Annuity Company. In keeping with the City's stated commitment to fully fund the retirement system, Prudential has indicated the need for an immediate payment of over $1.9 million to make the system whole.

- Liabilities for other postemployment benefits are increasing. In 2010, the annual required contribution for such benefits was $2,984,311. However, the City paid only $547,634, thus increasing the liability by $2,436,677. The aggregate unfunded liability was almost $30.0 million in 2010, and the City continues to utilize a "pay as you go" basis for funding these benefits.

- City debt levels were high in 2010, at $42,021,917. However, only $32,201,188 of that amount was subject to the statutory debt limitation of $39,900,995 (for 2010) imposed by Public Act 279 of 1909, the Home Rule City Act. Annual debt service payments exceeded $3.6 million. City voters have approved extra-voted millages to service much of this debt, but this may diminish their willingness to approve additional property taxes in the future. In addition, City officials plan to borrow an additional $3 million in 2012 to assist with cash-flow difficulties.

cc: Roger Fraser, Deputy State Treasurer
Frederick Headen, Director, Bureau of Local Government Services