3500 (Rev. 4-06)

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: June 21, 2012

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: Preliminary Review of the City of Allen Park

I. Background

On May 29, 2012, the Department of Treasury commenced a preliminary review of the finances of the City of Allen Park (City) 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 Allen Park resulted from the conditions enumerated in subdivisions (a), (q) 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 a decline in the City's bond rating, the inability of the City to avoid fund deficits, recurrent accumulated deficit spending, the rapid decline in taxable values, the lack of funding of the City's other post-retirement benefits, and the increasing debt of the City -- I conclude that probable financial stress exists in the City of Allen Park 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's long-term bond rating fell further below the BBB category and is considered "junk", speculative or highly speculative. Standard and Poor's, a credit-rating agency, downgraded the City's bond rating from BB+ to B and gave the City a negative outlook, which indicates it is likely that the rating will be downgraded further.

[1] Subsection (a) provides that "[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this act." Subsection (q) provides that "[a] local government has been assigned a long-term debt rating within or below the BBB category or its equivalent by 1 or more nationally recognized credit rating agencies." 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."

- The City officers have violated requirements of Section 17 of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, as amended, which states that the "the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined." For example for the year ending June 30, 2011, the police operations activity in the general fund went over budget by $196,120 and the administration activity exceeded its budget by $90,504. However, the most significant deviation from the final amended budget was in transfers out which went over budget by $1,726,349. In total, the general fund had expenditure line items that exceeded its budget by $1,819,966. The City's original budget ended with a positive fund balance of $2,514,481 for fiscal year 2011 while the final amended budget ended at $2,324,989 compared to an actual fund balance of only $505,023, an overestimation of $1,819,966. In addition, the City overestimated property tax revenues by $446,761 by not taking into account chargebacks of uncollectible delinquent taxes. District Court revenues were overestimated by $650,089. However due to the underestimation of other line items, the total general fund revenues were underestimated by $646,618.

- City officials have not filed an adequate or approved deficit elimination plan with the Department of Treasury for the fiscal year ending June 30, 2011. On December 29, 2011, City officials filed an audit report that reflected a $589,992 unrestricted cumulative deficit in the general fund and a $234,231 unrestricted deficit in the Southfield Lease Properties fund, the amount that needs to be eliminated in the City's plan. City officials had filed a plan that would reduce the deficits. The Department granted a "conditional" approval of the plan predicated on the passage of a May 8, 2012 millage proposal, public safety concessions, outsourcing, or both, as well as requiring monthly updates be provided to the Department by May 31, 2012. Subsequent to that date, the millage proposal was rejected by the City's voters. Consequently, the City is required to file a new deficit elimination plan. As of the date of this memorandum, the City was late in filing the updated plan and the monthly reports. The City's financial records were not up-to-date as of the time of this review. However, it is projected that the City will continue to have deficits in the general fund and the Southfield Lease Properties fund for 2012 and for 2013 although they should stabilize after 2013 if City officials follow through with their 2013 budget plans.

- The City's debt is significantly high primarily for business-type activities, the unfunded pension liability, and for post-employment health care. For the fiscal year ended June 30, 2011, annual debt service requirements on $59 million of business-type debt was $5,565,900 and will go up to $6,059,892 for 2012. In 2011, the unfunded pension liability was $24,000,000. The unfunded post-employment healthcare (OPEB) exceeded $120 million and continues to rise. The City does not make most of its OPEB annual required contribution of $8.2 million because it uses a pay-as-you-go method, only paying current retirees' benefits while not paying the rest of the obligation. In 2011, this liability increased by over $5 million and is projected to do the same for the fiscal year ending June 30, 2012. Also of concern is that the City has not yet obtained a required biennial actuarial report for OPEB costs. The last report completed was for the calendar year ending December 31, 2008. A new report will likely increase the annual required contributions.

- While the number of active members in the City's pension plan has decreased, from 176 in 1991 to 103 in 2011, the annual pensions increased from $1,042,595 to $6,908,395 during that same period. The funded ratio indicated in the latest actuarial evaluation shows that the City is 70.2% funded.

- In the June 30, 2010 fiscal year, City officials acquired property next to city hall for the purposes of establishing a movie studio. Revenues to pay for the debt incurred to construct the studios did not materialize. The City is left with annual debt service payments that have been difficult to make and must rely on significant transfers from the general fund. From the 2009 audit report, management of the City stated the following regarding the Southfield Lease Properties:

> "With potential reductions in state-shared revenue, increasing health care costs and reductions in property tax revenue due to the current economy, the pressure to maintain a responsible fund balance continues.
>
> During the 2009-2010 fiscal year, the Phase III, Economic Development Plan, will move into the execution stage in tandem with the launch of Phase IV, which is the Re-Investment Phase…The Reinvestment stage is segregated into two categories. The first category is the City investing in specific areas designed to result in job creation, and commercial business diversification…The Re-Investment Stage is a specific set of strategies and activities that will take 24 to 36 months to be completed.
>
> Should the Administration be successful, Phase III and Phase IV shall result in commercial growth, residential growth, and job growth which is the true solution of the economic challenges."

According to the 2010 audit report, "[i]n November 2009 the City completed the acquisition of 16630 Southfield Road. The City bonded for the purchase of this property along with work to be performed on the infrastructure and the building or moving of municipal facilities. The City's intentions on this 104 acre site are to lease the two buildings that are currently located there and to sell and/or ground lease the remaining vacant land."

In November of 2009, the City issued $31 million in general obligation bonds related to the Southfield Lease Properties for "the purpose of paying all or part of the cost of certain capital improvements together with all necessary appurtenances and attachments therefor in the City."

Before the close of the fiscal year, the property's value was devalued by over $4 million with an additional $2.3 million impairment the subsequent year.

Southfield Lease Properties	2010	2011	Projected 2012	Budget 2013
Operating Revenues	$ 1,373,863	$ 1,959,232	$ 2,285,000	$ 2,285,000
Operating Expenses	3,075,150	2,647,095	2,562,830	2,552,330
Operating Income (Loss)	(1,701,287)	(687,863)	(277,830)	(267,330)
Nonoperating Revenues (Expenses)				
Interest Expense	(1,276,465)	(2,148,519)	(2,148,515)	(2,117,866)
Impairment of Capital Assets	(4,023,914)	(2,300,000)		
Transfer from General fund		1,599,326	2,000,000	2,000,000
Other	397,655			
Total Nonoperating Rev (Exp)	(4,902,724)	(2,849,193)	(148,515)	(117,866)
Change in Net Assets	(6,604,011)	(3,537,056)	(426,345)	(385,196)
Beginning Net Assets	(333,036)	(6,937,047)	(10,474,103)	(10,900,448)
Ending Net Assets	$ (6,937,047)	$ (10,474,103)	$ (10,900,448)	$ (11,285,644)

- The general fund balance has decreased substantially since 2009 primarily because of the appropriation required to pay the debt service in the southfield lease properties fund. The non-operating revenue (expense) line item in the chart below consists primarily of these appropriations. The 2012 amount is reduced by the amount of note proceeds revenue received in that fiscal year. However, these revenues will be offset by the same amount being paid back by August which is in the subsequent fiscal year.

General Fund	2009	2010	2011	Estimated 2012
Operating Revenues	$ 22,729,638	$ 22,383,529	$ 20,084,222	$ 19,641,200
Operating Expenses	22,648,415	21,787,665	18,612,436	17,924,500
Operating Income (Loss)	81,223	595,864	1,471,786	1,716,700
Total Nonoperating Rev (Exp)	357,030	(2,424,940)	(4,681,244)	(2,500,000)
Change in Net Assets	438,253	(1,829,076)	(3,209,458)	(783,300)
Beginning Fund Balance	4,472,267	5,543,557	3,714,481	505,023
Ending Fund Balance	$ 4,910,520	$ 3,714,481	$ 505,023	$ (278,277)

Notes: 2010 Beginning fund balance restated upward in the amount of $633,036.
2011 unrestricted fund balance deficit was $589,992 and is estimated to increase in 2012.
2012 includes TAN proceeds that will be reversed in 2013 increasing the deficit significantly.

In November of 2011, the City requested two extra voted millages. The first was for police and fire and the second was for the Southfield Lease Properties debt. Voters approved the former, but rejected the latter, proposal. Again in May, the City put the request on the ballot for a two-year rate increase. It failed. On May 22, the City council then voted to eliminate its Police and Fire personnel and to outsource those operations saving approximately $3.5 million. In its proposed 2013 budget, the Council intends to use the new police and fire millage of just over $2.6 million to pay for the lower costs of outsourcing thereby freeing up funds to pay the Southfield Lease Properties debt service requirements which is also just over $2.6 million.

However, the outsourcing of police and fire personnel would happen by October 1 at the earliest. The budget also does not take into account exit and transition expenses that would be incurred if outsourcing were to happen. Other local units have not yet been contracted to perform these services since the process is still ongoing and may be considered still in the beginning stages. Consequently, the 2013 general fund budget which has decreased revenues by $4 million, but has also decreased expenditures by over $4 million (not including the new police and fire millage), is seemingly balanced. However, those numbers will not realistically happen by the end of that fiscal year because of exit and transition expenses that would be incurred if outsourcing of police and fire were to happen as was stated above.

- The City is experiencing significant cash flow shortages. The City received $2,050,000 in tax anticipation notes (TAN) in May 2012. Without it, the City would have run out of cash in the general fund. These notes will mature in October 2012 which will require the use of future tax revenues. At the end of May, the City had a cash balance in its general fund of $1.6 million because of the TANs.

  The City is withholding payments to vendors and others. At the end of May, there were five small boxes of invoices not yet entered into the City's accounting system that were being set aside for payment. The invoices totaled over $1 million with some dating back to January of 2012.

  At one point, it was the City's intention to pay off the TAN's with the proceeds from an Emergency Loan from the State. However, the City council is split on whether they will request such a loan. Without a similar inflow of cash, the City may run out of cash while substantially increasing the deficit condition in its general fund. Significant changes in the way the City spends will be required and is reflected in its budget adopted on May 22. Along with the plan to outsource its police and fire operations, the City has leased its community center and civic arena to a private company since those endeavors have lost money. However, as stated previously, the goals related to its police and fire operations will likely not be realized in such a short period of time.

- The City has delayed making payments to its pension plans. Historically, the City paid into the system on a monthly basis. However because of cash flow issues, the City stopped these payments in October 2011, but intends to make them up by the end of June. These payments are substantial and exceed $2 million annually. Years of exceptional pension benefits have increased the costs to the City. Current police and fire employees can retire at age 52 and enjoy multipliers of 2.9 with overtime used in the calculation if hired prior to 2009 and 2.5 if hired after that date with overtime not included[2].

[2] Multipliers are used in calculating retirement pay in defined benefit plans. For example, a 2.9 multiplier would be used by calculating 2.9% of the years of service times the final average compensation to calculate the yearly pension. For example, an employee working 30 years and making $50,000 per year before retiring would receive $43,500 in retirement (.029x30x50,000). Compare that to a factor of 1.5 formally used by the State of Michigan and the annual retirement would be $22,500, a $21,000 difference annually.

Other legacy costs are a growing unfunded pension and other post-employment benefits that have already been noted, but also include the current salary and benefit structure. Contracts with the police and fire unions dictate "minimum manning" requirements which reduce flexibility when it comes to those budgets. The police and fire budgets represented over 43% of the total general fund budget in 2011 (including transfers out to other funds) and hold 73% of the positions (excluding the City Council). According to a recent news article, "[i]n February, Wayne County Circuit Judge John Gillis ordered the city to hire more firefighters and to give back pay dating back to July 2011. The city has appealed that decision and is seeking a stay on the order."

- The 2011 audit indicated that there were factors that raised substantial doubt that the City could continue as a "going concern." Factors cited in that report include:

1. An impairment loss of approximately $4 million attributable to the Southfield Lease Properties fund.
2. Significant negative cash flow from the Southfield Lease Properties fund and substantial debt obligations of approximately $2 million each year.
3. The general fund balance deficit.
4. The failure of a 3.5 millage request for the Southfield Lease Properties which calls into question the ability of the City to meet its obligation payments.

- Taxable values of the City have fallen during the past several years which has reduced the amount of property taxes received. Since 2007, real and personal taxable values have fallen 24%.

Taxable Values	Year	Change
$ 1,084,114,503	2007	
1,037,125,624	2008	-4.3%
1,034,970,465	2009	-0.2%
908,807,719	2010	-12.2%
837,839,119	2011	-7.8%

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

City of Allen Park
593 Southfield Leased Properties
Debt Schedule

EXHIBIT I

	$2,725,000 General Obligation Bonds, Series 2010		**$3,000,000 General Obligation Bonds, Series 2009B**		**$25,275,000 General Obligation Tax Bonds, Series 2009A**		**Total Debt**			
	Principal	Interest	Principal	Interest	Principal	Interest	Fiscal Year	Principal	Interest	Total P&I
5/1/2010	$ -	$ -	$ -	$ 80,370.07	$ -	$ 849,283.70	2010	$ -	$ 929,653.77	$ 929,653.77
11/1/2010	-	48,509.24	-	85,601.25	-	904,562.50				
5/1/2011	-	72,162.50	-	85,601.25	-	904,562.50	2011	-	2,100,999.24	$ 2,100,999.24
11/1/2011	-	72,162.50	-	85,601.25	-	904,562.50				
5/1/2012	50,000.00	72,162.50	50,000.00	85,601.25	410,000.00	904,562.50	2012	510,000.00	2,124,652.50	$ 2,634,652.50
11/1/2012	-	71,412.50	-	84,351.25	-	890,981.25				
5/1/2013	55,000.00	71,412.50	55,000.00	84,351.25	420,000.00	890,981.25	2013	530,000.00	2,093,490.00	$ 2,623,490.00
11/1/2013	-	70,587.50	-	82,976.25	-	877,068.75				
5/1/2014	60,000.00	70,587.50	55,000.00	82,976.25	435,000.00	877,068.75	2014	550,000.00	2,061,265.00	$ 2,611,265.00
11/1/2014	-	69,612.50	-	81,601.25	-	862,659.38				
5/1/2015	65,000.00	69,612.50	60,000.00	81,601.25	450,000.00	862,659.38	2015	575,000.00	2,027,746.26	$ 2,602,746.26
11/1/2015	-	68,312.50	-	80,101.25	-	847,753.13				
5/1/2016	65,000.00	68,312.50	60,000.00	80,101.25	470,000.00	847,753.13	2016	595,000.00	1,992,333.76	$ 2,587,333.76
11/1/2016	-	67,012.50	-	78,601.25	-	832,184.38				
5/1/2017	70,000.00	67,012.50	65,000.00	78,601.25	490,000.00	832,184.38	2017	625,000.00	1,955,596.26	$ 2,580,596.26
11/1/2017	-	65,437.50	-	76,976.25	-	815,953.13				
5/1/2018	75,000.00	65,437.50	70,000.00	76,976.25	515,000.00	815,953.13	2018	660,000.00	1,916,733.76	$ 2,576,733.76
11/1/2018	-	63,656.25	-	75,226.25	-	798,893.75				
5/1/2019	80,000.00	63,656.25	70,000.00	75,226.25	540,000.00	798,893.75	2019	690,000.00	1,875,552.50	$ 2,565,552.50
11/1/2019	-	61,656.25	-	73,476.25	-	781,006.25				
5/1/2020	90,000.00	61,656.25	75,000.00	73,476.25	570,000.00	781,006.25	2020	735,000.00	840,265.00	$ 1,575,265.00
11/1/2020	-	59,181.25	-	71,320.00	-	760,343.75				
5/1/2021	95,000.00	59,181.25	80,000.00	71,320.00	600,000.00	760,343.75	2021	775,000.00	861,002.50	$ 1,636,002.50
11/1/2021	-	56,568.75	-	69,020.00	-	738,593.75				
5/1/2022	100,000.00	56,568.75	85,000.00	69,020.00	635,000.00	738,593.75	2022	820,000.00	886,177.50	$ 1,706,177.50
11/1/2022	-	53,818.75	-	66,576.25	-	715,575.00				
5/1/2023	110,000.00	53,818.75	90,000.00	66,576.25	670,000.00	715,575.00	2023	870,000.00	910,790.00	$ 1,780,790.00
11/1/2023	-	50,793.75	-	63,988.75	-	691,287.50				
5/1/2024	115,000.00	50,793.75	95,000.00	63,988.75	710,000.00	691,287.50	2024	920,000.00	939,565.00	$ 1,859,565.00
11/1/2024	-	47,631.25	-	61,257.50	-	665,550.00				
5/1/2025	125,000.00	47,631.25	95,000.00	61,257.50	755,000.00	665,550.00	2025	975,000.00	972,777.50	$ 1,947,777.50
11/1/2025	-	44,193.75	-	58,526.25	-	638,181.25				
5/1/2026	130,000.00	44,193.75	100,000.00	58,526.25	800,000.00	638,181.25	2026	1,030,000.00	1,005,440.00	$ 2,035,440.00
11/1/2026	-	40,618.75	-	55,651.25	-	609,181.25				
5/1/2027	140,000.00	40,618.75	105,000.00	55,651.25	850,000.00	609,181.25	2027	1,095,000.00	1,042,540.00	$ 2,137,540.00
11/1/2027	-	36,768.75	-	52,632.50	-	578,368.75				
5/1/2028	150,000.00	36,768.75	110,000.00	52,632.50	905,000.00	578,368.75	2028	1,165,000.00	1,083,802.50	$ 2,248,802.50
11/1/2028	-	32,643.75	-	49,470.00	-	545,562.50				
5/1/2029	160,000.00	32,643.75	120,000.00	49,470.00	960,000.00	545,562.50	2029	1,240,000.00	1,124,227.50	$ 2,364,227.50
11/1/2029	-	28,243.75	-	46,020.00	-	510,762.50				
5/1/2030	175,000.00	28,243.75	125,000.00	46,020.00	1,025,000.00	510,762.50	2030	1,325,000.00	1,173,527.50	$ 2,498,527.50
11/1/2030	-	23,431.25	-	42,332.50	-	473,606.25				
5/1/2031	185,000.00	23,431.25	130,000.00	42,332.50	1,090,000.00	473,606.25	2031	1,405,000.00	1,221,527.50	$ 2,626,527.50
11/1/2031	-	18,112.50	-	38,497.50	-	434,093.75				
5/1/2032	200,000.00	18,112.50	135,000.00	38,497.50	1,170,000.00	434,093.75	2032	1,505,000.00	1,283,220.00	$ 2,788,220.00
11/1/2032	-	12,362.50	-	34,515.00	-	391,681.25				
5/1/2033	210,000.00	12,362.50	145,000.00	34,515.00	1,250,000.00	391,681.25	2033	1,605,000.00	1,343,755.00	$ 2,948,755.00
11/1/2033	-	6,325.00	-	30,237.50	-	346,368.75				
5/1/2034	220,000.00	6,325.00	150,000.00	30,237.50	1,335,000.00	346,368.75	2034	1,705,000.00	1,408,125.00	$ 3,113,125.00
11/1/2034	-	-	-	25,812.50	-	297,975.00				
5/1/2035	-	-	160,000.00	25,812.50	1,430,000.00	297,975.00	2035	1,590,000.00	1,481,625.00	$ 3,071,625.00
11/1/2035	-	-	-	21,092.50	-	246,137.50				
5/1/2036	-	-	165,000.00	21,092.50	1,530,000.00	246,137.50	2036	1,695,000.00	1,572,185.00	$ 3,267,185.00
11/1/2036	-	-	-	16,225.00	-	190,675.00				
5/1/2037	-	-	175,000.00	16,225.00	1,640,000.00	190,675.00	2037	1,815,000.00	1,672,450.00	$ 3,487,450.00
11/1/2037	-	-	-	11,062.50	-	131,225.00				
5/1/2038	-	-	185,000.00	11,062.50	1,755,000.00	131,225.00	2038	1,940,000.00	1,777,125.00	$ 3,717,125.00
11/1/2038	-	-	-	5,605.00	-	67,606.25				
5/1/2039	-	-	190,000.00	5,605.00	1,865,000.00	67,606.25	2039	2,055,000.00	1,876,210.00	3,931,210.00
	$ 2,725,000.00	$ 2,361,759.24	$ 3,000,000.00	$ 3,329,080.07	$ 25,275,000.00	$ 35,946,083.74		$ 31,000,000.00	$ 43,554,360.55	$ 74,554,360.55