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STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: September 12, 2011

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: Preliminary Review of the City of Flint

I. Background

On August 29, 2011, the Department of Treasury commenced a preliminary review of the finances of the City of Flint 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, requires that a preliminary review be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the City of Flint resulted from the condition enumerated in subdivision (j), (m), (o) 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 interfund borrowing and appropriations, the lack of funding of the City's pension plans and other post-retirement benefits, -- I conclude that probable financial stress exists in the City of Flint 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 incurred deficits in many of its funds over several years. The following are fund deficits from 2007 to 2011:

[1] Subdivision (j) provides that the "local government has violated a requirement of sections 17 to 20 of the uniform budgeting and accounting act, 1968 PA 2, MCL 141.437 to 141.440." Subsection (m) provides that a "local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan". Subsection (o) provides that a "municipal government has ended a fiscal year in a deficit condition as defined in section 21 of the Glenn Steil state revenue sharing act of 1971, 1971 PA 140, MCL 141.921, or has failed to comply with the requirements of that section for filing or instituting a financial plan to correct the deficit condition." 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."

Fund	2007	2008	2009	2010	Unaudited 2011	
General		$ (7,046,820)	$ (10,113,744)	$ (14,621,546)	$ (11,149,907)	
Building Department		(1,550,369)		(576,276)	(1,251,459)	
Central Maintenance	$ (226,349)	(4,233,859)	(3,183,144)	(1,922,489)	(2,029,230)	*
Data Processing	(778,458)	(245,488)	(72,773)			
EDC	(26,772)	(10,721)	(58)	(7,404)		
EDC - Oak Business Ctr	(28,403)	(19,843)	(5,285)	(24,898)		
Garbage Collection				(909,283)	(1,444,581)	
Golf Course	(473,294)	(1,909,377)		(282,670)	(576,861)	*
Self Insurance					(33,580)	
Parks & Recreation				(163,096)	(185,255)	
Senior Citizens					(26,709)	
Water Supply				(5,795,973)	(9,009,825)	*
Total	$ (1,533,276)	$ (15,016,477)	$ (13,375,004)	$ (24,303,635)	$ (25,707,407)	

* Estimated

- Deficit Elimination Plans submitted by the City have not been followed. Starting with a deficit in 2008 of $7,046,820, the City submitted a five-year deficit elimination plan that projected a 2010 general fund deficit of 9,124,747. However, the 2010 actual deficit was $14,621,546 or $5,496,800 higher than projected and the 2011 deficit is estimated to be almost $11 million. The plan projected the deficit to be eliminated by 2014, but the updated deficit elimination plan submitted for 2010 does not eliminate the deficit until the year 2030 relying heavily on issuing additional debt of $12 million in 2013.

- The general fund has had operating losses since 2007 and fund deficits since 2008.

	6/30/2007	6/30/2008	6/30/2009	6/30/2010	Unaudited 6/30/2011
Revenues	$ 69,212,013	$ 66,823,137	$ 63,937,302	$ 57,189,454	$ 52,201,018
Expenditures	70,908,742	79,475,612	66,703,149	64,741,451	58,969,882
Net Income	(1,696,729)	(12,652,475)	(2,765,847)	(7,551,997)	(6,768,864)
Other Sources (Uses)	(866,831)	(568,589)	(478,527)	3,044,195	10,598,701
Net Change	(2,563,560)	(13,221,064)	(3,244,374)	(4,507,802)	3,829,837
Beginning Fund Balance	8,915,254	6,351,694	(6,869,370)	(10,113,744)	(14,621,546)
Ending Fund Balance	$ 6,351,694	$ (6,869,370)	$ (10,113,744)	$(14,621,546)	$(10,791,709)

It appears the City is a year behind in matching expenditures to revenues. For example, the expenditure for 2009 match the revenues for 2008 and the expenditures for 2010 match the revenues for 2009.

- The City relies on transfers from the water supply fund and the sewage disposal fund for general city operations. In 2009, the City increased its overhead charges from the water supply fund and the sewage disposal fund from $1 million to $2.4 million. Also in 2009, the City started charging a return on investments against the water supply and sewage disposal funds of $2.9 million. Combined, the City uses $5.3 million of water supply and sewage disposal money for general fund operations annually. This amount of annual appropriation is not a loan and is not expected be paid back to these funds.

The water supply fund has an unrestricted deficit, yet the City continues to transfer money from the fund. The unrestricted deficit was $5,795,973 in 2010 and is estimated to be $9,009,825 for 2011. In addition to the transfers out, both the water supply fund and the sewage disposal funds have lost money in their operations. The sewer disposal fund has lost over $61 million since 2001 and the water supply fund has lost almost $10 million since 2009. The City has recently implemented a 35% increase in water and sewer rates.

- The City has borrowed from other funds to compensate for its cash shortfalls. For example at June 30, 2010, the general fund owed other funds a total of $18,002,907 of which $11,698,376 was due to the sewage disposal fund. Another part of general fund borrowing was from the restricted local street fund in the amount of $1,059,914. Local street funds may only be spent on local streets in the City since they derive from Federal and State grants. Other uses for these funds is contrary to State statute. Another significant balance includes $1,683,733 that is due to the public improvement fund. Once money is put into the public improvement fund, it may not be used for any other purposes. Lastly, a major part of this interfund borrowing is from the self insurance fund for $2,139,590. Interfund borrowing continued to take place in 2011 as can be seen by cash shortages illustrated below.

- The City continues to experience a cash shortage. The City recently borrowed $8,000,000 in fiscal stabilization bonds, authorized under Public Act 80 of 1981, to assist with cash flow shortfalls. However, there remains many negative cash balances in the June 30, 2011 City records. For example, the general fund is over $9.5 million negative. The rubbish collection fund is almost $1.5 million negative and the drinking water revolving loan fund is over $3 million negative.

  These and other negative cash balances represent interfund borrowing that is not booked as such in the City records. As stated in the 2010 audit report, “[t]he majority of the City funds does not have their own cash accounts, but participate in a ‘pooled cash account’ where each fund’s cash resources are pooled with the cash balances of other City funds. Pooling individual fund cash resources provides flexibility in investment options and allows for consolidated and more efficient accounting.”

  The audit report continues, “[h]owever, pooling cash resources also allows individual funds to spend more money than they receive, creating a lending relationship between funds with a negative balance and those with a positive balance, making the funds financial dependent on each other.”

- The City’s ability to pay short-term obligations is uncertain. For 2010 in the general fund, the City had $9 million in short-term assets to cover almost $22 million in short-term obligations. There was not enough information to reach a meaningful conclusion in the unaudited records of the City for 2011 since total current assets equated to a negative figure.

- The City's pension is under 60% funded. Benefits are based on a factor ranging from 1.7 to 2.6 of the final average compensation. As of June 30, 2008, the last actuarial report for the 2010 audit period, there were 1,676 active members compared to 2,820 retirees. The unfunded accrued pension liability was over $39 million with a one year increase in the net pension obligation of $1,202,047.

- The City has failed to make staff reductions in accordance with its Deficit Elimination Plan. According to the 2010 audit report between 2001 and 2010, the City has reduced staffing from a total full time equivalent positions of 1525.8 to 767. Many of these reductions came from Police (336 to 122) and Fire (216 to 110). The City continues to reduce staff. However, of their planned 40 layoffs by July 2011, only 18 were made. Of the planned 25 layoffs after July, only seven were made.

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