



STATE OF MICHIGAN  
DEPARTMENT OF TREASURY

RICK SNYDER  
GOVERNOR

NICK A. KHOURI  
STATE TREASURER

**DATE:** May 30, 2017

**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. 5**

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 fifth report, following the previous report submitted on December 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.

<b>Requirement</b>	<b>Act Sec. No.</b>	<b>Compliance</b>
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 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)	The City has submitted 3 four-year financial plans to date. FRC has approved both: <ul style="list-style-type: none"> <li>• FY 2016-FY 2019 plan (approved April 20, 2015)</li> <li>• FY 2017-FY 2020 plan (approved April 18, 2016)</li> <li>• FY 2018-FY 2021 plan (approved April 17, 2017)</li> </ul>
FRC review and approval of all applicable contracts	6(6)	The City has submitted 447 applicable contracts and amendments to date. The FRC has approved 446 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 5 collective bargaining agreements and amendments to date. FRC has approved all of them.
Quarterly debt service certifications	6(11)	The City has provided all 9 quarterly certifications to date.
Consensus revenue estimates	7(a)	The City has held 5 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 175 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 4 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.

### February 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 February 16, 2017, the City held its consensus revenue estimating conference that considered revenue estimates/projections for FY 2017 through FY 2021. For general fund revenues for FY 2017, the consensus estimate reflected a decrease of only 0.1% from the September 2016 consensus estimate (i.e., a decrease from \$1,009.8 million to \$1,009.1 million). For FY 2017 through FY 2021, the general fund revenue projections are as follows:

<b>City of Detroit General Fund Revenues</b>				
February 2017 Consensus Revenue Projections				
\$ millions				
<b><u>FY 2017</u></b>	<b><u>FY 2018</u></b>	<b><u>FY 2019</u></b>	<b><u>FY 2020</u></b>	<b><u>FY 2021</u></b>
\$ 1,009.1	\$ 1,023.9	\$ 1,035.1	\$ 1,046.3	\$ 1,059.1

### FY 2017 Financial Update

Based on budget projections as of March 31, 2017, the City estimates a general fund surplus of at least \$51 million for FY 2017. The surplus is primarily being driven by unfilled vacancies within the City. A portion of the projected surplus may be utilized for recommend fleet replacements during FY 2017.

The City's cash position at the end of March 2017 was \$397 million. Cash is \$52.8 million higher than at the end of March 2016. Driving the increase in cash are primarily position vacancies and a \$20.8 million increase in income tax collections over the previous year.

### FY 2018 Budget and Four-Year Financial Plan

The City of Detroit submitted its Four-Year Financial Plan to the Financial Review Commission (FRC) as required by PA 181 of 2014, as amended, and was approved by the FRC on April 17,

2017. The FY 2018 budget and the underlying four-year plan, are different from the prior years' budgets and plans for several reasons. First, the significant restructuring of the Office of the Chief Financial Officer, the Department of Innovation and Technology, and the Public Safety departments has changed the information available to evaluate the projections; activities that were only envisioned in prior years are now a reality, making future planning easier. Second, departmental activities no longer segregate "baseline" activities, from "restricting" activities, making department budgets more straightforward and comparable year-over-year. Lastly, the FRC faces the possibility that after the City completes its FY 2016 Comprehensive Annual Financial Report (CAFR) and FY 2017 CAFR, expected later this year, the City will have successfully produced three years of budgetary surplus and met the other requirements of the FRC Act. If the City does meet the requirements of the Act the FRC shall waive its rights and duties as provided by Section 8 of the Act.

For these reasons, the FRC Staff focused on the FY 2018 Budget in detail, at a department level, monitoring all of the City Council Budget Hearings with Department Heads, reviewing the work of the Legislative Policy Division, and conducting our own due diligence with the OCFO and others, as we deemed appropriate. Provided below is a high-level summary of the City's General Fund Activity projected over the next following four years:

(\$000's) Fiscal Year	Adopted 2017	Recommend 2018	Forecast 2019	Forecast 2020	Forecast 2021
<b>Revenues</b>					
Taxes, Assessments, and Interest	\$ 604,863	\$ 627,299	\$ 637,575	\$ 648,119	\$ 658,949
Grants, Shared Taxes, and Revenues	196,619	196,965	197,357	197,752	198,137
Sales and Charges for Services	123,385	121,052	121,007	121,234	122,942
Fines, Forfeits, and Penalties	22,212	25,290	25,226	25,226	25,176
Contributions and Transfers	25,194	22,055	21,849	21,846	21,796
Miscellaneous	10,565	12,756	13,488	13,489	13,471
Licenses, Permits, and Inspection Charges	11,203	10,143	10,147	10,148	10,148
Sales of Assets/Compensation for Losses	14,442	5,553	5,695	5,695	5,695
Revenues from Use of Assets	1,345	3,299	3,299	3,299	3,299
<b>Total - Revenues</b>	<b>\$ 1,009,829</b>	<b>\$ 1,024,412</b>	<b>\$ 1,035,645</b>	<b>\$ 1,046,809</b>	<b>\$ 1,059,614</b>
<b>Expenditures</b>					
Salaries and Wages	\$ 404,490	\$ 427,998	\$ 427,991	\$ 413,034	\$ 408,980
Employee Benefits	186,901	192,132	197,302	197,302	201,224
Other Expenses	130,659	122,959	131,784	129,143	131,686
Operating Services	108,729	85,462	85,125	100,697	110,334
Fixed Charges	75,405	61,261	74,371	93,055	98,090
Professional and Contractual Services	65,981	75,756	72,476	68,661	65,798
Operating Supplies	28,310	39,055	37,513	35,835	34,420
Capital Equipment	8,851	19,417	8,712	8,710	8,710
Capital Outlays	504	372	372	372	372
<b>Total - Expenditures</b>	<b>\$ 1,009,829</b>	<b>\$ 1,024,412</b>	<b>\$ 1,035,645</b>	<b>\$ 1,046,809</b>	<b>\$ 1,059,614</b>
<b>Revenues - Prior Years Surplus</b>	<b>\$ 67,852</b>	<b>\$ 50,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Expenditures - Surplus Funded</b>					
Blight Reduction	\$ 40,000	\$ 30,000	\$ -	\$ -	\$ -
Capital Projects	27,852	10,704	-	-	-
Capital Equipment	-	9,296	-	-	-
	<b>\$ 67,852</b>	<b>\$ 50,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

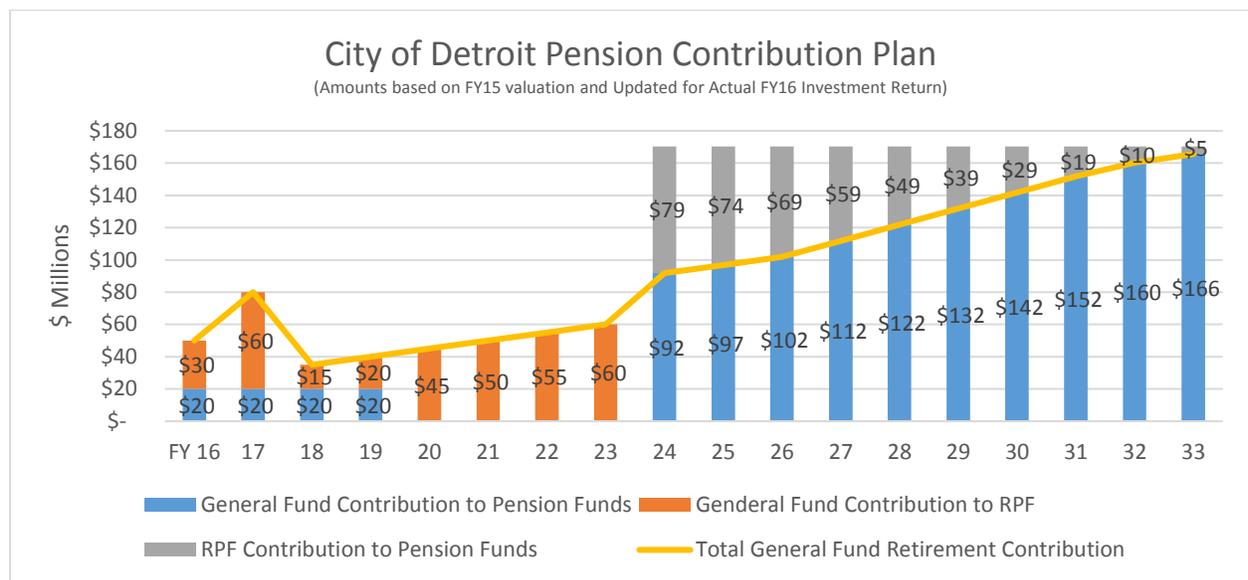
### The City’s Response to the Increased Pension Liability

As previously reported, the City is facing a funding cliff for the two pension plans that were frozen during the City’s chapter 9 proceedings. The City has determined that, in order to be able to meet its obligations in FY 2024 and thereafter, it will contribute, in excess of what it is required under the POA, the sum of \$335 million between now and FY 2023. These funds will be placed in a Section 115 trust to be known as the Retiree Protection Fund (the RPF trust). Section 115 is a provision in the Internal Revenue Code that excludes from income for tax purposes, income earned on funds set aside by a municipality for “the exercise of any essential governmental function”. The funds will be irrevocably placed in the trust.

The money put in the RPF trust does not reduce the pension liability since it is not being contributed immediately to the pension plans. The purpose of the RPF trust is to create an additional source of funds, beginning in FY 2024, from which the City will be able to fund pension obligations. In this way, the RPF trust will allow the City to systematically build a “ramp” of increasing legacy pension plan contributions that will be used to meet pension funding obligations without having to face a suddenly very high General Fund expenditure.

The RPF trust contributions and the interest earnings on the contributed funds (assumed by the City to be 4%) would be used to fund a portion of the annual pension contributions subsequent to FY 2023. Based on the City’s current plan and assumptions, the total contributions out of the RPF trust to the legacy pension plans would be \$427.7 million between FY 2024 and FY 2033.

Based on the most current information, the City’s actuarial consultant Cherion projects the annual required contribution (ARC) from the General Fund in FY 2024 and after to be \$167 million. To date, the City has already committed \$90 million in a transfer to the RPF trust before June 30, 2017. This is an encouraging commitment by the Mayor and City Council in tackling this difficult challenge. The table below shows the City’s current plan to utilize both General Fund contributions and contributions to and from the RPF trust to meet these required payments:



The City will annually update its newly created ten-year pro forma model and the Cherion model (based on the actual returns on the investment funds for the last fiscal year and any actuarial adjustments) so that each year the City and the FRC (until it dissolves as a matter of law) can review the funding levels to determine if the City is on track to meet its pension obligations in FY 2024 and thereafter.

### **Talent Management**

The FY 2018 budget assumes the City is able to employ qualified staffing for 9,439 budgeted positions. At present, more than 700 positions included in the current FY 2017 budget remain unfilled. Therefore, if the City achieves its annual FY 2018 revenue forecasts, and other expenditures do not increase, it is likely the City will generate a budget surplus in FY 2018 as a result of continuing open positions throughout the year.

The FY 2018-2021 four-year plan assumes annual Salary and Wage adjustments, inclusive of general wage increases, merit increases, the impact of employee retirements, employee attrition, and reduced overtime. Employee benefits are assumed to increase as a result of very modest increased healthcare premiums.

### **Blight Remediation**

The City's commitment to blight remediation comes in two forms: funding for the Detroit Land Bank Authority (DLBA) and funding for remediation of blighted structures. The four-year plan assumes \$44 million of dedicated funding for blight remediation in FY 2018, with \$14 million dedicated to the DLBA and \$30 million dedicated to remediation. In the following three years (FY 2019-2021), the assumed blight expenditures are limited to the \$14 million annual funding for DLBA. Consistent with previous practice, any additional blight initiatives during FY 2019-2021 will come from actual budget surpluses or external funding sources.

### **Capital Agenda**

The City's General Fund capital needs continue to outweigh resources currently available to meet that need. The capital fund needs not funded by the general fund are generally being met. The City has decided not to incur additional general fund debt at this time. It continues to focus on the improvement of its credit rating. The administration has taken a reasonable approach to funding new General Fund capital projects with prior year budgetary surpluses. We believe the City's careful and thoughtful approach to prioritizing capital projects is consistent with the City's priorities.

### **Budget Reserves**

The City's adopted FY 2017 budget estimates a City Budget Reserve of \$62 million at the conclusion of the FY 2017 budget year. This estimated Budget Reserve would equate to more than \$8 million above the City's statutory requirement. During the four-year planning period from FY 2018-2021, the City is estimated to maintain an annual City Budget Reserve surplus (above the 5% requirement) in the \$8-10 million range.

<b>City of Detroit</b>					
<b>Budget Reserve Schedule</b>					
(\$000's)	2017	2018	2019	2020	2021
Beginning Balance	\$ 62,280	\$ 62,280	\$ 62,280	\$ 62,280	\$ 62,280
Transfer In/(Out)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending Balance	\$ 62,280	\$ 62,280	\$ 62,280	\$ 62,280	\$ 62,280
Minimum Balance (5%)	\$ 53,884	\$ 53,696	\$ 51,757	\$ 52,316	\$ 52,956
<b>Budget Reserve Surplus (above 5%)</b>	<b>\$ 8,396</b>	<b>\$ 8,584</b>	<b>\$ 10,523</b>	<b>\$ 9,965</b>	<b>\$ 9,324</b>

This four-year plan reflects the fourth consecutive fiscal year of deficit free budgets since the City became subject to FRC oversight. The four-year financial plan continues to use reasonably conservative revenue and spending assumptions and factor in known programmatic priorities and operational changes that are expected. The four-year plan appropriately addresses debt obligations and other requirements contained in the Plan of Adjustment. The City has given careful thought and consideration to prioritizing capital expenditures, address blight, and fleet replacements given its limited resources and has developed a plan to address the FY 2024 funding cliff for legacy pension debt.