STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: March 13, 2013

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: Preliminary Review of the City of Hamtramck

I. Background

On February 11, 2013, the Department of Treasury commenced a preliminary review of the finances of the City of Hamtramck to determine whether or not a local government financial problem existed. Section 12(1) of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, requires a preliminary review to be conducted if one or more of the conditions enumerated therein occur. The preliminary review of the City of Hamtramck resulted from the conditions enumerated in subdivision (a) and (j) of Section 12(1) having occurred within the City.[1]

As summarized below, based upon information received and considered as part of the preliminary review -- including the inability of the City to avoid fund deficits, recurrent accumulated deficit spending, projected cash flow shortages resulting in improper inter-fund borrowing, the lack of funding of the City's retirement and other post-retirement benefits, and the financial decline of the City -- I conclude that a serious financial condition exists in the City of Hamtramck and recommend appointment of a financial review team.

II. Preliminary Review Findings

The preliminary review found the following:

[1] Subsection (a) provides that "[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this article. The request shall be in writing and shall identify the existing financial conditions that make the request necessary." Subsection (j) provides that "[t]he local government has violated a requirement of sections 17 to 20 of the uniform budgeting and accounting act, 1968 PA 2, MCL 141.437 to 141.440, and the state treasurer has forwarded a report of this violation to the attorney general."

- City officials have adopted budgets and budget amendments that do not comply with Public Act 2 of 1968, the Uniform Budgeting and Accounting Act. For example, in the fiscal year ending June 30, 2012, the City passed a General Fund budget that had a net negative $1.7 million change in fund balance due primarily to an over estimation of property tax revenues of $1 million and amounts exceeding their budgets for fire by $427,360 and public works by $457,828. This same budget resulted in an actual unrestricted General Fund deficit of $753,733. In November of 2012, City officials amended its budget without addressing an operating loss of $2.7 million. In other words, the City officials made what appears to be little effort to address its revenue shortfall by reducing expenditures as required by Public Act 2 of 1968. If the City officials were to continue to follow this amended budget through the remainder of its 2013 fiscal year, they would knowingly increase the City's General Fund deficit.

  Subsequently, officials submitted a deficit elimination plan that is unacceptable by the Department of Treasury. The plan includes significant revenue enhancements for the fiscal year ending June 30, 2013 amounting to $781,231 and $241,500 in expenditure cuts for the same period. Yet the City has not yet provided any evidence that the enhanced revenue is achievable or that the cuts have been made. Even if the enhancements and cuts were fully realized and all departments comply with the budget limitations, the City projects expenditures to exceed revenues by over $1.7 million which makes the fiscal year 2013 unrestricted budget deficit approximately $2.5 million. The deficit elimination plan fails to provide any reasonable assurance that the City is adequately addressing its structural deficit.

  The City cited in its request for a preliminary review the inability to achieve concessions from the employee union groups. Yet the deficit elimination plan indicates that the City expects $2.5 million in labor concession in 2015 when the union contracts expire. The plan provides no detail on the probability of attaining the concessions or how the City anticipates achieving them.

- City officials have used assets from other funds to increase cash flow in the General Fund. Among the more significant transactions include $110,206 from the Water and Sewer Fund and $500,000 from the Local Streets Fund. Borrowing from other funds is indicative of cash flow issues.

  As indicated in the following table, for the fiscal year ending June 30, 2009, the City had revenues that exceeded expenditures in the General Fund of over $1.3 million. However in fiscal year 2010, the opposite occurred with expenditures exceeding revenues by almost $1.2 million. Fiscal year 2011 saw an increase in property taxes because of a one-time payment from the City of Detroit and an increase in fund balance because of a $2 million transfer from the Budget Stabilization Fund. The overall trend for the City shows decreased revenues. Had the City paid attention to the decline in property tax revenue, and made the necessary cuts in fiscal year 2011, it could have potentially avoided a General Fund deficit while preserving the one-time payment and Budget Stabilization Fund transfer. However, failing to make reductions in expenditures created overall fund deficits.

General Fund:	2009	2010	2011	2012	2013 Projected
Revenues	$19,442,075	$15,950,187	$17,308,211[a]	$14,827,148	$16,097,514[c]
Expenditures	(18,056,312)	(17,141,107)	(17,649,427)	(18,130,533)	17,822,122)[c]
Revenues Over (Under) Expenditures	1,385,763	(1,190,920)	(341,216)	(3,303,385)	(1,724,608)
Other Financing Sources and (Uses)			2,000,000[b]		
Beginning Fund Balance	867,393	2,253,156	1,062,236	2,721,020	(582,365)
Ending Fund Balance	$ 2,253,156	$ 1,062,236	$ 2,721,020	$ (582,365)	$ (2,306,973)
Unassigned/Unreserved Ending Fund Balance	$ 2,162,215	$ 959,486	$ 2,519,246	$(753,733)	Not Available

Notes: [a] Increase in revenues due to one-time increased payment from Detroit related to the General Motors Detroit/Hamtramck Assembly plant.
[b] Transfer from the Budget Stabilization Fund in accordance with GASB Statement No. 54.
[c] Increased revenues and decreased expenditures are from the deficit elimination plan submitted by the City but not yet approved by the Department of Treasury.

- The City has delayed making approximately $2.2 million in required pension[2] contributions as a way to manage cash flow. It could run out of cash by April 2013 unless it continues to forego required contributions increasing the $2.2 million by an estimated $295,000 for each month it delays payment. The City will also need to delay the repayment of $500,000 to the Local Streets Fund as well as other payables. The City hopes to obtain an emergency loan instead so that it may meet its obligations and avoid a cash shortage.

- The unfunded liabilities of the City's pension and other post-employment benefits (OPEB) are significant obstacles to its long-term fiscal health. An actuarial evaluation based on data from the 2011 calendar year (the latest available) indicates that the pension plan has over $42 million in unfunded liabilities compared to $55 million in pension assets. Therefore, the pension plan is only 56.8% funded. The OPEB liability exceeds $47 million for which a funded ratio is not available since there are no plan assets as the City has adopted a "pay as you go" basis for financing. Between 2010 and 2011, the pension liability increased over $3.5 million and the OPEB liability has increased by over $16 million since 2009.

- While the Water and Sewer Fund has a significant Net Assets balance, a sizeable shift has taken place related to its operating income. Each year from fiscal year 2009 to fiscal year 2011 (see table), the City saw a positive operating income. Fiscal year 2010 even reflected an excess of $1.1 million. However, the audited financial statements from 2012 show an

[2] Michigan Constitution Article IX, Section 24 – Public pension plans and retirement systems, obligation - Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

operating loss of $409,999, which is the direct result of higher charges the City must pay to the City of Detroit for its water supply. Water and Sewer rates have not kept up with these increases even when they were raised in 2011 by 9.1 percent for water and 11 percent for sewer customers.

Water and Sewer Fund	**2009**	**2010**	**2011**	**2012**
Revenues	$4,733,048	$5,488,325[a]	$5,998,073[a]	$5,169,627
Expenditures	(4,398,404)	(4,361,153)	(5,834,743)	(5,579,626)
Operating Income	334,644	1,127,172	163,330	(409,999)
Non-Operating Revenue (Expenses)	(5,344)	300	5,321	43,531
Beginning Net Assets	$4,249,508	$4,578,808	$5,706,280	$5,874,931
Ending Net Assets	$4,578,808	$5,706,280	$5,874,931	$5,508,463

Note: [a] The cost to purchase water and sewage treatment from the City of Detroit in 2010 was $491,338 and $2,611,269, respectively; in 2011, it was $839,478 and $3,774,824.

City officials are implementing a study to investigate further rate increases.