



STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: May 28, 2015
TO: Governor Rick Snyder
FROM: Ann Storberg, Senior Policy Advisor to State Treasurer Nick A. Khouri
SUBJECT: Financial Review Commission's Biannual Report on Detroit

On behalf of Mr. Ron Rose, Executive Director for the Office of the Financial Review Commission, I am attaching for your consideration the biannual report by the Financial Review Commission for the City of Detroit as required by Section 6(8) of P.A. 181 of 2014. The report details the Commission's activities and formal requirements since the Commission became official under section 6(1) of the Act on the effective date of Detroit's plan of adjustment, December 10, 2014.

Attachment

Cc: Senator Arlan Meekhof, Majority Leader
Representative Kevin Cotter, Speaker of the House
Mayor Mike Duggan, City of Detroit
Council Member Brenda Jones, President Detroit City Council
Financial Review Commission members
Ron Rose



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DATE: May 28, 2015
TO: Governor Rick Snyder
FROM: Ron Rose, Executive Director Financial Review Commission
SUBJECT: Financial Review Commission's Biannual Report on Detroit

This report is being filed by the Financial Review Commission for the City of Detroit, by its Executive Director, pursuant to the requirements of Act 181 of 2014, section 6(8). A copy of this report is being delivered to the senate majority leader and the speaker of the house of representatives, and posted on the department of treasury web site. A copy is also to be delivered to the Mayor and Council President of the City.

The Commission became official under section 6(1) of the Act on the Effective Date of Detroit's plan of adjustment,¹ December 10, 2014. The Commission is responsible for determining that the City is complying with the Act and with its plan of adjustment.

I. General

The Commission has effectively started its program for oversight of the City. One of the Commission's significant efforts has been reviewing, understanding and approving of the City's 4-year financial plan, including participation in a formal revenue conference that preceded the 4-year plan, and review and approval of the City's major contracts.

Major changes are occurring in the City. The City has ambitiously and necessarily undertaken a new Enterprise Resource Planning system to replace the City's very outdated financial systems and installing a new payroll system. The Commission's staff and consultants have closely worked with the City with the purpose of being able to assure the Commission that the implementation of this project is eliminating as many risks as possible. At this time the Commission believes that the new technology improvements are going to be successful.

In addition, the Finance Department and Human Resources Department are undertaking major personnel restructurings with the goal of improving efficiencies, improving services, and reducing costs. The City's Chief Financial Officer John Hill, and his staff, have continually reported to the Commission and have been open to the Commission's staff to make these major efforts transparent.

¹ This Report uses words or phrases as defined in the Act.

While there are risks in these major undertakings, the City believes, and the Commission agrees that these are both necessary and reasonable because of the urgent need to modernize the way the City operates in order to start meeting the goals set forth in the plan of adjustment. It is anticipated that the new Enterprise Resource Plan will be implemented beginning in October, 2015.

Cooperation between the Commission and the City’s leadership is excellent and the City’s administration is doing everything it can to make information, both required and requested by the Commission, available to the Commission in a timely manner.

II. Activities of the Commission

A. Formal Requirements of the Commission

The Act has various requirements that are set forth below, and compliance with each requirement is noted.

| REQUIREMENT | ACT SEC. NO. | COMPLIANCE |
|--------------------------------------------------------|---------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Review and approve the City’s four year financial plan | 6(4) and 7(b) | The City duly and timely delivered its 4-year financial plan and the Commission approved the plan as presented on April 20, 2015. The Fiscal Year 2016 Budget was identical to that of the Emergency Manager as required by Public Act 279 of 1909 section 4t. See below for a discussion of the due diligence performed by the Commission regarding the 4-year plan. The 4-year plan complied with section 4t of the home rule city act. |
| Approve all applicable contracts | 6(6) | The City has presented all applicable contracts to the Commission for approval. As of the date of this report, approximately 120 contracts have been presented. The City’s Chief Procurement Officer, Boysie Jackson, together with many other City officers and employees have made presentations to a subcommittee of the Commission and after discussing each contract has approved them. The Commission is particularly focused on the competitive |

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|----------------------------------|-------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | nature of the bidding on contracts and if there was no competitive bidding, why not. The Commission is also focused on the reason for the contracts and how the contracts fit into the City's plan of adjustment. Prior to a contract being presented to the Commission, the contract must first be approved by the Mayor and City Council. Among many others, the Commission has approved the contracts contemplated by the proposed Detroit Water and Sewerage Department and Regional Water Authority transaction. |
| Collective Bargaining Agreements | 6(9) | There have been no amendments to existing collective bargaining agreements or new collective bargaining agreements since December 10, 2014. |
| Debt Service Schedules | 6(11) | The City has duly and timely filed with the Commission duly certified schedules of debt service due on bonds, leases, or other municipal debt. |
| Revenue Conferences | 7(a) | The Commission has participated in and approved Detroit's consensus revenue estimates under section 4t of the home rule city act. The Commission also participated in an informal review of revenues by the City to determine if revenues set forth in the approved 4-year financial plan was still a reasonable projection. |
| Amendments to 4-year plan | 7(c) | There have been no proposed amendments to the approved 4-year financial plan, although the City has informed the Commission that an amendment is likely to be presented to the FRC for approval with changes, among others, to reflect the results of the contemplated Detroit Water and Sewerage |

| | | |
|--------------------------------------------------------------------------------------------------------------------|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | Department and Regional Water Authority agreements. |
| Participation of the Chief Financial Officer | 7(d) | The City's Chief Financial Officer, John Hill, has fully cooperated with the Commission's requests by providing information requested and participating in meetings of the Commission when requested. |
| Approval of Commission for issuance of debt | 7(e) | There has been one request for the issuance of debt and that request has been approved. The request was to refund a debt issue of the Detroit Water and Sewerage Department in order, among other things, to obtain significant savings. |
| Approval of Chief Financial Officer | 7(g) | The Commission approved the appointment of the Chief Financial Officer of the City on January 26, 2015. |
| City to provide needed information and documents to carry out responsibilities and attend FRC meetings when needed | 7(m) | The City has been timely and responsive to requests for information and documents. City officials have attended all meetings when requested by the FRC. |
| Ethics Policy, By Laws | 5(8) and (11) | The Commission duly adopted an ethics policy and by laws. |

In summary, the Commission is satisfied that the City is in technical compliance with the Act.

B. City's Compliance with plan of adjustment

Section 6(2) of the Act also requires the Commission to assure that the City is complying with the terms of the plan of adjustment. An explanation of what it means to be in compliance with the plan of adjustment is important. A requirement to confirm a plan of adjustment is that the plan is feasible. Bankruptcy Judge Rhodes appointed an expert to help the Court determine whether the plan was feasible. That expert, Martha Kopacz, filed her report and two supplemental reports with the Court and gave extensive testimony during the hearings before Judge Rhodes to determine whether the plan of adjustment could be confirmed. The Court found that Ms. Kopacz's test of feasibility was an accurate statement of the standard. That standard is, after confirmation of the plan of adjustment, that the City "will be able to sustainably provide basic municipal services to the citizens of Detroit and to meet the obligations contemplated in the Plan without the significant probability of a default." Opinion at 113. The key document that both Ms. Kopacz and the Court relied on in finding that the plan of adjustment was feasible is the City of Detroit Plan of Adjustment – 40 year projections (the "Plan Projections"). The Plan

Projections have been posted on the Commission’s web site, at http://www.michigan.gov/documents/treasury/Detroit_FRC_Plan_of_Adjust_40_Year_Proj_10-21-14_490442_7.pdf?20150528155828. The Plan Projections include a 10 year by year financial forecast from fiscal years 2014 to 2023 (the “10 year forecast”). The 10 year forecast assumes significant improvements in the City’s operations and revenues that lead to the conclusion that in fiscal year 2024 the City can meet its then significant payment obligations to fund the two pension plans frozen pursuant to the plan of adjustment. In addition to its pension obligations in 2024 and beyond, the City’s debt service, even after the significant debt relief provided in the plan of adjustment, remains significant. In the view of the Commission, compliance with the plan of adjustment means that the City must make the improvements as contemplated by the Plan Projections, especially during the entirety of the first ten years.

The following table sets forth the size of the City’s long term bond and note obligations and pension obligations for the two pension obligations (the Police and Fire Pension System and General Retirement System) that were frozen as part of the plan of adjustment:

| \$ in millions | | | |
|----------------|-------------------|--------------|------------|
| FY | Debt Service (\$) | Pension (\$) | Total (\$) |
| 2015 | 94.2 | 14.6 | 108.8 |
| 2016 | 148.8 | 20.0 | 168.8 |
| 2017 | 145.8 | 20.0 | 165.8 |
| 2018 | 164.3 | 20.0 | 184.3 |
| 2019 | 161.5 | 20.0 | 181.5 |
| 2020 | 160.7 | 0 | 160.7 |
| 2021 | 159.6 | 0 | 159.6 |
| 2022 | 142.7 | 0 | 142.7 |
| 2023 | 138.3 | 0 | 138.3 |
| 2024 | 119.2 | 113.9 | 233.1 |
| 2025 | 141.4 | 111.4 | 252.8 |
| 2026 | 133.3 | 108.8 | 242.1 |
| 2027 | 126.4 | 105.7 | 232.1 |
| 2028 | 120.8 | 102.6 | 223.4 |
| 2029 | 113.2 | 100.0 | 213.2 |
| 2030 | 111.9 | 96.9 | 208.8 |

The plan of adjustment, with the Plan Projections, require the City, between fiscal years 2015 and 2023 to make very significant investments in the City totaling \$1.7 billion. These investments are referred to as Reinvestment Initiatives. These Reinvestment Initiatives, together with, and as a result of the Reinvestment Initiatives, private sector investments, are projected to allow the City to make the payments not only through fiscal year 2023, but into the succeeding years when the pension payment obligations substantially increase. As Ms. Kopacz concluded in her Reports to the Court, and quoted by Judge Rhodes in his Opinion, “the Plan Projections do not leave much room for error.” Opinion at page 128.

In his oral opinion on the record, Judge Rhodes stated the following:

It cannot be emphasized enough that the long term feasibility of the plan of adjustment will depend on the effectiveness of the Financial Review Commission. This is a matter of extraordinary weight and responsibility.

The Commission believes that one of its most important responsibilities during the entirety of its existence is to monitor the City's compliance with the Plan Projections so that the City can meet its obligations as set forth in the table above. In addition to the work accomplished to date, in the Report due to be filed with the Governor in December, 2015, the Commission will report on each of the steps it is taking to accomplish this task.

From the significant and almost daily contacts between the Commission's staff and the City's current administration, both the Mayor's office and his cabinet, and City Council, the Commission believes that the current leaders of the City have the vision, honesty, exceptional ability and work ethic to accomplish remarkable results for the City. It is also starting the long and difficult process of building a highly capable middle management structure. As the current leaders leave their positions, the challenge will be to replace them with new leaders who possess the same level of enthusiasm and capability as the current leaders. Between now and fiscal year 2023, the City must constantly strive to, and successfully make the improvements as those incorporated in the Plan Projections. A failure to do so can destroy what so many have worked so hard to achieve and what so many in the City's bankruptcy lost in order for the City to have this opportunity.

III. Staffing of and Consultants to Commission

The Department of Treasury, which is responsible for administering and funding the Commission, has hired a full time executive director and has made available a senior Treasury staff member to work on Commission matters. A senior staff member has also been hired to serve full time as an analyst for the Commission. Finally an executive assistant has joined the staff. At this time, there are no further hires contemplated.

Two consultants have been retained by the Commission, Martha Kopacz and her firm, Phoenix Management Services, and UHY, LLC. By adding Ms. Kopacz and her firm, the Commission has received the great benefit of her knowledge of the development of the Plan Projections and all of the assumptions behind those projections. Ms. Kopacz and her firm will continue to assist the Commission in developing the methods of monitoring the City's compliance with the Plan Projections. UHY, LLC, a Michigan based certified public accounting firm, is both reporting to the Commission on the progress being made in one of the City's critical investments, the implementation of a ERP system, and analyzing whether the City is complying with its current year budget. Both of the firms provided great assistance in reviewing the 4-year financial plan for fiscal years 2016-2019 and we expect the firms to do so for the 4-year financial plan for fiscal years 2017-2020.