



**City of Detroit
Office of Emergency Manager
Kevyn D. Orr**

**Financial and Operating Plan
May 12, 2013**

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DISCLAIMER

THE EMERGENCY MANAGER FOR THE CITY OF DETROIT (THE "EMERGENCY MANAGER") PREPARED THIS FINANCIAL AND OPERATING PLAN (THIS "PLAN") IN ACCORDANCE WITH SECTION 11 OF PUBLIC ACT 436 OF 2013 ("PA 436"). THIS PLAN IS PRESENTED IN A FORM DEVELOPED IN CONSULTATION WITH THE STATE TREASURER AND THE EMERGENCY MANAGER'S ADVISORS AND IS BASED ON (AND LIMITED BY) THE INFORMATION AVAILABLE TO THE EMERGENCY MANAGER AS OF THE DATE OF THIS PLAN. SUBSTANTIAL ADDITIONAL DATA IS BEING GATHERED OR DEVELOPED, AND CRITICAL FINANCIAL AND OPERATIONAL ANALYSES CONTINUE. THIS ADDITIONAL INFORMATION AND ANALYSIS, AS WELL AS CHANGES IN CIRCUMSTANCES, ARE EXPECTED TO HAVE A SIGNIFICANT IMPACT ON THE EMERGENCY MANAGER'S RESTRUCTURING PLAN. THUS, THIS PLAN IS A PRELIMINARY REPORT BASED ON THE EMERGENCY MANAGER'S WORK TO DATE AND REMAINS SUBJECT TO MATERIAL CHANGE AS THIS WORK PROGRESSES.

AS CONTEMPLATED BY SECTION 11(2) OF PA 436, THIS PLAN WILL BE REGULARLY REEXAMINED BY THE EMERGENCY MANAGER AND THE STATE TREASURER AND MAY BE MODIFIED FROM TIME TO TIME BY THE EMERGENCY MANAGER ON NOTICE TO THE STATE TREASURER. WITHOUT LIMITING THE FOREGOING, IF THE EMERGENCY MANAGER MODIFIES HIS REVENUE ESTIMATES, THE PLAN WILL BE MODIFIED TO CONFORM TO THE REVISED REVENUE ESTIMATES.

THIS PLAN IS BASED ON NUMEROUS PROJECTIONS AND ASSUMPTIONS CONCERNING FUTURE UNCERTAIN EVENTS. THESE PROJECTIONS AND ASSUMPTIONS INCLUDE, AMONG OTHERS, ESTIMATES OF TAX AND OTHER REVENUES AND FUTURE BUSINESS AND ECONOMIC CONDITIONS IN THE CITY, ALL OF WHICH ARE BEYOND THE CONTROL OF THE CITY. THIS PLAN LIKEWISE IS PREMISED ON THE FAVORABLE OUTCOME OF CERTAIN RESTRUCTURING INITIATIVES AND NEGOTIATIONS, SOME OF WHICH MAY BE SUBJECT TO LEGAL CHALLENGES, THE OUTCOME OF WHICH IS UNCERTAIN. THIS PLAN ALSO REQUIRES THE CITY TO OBTAIN ACCESS TO CERTAIN PROCEEDS OF FINANCINGS AND OTHER GRANTS AND THIRD PARTY ASSISTANCE. THERE CAN BE NO ASSURANCE THAT THE PROJECTED OUTCOMES WILL OCCUR. FOR ALL OF THESE REASONS, THE EMERGENCY MANAGER'S RESTRUCTURING PLAN MAY NEED TO BE MODIFIED FROM THE TERMS PRESENTED HEREIN, AND SUCH DIFFERENCES COULD BE MATERIAL.

1. INTRODUCTION

a. Introduction

The Emergency Manager submits this Financial and Operating Plan (this "Plan") to the State Treasurer as required by section 11(2) of Public Act 436 of 2012 ("PA 436"). Consistent with section 11(1) of PA 436, the objectives of this Plan are to ensure that the City of Detroit (the "City") is able to provide or procure governmental services essential to the public health, safety and welfare of its citizens and to assure the fiscal accountability and stability of the City. In doing so, it is imperative that a stable financial foundation for the City be established in a manner that also promotes private investment in the City and revitalization of the community in a sustainable fashion.

As provided in section 11(3) of PA 436, this Plan is presented in a form developed in consultation with the State Treasurer. In preparing this report, the Emergency Manager necessarily relied on information available or developed in the initial weeks of his engagement. After his appointment approximately six weeks ago as the emergency financial manager under former Public Act 72, the Emergency Manager commenced an intensive period of outreach and study of the significant reform work performed to date. Specifically, the Emergency Manager relied substantially on: (i) the roadmap to reform embodied in the Financial Stability Agreement between the City and the State, dated April 4, 2012 (the "Consent Agreement"); (ii) the important reform initiatives begun under the leadership and stewardship of Mayor Bing's administration; and (iii) the input received from City Council, community leaders, civic leaders, business leaders, State partners, surrounding county leaders and other key stakeholders.

As a result of the significant efforts commenced by Mayor Bing and the City's partners in State government regarding comprehensive City reform over the past year, the Emergency Manager has a solid foundation from which to build a comprehensive restructuring plan for the City. Substantial additional data are being gathered and organized, and various critical financial and operational analyses remain in process as of the date of this Plan. Accordingly, this Plan is a preliminary report based on the Emergency Manager's work to date and remains subject to material change in all respects as his work progresses. See Disclaimer at p. ii. The Emergency Manager believes that finalization of a comprehensive restructuring plan will continue to be a collaborative effort among interested stakeholders. As contemplated by section 11(2) of PA 436, this Plan shall be regularly reexamined by the Emergency Manager and the State Treasurer and may be modified from time to time by the Emergency Manager after notice to the State Treasurer. Without limiting the foregoing, if the Emergency Manager modifies his revenue estimates, this Plan will be modified to conform to the revised revenue estimates.

The calculation of the City's total debt obligations as set forth herein may be marginally greater than the amounts previously addressed publicly. Notably, there is also a risk that the total debt will increase after further examination of relevant data. And, while it is expected that revenues will remain at current levels for the near term, there is the possibility that revenues may decline

due to a number of factors, including changing demographics, tax reform and assessment rationalizations. Accordingly, this current snapshot of the City's financial health might change as the Emergency manager continues to collect and analyze additional data. What is clear, however, is that continuing along the current path is an ill-advised and unacceptable course of action if the City is to be put on the path to a sustainable future.

Finally, the Emergency Manager anticipates conducting a public informational meeting with respect to this Plan as required by section 11(4) of PA 436 within the next 30 days. Prior to that time, it is likely that the Emergency Manager will discuss this Plan in various public venues to further illuminate these initial observations.

b. Summary of the current financial condition of the City

Accumulated Deficit

The City has faced strong economic headwinds during the past several decades and continues to face difficult economic conditions and deteriorating demographics, including declining population, high unemployment, significant reduction in State revenue sharing and decreases in income and property taxes.

Excluding proceeds from debt issuances, the City's expenditures have exceeded revenues from fiscal year 2008 to fiscal year 2012 by an average of \$100 million annually. These financial shortfalls have been addressed with long-term debt issuances (e.g., \$75 million in fiscal year 2008, \$250 million in fiscal year 2010 and \$137 million in fiscal year 2013) and by deferring payments of certain City obligations, such as contributions to the City's two pension funds.

The accumulated unrestricted deficit was \$326.6 million at the end of fiscal year 2012. Fiscal year 2013 (year ending June 30, 2013) is currently projected to add approximately \$60 million to the accumulated unrestricted deficit balance (excluding the impact of the \$137 million debt issuance).

Cash Flows and Liquidity

The City had negative cash flows of \$115.5 million in fiscal year 2012 (year ended June 30, 2012) and borrowed a total of \$80 million from Bank of America in March 2012 (of which \$50 million was drawn by the General Fund) to avoid running out of cash. The City is projecting negative cash flows of approximately \$90 million in fiscal year 2013 and would run out of cash by year-end if not for (i) the deferral of payments for City obligations, including pension contributions, and (ii) the receipt of proceeds from the escrow account established as part of the \$137 million August 2012 bond refinancing transaction, disbursements from which are controlled by the State.

As of April 26, 2013, the City had actual cash on hand of \$64 million but had current obligations of \$226 million to other funds and entities in the form of loans, property tax distributions, and deferred pension contributions and other payments. Therefore, the City's net cash position was

actually negative \$162 million as of April 26, 2013. The City has been deferring, and will need to continue to defer, payments on its current obligations in order to avoid running out of cash

Total City Obligations and Credit Ratings

The City has obligations totaling at least \$15 billion, including General Fund debt (\$1.1 billion), enterprise fund debt (\$6.0 billion), Pension Obligation Certificates ("POCs") and related derivative instruments (\$1.8 billion), other post-employment benefit ("OPEB") obligations, including retiree medical costs (currently estimated at approximately \$5.7 billion as of June 30, 2012) and other obligations (\$0.4 billion). In addition, the City's pensions are underfunded by at least \$0.6 billion, and perhaps significantly more once appropriate actuarial assumptions and current data are considered.

For fiscal year 2013, the General Fund is expected to make payments of approximately \$230 million related to general obligation debt and POC obligations, \$31 million for pension contributions (and will defer another \$108 million in pension payments) and approximately \$200 million for healthcare benefits, of which more than two thirds relates to retiree benefits. During fiscal year 2013, in order to make current annual required contributions and repay prior year deferred pension contributions, the General Fund would have had to make aggregate pension contributions of approximately \$139 million, which together with healthcare benefit payments (approximately \$200 million), total approximately \$339 million (33% of fiscal year 2013 revenues, excluding the impact of debt issuance). Annual payments on account of these legacy liabilities are expected to increase in the future if no action is taken to mitigate them.

The City's credit ratings (S&P – B/B; Fitch – CCC/CC; and Moody's – Caa1/Caa2) have been deteriorating rapidly and are at historical lows, reflecting the distressed financial condition of the City. These low credit ratings inhibit the City's ability to borrow. The City has suffered multiple credit downgrades in recent years, resulting in credit ratings that are lower than any other major US City and below investment grade (i.e., junk status). Further, due to legal debt limits, the City has effectively exhausted its ability to borrow.

c. Key actions taken by the Emergency Manager to date

The Emergency Manager was appointed by the Local Emergency Financial Assistance Loan Board as the emergency financial manager under Public Act 72 of 1990 on March 14, 2013, and this appointment became effective as of March 25, 2013. On March 28, 2013, PA 436 replaced Public Act 72, and the Emergency Manager became the emergency manager under the new statute.

Since his appointment, the Emergency Manager, among other things, has: (i) met with interested parties, government officials and professional advisors to gather information about the City's restructuring needs and priorities; (ii) participated in interviews and press conferences with local, regional and national news outlets to provide information to the public and promote transparency; (iii) established the Emergency Manager's office and hired limited support staff;

(iv) issued certain critical orders related to the operation of the City under the Emergency Manager's oversight; (v) initiated a comprehensive review of public services, particularly public safety and lighting; and (vi) taken initial steps to develop his comprehensive restructuring plan for the City. Certain of these activities are described in greater detail below. Although the Emergency Manager has been working in this role for barely six weeks and much remains to be done, substantial and meaningful progress has been made.

As noted in Section 1(a) above, the Emergency Manager has sought and continues to collect information about the City's current operations, cash flow, financial obligations, causes of the City's problems and ideas for the future of Detroit. Specifically, the Emergency Manager has relied substantially on, among other things, (i) the roadmap to reform embodied in the Consent Agreement; (ii) the important reform initiatives begun by Mayor Bing; and (iii) as described further below, the input received from City Council, community leaders, civic leaders, business leaders, State partners, surrounding county leaders and other key stakeholders. As a result of the significant efforts commenced by Mayor Bing and the City's partners in State government regarding comprehensive City reform over the past year, the Emergency Manager has a foundation from which to build a comprehensive restructuring plan for the City.

An important part of the Emergency Manager's initial efforts was gathering information and input from a wide variety of perspectives by meeting with numerous individuals and groups, including:

- Mayor Bing and members of his staff;
- All City Council members;
- Members of the Financial Advisory Board;
- Governor Snyder and members of his staff;
- Treasurer Dillon and members of his staff;
- Directors of various City Departments;
- Union members and leaders;
- The City's Pension Boards;
- Members of the State Legislature;
- Other Local, State and Federal elected officials;
- Leaders of numerous civic, private and charitable organizations in the region; and
- Citizens and citizen groups, including groups protesting the Emergency Manager's appointment.

These meetings have been productive and have helped the Emergency Manager develop a better understanding of issues facing the City, the views of various stakeholders and potential solutions to the City's problems that may be incorporated into a comprehensive restructuring

plan. To the extent possible and as permitted by law, the Emergency Manager anticipates building and maintaining cooperative working relationships with each of these groups, and other interested parties, as he develops and implements his plan to address the City's financial and operational needs.

The Emergency Manager also has established a regular schedule of meetings with the City's restructuring advisors. The Emergency Manager has directed these advisors to review the City's operations and financial obligations to help him develop the terms of a comprehensive plan to address the pressing public safety needs of the City and its residents, improve the quality of life for all Detroiters, provide for and encourage necessary reinvestment in the City, restructure the City's short- and long-term debt, return the City to sound financial footing and improve the effectiveness and efficiency of the City's operations. These advisors are continuing their active review, begun under the direction of Mayor Bing consistent with the Consent Agreement, of all aspects of the City's finances and operations to assist the Emergency Manager in developing, as quickly as possible, a sustainable and comprehensive restructuring plan to meet these goals.

Because the Emergency Manager position is new, the office of the Emergency Manager had to be created from scratch. The Emergency Manager recently has hired a Chief of Staff and two other staff members to help coordinate the Emergency Manager's activities and to serve as an additional interface with citizens of the City. Further, to promote transparency and openness in the restructuring process, the Emergency Manager has provided information about his goals and activities in various media interviews and public speaking engagements. The Emergency Manager also has established a page on the City of Detroit's website to provide free public access to the Emergency Manager's orders, press releases, applicable Michigan statutes and other information related to the activities of the Emergency Manager and the City's restructuring efforts.

The Emergency Manager has also kept the Mayor and the City Council informed of his initiatives. The Emergency Manager believes that the Mayor and City Council can play a role in the complex process of revitalizing the City. Consequently, at this time, the salaries and benefits of the Mayor and City Council members have been maintained. See Emergency Manager Order No. 1. The Emergency Manager also has issued an order permitting the Mayor and the City Council to continue their normal course work at this time, subject to the Emergency Manager's final review and approval of all decisions made. See Emergency Manager Order No. 3. The Emergency Manager has issued other orders designed to provide for the smooth operation of the City under his ultimate oversight. The Emergency Manager continues to review the operations of the City and expects that additional procedures will be established over time to address operational issues during his tenure.

Even as a comprehensive restructuring plan is being developed, public health and safety has remained a top priority of the Emergency Manager. Improving the quality of life of Detroiters is essential to any stabilization and revitalization of the City. Moreover, as described in this Plan, promoting reinvestment in the City to improve Detroit citizens' quality of life is an essential

touchstone of any restructuring plan. The Emergency Manager has taken several immediate steps designed to improve public health and safety in the short term. These actions include the following:

- The City commenced, and the Emergency Manager has continued, a critical review of police, fire, ambulance and other emergency medical and safety related services to develop a comprehensive plan to upgrade outdated or poorly maintained emergency vehicles, equipment and facilities. The Emergency Manager also took necessary steps to ensure that the City's new command center is operating in a timely fashion.
- The Emergency Manager has issued an order accepting the donation of new vehicles for the police, fire and emergency response teams by private sector donors.
- The City has been interviewing candidates and expects to announce the appointment of a new police chief for the City imminently.
- Building on the work already completed by Mayor Bing and others, the Emergency Manager has engaged in discussions to establish and implement a plan to fix street lights and address the City's power grid as promptly as possible. Several initiatives relating to these matters are in process.
- The Emergency Manager has initiated a comprehensive review of the City's application for and administration of grants. The goal of this review is to ensure that the maximum amount of resources are obtained from private, state and federal funding sources and that grants received reach those they are intended to benefit and are applied efficiently to address critical public health, safety and quality of life needs.

The Emergency Manager recognizes that these are just the first steps on a long road.

2. STRATEGIC CONSIDERATIONS

a. Public Safety initiatives

i. Police Department

The Detroit Police Department ("DPD") currently has approximately 2,970 employees (2,540 sworn members and 430 civilian members). DPD currently is operating under two federal consent decrees that stem from lawsuits brought by the U.S. Department of Justice in 2003. DPD has made significant progress in addressing the issues identified in these consent decrees. Nevertheless, some work remains. For example, over the last five years, DPD has had five different police chiefs, all with varying approaches to rehabilitating DPD's operations. As a result, DPD's efficiency (officers per capita, response times), effectiveness (case closure rate, crime reduction) and employee morale are extremely low.

Based on recent reviews of DPD and input from the Michigan State Police and other law enforcement agencies, it is clear that improvements in DPD's operations and performance

could be achieved through the strategic redeployment of resources, civilianization of administrative functions, other labor efficiencies and revenue enhancements. Additional investment in information technology ("IT"), infrastructure, equipment, fleet, facilities and personnel (both new recruits and experienced hires) will be required, as these key inputs have been neglected for many years. The Emergency Manager's comprehensive restructuring plan will include this crucial investment.

The Emergency Manager recently entered into an outsourcing contract with the Michigan Department of Corrections ("MDOC") to consolidate all DPD pre-arraignment jail operations into one centralized jail. The City has interviewed candidates and intends to hire a new Police Chief imminently. In addition, the Emergency Manager is retaining a third-party police expert to develop a strategic restructuring plan for DPD. The Emergency Manager anticipates implementing significant structural, operational and cost changes to DPD to improve public safety across Detroit and to improve operations and morale within DPD.

ii. Fire Department/ Emergency Medical Services

The Detroit Fire Department ("DFD") is comprised of ten divisions, including the Fire Fighting Division and Emergency Medical Services (EMS) Division. DFD currently has approximately 1,173 employees, including 812 in the Fire Fighting Division and 249 in the EMS Division. DFD maintains and operates 52 facilities throughout the City. Due to current staffing and equipment constraints, up to 12 facilities could be largely inoperational on any given day.

DFD currently is undergoing a comprehensive review of its operations, policies and procedures. In addition to reviewing day-to-day operations for more efficient utilization of personnel and other resources, station configurations and technology applications, DFD is reviewing options for shared services and contract services. Based on recent analyses, improvements in DFD could be achieved through the strategic redeployment of resources, civilianization of administrative functions, other labor efficiencies and revenue enhancements. Investments in IT infrastructure, apparatus maintenance and new recruits will be required to achieve improvements.

The Emergency Manager intends to retain a third-party expert in this field to assist in developing a strategic restructuring plan for DFD. The Emergency Manager anticipates implementing significant structural and cost changes to DFD to improve public safety across Detroit.

b. Transportation initiatives

The Detroit Department of Transportation ("DDOT") provides public transit services primarily for the citizens of Detroit. DDOT primarily provides services within City limits, but also provides transportation to and from neighboring communities. DDOT's operations also include the

Detroit Transportation Corporation, which operates the Detroit People Mover (the "DPM"), a light rail elevated train that provides public transportation in Downtown Detroit.

DDOT historically has required an annual General Fund subsidy ranging from \$75 million to \$85 million, of which approximately \$5 million to \$6 million is attributable to the DPM. As a result of restructuring activities in 2012, which included hiring a consulting firm, reducing fleet size and making service adjustments, the City was able to significantly reduce the General Fund subsidy to DDOT by approximately \$15 million with little impact on ridership.

In 2011, the City did not deliver reliable, scheduled bus service. Since that time, the City has been studying methods to reform and improve operations and service to Detroit's citizens. Certain schedule changes were made in 2012 to alleviate certain immediate service problems. As part of Phase II of the DDOT restructuring process, the City and its advisors currently are investigating additional short-term and long-term efficiencies that would improve bus services and further reduce the required General Fund subsidy for DDOT's operations.

c. Public Lighting initiatives

The Public Lighting Department ("PLD") currently owns and operates the City's electricity grid . PLD serves over 200 commercial electric customers and a majority of the City's 88,000 streetlights. PLD's primary objectives are to provide safe and reliable power to its customers and to re-establish a reliable lighting footprint encompassing Detroit's main thoroughfares and population centers. Both the streetlights and the grid are in need of significant capital investment to provide reliable lighting and electricity to Detroit's citizens and businesses. Current third-party estimates for required capital expenditures equate to approximately \$160 million for lighting improvements and between \$250 million to \$500 million for electricity (grid) improvements. To address the need for both improved service and major capital investment in the grid and streetlights, the City has developed, and is continuing to refine, a comprehensive plan to overhaul the department and its assets. A five-to-seven year plan will result in a new streetlight infrastructure and the transition of the City's electricity grid to a third party operator. Specifically, the plan calls for the City to transfer operation and maintenance of its streetlights to a newly formed public lighting authority ("PLA") with the ability to issue debt. Proceeds from the debt issuance will be used to overhaul the current street lighting infrastructure. During early 2013, major legislation was to enable execution of the City's plan. In particular, Senate Bill 970 and House Bill 5705 provided a funding mechanism for the PLA, and House Bill 5688 authorized Detroit to establish the PLA. The PLA's articles of incorporation were adopted in February 2013.

In the short-term, the City plans to address long-standing lighting outage complaints by working with a third party to replace bulbs and fix wiring related issues to address citizen concerns and improve public safety. In the long-term, the PLA's primary goal will be to reconfigure the street lighting footprint and pare down the current number of streetlights from approximately 88,000 to approximately 46,000. The new lighting footprint will cater to Detroit's current population

centers and provide reliable service and added safety where it is needed most. The projected three-year overhaul project will consist of a phased replacement of approximately 15,000 lights per year commencing in mid-fiscal year 2014 and a conversion of the electrical feed onto a third party grid. The streetlights will continue to be assets of the City with the asset overhaul and continuing operations funded by the PLA.

The Emergency Manager believes that it is in the best interest of the citizens of Detroit for the City to exit the power supply business. As of 2010, when the City ceased generating a portion of the electricity it sold, the grid has solely operated as a resale mechanism for its 200-plus customers. The current state of the City's electricity grid has been characterized as unreliable, as well as a liability to the City and its citizens. Additionally, based on the level of required maintenance coupled with labor costs, the grid continues to operate at a loss. The City estimates that a \$250 million to \$500 million capital improvements program would be required to modernize the system – funds that the City simply does not have and cannot generate. Accordingly, the Emergency Manager seeks both to limit the City's exposure to the liabilities associated with an aging grid and provide a solution to ensure reliable power to the City of Detroit. For this reason, the City's electricity customers will be transitioned to a third party, and the grid will be closed down pursuant to a phased plan.

The transition process will begin in fiscal year 2014, and continue over five to seven years, with a transfer of all customers (including the City) to third party-owned meters, resulting in the City exiting the electricity re-sale business. Electricity customers will become customers of the third party. During the transition period, PLD will slowly wind-down its operations and maintenance staff in proportion with the closing sections of the City-operated electricity grid.

d. Abandoned property, blight and land use initiatives

Blight is one of the City's most pervasive and pressing problems. It is both a public safety and a public health issue for the City. In its 139 square miles, the City includes at least 60,000 parcels of vacant land (constituting approximately 15% of all parcels in the City) and approximately 78,000 vacant structures, of which 38,000 are estimated to be in potentially dangerous condition.

This surplus land presents enormous socio-economic challenges and affects public health, crime rates, economic development and property values. All City services are less efficient, and under-resourced, because these services must be provided over a large geographic area with low population density. Indeed, blight adds to the strain on the City's public safety resources. Despite significant population decreases and the widespread abandonment of properties throughout the metro area, the City still provides services to a geographic area larger than Boston, Manhattan and San Francisco combined. Falling levels of economic activity also feed into a smaller ratepayer base to support City services, including water, sewer and electricity.

In light of the foregoing, the City has been developing strategies for addressing the surplus land, using three neighborhood categories (steady, transitional and distressed), as there are unique

challenges for each. Addressing these issues requires increased collaboration across jurisdictions, including the State of Michigan, Wayne County, the City of Detroit, Detroit Public Schools, Detroit Housing Commission and non-governmental and community-based agencies. The initiatives underway will be incorporated into the Emergency Manager's comprehensive restructuring plan. By addressing the problems presented by surplus land and blight, the Emergency Manager believes that the City can stabilize the tax base and property values; more efficiently and effectively deliver City services; improve health, safety and quality of life for Detroiters; and foster increased land utilization within the City.

The City continues to evaluate, options for the demolition of vacant structures and removal of brush on vacant land. Meaningful success will require adequate funding; policy development coordination among governmental, non-governmental and community-based agencies; and aggressive enforcement of blight and dangerous building laws and ordinances. Success also will require that the City succeed in sorting through title issues with respect to abandoned properties. Pilot programs addressing demolition of vacant structures and blight have been tested and continue to be refined to ensure fiscally sound and effective results. It is likely that regulatory and statutory reform related to, among other things, the demolition process, will be required to enhance the speed and effectiveness of remediation that the problem demands.

e. Recreation initiatives

The City's declining revenues and associated budget cuts significantly impacted the Recreation Department in terms of service delivery, facilities maintenance and capital improvements. The City recognized a \$16.2 million General Fund net tax cost for Recreation Department activities in fiscal year 2012. Funding shortages threaten the ability to deliver key recreational services on which the City's citizens have come to depend, many of which benefit the City's youth, including summer programs, day camps, pool/park operations, sports leagues and senior programs. Over the years, several recreation centers have closed and, without a significant change to the way recreational services are provided, the City may be forced to close additional recreational centers, which could affect over 200,000 users.

The current phase of the City's recreation plan focuses on the City's 17 open recreation centers with the goal of: (i) enhancing the level of service that the centers provide to Detroit citizens and (ii) reducing their dependence on City subsidies for their maintenance and operation. The current plan includes placing the centers in an independent trust (the "Trust") that will be funded by a combination of City dollars, grants and targeted fund-raising proceeds. The Trust construct will allow the City to reduce its next tax cost while turning daily operations and programming over to experienced entities capable of providing improved recreation services to the citizens of Detroit. This plan provides a path to enhance recreation offerings in the City and to ensure that the City will not have to close additional facilities.

The Trust will oversee and manage the City's recreation centers, including capital improvements, and will, in turn, be governed by an independent body consisting of a board of directors

appointed by City officials. The City will fund the Trust with a fixed contribution on an annual basis (thus defining and minimizing its long-term costs), and the Trust will be responsible for securing additional funding from external contributions to supplement fee-based programming provided by third party operators. These initiatives are expected to be incorporated into the Emergency Manager's comprehensive restructuring plan

f. Asset evaluation

The Emergency Manager currently is evaluating the City's assets to determine the most advantageous course of action to preserve or maximize the value of such assets for the long-term benefit of the City. The City will evaluate all options, including preserving the status quo, entering into partnerships with other public entities, outsourcing of operations and transferring non-core assets to other private or public entities in sale, lease or other transactions. No decisions have been made regarding any particular asset, and the Emergency Manager will continue to evaluate options for inclusion in his comprehensive restructuring plan.

g. Detroit Water and Sewerage Department

The Detroit Water and Sewerage Department ("DWSD") is one of the largest municipal water and sewerage departments in the nation and provides water and wastewater services to the City and many suburban communities in an eight-county area, covering 1,079 square miles. The water system serves approximately 4 million people, and the sewer system serves approximately 3 million people.

In 1977, the United States Environmental Protection Agency sued the City and the DWSD and alleged that the City was violating the Clean Water Act ("CWA"). The case was captioned United States of America v. City of Detroit, et al., No. 77-71100 (E.D. Mich.) (the "EPA Litigation"), and remained pending – and the DWSD operated under federal oversight – for more than 35 years (until March 27, 2013) owing to "a recurring cycle" of compliance failures with regard to the CWA and National Pollutant Discharge Elimination System ("NPDES") permits required by the Michigan Department of Environmental Quality ("MDEQ"). In July 2011, the DWSD agreed to undertake remedial measures in an Administrative Consent Order ("ACO") negotiated with the MDEQ. The ACO established a compliance program with regard to areas of persistent dysfunction (e.g., maintenance; inadequate capital expenditures and related planning; inadequate staffing; restrictive procurement policies).

Determining that the ACO, by itself, could not guarantee the DWSD's long-term compliance with CWA and NPDES standards, the United States District Court for the Eastern District of Michigan (the "District Court") ordered a "Root Cause Committee" comprised of City/DWSD officials to submit a plan addressing the "root causes" of the DWSD's noncompliance with applicable law. The Root Cause Committee drafted – and the District Court adopted – a "Plan of Action," which proposed to restructure the DWSD to address systemic dysfunction within the DWSD and achieve long-term compliance with federal and state standards. A report submitted by the Root Cause Committee in March 2013 recommended that there be an autonomous authority created

to oversee DWSD's operations that would make recurring payments to the City for the use and operation of the City's water and sewer assets.

The City's financial issues, the DWSD's internal dysfunction and an inability to raise rates for DWSD customers have resulted in significant historical under-spending on critical capital expenditures that must be addressed in the near and intermediate term. DWSD's July 2012 Capital Improvement Program totals approximately \$1.5 billion over the next five years and beyond, with approximately \$270.2 million budgeted for water and sewer projects for the current fiscal year.

By an order dated March 27, 2013, the District Court dismissed the EPA Litigation and stated that it was satisfied that the court's orders and the ACO "have been substantially implemented." Closing the case was appropriate, the court said, "because the existing [ACO] is a sufficient mechanism to address any future issues regarding compliance with the DWSD's NPDES permit and the [CWA]."

The Emergency Manager currently is evaluating the recommendations in the Root Cause Committee's report and other operational and financial issues involving DWSD. Substantial analysis is required not only of the proposed transaction recommended by the Root Cause Committee report, but of the prior orders entered by the District Court in the EPA Litigation, the current and future intersection of the DWSD and its current and former personnel with those of the City and the related treatment of legacy and other related debt obligations related thereto. Further, a plan to address the deferred capital projects must be developed. The Emergency Manager will continue to evaluate all options for DWSD for inclusion in his comprehensive restructuring plan.

3. OPERATIONAL CONSIDERATIONS

a. Department operational initiatives

The City is in the process of performing in-depth department reviews to evaluate and improve efficiency and productivity and reduce redundancy. The department review process primarily focuses on the following:

- Developing an understanding of current revenue generation activities and identifying and implementing possible revenue enhancement initiatives;
- Preparing process flow charts, including of internal controls, and developing recommendations for improved processes and controls;
- Identifying and implementing short-term and long-term cost efficiencies;
- Performing various benchmarking studies against comparable cities and working to identify best practices;

- Identifying areas of deficient services and possible alternative service delivery methods to improve those services;
- Evaluating department labor requirements given current processes;
- Inventorying and identifying current IT systems and developing a plan to improve the Enterprise Resource Planning ("ERP") and related systems and allowing the City to use technological improvements to provide better services at a lower cost;
- Establishing a more rigorous grants management and sourcing process;
- Developing a capital plan that meets the City's current and future requirements; and
- Preparing a restructuring cost plan.

Building upon this work, the Emergency Manager plans to utilize the following "guiding principles" in his plan to restructure the City's departments:

- Improve service delivery to residents and businesses;
- Stabilize and enhance revenues;
- Establish more efficient processes, taking advantage of technologies where possible ;
- Eliminate redundancies; and
- Operate comparable to benchmark cities using best practices.

b. Labor initiatives

i. Bargaining unit overview / CBA consolidation

The City is or was a party to 48 collective bargaining agreements ("CBAs") and has made great strides under the Consent Agreement, in reducing costs imposed by its numerous active and expired CBAs between the City and various labor organizations representing City employees, many of which had been amended by interest arbitration awards issued by arbitrators appointed pursuant to Public Act 312. Under the Consent Agreement, the City has unilaterally implemented City Employment Terms ("CETs"), which were approved by the Financial Advisory Board (the "FAB") appointed by the Governor, the Treasurer, the Mayor and City Council under former Public Act 4 (now repealed). Currently, a substantial percentage of the City's employees are not governed by current CBAs, and many are working under CET terms and conditions of employment and/or those terms and conditions implemented or established through statutory interest arbitrations. The prevalence of so many CETs and interest arbitration awards is symptomatic of the historically contentious relationship between the City and organized labor.

PA 436 suspends the City's statutory duty to bargain under the Public Employment Relations Act (the "PERA") (2012 Mich. Pub. Acts 436, § 8(11)). Nevertheless, the City currently is engaged in collective bargaining with several labor organizations representing

City employees. For example, the City currently is bargaining with transportation employees covered by Section 13(c) of the Federal Urban Mass Transit Act, 49 U.S.C. § 5333(B) ("UMTA"). Pursuant to Section 13(c) of the UMTA, in 1991, the City entered into certain labor agreements with transportation unions and affirmed its commitment to engage in collective bargaining with transportation unions to receive federal funding for its urban transportation system. By a letter dated April 12, 2013, the U.S. Department of Labor, Office of Labor-Management Standards ("OLMS") requested assurances from the City that PA 436 does not affect the City's ability to comply with its collective bargaining obligations under Section 13(c) of the UMTA. To alleviate any potential issues with OLMS, the City recently notified its transportation unions (representing approximately 1,000 employees) that it will continue to engage in collective bargaining as required by Section 13(c). These negotiations are likely to continue unless and until the Emergency Manager determines another course.

In this vein, although the City informed non-transportation unions representing its employees that the duty to engage in bargaining has been suspended by Public Act 436, several unions have made demands for negotiations with the City. In addition, at least five labor organizations representing uniformed employees (police and firefighters) have requested interest arbitration under Public Act 312. The City has notified the Michigan Employee Relations Commission ("MERC"), as well as the unions and arbitrators in these cases, that these Public Act 312 interest arbitration proceedings should be postponed or dismissed pursuant to PA 436. To date, neither the MERC nor the arbitrators have agreed to do so, and these interest arbitration proceedings remain pending.

As the foregoing demonstrates, the City requires a comprehensive labor strategy for managing these union relationships. The City and its advisors are developing such a strategy as a critical part of this Plan. Section 12(1)(l) of PA 436 authorizes the Emergency Manager to "[a]ct as the sole agent of the local government in collective bargaining with employees or representatives and approve any contract or agreement." Further, after complying with certain procedural requirements, section 12(1)(k) of PA 436 authorizes the Emergency Manager to "reject, modify or terminate" CBAs. Accordingly, as part of any restructuring plan, the Emergency Manager will be empowered to seek concessions from organized labor.

This power will be exercised, if necessary or desirable, with the knowledge and understanding that many City employees already have absorbed wage and benefit reductions pursuant to the now-repealed Public Act 4. Unilaterally implemented CETs imposed numerous concessions on City employees, including freezing, reducing or eliminating active employee benefits, reducing or eliminating pension and retiree medical benefits and reducing wages by 10%. The CETs also negated seniority protections in various CBAs by expanding management rights, modifying methods and processes by which work is performed, changing shifts, hours of operation and overtime procedures; and revising or eliminating job classifications. In addition to concessions imposed by the CETs,

in some cases and as noted above, concessions have been granted through statutory interest arbitration processes.

These labor cost concessions have not been uniformly applied to all bargaining units, and some City employees have not been affected by these measures. The Emergency Manager's comprehensive labor strategy will be developed with a view toward ensuring that any concessions are equitably distributed across all bargaining units (as well as across unrepresented employees) and that the impact of these concessions on employees are mitigated to the extent possible. Under section 12(1)(k) of PA 436, the Emergency Manager must "meet and confer" with unions representing affected employees prior to exercising his prerogatives, and priority in these discussions may be given to employees who have not yet been required to accept concessions. In addition, the City will evaluate whether changes to CETs or contracts may be required to facilitate operational changes called for by this Plan and whether such changes may be implemented in a way that enhances both the quality of life for City employees and their productivity.

ii. Compensation

During the last 3 years, the City has implemented compensation reductions to its work force in the form of budget-required furlough days ("BRF"), wage reductions and reductions in other wage related items, such as vacation days, sick days, longevity payments and overtime rules. The City implemented BRFs equivalent to 10% of wages (one furlough day every other week) to non-uniform employees in September 2009. In August 2012, as part of the CET implementation, BRFs were eliminated for non-uniform employees and replaced with a permanent 10% wage reduction.

The CETs also imposed a 10% wage reduction on Detroit Police Officer Association ("DPOA") members in August 2012. DPOA challenged the CETs as part of an Act 312 arbitration process; a decision in that arbitration reduces the 10% wage reduction to 5% effective January 2014.

The CETs, implemented on all unions with contracts expired on or before June 30, 2012, also included compensation reductions, as follows:

- Freezing sick leave banks and eliminating reserve sick leave accrual;
- Eliminating sick time cash payouts for future earned time;
- Eliminating the ability to reinstate furlough days;
- Eliminating the \$3-per-day allowance for daily car usage;
- Eliminating four to six annual bonus vacation days; and
- Reducing vacation accrual to 160 hours from 320 hours.

The following additional CET changes were implemented on DPOA members:

- Limiting paid time for court if less than two hours;
- Eliminating educational reimbursement;
- Requiring 80 hours to be worked in the prior work period to be eligible for overtime;
- Changing payment of holiday earnings;
- Suspending the 2% wage differential while on promotional roster;
- Eliminating the option to receive pay for court and returning to banking the first 60 hours of court time;
- Eliminating bonus vacation days; and
- Delaying separation payments.

As noted above, as part of his restructuring plan, the Emergency Manager is empowered to seek further concessions from organized labor, if necessary or desirable. The Emergency Manager will evaluate whether and what further modifications may be required in light of the significant concessions already achieved.

iii. Medical benefits reform

The City provides health benefit plans to over 28,500 active and retired employees, and their dependents. Approximately 10,000 active employees receive benefits, and approximately 18,500 retirees receive benefits. Most recipients are uniformed police or fire employees or retirees. The City maintains over 20 benefit plans and utilizes ten vendors to provide benefits. The City has contracted with ADP to provide benefit systems and support beginning in mid- fiscal year 2014. ADP's assistance will help the City improve benefits administration because the current benefit group within the City is understaffed, and benefit systems are archaic.

Absent changes, the annual net cash spend for the City to provide healthcare benefits to its employees and retirees for the next fiscal year is expected to be approximately \$263 million (of which nearly \$200 million is paid by the General Fund), broken down as follows:

	Active	Pre-Medicare Retiree	Medicare Retiree	Total
Expected FYE 2014 Cash (in millions)	\$87	\$71	\$105	\$263

The City's current OPEB obligation (e.g., for retiree medical costs) is estimated to be in excess of \$5.7 billion based on the most recent actuarial valuation performed (as of June 30, 2011). The entire OPEB obligation is unfunded.

As part of his comprehensive restructuring plan, the Emergency Manager will evaluate options to reduce or eliminate certain healthcare costs for both active and retired employees.

iv. Pension reform

The City provides two defined benefit pension plans for its employees and retirees – the Detroit General Retirement System ("DGRS") and the Police & Fire Retirement System ("PFRS"). Both plans can be characterized as "mature" based on the ratio of active employees to retirees and beneficiaries. For DGRS, active employees represented approximately 39% of total plan participants as of June 30, 2011, compared to approximately 51% of total plan participants as of June 30, 2004. As a result, annual allowances (payments to retirees and beneficiaries) have grown to approximately 70% of payroll for the year ended June 30, 2011, compared to approximately 35% of payroll for the year ended June 30, 2004. A similar situation exists with PFRS, although the ratio of active employees to retirees and beneficiaries started to decline earlier. For PFRS, active employees represented approximately 31% of total plan participants as of June 30, 2011 compared to approximately 38% of total plan participants as of June 30, 2004. Annual allowances for PFRS have grown to approximately 114% of payroll for the year ended June 30, 2011 compared to approximately 79% of payroll for the year ended June 30, 2004.

According to the June 30, 2011 valuation reports prepared by the pension funds' actuary, the actuarial funding levels for DGRS and PFRS were approximately 83% and 100%, respectively. The City is currently evaluating these reports and the reasonableness of the assumptions underlying them, as well as certain disconcerting past practices associated with both pension funds that have adversely affected funding levels. The actuarial value of assets in the funding calculations include the value of assets contributed to the plans from the issuance of POCs in 2005 of approximately \$740 million for DGRS and \$631 million for PFRS, but actuarial liabilities do not reflect the obligations to holders of the POCs. The difference between the actuarial value of assets and actuarial accrued liabilities represents the Unfunded Actuarial Accrued Liability ("UAAL"). Both plans amortize the UAAL over a thirty-year period for purposes of calculating annual employer contributions to the plans. The amortization of the UAAL does not occur evenly over the thirty-year period; rather, payments are heavily weighted toward the end of the period, which introduces significant funding risk to the plans. The employer computed contributions for any given year take into account the normal cost of the plan (i.e., the cost of new benefits accrued for the year) as well as that year's amortization of the UAAL. For the plan year ended June 30, 2011, employer computed contributions as a percentage of payroll were approximately 23% for both plans.

The actuarial value of plan assets differs from the market value of plan assets as of a measurement date based on the policy adopted by both plans to smooth differences between actual returns on assets and assumed rates of return on assets over a seven-year

period. As of June 30, 2011, the market values of plan assets were significantly lower than actuarial values of plan assets for DGRS and PFRS by approximately \$660 million and \$425 million, respectively. Unless future actual rates of return exceed assumed rates of return, the recognition of these losses will cause employer computed contributions to increase significantly, both in dollar amounts and as a percentage of payroll.

Recently, individuals associated with both plans have been indicted by federal authorities for alleged criminal activities involving the plans over the past several years. The Emergency Manager is considering his legal options in light of these events.

As required by PA 436, a task force has recently been formed to analyze the pension plans. Areas of inquiry include reviewing the reasonableness of the assumptions underlying actuarial valuation calculations and the impact of changes on required contributions as a result of changes to those assumptions; calculating the value of plan assets and liabilities under new standards required by the Governmental Accounting Standards Board ("GASB") that will be required beginning in 2014; conducting a participant audit to obtain reasonable assurances that benefits are being accrued and payments are being calculated accurately; and evaluating the governance structure of each plan to ensure best practices are utilized. As a result of this analysis and as part of his comprehensive restructuring plan, the Emergency Manager may suggest modifications to the plans to ensure the plans are structurally sound.

v. Staffing – recruiting and retention

Based on the department review work performed to date and discussed in Section 3(a) above, most City departments and functions are understaffed given current processes. It is likely that efficiency improvements will significantly reduce needed staffing levels in the long term. For example, with a well-functioning fully integrated ERP system and better financial and operational processes taking advantage of improved technologies, overall employee headcount ultimately may be lower in the future than it is today. However, to stabilize current operations and to effectuate a significant restructuring effort, additional labor resources likely will be required in the short-term.

The Emergency Manager is working on developing "best practices" to recruit talented individuals to assist with these efforts. In addition, the Emergency Manager is working to identify and implement initiatives to retain the City's current high-performing individuals. This effort will involve the re-implementation of a City-wide employee evaluation system and re-evaluation of the City's compensation structure.

vi. Workers compensation liability strategy

The City incurs significant workers compensation claims. The City has paid approximately \$15 million in workers compensation claims annually in each of the last two fiscal years. The Emergency Manager is working to identify how to reduce the number and amount of

workers compensation claims through implementing proactive safety and training programs and mitigation strategies once a claim has been reported and/or occurred.

4. PRELIMINARY VIEWS ON RESTRUCTURING PLAN

a. Introduction

i. Focus on public safety and reinvestment in the City

It is anticipated that the restructuring of the City will focus on three primary areas essential for the City's successful rehabilitation: (a) improving public safety and promoting reinvestment in the City; (b) evaluating and restructuring the City's long term liabilities; and (c) evaluating and streamlining the City's operations.

Enhancing public safety is the Emergency Manger's paramount concern. Current levels of municipal services of all types to residents and businesses within City limits, including public safety services, are inadequate. With high crime rates and poor public services in many areas, the health, safety and quality of life of Detroiters has suffered materially. Tax revenues have decreased over time as the population of the City has dwindled to less than half of its postwar peak and the local economy has suffered, with unemployment tripling since 2000. To conserve its limited (and diminishing) resources, the City has engaged in cost cutting measures, many of which are discussed above, and has deferred capital investments (including, but not limited to, lighting maintenance and upgrades in critical equipment for the City's safety forces) over an extended period of time. Looking forward, one key to the success of Detroit's restructuring will be to reverse these trends and secure sufficient funding streams to secure reinvestment in the City and directly improve the lives of Detroiters, as well as attract new residents and businesses. As discussed above, some of these initiatives have been started.

City cost-cutting has resulted in substantially decreased funding for key departments and the deferral of critical investments that directly impact public health and safety. The City now faces a host of problems due to this lack of investment: an aging fleet of vehicles and public safety equipment, failing infrastructure (such as roads, bridges, parks, the lighting grid and streetlights), outdated computer and reporting systems and substantial blight, among other problems. Similarly, key City services – including those critical to public health and safety – operate at a less than optimal level. Response times for police, fire and other emergency services are too long, and the City has struggled to provide basic services to the entire 139-square-mile metro area.

This Plan provides that an immediate focus of the City's efforts will be to improve all of these areas by redeploying resources strategically, adopting efficiencies where possible and investing to improve the quality of life in the short term and drive savings in the future. For example, as noted in Section 2 above, efforts are underway to address public lighting deficiencies by restructuring the way lighting is provided within the City and developing a

plan to perform basic but overdue maintenance (such as replacing light bulbs and repairing light fixtures) in the current population centers. Investment in police, fire and emergency infrastructure is also a priority – both in the areas of new equipment on the streets and with respect to systems and infrastructure to support the work of public safety officers. Public transportation is being evaluated to focus on key transportation corridors, improve services and begin upgrading systems and equipment. The Emergency Manager will also evaluate the potential for regional solutions to certain of these issues.

This Plan calls for the intensification of the recent effort to address blight through a coordinated program of foreclosures, demolition, public/private partnerships and targeted investments to revitalize certain borderline or faltering neighborhoods. To achieve success, this effort will require greater cooperation and coordination of several state, county and local agencies and, ultimately, may require modifications to the regulatory framework to expedite the City's ability to address and resolve blight. Removing blight pays big dividends by reducing fires and emergencies and attendant costs, eliminating public nuisances and related safety risks, stabilizing neighborhoods, decreasing crime, increasing property values and improving the quality of life.

Under the Emergency Manager's leadership, the City will continue to work with the State to address these important issues. The State's statement of support for many of these initiatives is documented in the Consent Agreement. See, e.g., Consent Agreement at Annex E.

ii. Addressing the City's liabilities

To promote reinvestment and revitalization, the City must establish itself on firm financial footing. The City currently faces short- and long-term debt and other financial obligations that are not sustainable. The City has liabilities of approximately \$9.4 billion in special revenue bonds, state revolving loans, pension certificates of participation (i.e., POCs), mark-to-market swap liabilities, unlimited and limited tax general obligation bonds and various other funded City debts. Debt service payments place a significant strain on the City's budget. In addition, as described in Section 3 above, the City faces substantial unfunded OPEB obligations for retiree medical expenses, most recently estimated at \$5.7 billion, and hundreds of millions of dollars (perhaps billions based on more recent actuarial calculations with more conservative assumptions) in pension funding requirements. Recently, tens of millions of dollars of pension funding and other payments have been deferred to manage a severe liquidity crisis at the City. Even with these deferrals, the City has operated at a significant and increasing deficit. It is expected that the City will end this fiscal year with approximately \$125 million in accumulated deferred obligations and a precariously low cash position.

The strain of servicing these liabilities, particularly as revenues have decreased, has required deep across-the-board cuts to vital City departments, investments and programs.

Restructuring the City's liabilities in a fair and equitable manner across all relevant stakeholders is necessary for the City's operational and financial survival. In fact, it is overdue. Importantly, the restructuring of this debt is not simply a means to help the City service its existing obligations. The restructuring of this debt must be viewed in the larger context of returning the City to overall financial health and future sustainability. The restructuring of the City's debt and other liabilities is essential to provide the City with a strong balance sheet and the financial foundation to raise new capital, attract new public and private investors and make the necessary reinvestments in the City. Without a significant restructuring of its debt, the City will be unable to break the cycle of damaging cutbacks in essential municipal services and investments. Moreover, without a significant restructuring of its debt, the City will be unable to dedicate sufficient revenues to the critical task of reinvesting in needed improvements to public safety and quality of life for City residents and businesses. A restructuring is crucial for the City to grow.

This Plan recognizes that interest rates, amortization, outstanding principal amounts, security interests, legacy liabilities and all other aspects of short- and long-term debt must be evaluated as part of the City's comprehensive restructuring. Significant and fundamental debt relief must be obtained to allow the City's revitalization to continue and succeed.

iii. Rationalizing the City's operations

In support of the overall success of the City's revitalization, this Plan contemplates an operational restructuring to improve the efficiency, effectiveness and coordination of the City government. The City's operations have become dysfunctional and wasteful after years of budgetary restrictions, mismanagement, crippling operational practices and, in some cases, indifference or corruption. Outdated policies, work practices, procedures and systems must be improved consistent with best practices of 21st century government. A well run City will promote cost savings and better customer service and will encourage private investment and a return of residents.

Efforts to optimize the operations of the City were agreed to by Mayor Bing. For example, the Consent Agreement included a list of 21 categories of an Operational Reform Program, and other operational initiatives. See, e.g., Consent Agreement at Annex B and Annex E. As a starting point for this Plan, the Emergency Manager has assumed that the Operational Reform Program outlined in the Consent Agreement will continue to serve as a useful guide for optimizing the City's operations.

As discussed in Section 3(a) above, the City, with the help of its advisors, has been working department-by-department review to implement a comprehensive operational reform program. Certain departments may be consolidated to improve efficiency, oversight and accountability. Some operations might be conducted more efficiently through outside contractors, and opportunities to privatize certain functions will be pursued where

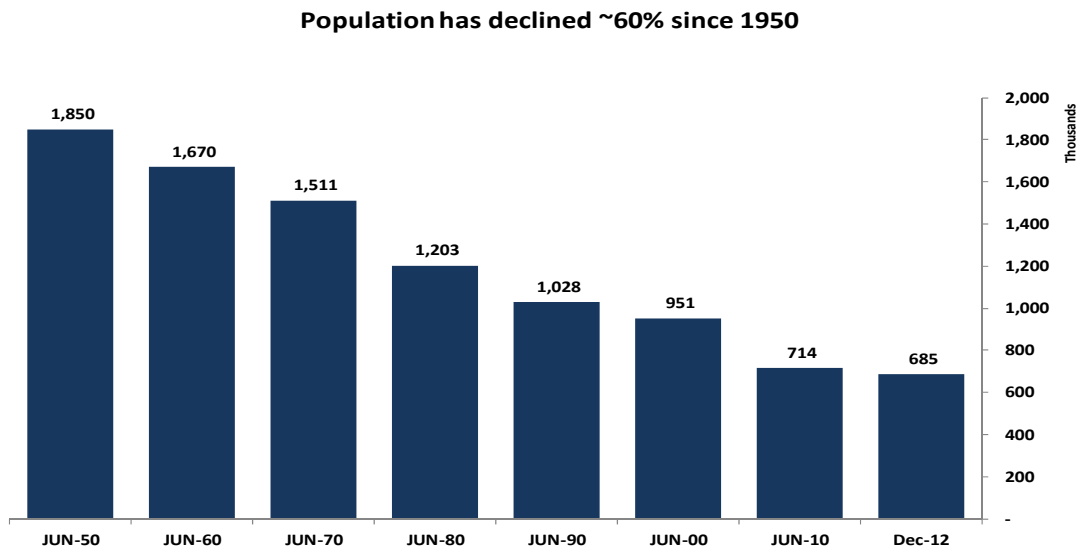
appropriate. Systems and procedures will be evaluated for improvement in key areas, such as tax collection and grants management, to enhance productivity, monitoring and results. Purchasing and contracting rules are undergoing a critical review to minimize wasteful spending. Payroll and other functions are being modernized and consolidated.

In some cases, changes to the City Charter and the City Code, or other legislative initiatives, may be needed to support needed operational enhancements and reduce unnecessary bureaucracy. Operational improvements under this Plan also require labor reform. Unproductive employment terms and other aspects of the City's CBAs and other labor agreements at times have undermined the City's efforts to operate as efficiently as possible and in accord with contemporary municipal standards. This Plan calls for labor agreements to be reviewed and, if necessary, revised, only after taking into consideration the significant modifications that have already been implemented voluntarily, via concessions, and by the CETs, to support the City's initiatives to improve operational efficiency. Some elements of this labor reform are identified on Annex D to the Consent Agreement. As contemplated by this Plan, the Emergency Manager will continue to pursue necessary or desirable changes to labor practices to improve City operations, and he will continue to consult with affected parties while doing so. Of course, these changes will be pursued after consultation with, and input from, affected stakeholders.

b. City of Detroit financial condition

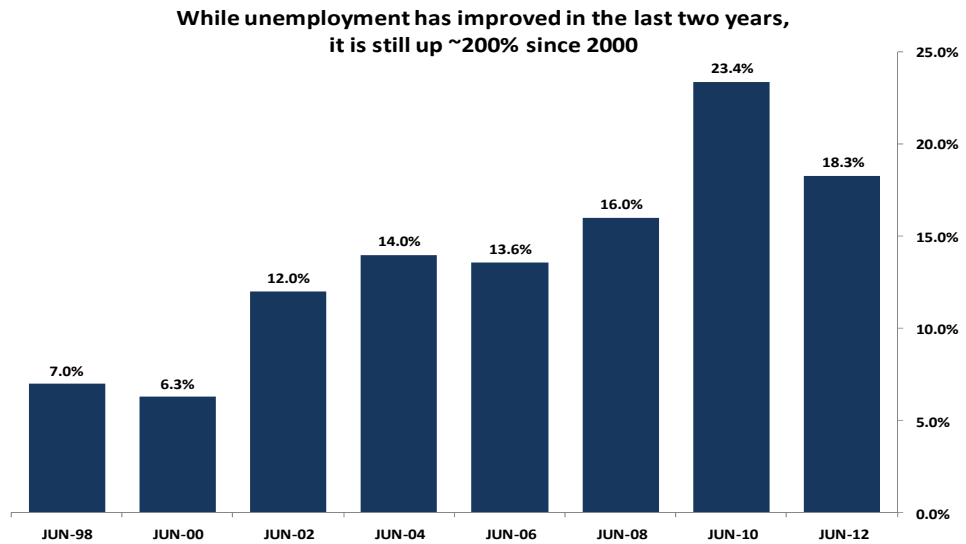
i. Historical demographic trends

Over the past several decades, the City has faced strong economic headwinds. Population has declined by approximately 60% since 1950.

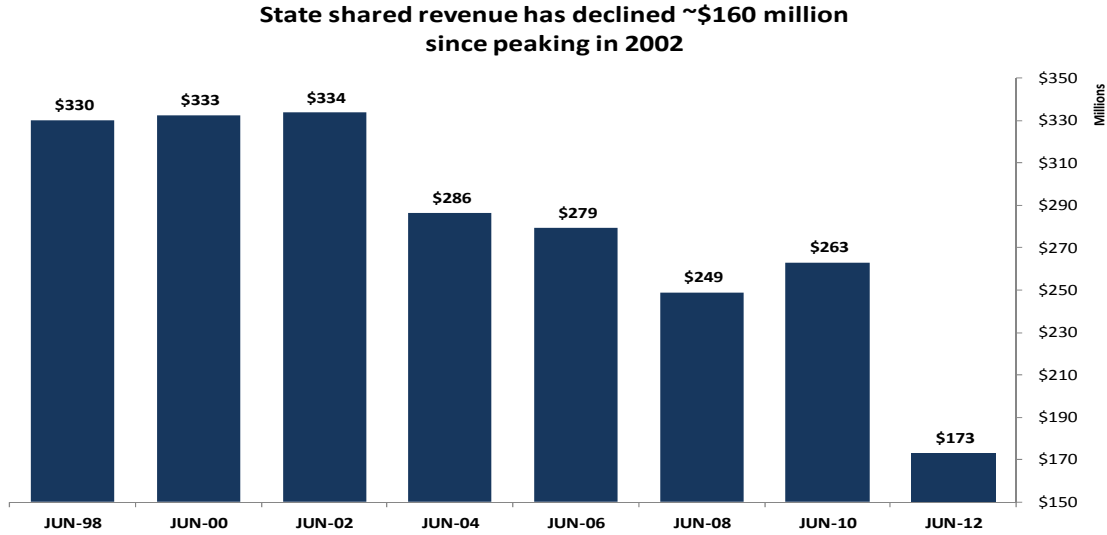


Note: December 2012 population estimate based on SEMCOG's December 2012 Report on Population and Household Estimates

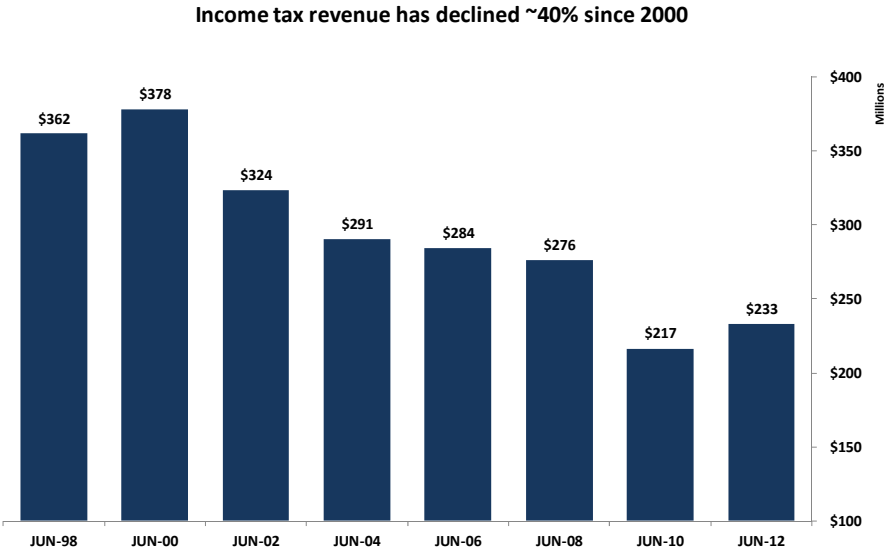
While unemployment has improved during the last two years, it has increased by approximately 200% since 2000.



State shared revenues have declined approximately \$160 million since peaking in 2002.



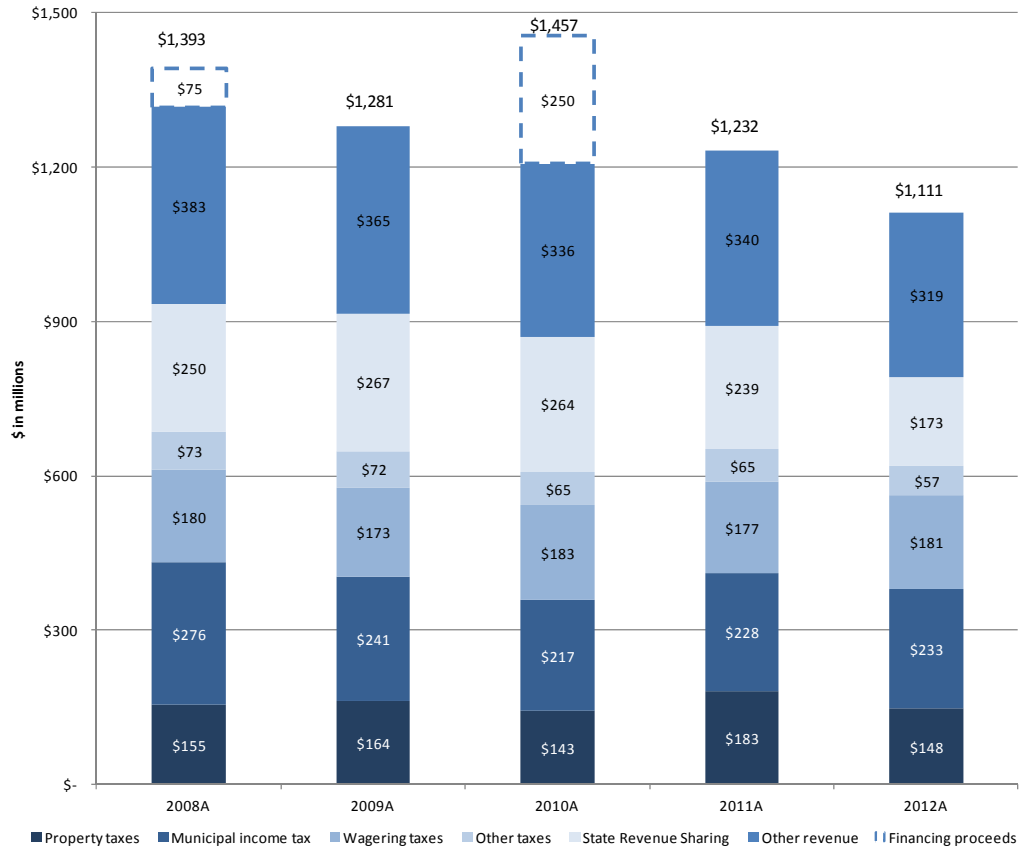
Income tax revenue has declined 40% since 2000.



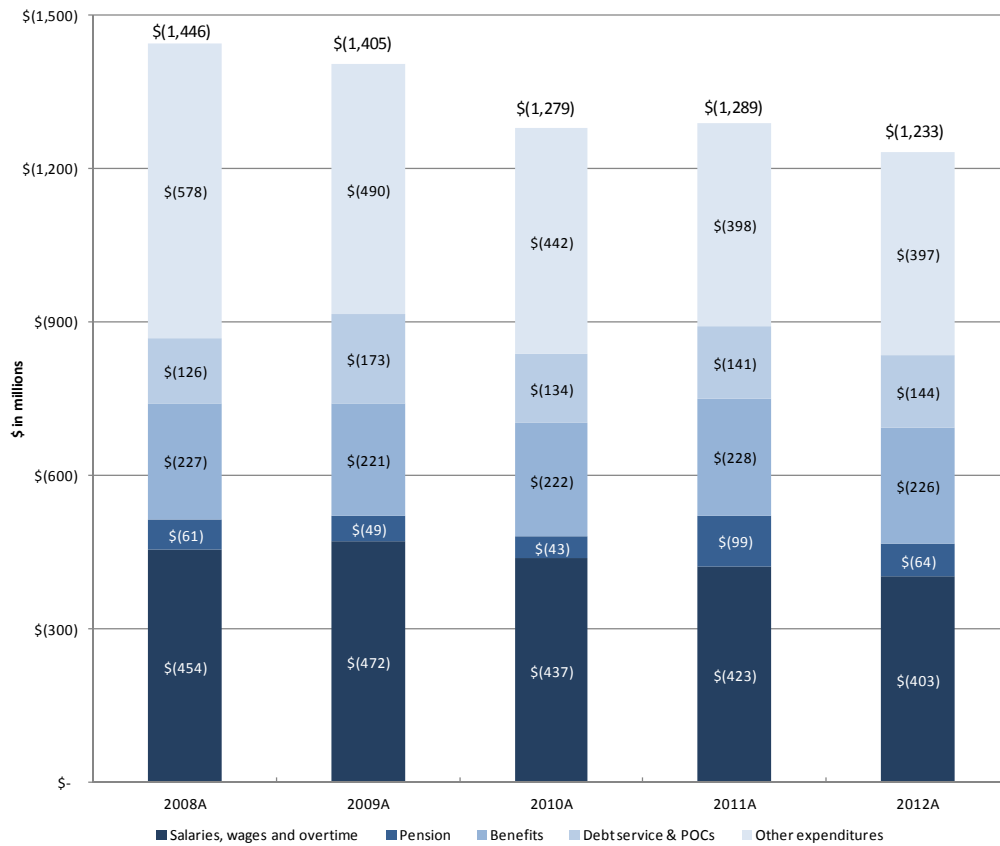
ii. Historical revenues and expenditures

The City’s revenues have been declining year-over-year. Expenses, too, have been declining, but at a rate that is not keeping pace with the decline in revenues.

Revenues

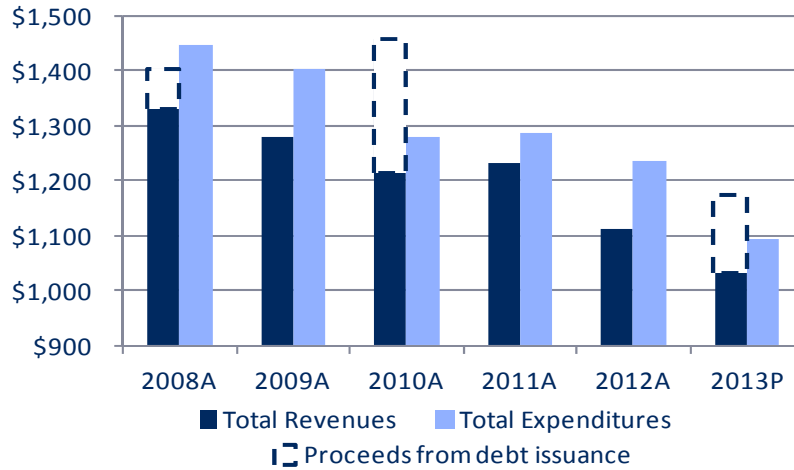


Expenses



The City of Detroit continues to incur expenditures in excess of revenues despite cost reductions and proceeds from long-term debt issuances. In other words, Detroit spends more than it takes in – it is clearly insolvent on a cash flow basis.

Revenues/Expenditures

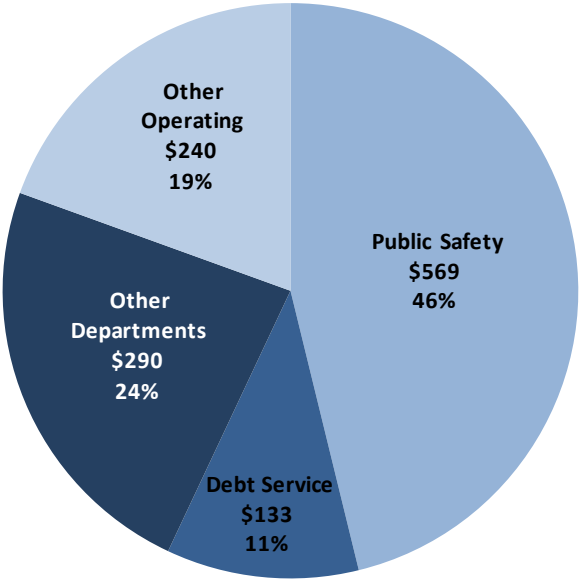


The City has attempted to address these deficits by cutting costs in most areas of spending (headcount, wages and benefits, maintenance and capital improvements, etc.) and by issuing increasing and alarming amounts of debt (e.g., Fiscal Stability Bonds). As noted above, the drastic cost-cutting actions taken over the years have severely impacted most City service departments and deferred critical investment needed by the City resulting in:

- Decreasing levels of core services to Detroiters (public safety, transportation, recreation, etc.);
- Aging fleets of vehicles and equipment and lack of investment in infrastructure;
- Highly manual processes and inefficiencies in every day functions within City government;
- Obsolescence in computer systems and related reporting systems; and
- Deferral of pension system contributions, which exacerbates the pension plans' underfunded status.

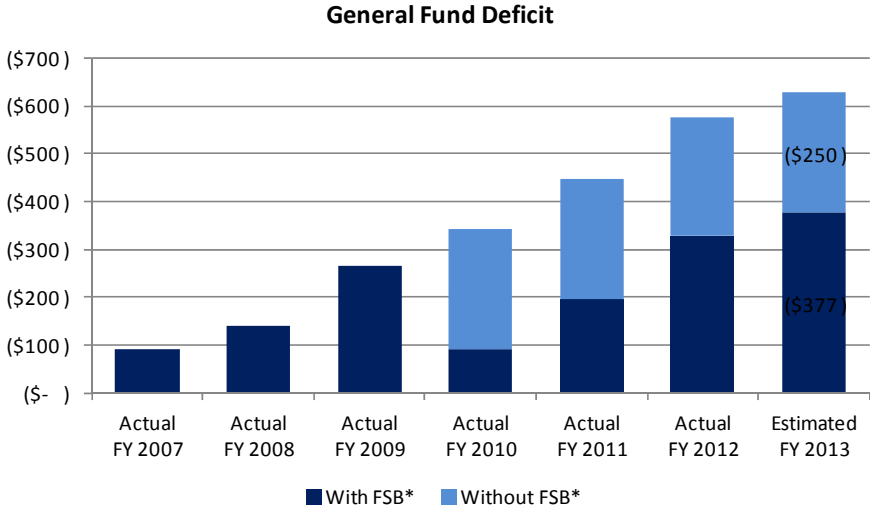
FY 2012 Actual Expenses (General Fund)

(\$ in millions)



iii. Historical deficit

The City's accumulated deficit has grown significantly during the last several years.



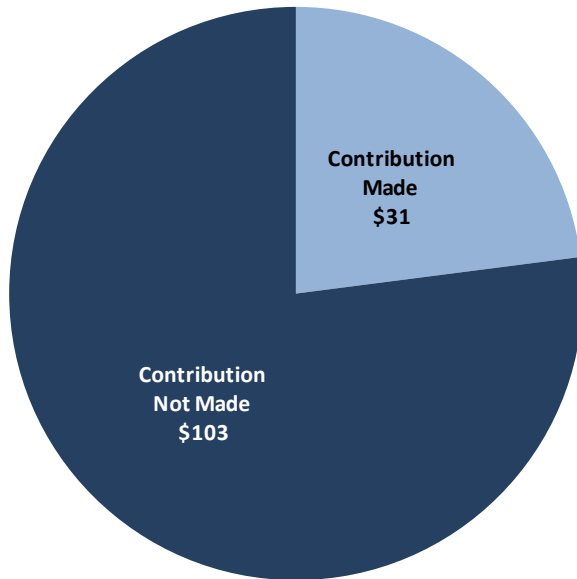
* Fiscal Stabilization Bonds ("FSB") were issued in FY 2010, which caused a one-time deficit reduction.

iv. Deferrals and amounts owed to other funds/entities

Over the past several years, the General Fund has relied on deferring necessary payments and cash pooling to manage working capital needs. As of April 26, 2013, the General Fund had outstanding deferrals and amounts due to other funds and entities of approximately \$226 million. This means that, to fund its day-to-day operations, the City's General Fund has deferred expenditures and disbursements and relied on other funds' cash since it does not generate sufficient cash flow of its own and does not have adequate cash reserves. Without these deferrals and working capital strategies, the City would have \$226 million less cash available for its operations. These tactics are effectively borrowings and are in themselves debt obligations of the City that must be repaid.

The following chart illustrates the deferrals of pension contributions for the current fiscal year.

**FY 2013 Required Contributions
(General Fund) (\$ in millions)**



c. Short-term liquidity

i. Short-term liquidity outlook

General Fund net cash flows are expected to remain negative due to the historical drop in revenues and increasing legacy liabilities absent significant structural changes. While the

City is projecting to maintain a positive cash balance through December 2013, this is only as a result of the significant amount of payment deferrals and amounts borrowed from, and owed to, other funds, which is clearly not sustainable in the long run. Structural change must occur to address the City's operating deficit and cash burn. Further, there are a number of risks to the cash forecast that could negatively impact the City's ability to achieve its forecast.

ii. Cash flow risks

Risks associated with the cash flow forecast include:

- Timing and amount of delinquent property tax collections from Wayne County;
- Timing and amount of refinancing proceeds receipts;
- The effect of pending Public Act 312 arbitration proceedings;
- Legal challenges to CETs or other cost saving initiatives;
- Timing and amount of required pension contributions and other deferred expenditures;
- Potential tightening of terms by vendors; and
- Spikes in medical claims due to increased activity.

iii. Countermeasures

As an ongoing effort to manage cash flow through FY 2013, the City organized a committee to identify and aggressively pursue revenue enhancement and cost-cutting opportunities. Short-term (one-time) opportunities include collection of past due receivables, payment deferrals, expense recoveries and draw down of escrow funds. Approximately \$50 million of short-term countermeasures have been achieved through April 2013. Long-term (permanent) opportunities include wage and benefit modifications, further headcount reductions through layoff and attrition, vendor management and fee increases. Approximately \$10 million of long-term countermeasures have been achieved through April 2013.

As set forth in some detail above, these measures are insufficient to eliminate cash deficits, and they contribute to the further deterioration of the City's ability to provide services to its citizens, residents and its business community. These one-off fixes have short-term benefits but do not address the City's structural deficit – the true gap between the City's revenue stream and its current and deferred debt obligations. This path is not sustainable. More substantial measures are required to restore the City to a vibrant, thriving, safe and fiscally sound metropolis that can attract residents and new business.

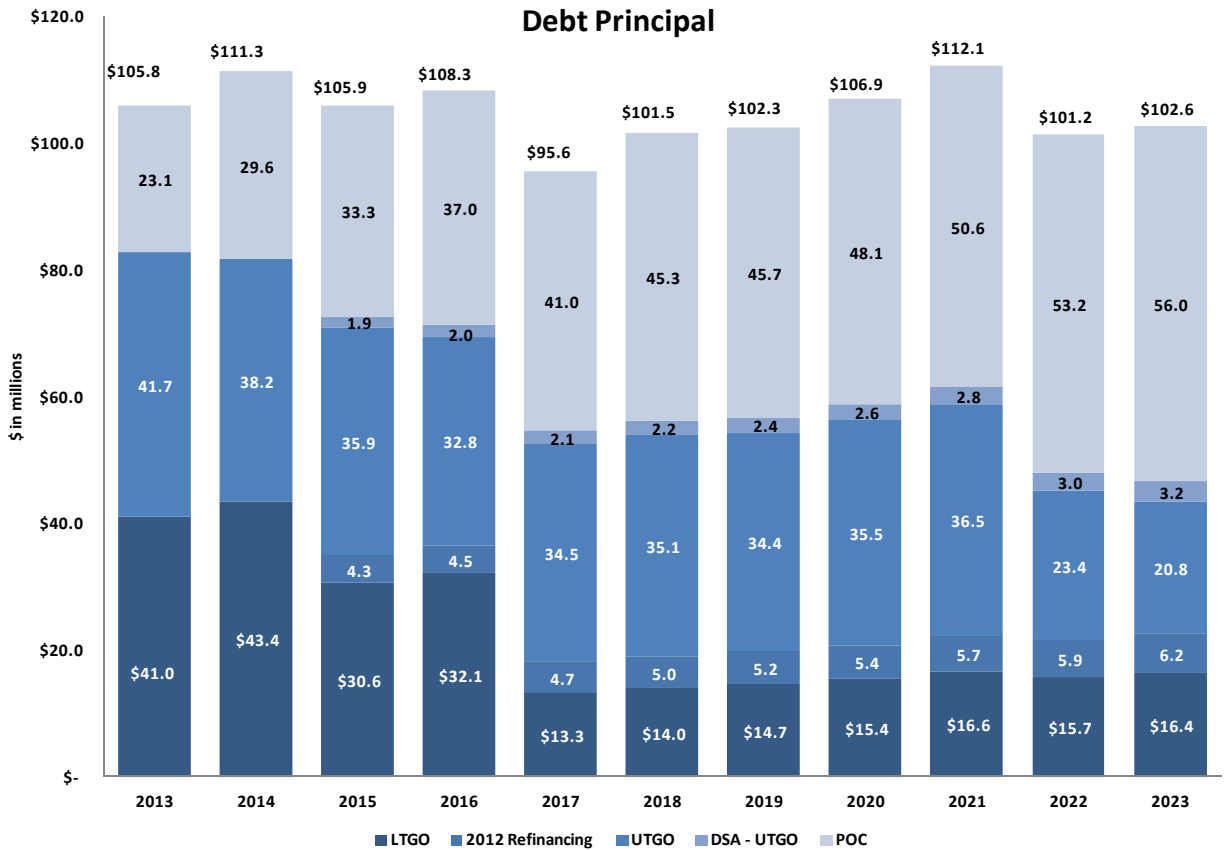
d. Long-term outlook

i. Expenditure trends

The restructuring initiatives contemplated by this Plan will necessarily have an impact on General Fund operating expenses, such as professional and contractual services, materials and supplies and purchased services, payroll and benefits. Some of those categories will increase, and some will decrease as restructuring initiatives are implemented. Without giving effect to any restructuring initiatives, debt service will decrease in FY 2017 due to the scheduled maturities of limited tax general obligation ("LTGO") bonds; however, funds will be required to retire those securities. In the near term, debt service remains at the same level. Various tranches of LTGO bonds will mature, which will be offset by increases to the principal portion of POC debt service in accordance with scheduled amortization.

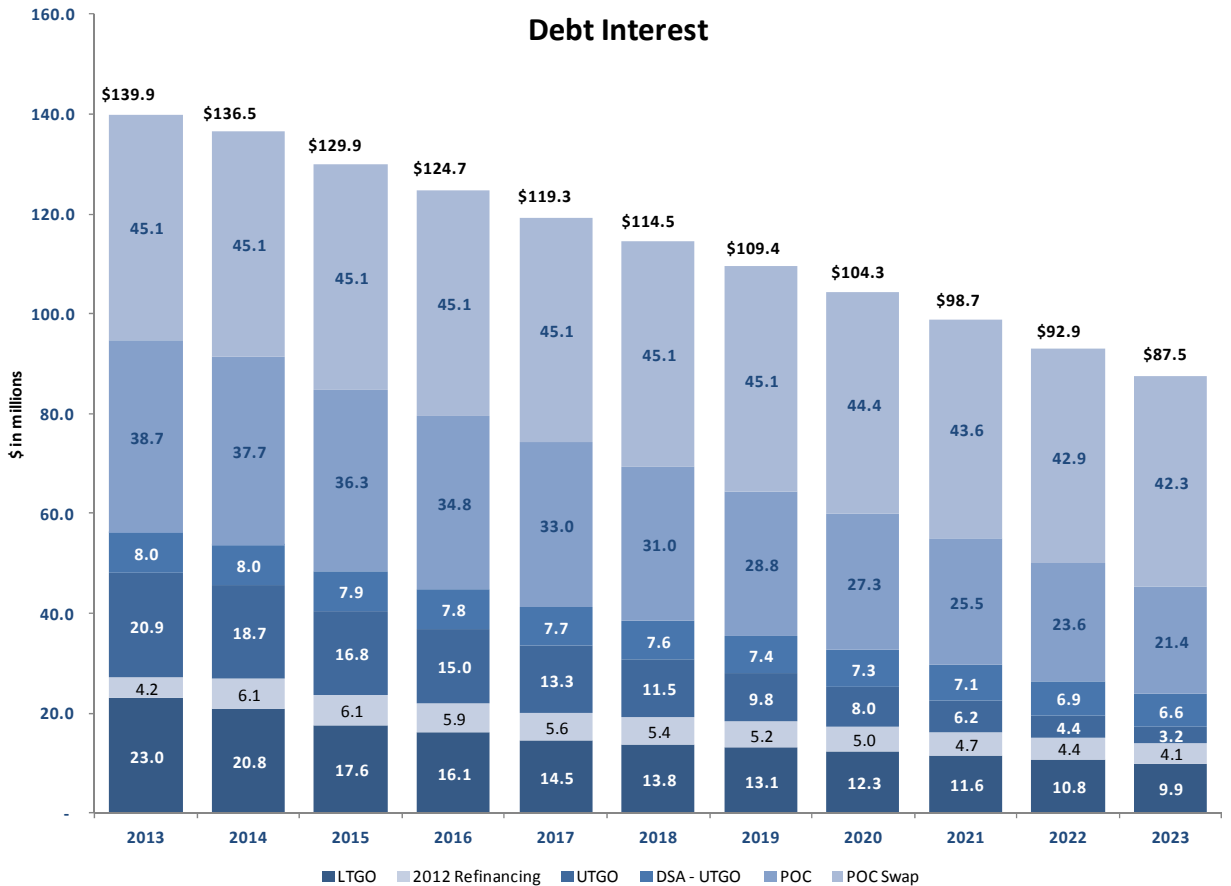
Debt Service Payments (Principal)

Scheduled principal payments on existing General Fund debt are projected to decline after 2014 and then, beginning in 2018, increase gradually through 2021. The increase is primarily due to escalating scheduled POC debt service, which will more than double from \$23.1 million in fiscal year 2013 to \$56 million in fiscal year 2023.



Debt Service Payments (Interest)

POCs (including swaps) remain the largest component of interest payments. Approximately 80% of total POC payments are covered by the General Fund.



ii. Capital expenditure requirements

As discussed above, over the past decade, the City has made minimal capital investments in facilities, fleets, equipment and IT systems. As a result, the City's infrastructure and public safety fleet are aged and decrepit, which, in turn, increases the City's operating and repair costs and decreases its productivity. The City and its advisors are reviewing all capital assets to ascertain the obviously necessary capital investment necessary to bring facilities, fleets and IT systems up to minimum utility and functional standards.

Given the current state of its aging and outdated infrastructure, the City will need to make significant investments to upgrade capital assets so that it can provide necessary services to its citizens and residents. Moreover, the City will have to budget for increased annual capital expenditures in the future to properly maintain and renew its capital assets.

iii. Total short and long-term liabilities

Liabilities by Fund⁽¹⁾⁽²⁾						
	General Fund⁽³⁾	Trans. Fund	Parking Fund	Sewage Fund	Water Fund	TOTAL
UTGO Bonds	\$511	-	-	-	-	\$511
LTGO Bonds	576	6	-	-	-	582
Revenue Bonds	-	-	10	2,884	2,556	5,451
Pension Obligation Certificates	1,452	-	-	-	-	1,452
State Revolving Loans	-	-	-	508	23	531
Notes/Loans Payable	124	-	-	-	-	124
Total Debt	\$2,662	\$6	\$10	\$3,393	\$2,579	\$8,651
POC Swaps ⁽⁴⁾	377	-	-	-	-	377
Other Liabilities ⁽⁵⁾	210	22	10	11	20	274
Total Balance Sheet Liabilities	\$3,249	\$28	\$21	\$3,404	\$2,599	\$9,301
Pension UAAL ⁽⁶⁾	403	91	N/A	73	77	644
OPEB UAAL ⁽⁷⁾	4,416	515	13	404	379	5,726
Total UAAL	\$4,820	\$605	\$13	\$477	\$455	\$6,370
Total Balance Sheet Liabilities/UAAL	\$8,069	\$634	\$34	\$3,880	\$3,055	\$15,671

1. Source: June 30, 2012 City of Detroit CAFR unless otherwise noted. Pro forma for debt issuance in August 2012 but not for any debt paydowns subsequent to June 30, 2012.
2. Excludes liabilities associated with City of Detroit Component Units (e.g., Downtown Development Authority, Detroit Public Library).
3. Includes some non-General Fund governmental activities liabilities.
4. Swaps mark-to-market per counterparty reporting as of March 28, 2013.
5. Includes accrued compensated absences, accrued worker's compensation, claims and judgments, accrued pollution remediation, advances from other funds and capital lease payables. Excludes on-balance sheet OPEB liability and current liabilities.
6. Distributions across funds represents estimated pro rata share of unfunded pension liability per CAFR. UAAL value may change significantly depending on actuarial assumptions.
7. Distributions across funds represents estimated pro rata share of unfunded OPEB liability per CAFR. Excludes \$1MM of Non-Major Proprietary fund OPEB liability. UAAL value may change significantly depending on actuarial assumptions.

General Fund Debt

The City has four primary categories of debt-related obligations that directly and significantly impact General Fund cash flows. These obligations, which currently total approximately \$2.9 billion, include:

- Unlimited Tax Obligation bonds (\$511 million outstanding);
- Limited Tax General Obligation bonds (\$576 million outstanding);

- Pension Obligation Certificates (\$1.45 billion outstanding); and
- Eight interest rate swap contracts on \$800 million of Pension Obligation Certificates (\$377 million mark-to-market obligation as of March 28, 2013).

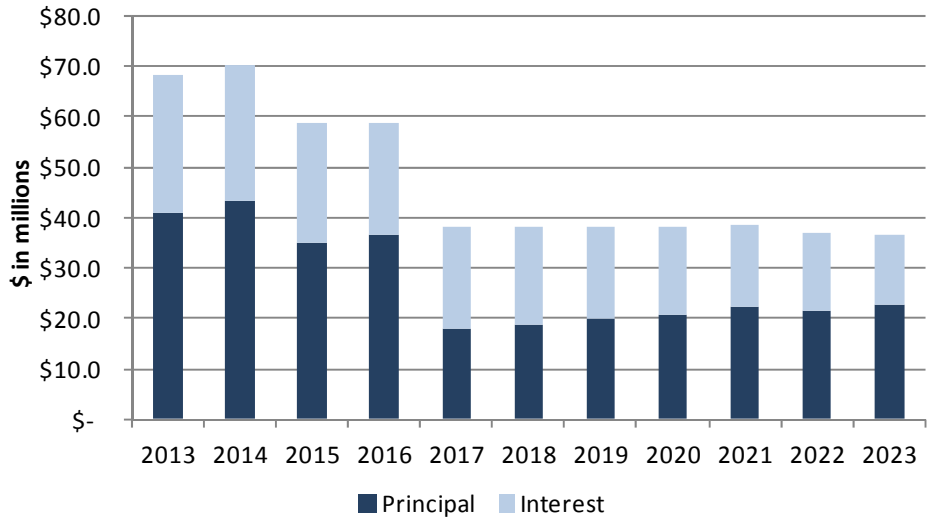
Fiscal year 2013 General Fund debt service payments of \$246 million for these obligations represent approximately 19.3% of the General Fund budget. The General Fund is partially reimbursed by enterprise funds for debt service on the Pension Obligation Certificates and associated swaps.

The City is currently evaluating options to adjust its funded debt obligations to better fit its projected cash flow profile, which may include a range of alternatives that could include, among other things:

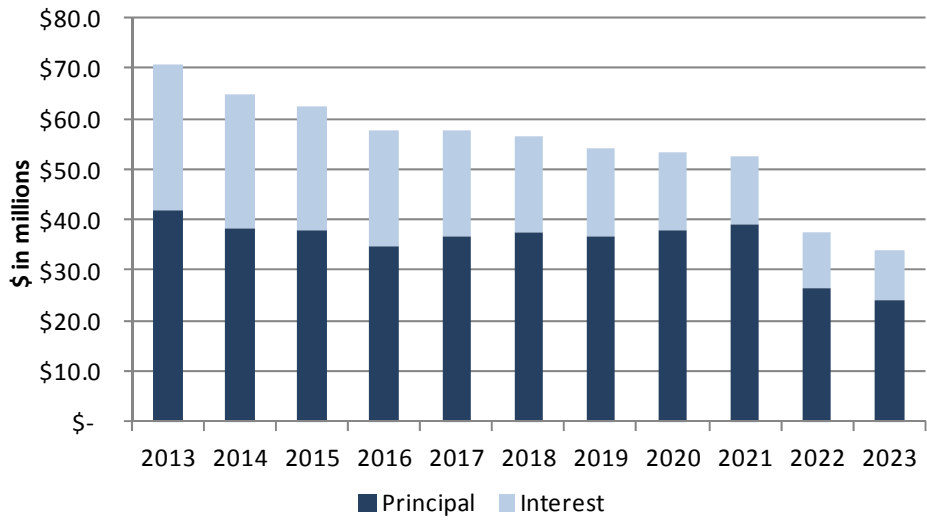
- Rescheduling principal amortization without reduction in principal to provide near-term debt service relief;
- Permanently reducing the principal amount of debt outstanding (either *pro rata* across all maturity periods or for select payment dates);
- Reducing interest rates, as appropriate, to achieve targeted cost savings or compensate for lost/extended principal; or
- Issuing new debt to provide certain cash recoveries to creditors.

Payments under the swap contracts are currently being serviced by the General Fund and are backed by City casino tax revenues pursuant to a 2009 collateral agreement. Credit rating downgrades in March 2012 triggered a termination event for the swaps, which entitled the swap counterparties to demand ratable payment of the termination amount over seven years and to divert and withhold casino revenues pending such payment. Additionally, the Governor's declaration of a financial emergency for the City on March 1, 2013, and his appointment of an emergency financial manager for the City on March 14, 2013, constituted additional swap termination events, which may lead to a demand for immediate payment of the termination payment. The City has been in discussions with swap counterparties in an effort to achieve a consensual resolution to the swap issues; these discussions will continue as part of the comprehensive restructuring process.

LTGO Debt Service (incl. 2012 Refinancing)



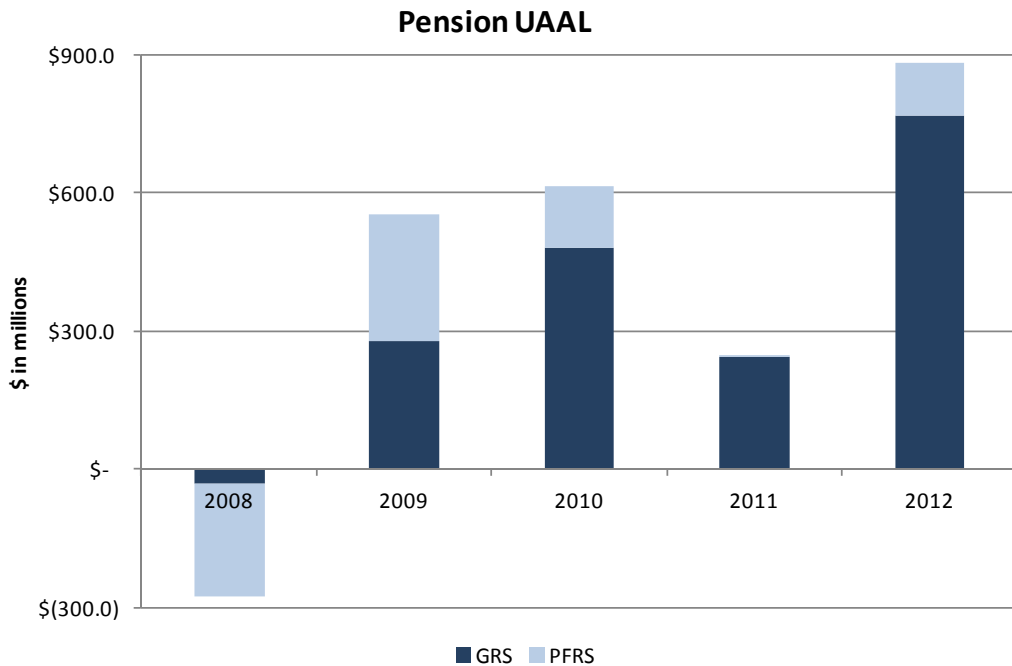
UTGO Debt Service (incl. DSA)



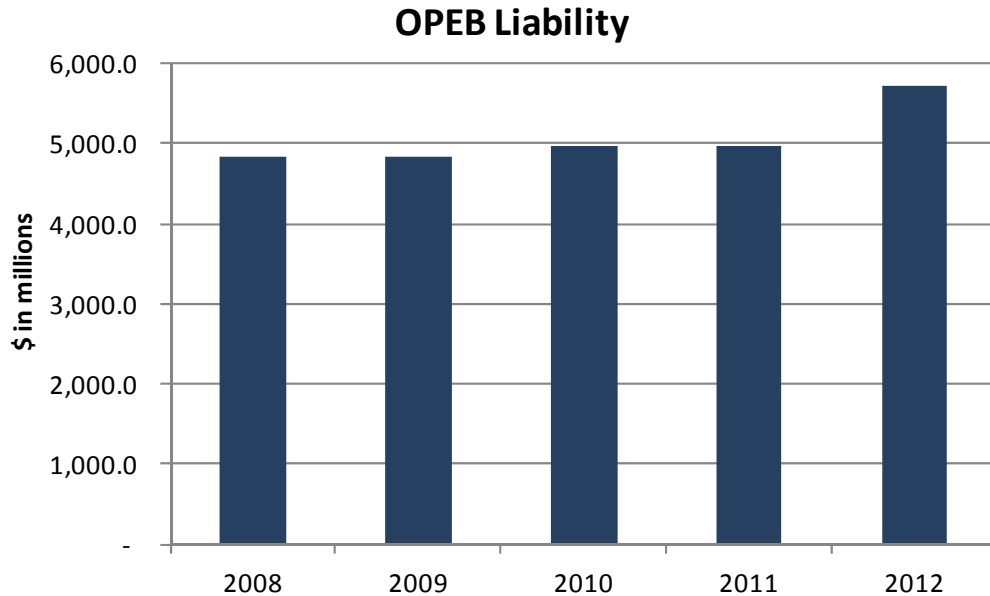
Unfunded Actuarial Accrued Liabilities (“UAAL”)

The City has significant unfunded actuarial accrued liabilities for pension and other post-employment (retiree) health benefits (i.e., OPEB). The pension and OPEB UAALs represent the estimated cumulative future expense for funding these obligations on an annual basis. For fiscal year 2013, pension expense of \$69 million and retiree health expense of \$151 million will represent approximately 5.4% and 11.9% of the General Fund budget, respectively. As of June 30, 2011, the most recent actuarial reports provided to the City by the pension funds showed the pension UAAL at \$646 million. Utilizing more current data and/or more conservative assumptions could cause that deficiency to rise into the billions of dollars. The OPEB UAAL stood at \$5.7 billion as of June 30, 2011, per the 2012 CAFR. The City is in the process of reviewing the underlying actuarial assumptions for these figures.

With the City retiree pool currently outnumbering active employees by an over-2 to 1 margin and growing, the City must address pension and retiree healthcare liabilities as part of any comprehensive restructuring. As discussed above in Section 3(b), the City and its advisors are currently evaluating ways to reduce these unfunded liabilities, which involves an evaluation of plan design and benefits offered, to identify potential cost savings.



Note: GRS UAAL includes General City, DWSD, DDOT, and Library. The reduction in PFRS UAAL in fiscal year 2011 was due to the Act 312 awards in April 2011 and September 2011.



Detroit Water and Sewerage Department Debt

DWSD has issued approximately \$5.9 billion of debt to finance its capital budget. This debt includes:

- \$2.9 billion of revenue bonds issued by the Sewerage Fund;
- \$2.6 billion of revenue bonds issued by the Water Fund; and
- \$531 million of loans from the state revolving fund, the majority of which are from Michigan’s Water Pollution Control Revolving Fund for the Detroit Sewerage Fund.

Debt service on the DWSD debt is included in the formula used to set water and sewer rates, which are paid by users of the water and sewer systems. The current credit ratings for this debt and the cost of capital currently available to DWSD may not accurately reflect the quality of DWSD’s projected revenue streams or the achievements associated with DWSD’s ongoing operational restructuring initiatives.

Other Liabilities

The City has other obligations totaling approximately \$408 million, which include:

- Notes/Loans Payable (\$124 million outstanding) are used by the City to provide funds for various public improvement projects;
- Parking Fund Bonds (\$10 million outstanding) provided financing for the construction and maintenance of various parking facilities;
- Transportation Fund LTGO Bonds (\$6 million outstanding) provided financing for the City’s public transportation needs and maintenance; and

- Other Liabilities (\$274 million outstanding) include accrued compensated absences, accrued workers' compensation, claims and judgments, accrued pollution remediation, advances from other funds and capital leases payable.

5. APPENDICES

a. Summary of Draft Fiscal Year 2013-2014 Budget

(\$ in millions)	FY 2014 Draft Budget		
	General Fund ¹ (Fund 1000)	Other ²	Total
Property taxes	\$ 113.7	\$ 83.9	\$ 197.6
Municipal income tax	239.7	-	239.7
Utility users tax	40.5	-	40.5
Wagering tax	173.0	-	173.0
Shared taxes	184.3	-	184.3
Sales and charges for service	169.4	1,070.4	1,239.9
Grant revenue	-	97.5	97.5
Other taxes/assessments/interest	12.6	62.3	75.0
Licenses/permits/inspect charges	8.8	20.1	28.9
Financing proceeds	-	-	-
Other revenues	66.4	115.7	182.1
Total revenues	\$ 1,008.5	\$ 1,449.9	\$ 2,458.4
Salary & wages	(313.5)	(195.3)	(508.8)
Medical benefits	(138.7)	(85.5)	(224.2)
Pension	(79.0)	(50.3)	(129.3)
Other benefits	(33.1)	(21.5)	(54.6)
Professional/contractual services	(50.1)	(115.8)	(165.8)
Operating services	(66.9)	(159.4)	(226.3)
Operating supplies	(60.9)	(79.3)	(140.2)
Debt service	(69.1)	(495.8)	(564.9)
POC payments	(74.8)	(37.3)	(112.1)
DDOT subsidy	(68.2)	-	(68.2)
Capital investment/major repairs	(2.1)	(44.0)	(46.1)
Other expenses	(52.3)	(165.7)	(218.0)
Total expenditures	\$ (1,008.5)	\$ (1,449.9)	\$ (2,458.4)
Surplus/(deficit)	\$ -	\$ -	\$ -

Notes

1. \$112m POC expense double count and offsetting revenue (per debt covenant requirements) not included above
2. Other includes DWSD, DDOT, Debt service fund, Parking (enterprise portion), BSEED (enterprise portion), Airport, grants

THE BUDGET PRESENTED ABOVE HAS NOT BEEN APPROVED BY THE EMERGENCY MANAGER, AND NO ASSURANCE CAN BE GIVEN THAT IT WILL BE APPROVED BY THE EMERGENCY MANAGER. ACCORDINGLY, THE BUDGET SHOULD BE REGARDED AS PRELIMINARY AND SUBJECT TO MATERIAL CHANGE.

THE BUDGET PRESENTED ABOVE WAS PREPARED AS A BALANCED BUDGET CONSISTENT WITH SECTION 16(7) OF THE UNIFORM BUDGETING AND ACCOUNTING ACT, MCL § 141.436(7) (THE "BUDGET ACT"). THE BUDGET INCLUDES BORROWING BY THE GENERAL FUND FROM OTHER CITY FUNDS AND ACCOUNTS, A CONTINUING MORATORIUM ON THE CITY'S CONTRIBUTIONS TO THE PENSION FUND AND THE CREATION OF NOTES BY THE CITY TO THE PENSION FUNDS IN LIEU

OF SUCH CONTRIBUTIONS, AND THE CONTINUED DEFERRAL OF PREVIOUSLY DEFERRED LIABILITIES. THE CONTINUATION OF THESE PRACTICES INCREASES THE OBLIGATIONS OF THE CITY IN FUTURE PERIODS. THERE CAN BE NO ASSURANCE THAT THE CITY WILL, OR WILL BE ABLE TO, CONTINUE TO BORROW FROM OTHER FUNDS OR DEFER CURRENT OR PREVIOUSLY DEFERRED LIABILITIES. IN ADDITION, THE BUDGET INCLUDES COST SAVING INITIATIVES, INCLUDING RECENT MODIFICATIONS TO CITY EMPLOYMENT TERMS. THERE CAN BE NO ASSURANCE THAT THE CITY WILL BE ABLE TO REALIZE ALL OF THE BENEFITS OF SUCH COST SAVINGS INITIATIVES.

THIS BUDGET PRESENTED ABOVE IS BASED ON NUMEROUS PROJECTIONS AND ASSUMPTIONS CONCERNING FUTURE UNCERTAIN EVENTS. THESE PROJECTIONS AND ASSUMPTIONS INCLUDE, AMONG OTHERS, ESTIMATES OF TAX REVENUES AND FUTURE BUSINESS AND ECONOMIC CONDITIONS IN THE CITY, ALL OF WHICH ARE BEYOND THE CONTROL OF THE CITY. THERE CAN BE NO ASSURANCE THAT THE PROJECTED OUTCOMES WILL OCCUR. FOR ALL OF THESE REASONS, ACTUAL RESULTS MAY DIFFER FROM THE BUDGET PRESENTED HEREIN, AND SUCH DIFFERENCES COULD BE MATERIAL.

b. Short-Term cash flow forecast

General Fund

Monthly Cash Flow Forecast

<i>\$ in millions</i>	5	4	5	4	4	5	4	4	Total
	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	
	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	
Operating Receipts									
Property taxes	\$ -	\$ 66.3	\$ 42.0	\$ 185.2	\$ 14.5	\$ 7.3	\$ 3.5	\$ 23.9	\$ 342.7
Income & utility taxes	28.2	22.3	27.4	21.6	21.2	27.0	21.6	21.2	190.4
Gaming taxes	13.7	9.6	14.9	14.4	9.1	23.5	10.5	9.6	105.2
Municipal service fee to casinos	-	-	-	7.6	-	-	4.0	4.0	15.6
State revenue sharing	30.1	-	30.6	-	30.6	-	30.6	-	121.9
Other receipts	30.3	24.6	27.5	26.1	26.2	33.3	26.6	26.2	221.0
Refinancing proceeds	20.0	-	-	-	-	-	-	-	20.0
Total operating receipts	122.3	122.7	142.4	254.9	101.6	91.1	96.8	84.9	1,016.8
Operating Disbursements									
Payroll, taxes, & deductions	(35.7)	(26.8)	(31.0)	(26.6)	(26.6)	(35.5)	(26.6)	(26.6)	(235.3)
Benefits	(16.0)	(16.0)	(16.0)	(16.0)	(16.0)	(16.0)	(16.0)	(16.0)	(128.0)
Pension contributions	-	-	(7.0)	(6.9)	(2.0)	(11.7)	(6.8)	(6.8)	(41.2)
Subsidy payments	(8.0)	(8.0)	(5.5)	(3.7)	(4.6)	(4.6)	(4.6)	(4.6)	(43.5)
Distributions (w/o DDA increment)	(20.0)	(12.2)	(16.5)	(93.8)	(44.4)	(6.3)	(1.2)	(1.5)	(195.8)
DDA increment distributions	-	(5.5)	-	-	-	-	-	(8.0)	(13.5)
Income tax refunds	(3.4)	(2.9)	(2.4)	(2.6)	(0.5)	(0.3)	(1.4)	(0.9)	(14.4)
A/P and other disbursements	(32.4)	(29.2)	(35.3)	(29.3)	(28.5)	(36.1)	(29.3)	(29.3)	(249.4)
Sub-total operating disbursements	(115.4)	(100.7)	(113.6)	(178.8)	(122.6)	(110.6)	(85.9)	(93.6)	(921.2)
POC and debt related payments	(25.8)	(36.6)	(7.4)	(4.2)	(5.8)	(8.5)	(7.3)	(15.5)	(111.0)
Total disbursements	(141.2)	(137.3)	(120.9)	(183.0)	(128.4)	(119.1)	(93.2)	(109.1)	(1,032.2)
Net cash flow	(19.0)	(14.6)	21.5	71.8	(26.8)	(27.9)	3.7	(24.2)	(15.5)
Cumulative net cash flow	(19.0)	(33.5)	(12.1)	59.7	33.0	5.0	8.7	(15.5)	
Beginning cash balance	63.7	44.7	30.1	51.6	123.4	96.6	68.7	72.4	63.7
Net cash flow	(19.0)	(14.6)	21.5	71.8	(26.8)	(27.9)	3.7	(24.2)	(15.5)
Cash before required distributions	\$ 44.7	\$ 30.1	\$ 51.6	\$ 123.4	\$ 96.6	\$ 68.7	\$ 72.4	\$ 48.2	\$ 48.2
Accumulated property tax distributions	(6.1)	(22.4)	(34.3)	(65.3)	(30.7)	(29.3)	(30.5)	(47.3)	(47.3)
Cash net of distributions	\$ 38.6	\$ 7.7	\$ 17.3	\$ 58.1	\$ 66.0	\$ 39.4	\$ 41.9	\$ 0.9	\$ 0.9
Memo:									
Accumulated deferrals	(65.8)	(124.6)	(120.2)	(115.8)	(116.0)	(107.1)	(102.7)	(98.3)	

NOTE:

General Fund cash activity and the forecasts herein are based on estimated cash activity for the General Fund main operating account. In addition to General Fund cash (Fund 1000), the main operating account also contains cash balances and cash activity of the Risk Management Fund, Construction Fund, Street Funds, Solid Waste Fund, General Grants and Motor Vehicle Fund ("Other Funds"). While the cash balances related to these Other Funds are pooled with General Fund cash, the City does maintain a separate accounting of due to/from balances for each fund. Since the General Fund commonly borrows from Other Funds, actual cash balances in the General Fund accounts at any given point in time is higher than that which actually belongs solely to the General Fund.