STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: November 29, 2016

TO: Governor Rick Snyder

FROM: Ronald L. Rose, Executive Director for City of Detroit Financial Review Commission

SUBJECT: **Detroit Financial Review Commission Biannual Report No. 4**

This report is being filed on behalf of the Detroit Financial Review Commission (the "FRC") by its Executive Directors, 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. This is the FRC's fourth report, following the previous report submitted on June 1, 2016. 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)	City is implementing programs consistent with its plan of adjustment. FRC provided its annual certification of City's statutory compliance on September 15, 2016. The next certification is due by October 1, 2017.
FRC review and approval of annual four-year financial plan	6(4) and 7(b)	City has submitted 2 four-year financial plans to date. FRC has approved both: • FY 2016-FY 2019 plan (approved April 20, 2015) • FY 2017-FY 2020 plan (approved April 18, 2016)
FRC review and approval of all applicable contracts	6(6)	City has submitted 347 applicable contracts and amendments to date. FRC has approved 346 of them.
City and CFO provide needed information and documents and attend FRC meetings when needed	6(7), 7(d), and 7(o)	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)	City has submitted 5 collective bargaining agreements and amendments to date. FRC has approved all of them.
Quarterly debt service certifications	6(11)	City has provided all 7 quarterly certifications to date.

Consensus revenue estimates	7(a)	City has held 4 consensus revenue estimating conferences, as required to date. City provided its revenue estimates to FRC for review.
FRC review and approval of budget amendments	7(c)	City has submitted 99 FY 2016 budget amendments to date. FRC has approved all of them.
FRC review and approval of requests to issue debt	7(e)	City has submitted 4 debt issuance requests to date. FRC has approved all of them.
FRC approval of Chief Financial Officer appointment	7(g)	FRC approved the appointment of the City's current Chief Financial Officer on January 26, 2015.

September 2016 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 22, 2016, the City held its consensus revenue estimating conference that considered revenue estimates/projections for FY 2016 through FY 2021. For general fund revenues for FY16, the consensus estimate reflected a decrease of only 0.3% from the February 2016 consensus estimate (i.e., a decrease from $1,048.5 million to $1,045.8 million). For FY17 through FY21, the general fund revenue projections are as follows:

City of Detroit General Fund Revenues
September 2016 Consensus Revenue Projections
$ millions

FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
$ 1,008.3	$ 1,019.3	$ 1,027.8	$ 1,038.3	$ 1,050.6

FY 2016 and FY 2017 Year-End Projected General Fund Balances

Based on budget projections as of August 15, 2016, the City estimates a general fund surplus of at least $41 million for FY16. Of this $41 million, the City has set aside $20 million for future legacy pension[1] contributions (discussed further below). The City is currently undertaking its year-end closing and will request its FY16 comprehensive annual financial report ("CAFR") due date be extended from December 31, 2016 to March 31, 2017.

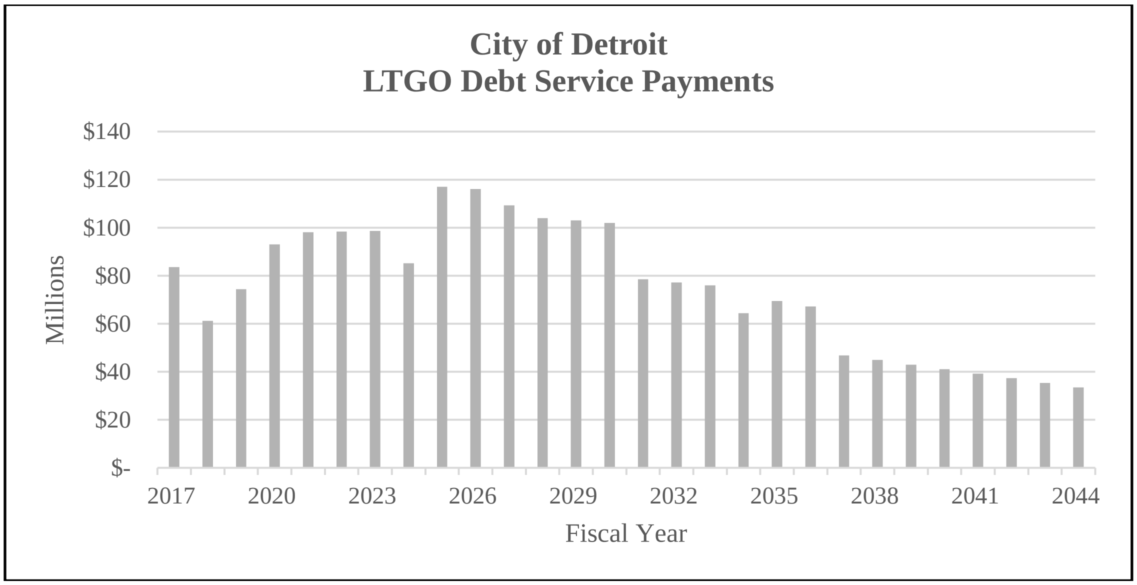
For FY17, based on budget projections as of November 16, 2016, the City estimates it will finish the fiscal year ending June 30, 2017, with a general fund surplus of approximately $30 million. The source of the general fund surplus is primarily due to underspending in personnel-related expenses due to a temporary delay in hiring and debt service relief achieved through the recent bond refunding (described below).

[1] "Legacy pension" refers to the two previous pension plans (the Police and Fire Retirement System and the General Retirement System) that were modified, frozen, and closed in the City's chapter 9 bankruptcy proceedings (also referred to as the "Component II" plans). It does not include the City's obligation under the new pension plans (also referred to as the "hybrid" or "Component I" plans).

2016 Debt Refunding

In August 2016, the City, through the Michigan Finance Authority, issued approximately $606 million in refunding municipal obligations to refund unlimited tax general obligation (UTGO) debt of approximately $260 million and limited tax general obligation (LTGO) of approximately $345 million. Overall, the refunding achieved a net present value savings of approximately $60.1 million (9.89%). The refunding of the UTGO bonds is expected to reduce the city debt millage levy by approximately 1.24 mills per year for FY18 through FY21. The LTGO refunding provided some general fund debt service relief for FY17 through FY20 while still achieving a net present value savings of $34.1 million.

The graph below shows the debt service requirements for all of the City's LTGO obligations. This graph shows that the general fund debt service payments are highest in FY25 through FY30, with annual payments in excess of $100 million.



Update to the Ten-Year Plan

The City is preparing an updated ten-year plan that will replace the ten-year plan that was developed in its chapter 9 bankruptcy proceedings. The results from this updated plan, which is going to be completed in December 2016, will be one of the important tools used in conjunction with planning for meeting its legacy pension obligations, described below. The new plan will include a bridge from the prior ten-year plan to the new plan.

Five-Year Capital Plan and Capital Strategy

The City has recently completed and submitted to City Council its five-year capital plan as required every two years under its Charter. As it prepared its five-year capital plan, the City used this opportunity to develop a new capital planning *process* to ensure effective management of City infrastructure over its life-cycle and get all of its assets to a state of good repair. Consistent with best practices, the City hopes eventually to implement a ten-year capital plan. This will further assist in the City's long-term planning of how to meet its legacy pension obligations.

Legacy Pension Obligations

As discussed in the FRC's June 1, 2016, Biannual Report No. 3, the City is facing a long-term challenge to fund its legacy pension obligations. The City's plan of adjustment ("POA") contemplated a ten year period (FY14-FY23) when the City was only required to make a relatively small amount of pension contributions from its general fund. The contemplation was that during the period through FY24, notwithstanding the State's, various foundations' and the DIA's contributions, the pension funds would be defunded. Beginning in FY24, the City is required to make substantial annual contributions from its general fund to allow the pension funds to pay the benefits due.

Originally, in the City's POA the amount to be paid by the City's general fund in FY24 was projected to be $111 million. However, based on Gabriel Roeder's (the pension systems' actuary) 2015 actuarial valuation reports, the estimated liability in FY24 and beyond is projected to be approximately $200 million. Gabriel Roeder, in arriving at its projection, used a thirty year amortization, with level principal payments and declining interest payments. One material reason for the change from the original projection in the POA was a change in mortality tables. Another reason was that the effective date of the POA, as well as the time it took to effectuate the changes, took longer than originally anticipated.[2] Furthermore, it should be noted that the estimated liability in FY24 and beyond is likely to be even higher once the FY16 actuarial valuation reports are completed because the earnings on investments for FY16 were considerably lower than the assumed rate of return of 6.75%. Adding to the uncertainty of the projections is the fact that the payment amounts to be contributed in FY24 and beyond to the pension legacy obligations depend on various factors such as rate of return, need for liquidity, and actuarial assumptions for these closed systems. The amount to be contributed by the City in FY2024 will be made by the Investment Committees of each of the pension systems.

Once it became apparent that the projected liability in FY24 would be substantially higher than that anticipated by the POA, the City announced that it would set aside $20 million from its FY16 Fund Balance (referenced above), $10 million from a FY16 budgeted contingency fund that was not utilized, and that it would include in its FY17-FY20 Four-Year Plan $10 million per year more than that required in the POA. The commitment of the City, based on the above set-

[2] A more detailed description of the change in projected pension legacy obligations can be found in the November 24, 2015, Detroit Financial Review Commission Biannual Report.

asides, total $70 million more than required by the POA. The City recognizes that this sum may be inadequate.

The City recognizes the importance of developing a pension funding strategy so that it will be able to meet its obligations to fund the pension plans. To this end, in June 2016, the City hired Cheiron, Inc. as its pension consultant. Under this engagement, Cheiron has worked with the City to develop a pension funding model that demonstrates the results of changing various factors such as the anticipated returns on investments and various contribution amounts that the City might make between now and FY23. The City is meeting with the Chairs of the two pension plans' Investment Committees both to keep them apprised of the actions the City is taking and to obtain their input and advice. The FRC is taking an active role. The City has been extremely transparent with the FRC in its actions and preparation for the methods of dealing with the anticipated very large pension liabilities. The FRC attends and participates both in all the meetings between Cheiron and the City and in the meetings of the Investment Committees. In addition, the FRC continues to meet with the City to discuss the various approaches that will lead to a long-term plan to allow the City to be successful in funding its pension obligations. The combination of the Cheiron model, the new ten-year financial plan, the new five-year capital plan, the FY16 pension valuation reports, the upcoming budget process for FY18 and the four-year plan for FY18-FY21 will form the basis for the decisions that have to be made by the City and approved by the FRC in connection with adequate funding of the pension plans.

Additional Highlights

- The citywide reassessment of residential properties is expected to be completed by December 2016 impacting property tax collections for the FY 2018 Budget. Commercial reassessments are scheduled to be completed in calendar year 2017 impacting collections for the FY 2019 Budget.

- Of the $233.2 million in available bond proceeds from the Exit Financing, $180.9 million has been approved for projects ($140 million in expenses incurred) and approximately $50 million is still reserved for projects under review.

- The City must submit its FY18-FY21 Four-Year Financial Plan to the FRC by the statutory deadline of March 23, 2017.

This report was modified from its original release to correct a typographical error. Specifically, in the table on page one, the row entitled "FRC review and approval of all applicable contracts" was corrected to show the number of contracts approved was 346.