4425 (Rev. 04-15)

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

June 30, 2015

Mr. Harlan Goodrich, Secretary
Local Emergency Financial Assistance Loan Board
Local Audit and Finance Division
Michigan Department of Treasury
Lansing, MI 48909

Dear Mr. Goodrich:

On June 19, 2015, a preliminary review of the Charter County of Wayne (County) began pursuant to Section 4 of PA 436, the Local Financial Stability and Choice Act. An Interim Report of the Preliminary Review was sent to the County on June 25, 2015. The County was then given five days to respond to that Interim Report.

The County Executive Office, via e-mail, notified the Department of Treasury on June 29, 2015 that it did not have any comments regarding the Interim Report. The County Commission, via e-mail, provided comments to the Department of Treasury on June 30, 2015. In its response to the Interim Report, the County Commission did not submit any evidence or information which caused the Department of Treasury to amend the final report. Copies of both the Interim Report of the Preliminary Review and the County's responses are included as attachments to the Final Report of the Preliminary Review.

As required by Section 4(2) of the Act, the Final Report of the Preliminary Review of the County is being transmitted to the Local Emergency Financial Assistance Loan Board for its review. The Local Emergency Financial Assistance Loan Board will determine whether probable financial stress exists in the County.

Sincerely,

Thomas F. Saxton

Thomas F. Saxton
Chief Deputy State Treasurer

cc: Wayne County Commission
Wayne County Elected Officials

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: June 30, 2015

TO: The Local Emergency Financial Assistance Loan Board

FROM: Nick A. Khouri, State Treasurer

SUBJECT: Final Report - Preliminary Review of Charter County of Wayne

I. Background

On June 19, 2015, the Department of Treasury commenced a preliminary review of the finances of Wayne County to determine whether or not a local government financial problem existed. Section 4(1) of Public Act 436 of 2012, the Local Financial Stability and Choice Act, permits a preliminary review to be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the Wayne County (County) resulted from the conditions enumerated in subdivision (a), (o), (p), (r), and (s) of Section 4(1) having occurred within the County.[1] In addition to the conditions which brought about the preliminary review, other conditions were determined to exist during the course of conducting the reviewing including (j), (k), and (n).

During the preliminary review, Michigan Department of Treasury staff met with various County officials including Tony Saunders, Chief Restructuring Officer/Interim Chief Financial Officer; Mathieu Dube, Deputy Chief Financial Officer; Jerome Pokorski, Assistant Budget Director; David J. Szymanski, Chief Deputy Treasurer; Christa J. McLellan, Deputy Treasurer-Financial Services; and Paul Zelenak, Department Administrator – Tax Accounting.

II. Preliminary Review Findings

The preliminary review found the following:

[1] Subsection (a) provides that "the chief administrative officer of a local government requests a preliminary review." 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." Subsection (k) provides that "[t]he local government fails to timely file an … audit that conforms with the minimum procedures and standards of the state financial authority and is required for local governments under the uniform budgeting and accounting act." Subsection (n) provides that "[a] local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan." Subsection (o) provides that a "court has ordered an additional tax levy without the prior approval of the governing body of the local government." Subsection (p) provides that "[a] municipal government has ended a fiscal year in a deficit condition." Subsection (r) provides that a "local government has been assigned a long-term debt rating within or below the BBB category or its equivalent by 1 or more nationally recognized credit rating agencies." Subsection (s) provides that "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress."

- On June 17, 2015, Wayne County Executive, Warren C. Evans, cited section 4(1)(a) of Public Act 436 of 2012, by asking that a "preliminary review be conducted to determine the existence of probable financial distress within the County." Mr. Evans further stated that "I recommend that a financial emergency be declared in the County."

- County officials violated requirements of Section 17 of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, which states, in part, that the "the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined." For example, for the fiscal year ending September 30, 2014 in the General Fund, the County Jail, the Prosecuting Attorney Office, and the Sheriff Department activities went over budget by $14.8 million, $2.7 million, and $1 million, respectively. Several revenue line items including Transfers In did not meet expectations falling short by over $42 million. Consequently, the net budgeted change in fund balance was negative $18,911,000; that is, according to the budget, fund balance was budgeted to fall by $18,911,000.

- County officials failed to file an audit report that conforms with the minimum procedures and standards of the Michigan Department of Treasury and is required for local governments under the Public Act 2 of 1968, Uniform Budgeting And Accounting Act. Local governments in the state of Michigan are required to pass budgets on an activity level or lower (for example, Prosecuting Attorney or Sheriff). The County's audit report does not comply with this requirement by reporting their budgets on the higher, function level (for example, Public Safety). As stated by County management, the "appropriated budget for the General Fund is adopted by function (e.g., general government, public safety, public works, etc)."

- The County has ended a fiscal year in a deficit condition and is in breach of its obligations under a deficit elimination plan. For the fiscal year ending September 30, 2014, deficits existed in the entity-wide governmental activities of $373 million in unrestricted net assets. Unrestricted General Fund deficits peaked at $156.4 million in 2013 and were reduced to $82.8 million in 2014. The recent reduction in the deficit is primarily due to a transfer of $91.6 million from the Delinquent Tax Revolving Fund which will increase borrowing costs for the County when annually purchasing delinquent taxes from local units of government within the County. According to the County, $153 million more will be transferred in 2015. Unrestricted deficits in the General Fund began in the fiscal year of 2008 with an unrestricted deficit of $10.6 million. Without taking remedial measures, the County is projecting a $171.4 million deficit by fiscal year 2019.

  Other funds that had deficits in 2014 were the Health Fund of $5 million, the Nutrition Fund of $3.2 million, the Community and Economic Development Fund of $2.3 million.

  County officials had not filed an adequate or approved deficit elimination plan with the Department of Treasury for fiscal years 2010, 2011, and 2012. For fiscal year 2013, County officials' plan to transfer $81 million from the Delinquent Tax Revolving Fund ($91.6 million was actually transferred) and the creation of a Waste Water Authority[2] to realize a one-time payment of $121 million from participating communities was not certified by the Department of Treasury. No plan has been submitted for 2014 which was due when the audit was submitted at the end of March 2015.

- On May 29, 2015, the Circuit Court of Wayne County issued a judgment in favor of the retirement system for more than $49 million without the prior approval of the County's governing body. On June 4, the County Board of Commissioners voted to pay the levy with Delinquent Tax Revolving Fund money. However, the County executive vetoed the action. Consequently, a judgment levy will be placed on the County's tax rolls.

  As stated by County management in the most recent audit report, "[c]ost pressures, particularly in the healthcare and pension area, continue to challenge County finances. Pensions, retiree healthcare and other postemployment benefits (OPEB) make up 70% of the County's long-term liabilities. The defined benefit plan is 45% funded, and no significant effort has been made to prefund OPEB liabilities."

- The County's primary pension plan is 45% funded and has a liability of $910.5 million based on the last actuarial valuation performed dated September 30, 2013. This is contrasted with a 94.8% funded ratio in 2004 and a total liability of $49.6 million at that time.

  Over the past 10 years, the County's funded ratio has been cut by 49.7% while its unfunded liability has increased to more than 18 times its 2004 balance. This decline in funding was caused by reopening plans to new members in 2002 and 2008, underperforming investments, increasing payrolls, and generous incentives including those for early retirement that waived the age requirements and enabled plan members to buy years of service at discounted rates.

- Recently, the County's credit rating was downgraded by the three major credit rating services. Moody's rating is now at Ba3, the Fitch rating is at B, and the Standard and Poor's rating is now at BB+. On June 24, 2015, Standard and Poor's placed the County on CreditWatch with negative implications. The Fitch and the Standard and Poor's ratings are classified as non-investment grade, speculative, or junk and the Moody's rating is only slightly better. (See enclosed reports.)

- Total long-term obligations of the County including component units, but not including pension obligations, amounted to $3.3 billion for the fiscal year ended September 30, 2014. Total obligations compared to total Net Position (i.e., debt to equity ratio) is 2.2 (i.e., long-term obligations are 2.2 times the size of the County's Net Position). A ratio of less than 1.0 may be considered acceptable by the Department of Treasury.

- Over the past several years, taxable values within the County declined approximately 24% reducing the amount of property taxes received. Since 2007, the property tax revenues in the General Fund declined by over $156 million while total expenditures increased by over $50 million.

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[2] The Waste Water Authority has not yet been created.

- For the last several years, County officials have issued tax anticipation notes to meet cash flow shortages. The amounts borrowed for these purposes were $60 million in 2009, $100 million in each of the years of 2010 through 2012, $90 million in 2013, and $75 million in 2014. This prolonged use of short term borrowing provides evidence of a declining cash position. The County has projected significant cash shortages of over $100 million in its General Fund until September when the summer tax levy is collected. There also appears to be borrowing from the restricted Roads Fund in 2012 and 2013 for at least $27 million and $8 million, respectively.

- Total interfund loans in fiscal year 2012 were $110.9 million, an increase of $95.5 million from the prior year. The majority of these interfund loans, $87.4 million, was borrowed by the General Fund. In 2013, total interfund amounts increased to $148.8 million. The General Fund owed $106 million of this to other funds. The Juvenile Justice Fund owed $21.4 million of the $148.8 million to other funds. In fiscal year 2014, the total interfund balance improved by decreasing to $64.7 million. The General Fund owed roughly $39.5 million of this amount to the Delinquent Tax Revolving Fund. Large interfund borrowing may be indicative of cash flow concerns.

- County officials made significant recurring transfers between funds. For the past five years, County officials transferred out of the General Fund to other funds an average of $109.5 million annually. Sixty-seven percent ($74 million) of these transfers were to the Juvenile Justice Fund and 13% ($14.5 million) were to Non-major Governmental funds. Over the same period, the Delinquent Tax Revolving Fund's average transfer out was $35.7 million. The majority of the transfers from the Delinquent Tax Revolving Fund were to the General Fund increasing from $4 million in 2010 to $91.6 million in 2014. Large interfund transfers may be indicative of cash flow concerns.

- In September 2011, the County began construction of a $300 million jail to replace and consolidate three aging jail facilities. In June 2013, construction was halted when estimates put the cost of completion at $391 million. From May 1, 2014 to April 30, 2015, County officials spent roughly $14.3 million on servicing the debt related to the construction and $725,000 for site preservation costs. It remains unclear whether the County will sell the site or finish the partially built jail.

Enclosure
cc: Wayne Workman, Deputy State Treasurer
Ed Koryzno, Director, Bureau of Local Government Services

MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
27 FEBRUARY 2015

Rate this Research

RATINGS

Wayne County	
General Obligation Limited Tax	Ba3 negative

KEY METRICS:

	2012	2013	2014
Full valuation ($ billions)	$87.1	$85.8	$85.0
Available fund balance as a percentage of revenues	-9.7%	-4.1%	-5.6%

	2000	2010	2012
Median family income (% of US)	91.3%	87.7%	81.6%
Population (millions)	2.1	1.8	NA

ANALYST CONTACTS

David Levett 312-706-9990
Analyst
david.levett@moodys.com

Matthew Butler 312-706-9970
AVP-Analyst
matthew.butler@moodys.com

Henrietta Chang 312-706-9960
VP-Sr Credit Officer
henrietta.chang@moodys.com

Jack Dorer 212-553-1332
MD-Public Finance
jack.dorer@moodys.com

Wayne County, MI - Local Government

County Grapples with Rapidly Declining Tax Base and Limited Financial Flexibility

Wayne County's ability to combat a declining tax base and persistent operating deficits is hindered by its limited revenue-raising flexibility and barriers to reducing expenditures. Without significant budget adjustments, the ongoing structural imbalance raises the likelihood of impaired cash flows and increased state intervention. On February 6, we downgraded the county to Ba3 from Baa3. Key factors driving the county's rating below investment grade:

» **Wayne County's narrow liquidity is propped up by its Delinquent Tax Revolving Fund (DTRF).** The county is increasingly reliant on transfers from the DTRF, which is not sustainable as the fund's available cash is being depleted. Exhaustion of DTRF liquidity would impair county cash flows given the General Fund's net cash position of negative $5.3 million at the close of fiscal 2013.

» **The county has yet to substantially reduce expenditures or make other structural changes.** Growing demand for services such as public safety has limited the county's ability to cut costs. The county's new management team is planning substantial adjustments, but any significant reductions in payroll or retiree benefits will need to go through a collective bargaining process.

» **Tax caps stymie Wayne County's ability to offset tax base declines.** Property taxes are an important revenue source for the county, comprising over half of General Fund revenues. The county's taxable values have declined 24% since 2007. The county's property tax rates are capped, which results in revenue losses as taxable values decline and limits how quickly revenues can grow once values begin to recover.

» **Weak demographic trends pose barriers to economic revitalization.** The county's population continues to decline, led by migration out of Detroit (issuer rating B3 stable). Population trends are more stable in suburban parts of the county. The county is experiencing some economic recovery, though unemployment remains high and the labor force continues to shrink.

Narrow liquidity propped up by Delinquent Tax Revolving Fund (DTRF)

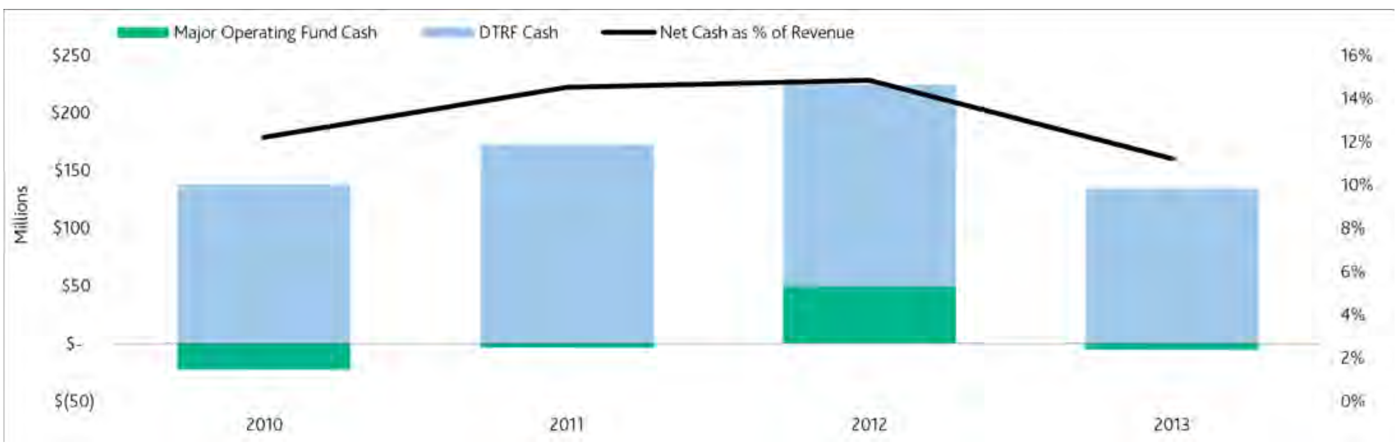
The county is increasingly reliant on transfers from the DTRF, which is not sustainable as the fund's available cash is being depleted. The reliance is rooted in an ongoing operating imbalance driven by a declining revenue base and expenditure pressures. Property taxes, the county's largest source of operating revenue, declined over 20% since 2007. During that same period, General Fund expenditures increased by 5%, or 1.5% annually. This structural imbalance has led to significant General Fund operating deficits in each of the last five years, net of transfers, reducing available operating net cash position from $13.3 million in fiscal 2010 to a negative $5.3 million at the close of fiscal 2013.

The fiscal 2013 net cash position consisted of a $57 million deficit in the General Fund, net of tax anticipation notes (TANs) outstanding at year-end, offset by a positive cash balance in the Mental Health Fund, from which the county has relied on internal borrowings to support general cash flow. We also consider unrestricted cash from the county's DTRF in our assessment of its total operating liquidity. Including unrestricted cash from the DTRF, fiscal 2013 operating liquidity was a positive $77.2 million, or a still slim 6% of core operating revenue.

The DTRF is an enterprise administered by the county treasurer, who has discretion to release available resources from the reserve to fund general county operations. In recent years, the treasurer has designated increasing amounts of the reserve as unrestricted and available. Exhibit 1 shows the county's available operating cash trend, including all DTRF cash, both restricted and unrestricted. Beginning in 2014, the majority of the accumulated cash will have been transferred to the General Fund. Going forward, the treasurer will still be able to transfer any current year net revenues from the DTRF to the General Fund, which have averaged $42 million annually from 2009 through 2013. The net income increased in recent years as delinquencies increased; going forward, they are projected to decline in line with delinquencies.

Exhibit 1

Wayne County's Total Operating Liquidity Declining, Despite Increasing DTRF Support



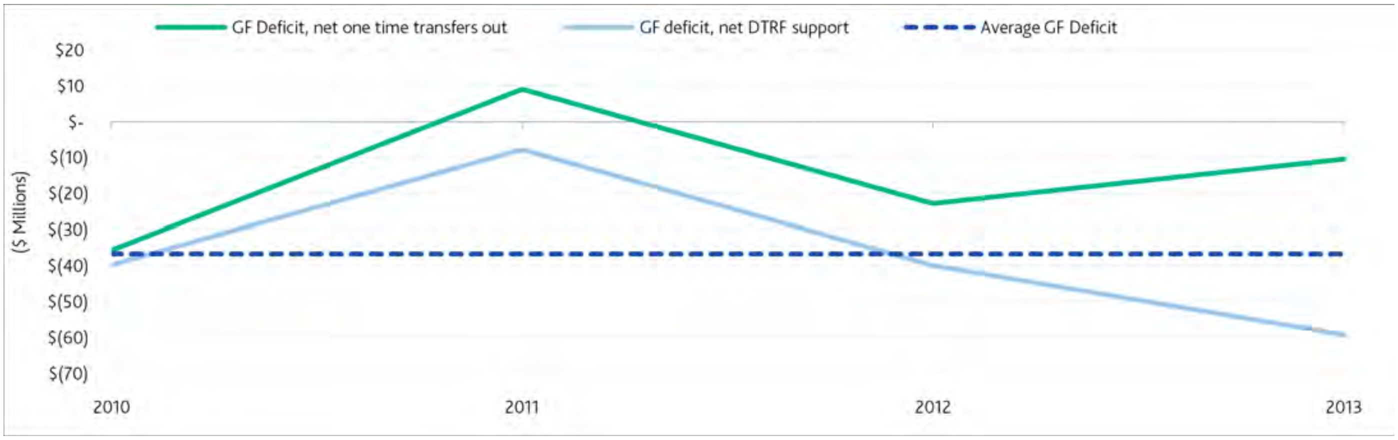
Source: County CAFR (2010-2013)

Projected DTRF annual net income is not likely to be sufficient to close the county's General Fund operating deficit. Exihibit 2 shows the increasing annual operating deficit, which has reached $60 million as of the most recent audited fiscal year. While the county's fiscal 2014 CAFR is not yet available, it is likely to depict a further operational shortfall, partially offset by a transfer from the DTRF.

Exhibit 2

Wayne County General Fund Operating Deficit Reached $60 Million in Fiscal 2013

Annual Deficits Averaged $36.6 Million from 2010-13



Source: County CAFR (2010-2013)

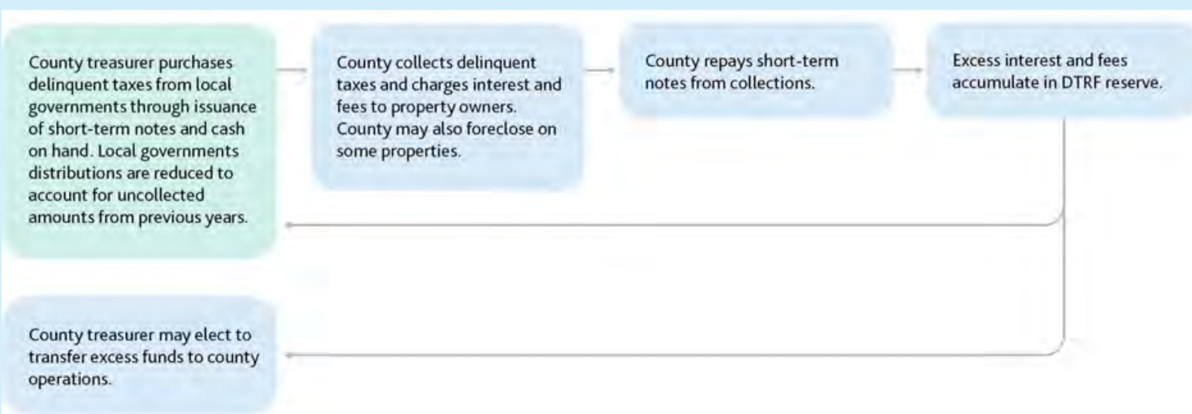
Delinquent Tax Funds Benefit Michigan Counties

Most Michigan counties maintain a Delinquent Tax Revolving Fund (DTRF) to manage the flow of delinquent tax collections, which are typically collected over two to three years following the tax year in which bills are due. Counties take on the responsibility for collecting all delinquent property taxes within their jurisdiction after purchasing the delinquencies from all of its underlying municipalities. It then recoups the proceeds from collecting the delinquencies, plus any accumulated fees and interest due on the delinquencies. In some cases, the counties pursue foreclosures and auctions to recoup the value of the delinquencies.

At the end of the collection period, any delinquencies that remain unpaid are due from the underlying municipality. This typically does not require a payment from the municipality as the county will simply deduct the outstanding amount from the new delinquencies it will purchase from that municipality. The excess revenues earned are available for the county's general operations. Some counties will issue short-term notes to fund the purchase of delinquencies. Exhibit 3 shows the process flow of the DTRF and distributions to local governments, from the county treasurer purchasing delinquent tax rights to the generation of net income.

Exhibit 3

DTRF Purchases Collection Rights from Local Governments and Keeps Interest and Fees



Source: Moody's Investors Service

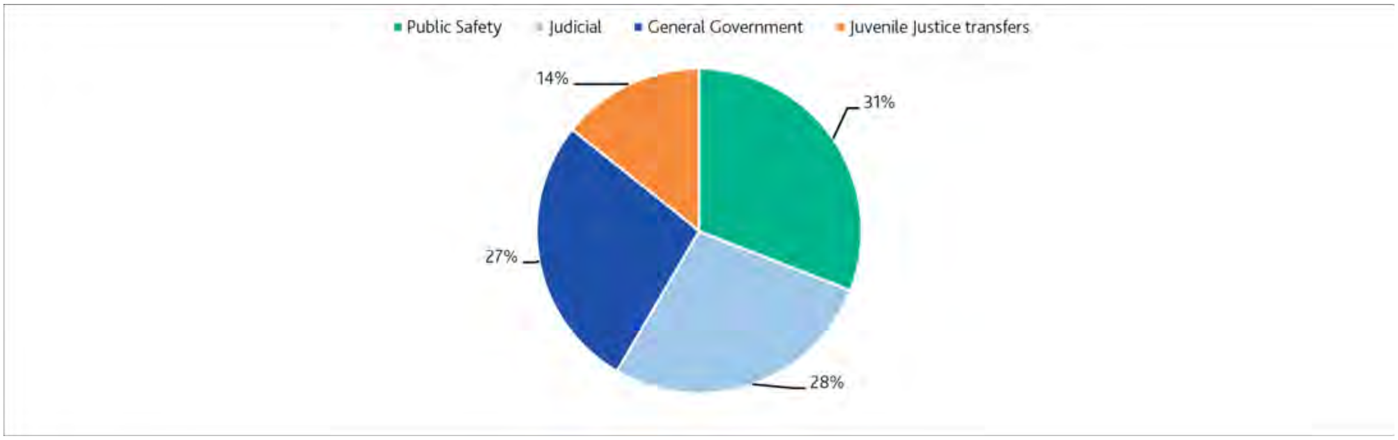
Wayne County has yet to substantially reduce expenditures or make other structural changes

The county's capacity to reduce expenditures has remained limited by growing service demands, especially for public safety in economically challenged areas, including Detroit and its neighboring communities. Combined public safety and judicial services comprise nearly 50% of the county's General Fund budget, with the addition of juvenile justice services bringing total social service expenses to 61% (see Exhibit 4). While the county has successfully reduced expenditures for juvenile justice services, costs for public safety and judicial operations increased a cumulative 27% from 2009 through 2013. The county has faced hurdles reducing wages and benefits through collective bargaining. In addition, the county sheriff and county prosecutor, who are separately elected officials, have successfully challenged budget cuts in their respective departments by filing lawsuits against the county.

Exhibit 4

Key Social Services Comprise the Majority of Wayne County's Budget

Fiscal 2013 Expenditures



Source: Wayne County FY13 CAFR

Wayne County has a new management team in place, which is planning for substantial adjustments in county operations and expenditure structure. Any significant reductions in payroll or benefits will require the support of various employee groups. Non-wage personnel costs in the General Fund include approximately $54 million of combined pension and retiree health care expenditures. The county could reduce normal pension costs through wage or personnel reductions, but has little flexibility to cut accrued benefits. Trimming retiree health care expenditures carries more legal flexibility. A 2012 circuit court decision affirmed reductions the county implemented in 2009, providing likely support for future adjustments. Still, cuts to health care benefits will likely be a target for litigation, which at the very least could delay implementation and provide the county with little help in addressing its budget imbalance.

The county has submitted a Deficit Elimination Plan to the state. Should the county fail to adequately reduce expenditures, the state could increase its oversight under Public Act 436. If the state were to declare a financial emergency under the act, the county would have several options, including requesting an emergency manager appointment, or seeking authorization to file for Chapter 9 protection.

Tax caps stymie Wayne County's ability to offset tax base declines

The county's ability to eliminate operating deficits with tax increases is limited. The county's full valuation remains sizable, but declined by a cumulative 36% in the seven years since 2007, falling from a peak of $132 billion to the current $85 billion. Detroit accounts for 19% of the county's full valuation. The county's property taxes are based on taxable valuation, which declined by 24% since 2007, driving a corresponding 23% drop in the county's property tax levy through 2013.

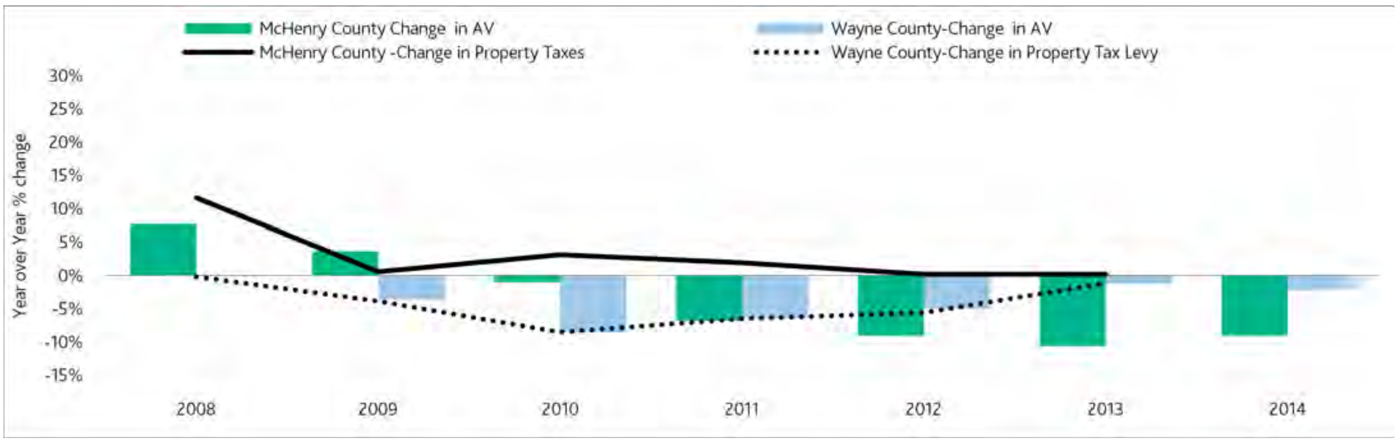
The maximum millage rate for Wayne County is established in its charter though voters can approve additional levies, last done in the late 1990s. The property tax levy is further restricted by provisions in the state constitution and state statute, commonly known as the Headlee Amendment and Proposal A. The Headlee Amendment limits revenue growth generated from existing property to the rate of growth in the Consumer Price Index (CPI). The limit creates a permanent reduction in the allowable tax rates, so the impact continues even when values are depreciating. Proposal A limits growth in taxable valuations. Since the county is levying at the maximum millage rates permissible under the caps and there were no voter overrides in recent years, the county saw substantial drops in property tax receipts from declining taxable valuation.

There are large variations in taxing limitations among states. For example, Exhibit 5 illustrates the impact of rate limitations on property tax revenues through a comparison of Wayne County to McHenry County, IL (Aaa). Illinois counties are generally subject to much less onerous rate limits than those in Michigan. McHenry, a rapidly growing county near Chicago, has experienced a greater decline in assessed values than Wayne County. However, McHenry is not subject to any rate limitation for its Corporate Fund tax rate and its operating levies can grow up to the greater of 5% or the Consumer Price Index (CPI). Despite steep declines in assessed values, McHenry County's rate raising flexibility has allowed property tax revenues to continue to grow, albeit at a slower pace.

Exhibit 5

Valuation Declines Have Disparate Impact on Government Revenues

Change in Revenues and Valuations for Wayne County, MI and McHenry County, IL



Source: Continuing disclosures, offering statements, CAFRs

While most of the taxable valuation in southeast Michigan is showing signs of stabilization or recovery, Wayne County's overall values continue to depreciate, most recently with a 2.2% decline in 2014. The decline is largely driven by Detroit, however, and the county's valuation outside of Detroit is showing signs of stabilization with a 2.3% increase in 2014.

Even when values do begin to recover, the limitations posed by Headlee and Proposal A will substantially slow the recovery of property tax revenues. Regardless of how far taxable and market values fall and how fast they recover, municipal property tax revenues in Michigan can generally only grow by CPI, absent voter approval or new development.

Weak demographic trends pose barriers to economic revitalization

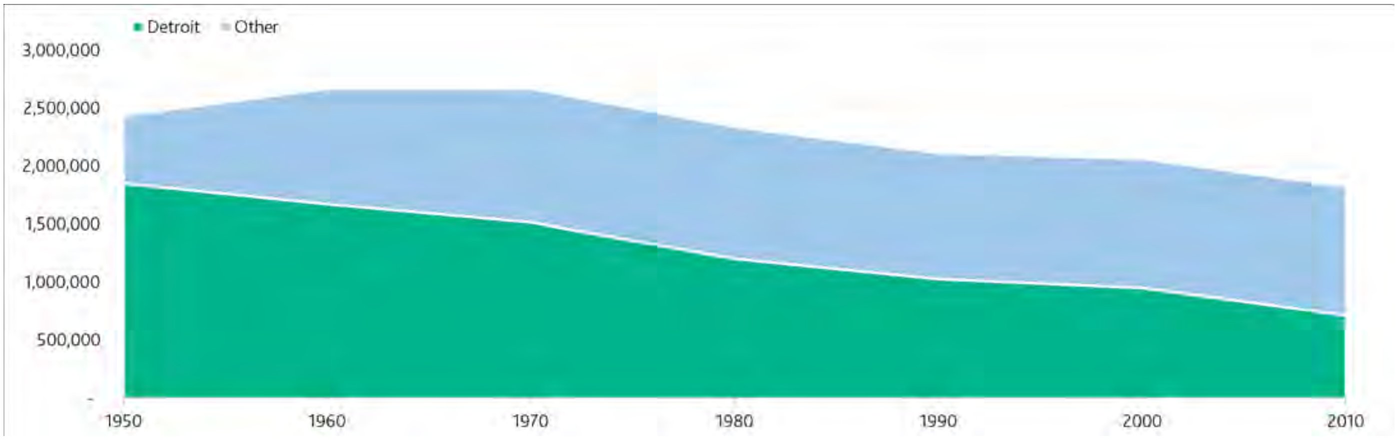
A weak demographic profile and struggling economy are major drivers of not only expenditure pressure, but revenue declines. The county has suffered from decades of population loss led by the City of Detroit. Migration out of the city, as well as other neighboring suburbs, has contributed to a steady decline in county population since 1970 and was the principal factor in a 12% loss in the 2010 census.

Detroit comprised just 38% of the county's population in 2010, down from 52% in 1980. Population outside of Detroit (see Exhibit 6) has remained relatively stable. The state's population has also declined over the last decade, albeit at a slower rate.

Exhibit 6

Detroit Losses Lead to a Shrinking Wayne County Population Base

Wayne County Population 1950-2010



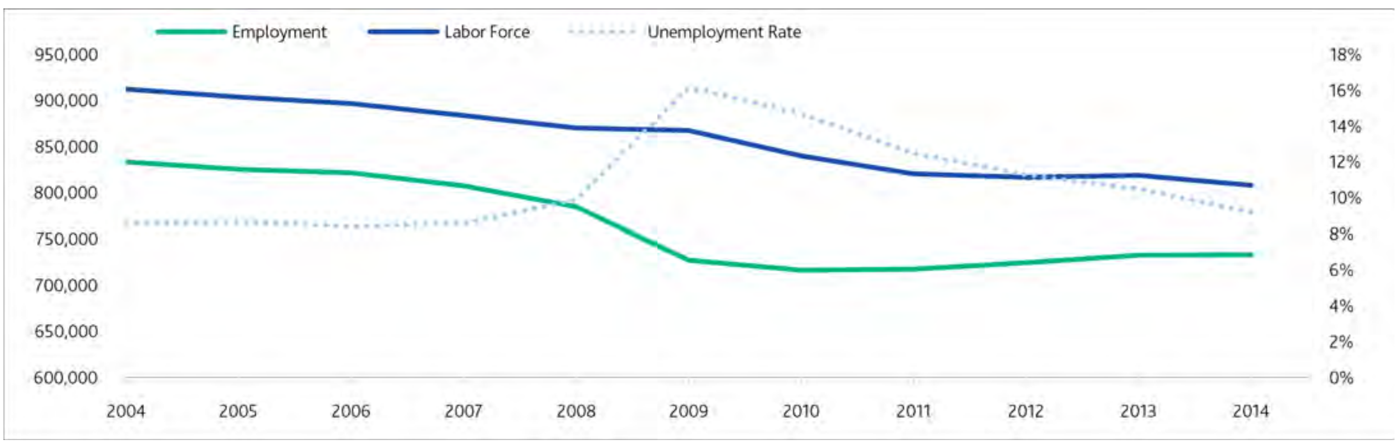
Source: US Census Bureau

Median family income (MFI) in the county is estimated at a modest 82% of the national figure. The county's December 2014 unemployment rate is well above the national average at 7.4%. While this is much improved from monthly rates that exceeded 16% in 2009 (see Exhibit 7), it also reflects a 7% decline in the labor force over the same time period. Favorably, total employment in the county has grown modestly in each of the past few years.

While the overall economic profile is weak, the county has pockets of affluence, including Livonia (Aa2, MFI 128% of the US), Northville Township (unrated, MFI 178% of the US), and Grosse Pointe (Aa2, MFI 208% of the US).

Exhibit 7

Wayne County's Unemployment Rate Improves, but the Labor Force Continues to Contract



Source: US Department of Labor

Moody's Related Research

» Moody's downgrades Wayne County, MI's GOLT to Ba3 and maintains negative outlook

» Michigan Tax Caps Limit Benefit of Real Estate Gains

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

AUTHORS
David Levett
Hetty Chang
Matt Butler

EDITOR
David Goetzl

DATA VISUALIZATION
Lisa Mahapatra

STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Wayne Charter County, Michigan; General Obligation; General Obligation Equivalent Security; Note

Primary Credit Analyst:
Jane H Ridley, Chicago (1) 312-233-7012; jane.ridley@standardandpoors.com

Secondary Contact:
John Sauter, Chicago (1) 312-233-7027; john.sauter@standardandpoors.com

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Summary:

Wayne Charter County, Michigan; General Obligation; General Obligation Equivalent Security; Note

Credit Profile		
US$186.9 mil GO ltd tax nts (federally taxable oblig) ser 2015 due 12/01/2017		
Short Term Rating	SP-1	New
Wayne Charter Cnty GO		
Long Term Rating	BB+/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'SP-1' rating to Wayne Charter County, Mich.'s limited-tax general obligation (GO) delinquent tax notes series 2015. At the same time, Standard & Poor's affirmed its 'BB+' rating on the county's limited-tax GO bonds.

The rating on the notes is based on our assessment of the following credit factors:

- A lien on pledged tax revenues in favor of the trustee on behalf of note holders;
- The requirement to place collected tax revenues in a segregated enterprise fund, separate from the county's general operations;
- A note reserve fund held by the trustee and funded at 10% of par;
- A prohibition in state statute for the county to use tax collections for any other purpose than for the payment of notes (e.g., general fund purposes);
- Adequate projected coverage that improves when incorporating the note reserve account; and
- Limited-tax GO pledge.

The 2014 real property taxes due to Wayne County, outstanding and uncollected as of June 1, 2015, and the county's limited-tax GO pledge secure the series 2015 notes. Pledged revenues securing the notes include $192.1 million of 2014 delinquent property taxes, plus statutory interest and fees estimated to be delinquent after June 1, 2015. The notes can be issued as fixed or variable rate, and the structure considered in this rating is fixed rate notes. Should the notes be sold as variable rate, we understand there would be no put feature, and we expect coverage would be similar to coverage on the fixed rate notes.

On a weekly basis, the county will transfer collections to the trustee. Wayne County has also created a note reserve of $18.7 million to be held with the trustee as alternate liquidity (10% of par). For all notes issued, all delinquent taxes, plus statutory interest and fees (including chargebacks from local governments on amounts that are uncollectible) and cash on hand in the delinquent tax fund provide coverage of note debt service by pledged revenues on the five maturity dates (December 2015, June and December 2016 and 2017) of 1.20x, 1.20x, 2.43x, 2.18x, and 1.61x, respectively. Coverage with the note reserve goes up to 1.67x, 1.65x, 3.12x, 2.72x, and 1.95x at each of the maturity dates.

Wayne County's full faith and credit, limited-tax GO pledge provides additional security to the extent that collections are insufficient to make debt service payments. Historically, delinquent tax collections have been sufficient to pay debt service when due, and the county expects the same for the 2015 notes. After starting to slow in 2008, the collection pace in recent years has improved, and the county reports that this year tax payments have been picking up speed.

The county has covenanted in the indenture that as long as these notes are outstanding it will not issue additional notes secured by the 2014 delinquent taxes.

In conjunction with the sale of the notes, Wayne County's special bankruptcy counsel has issued an opinion regarding their expectations as to treatment of the notes should the county file for bankruptcy. Although these opinions provide us with additional comfort regarding the legal constructs that protect the enterprise funds from invasion by the county in a bankruptcy context, they do not, in our opinion, fully mitigate concerns related to treatment of the notes should the county file for bankruptcy. As we have observed in other bankruptcy proceedings, including that of Detroit, Mich., municipal bankruptcy is an inherently unpredictable and messy process where settlements rather than expected legal treatment often drive recoveries. Nevertheless, given statements made by the county regarding its restructuring plan and its current trajectory, the county does not appear to be poised to file for bankruptcy; we have factored these statements into our analysis.

The 'BB+' rating on the county's GO limited-tax bonds is constrained by Wayne County's chronic structural imbalance and persistent negative unassigned general fund balance; these two circumstances have led to pressures on the management score that result in a rating cap of 'BBB-' for unlimited-tax bonds; a one-notch differential is made between the unlimited- and limited-tax ratings based on the county's weak financial position and ongoing budgetary challenges. The county's series 2012 limited-tax bonds are also secured by tourism taxes, but the rating is based on the strength of the GO pledge.

The rating reflects our understanding that the process of contract negotiations and other adjustments planned by the county will make meaningful progress in closing the county's structural budget gap and eliminating the accumulated deficit in the near term. The negative outlook reflects the magnitude of this undertaking, and our opinion that the time frame for making the changes could be drawn out beyond the county's current expectations. The county has made progress on these goals and indicates it remains largely on track with its original time frame. However, the magnitude of the changes remains significant, and their outcome will have a major impact on the county's long-term financial health and stability.

Other rating factors include:

- Very weak economy, with significant population decline, but access to a broad and diverse metropolitan statistical area (MSA);
- Very weak management, with "good" financial policies and practices under our Financial Management Assessment methodology, but the lack of a plan in place that is sufficient to address the county's ongoing structural imbalance;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2014; the county closed 2014 with an operating surplus in the general fund but a slight operating deficit at the total governmental fund level;

- Very strong liquidity, with total government available cash of 18.3% of total governmental fund expenditures and 3.3x governmental debt service;
- Weak debt and contingent liability profile, with debt service carrying charges of 5.6% of expenditures and net direct debt that is 64.6% of total governmental fund revenue; and
- Strong institutional framework score.

Very weak economy

We consider the county's economy very weak. Wayne Charter County, with an estimated population of 1.8 million, is located in the Detroit-Warren-Dearborn, Mich. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 80.9% of the national level and per capita market value of $48,719. Overall, the county's market value fell by 1.6% to $85.8 billion in 2014, but rebounded a bit to $88.8 billion in 2015. Weakening Wayne Charter County's economy is its demographic profile, which includes significant population decline of 7%. The county unemployment rate was 10.0% in 2014.

Despite being part of a broad and diverse MSA, Wayne County's economy continues to struggle, brought down by falling taxable values, as well as high unemployment and a declining population. However, after seven straight years of declining taxable value, the figures for 2015 show growth of 0.5%, for a total value of $40.2 billion. The county's unemployment rate dropped to 10.0% for 2014, putting it just on the other side of the cutoff for high unemployment under our criteria (for rates over 10%).

Very weak management

We view the county's management as very weak, although it has "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Despite the existence of a wide range of policy and planning documents, the county's management score remains very weak due to the chronic structural imbalance. This assessment is based on the county's inability to date to implement meaningful changes that would cure the structural imbalance. The nature of this challenge has prompted an adjustment to the management score regarding the existence of political gridlock; in turn, gridlock has led to an inability to make structural reforms for two consecutive years. The combination of these conditions results in an overall management score of very weak, which constrains the rating at 'BBB-'.

Although these long-standing conditions haven't been cured to date, the new county executive has continued to move his recovery plan forward, addressing many of these issues. However, in our view it is still too soon to see if the kind of major changes necessary to transform the operating structure will occur.

The county uses historical data to build its budget and zero-based budgeting for both revenues and expenditures. The budget is monitored through monthly reporting to the board on year-to-date, as well as projections for year-end. To facilitate long-term financial planning, the county produces a two-year budget as well as a formal five-year budget projection designed to address its goal of structural balance. Wayne County also annually updates a formal five-year capital improvement plan that identifies sources of funding. It has its own investment policy and provides quarterly updates to the board on holdings and earnings, and also a comprehensive debt management policy. It also has a formal fund balance policy of two months' reserves; however, it has not met that standard for some time.

Adequate budgetary performance

Wayne Charter County's budgetary performance is adequate in our opinion. The county had surplus operating results in the general fund of 1.8% of expenditures, but a slight deficit result across all governmental funds of 0.8% in fiscal 2014. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2014 results in the near term. Additionally, we expect Wayne Charter County's structural imbalance will continue and while it has been making progress, management still does not have an executed plan in place that is sufficient to address the imbalance, which is a negative credit factor.

Following higher transfers in from the Delinquent Tax Revolving Fund in the past several years, the county's operating performance has improved, although not structurally. Wayne County continues to address its structural imbalance through cost-cutting, particularly on large obligations. Although the new administration's cuts have not been finalized or demonstrated results, there is clearly movement toward making the changes. However, current projections for 2015 do not result in an improvement in the score, so potential deterioration has been factored in to the score.

Very weak budgetary flexibility

The available fund balance includes negative $82.8 million (negative 14.0% of expenditures) in the general fund and $85.5 million (14.5% of expenditures) that is outside the general fund but legally available for operations.

Under current projections, the county believes it could end fiscal 2015 with a slight positive balance in the general fund should all of the proposed cuts and adjustments be implemented. Although the improvement is unlikely to move the score to weak from very weak, if the county ends the year with a positive general fund balance it would be the first time since 2007.

After ending any fiscal year with a negative unreserved balance in the general fund, municipalities in Michigan are required to file a deficit elimination plan with the state. The county has filed several versions of this in the past, and does not have a current plan on file. However, it has created a Recovery Plan to address the accumulated deficit and regain structural balance. The Recovery Plan includes key restructurings of pension and other postemployment benefit (OPEB) obligations as well as other adjustments, and is the day-to-day road map the county is using as it proceeds with its transformation.

Very strong liquidity

In our opinion, Wayne Charter County's liquidity is very strong, with total government available cash of 18.3% of total governmental fund expenditures and 3.3x governmental debt service in 2014. In our view, the county has satisfactory access to external liquidity if necessary.

The strength of Wayne County's liquidity position is derived from pooled cash. In our view, access to external liquidity and the capital markets remains only satisfactory due to the mention of bankruptcy by the county earlier this year. Projections for cash shortfalls show cash levels to be sufficient through the fiscal year, particularly when incorporating planned operating cost adjustments.

Weak debt and contingent liability profile

In our view, Wayne Charter County's debt and contingent liability profile is weak. Total governmental fund debt service is 5.6% of total governmental fund expenditures, and net direct debt is 64.6% of total governmental fund revenue.

The county continues to struggle with the bond-funded jail project that was put on hold last year due to significant cost overruns and remains in limbo while the county determines the next steps. The jail bonds carry the county's long-term GO pledge and Wayne County has indicated it will continue to make debt service payments even while the project is stalled.

One of the county's primary objectives in its restructuring plan is to structurally adjust its long-term liabilities for pensions and OPEB. Negotiations with unions are currently underway and Wayne County believes they should yield significant operational savings over time. Although the county has received the adjustment for a large pension obligation, we believe the changes it is pursuing to fund that obligation indicate it has a plan to try to contain long-term retiree costs. However, should the plan not be implemented in its entirety or have fewer long-term benefits than projected, this adjustment will be reversed.

Wayne Charter County's combined pension and OPEB contributions totaled 11.7% of total governmental fund expenditures in 2014. Of that amount, 7.2% represented contributions to pension obligations and 4.5% represented OPEB payments. The county made 104% of its annual required pension contribution in 2014.

A recent settlement with retirees regarding the inflation equity reserve (commonly known as the 13th check) has resulted the county making a one-time payment of $49.8 million. The county plans to fund this through a one-year judgment levy as well as non-general fund reserves, and does not anticipate further 13th check-related payments.

Strong institutional framework

The institutional framework score for Michigan counties with a population greater than 4,000 is strong.

Outlook

The negative outlook on the bonds reflects Standard & Poor's expectation that making the significant, meaningful adjustments necessary could be a long and challenging process for the county, and could take longer than anticipated. Without clear, demonstrable progress in the next year to regain structural balance and reduce the county's sizable pension and OPEB burden, we could lower the rating. In addition, should Wayne County's liquidity position deteriorate significantly, we would lower the rating. An outlook revision to stable over the one-year outlook horizon is possible if there is evidence of meaningful changes to the county's operations, specifically with regard to structural balance. However, without Standard & Poor's seeing clear evidence of the ability to execute structural reforms and the elimination of political gridlock within the county's operations, the rating is precluded from going any higher, and could well be lowered.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Special Tax Bonds, June 13, 2007

- USPF Criteria: Short-Term Debt, June 15, 2007
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

Institutional Framework Overview: Michigan Local Governments

Ratings Detail (As Of June 11, 2015)		
Wayne Charter Cnty GO ltd tax nts (federally taxable oblig) ser 2015 due 12/01/2017		
Short Term Rating	SP-1	Affirmed
Wayne Charter Cnty GO (AGM)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Wayne Cnty downriver swg disp sys rfdg bnds ser 1999 A dtd 08/10/1999 due 11/01/1999-2013		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Detroit-Wayne Cnty Stadium Auth, Michigan		
Wayne Charter Cnty, Michigan		
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) stadium (AGM)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) GO		
Long Term Rating	BB+/Negative	Affirmed
Michigan Fin Auth, Michigan		
Wayne Charter Cnty, Michigan		
Michigan Fin Auth (Wayne Charter County) GO		
Long Term Rating	BB+/Negative	Affirmed
Michigan Mun Bnd Auth (Wayne Charter Cnty) local govt ln prog (ASSURED GTY)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Wayne Cnty Bldg Auth, Michigan		
Wayne Charter Cnty, Michigan		
Wayne Cnty Bldg Auth (Wayne Charter Cnty) GO equiv		
Long Term Rating	BB+/Negative	Affirmed

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Detroit-Wayne County Stadium Authority
Wayne Charter County; General Obligation; General Obligation Equivalent Security

Primary Credit Analyst:
Jane H Ridley, Chicago (1) 312-233-7012; jane.ridley@standardandpoors.com

Secondary Contact:
John Sauter, Chicago (1) 312-233-7027; john.sauter@standardandpoors.com

Table Of Contents

Summary:

Detroit-Wayne County Stadium Authority Wayne Charter County; General Obligation; General Obligation Equivalent Security

Credit Profile		
Wayne Charter Cnty GO		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative

Rationale

Standard & Poor's Ratings Services has placed its 'BB+' rating on Wayne Charter County, Mich.'s limited-tax general obligation (GO) bonds on CreditWatch with negative implications. The CreditWatch placement reflects Standard & Poor's expectation that, with the onset of actions under Michigan Act 436, the county could lose some of the autonomy currently held by the CEO and his staff.

On June 17, Wayne County's CEO Warren Evans submitted a letter to the treasurer of the State of Michigan requesting a preliminary financial review of the county, as described in Michigan Act 436. If the governor accepts the county's request for a financial review and the process continues as described in Act 436, the Wayne County board could choose one of four possible outcomes: (1) a consent agreement; (2) an emergency manager; (3) a neutral evaluation; or (4) a move to file for Chapter 9 bankruptcy.

In our previous GO analysis, we stated that starting with negotiations and using all other actions allowable Michigan law, Wayne County plans to use all of its possible negotiating power to close the structural imbalance and address the low pension funding levels and outstanding other postemployment benefits unfunded accrued actuarial liability. In our view, the county's request for financial review does not signal the start of filing for bankruptcy, but rather a step in its stated goal of using all possible tools to regain structural balance.

However, given the uncertainty associated with these four options--as well as the potential for a prolonged time frame to make additional meaningful structural changes while this process is underway--we have placed the rating on CreditWatch.

Although we don't currently believe that bankruptcy is an option under consideration, uncertainties associated with the potential appointment of an Emergency Manager are significant enough that we believe a rating action could be warranted should that be the outcome. This is primarily due to the autonomy an Emergency Manager has under Act 436, and the possibility that the restructuring plan as developed by the CEO's staff would be changed significantly, and include fewer long-term structural adjustments.

For additional information on our GO rating on Wayne County, please see the summary analysis published June 11, 2015, on RatingsDirect.

The negative CreditWatch reflects Standard & Poor's expectation that with the onset of actions under Michigan Act 436, the county's autonomy to self-direct its restructuring could be diminished if an emergency manager is ultimately selected. In our view, this could mean that making the significant, meaningful adjustments necessary could be delayed or adjusted, which would have an impact on the county's long-term financial health. Should the county retain control over its restructuring--such as via a consent agreement--we could remove the rating from CreditWatch and assign a negative outlook, reflecting the long-term budget pressures the county is facing. In our view, the appointment of an emergency manager would not leave as much control with the county staff--and potentially could open the possibility for the county to veer off course to regaining structural balance--in which case, we could lower the rating. Regardless, if the timeframe of changes slows markedly, we could lower the rating.

Notwithstanding the uncertainty of the county's near-term management control, without the county's clear, demonstrable progress in the next year to regain structural balance and reduce its sizable pension burden, we could lower the rating. In addition, should Wayne County's liquidity position deteriorate significantly, we could lower the rating. Without Standard & Poor's seeing clear evidence of the county's ability to execute structural reforms and the elimination of political gridlock within the county's operations, the rating is precluded from going any higher, and could well be lowered.

Standard & Poor's expects to resolve the CreditWatch within the next 90 days.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of June 23, 2015)		
Wayne Charter Cnty GO (AGM)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Wayne Cnty downriver swg disp sys rfdg bnds ser 1999 A dtd 08/10/1999 due 11/01/1999-2013		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Detroit-Wayne Cnty Stadium Auth, Michigan		
Wayne Charter Cnty, Michigan		
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) stadium (AGM)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) GO		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative
Michigan Fin Auth, Michigan		
Wayne Charter Cnty, Michigan		
Michigan Fin Auth (Wayne Charter County) GO		

Ratings Detail (As Of June 23, 2015) (cont.)		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative
Michigan Mun Bnd Auth (Wayne Charter Cnty) local govt ln prog (ASSURED GTY)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Wayne Cnty Bldg Auth, Michigan		
Wayne Charter Cnty, Michigan		
Wayne Cnty Bldg Auth (Wayne Charter Cnty) GO equiv		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

4425 (Rev. 04-15)

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

DATE: June 25, 2015

TO: The Local Emergency Financial Assistance Loan Board

FROM: Nick A. Khouri, State Treasurer

SUBJECT: Interim Report - Preliminary Review of Charter County of Wayne

I. Background

On June 19, 2015, the Department of Treasury commenced a preliminary review of the finances of Wayne County to determine whether or not a local government financial problem existed. Section 4(1) of Public Act 436 of 2012, the Local Financial Stability and Choice Act, permits a preliminary review to be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the Wayne County (County) resulted from the conditions enumerated in subdivision (a), (o), (p), (r), and (s) of Section 4(1) having occurred within the County.[1] In addition to the conditions which brought about the preliminary review, other conditions were determined to exist during the course of conducting the reviewing including (j), (k), and (n).

During the preliminary review, Michigan Department of Treasury staff met with various County officials including Tony Saunders, Chief Restructuring Officer/Interim Chief Financial Officer; Mathieu Dube, Deputy Chief Financial Officer; Jerome Pokorski, Assistant Budget Director; David J. Szymanski, Chief Deputy Treasurer; Christa J. McLellan, Deputy Treasurer-Financial Services; and Paul Zelenak, Department Administrator – Tax Accounting.

II. Preliminary Review Findings

The preliminary review found the following:

[1] Subsection (a) provides that "the chief administrative officer of a local government requests a preliminary review." 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." Subsection (k) provides that "[t]he local government fails to timely file an … audit that conforms with the minimum procedures and standards of the state financial authority and is required for local governments under the uniform budgeting and accounting act." Subsection (n) provides that "[a] local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan." Subsection (o) provides that a "court has ordered an additional tax levy without the prior approval of the governing body of the local government." Subsection (p) provides that "[a] municipal government has ended a fiscal year in a deficit condition." Subsection (r) provides that a "local government has been assigned a long-term debt rating within or below the BBB category or its equivalent by 1 or more nationally recognized credit rating agencies." Subsection (s) provides that "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress."

- On June 17, 2015, Wayne County Executive, Warren C. Evans, cited section 4(1)(a) of Public Act 436 of 2012, by asking that a "preliminary review be conducted to determine the existence of probable financial distress within the County." Mr. Evans further stated that "I recommend that a financial emergency be declared in the County."

- County officials violated requirements of Section 17 of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, which states, in part, that the "the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined." For example, for the fiscal year ending September 30, 2014 in the General Fund, the County Jail, the Prosecuting Attorney Office, and the Sheriff Department activities went over budget by $14.8 million, $2.7 million, and $1 million, respectively. Several revenue line items including Transfers In did not meet expectations falling short by over $42 million. Consequently, the net budgeted change in fund balance was negative $18,911,000; that is, according to the budget, fund balance was budgeted to fall by $18,911,000.

- County officials failed to file an audit report that conforms with the minimum procedures and standards of the Michigan Department of Treasury and is required for local governments under the Public Act 2 of 1968, Uniform Budgeting And Accounting Act. Local governments in the state of Michigan are required to pass budgets on an activity level or lower (for example, Prosecuting Attorney or Sheriff). The County's audit report does not comply with this requirement by reporting their budgets on the higher, function level (for example, Public Safety). As stated by County management, the "appropriated budget for the General Fund is adopted by function (e.g., general government, public safety, public works, etc)."

- The County has ended a fiscal year in a deficit condition and is in breach of its obligations under a deficit elimination plan. For the fiscal year ending September 30, 2014, deficits existed in the entity-wide governmental activities of $373 million in unrestricted net assets. Unrestricted General Fund deficits peaked at $156.4 million in 2013 and were reduced to $82.8 million in 2014. The recent reduction in the deficit is primarily due to a transfer of $91.6 million from the Delinquent Tax Revolving Fund which will increase borrowing costs for the County when annually purchasing delinquent taxes from local units of government within the County. According to the County, $153 million more will be transferred in 2015. Unrestricted deficits in the General Fund began in the fiscal year of 2008 with an unrestricted deficit of $10.6 million. Without taking remedial measures, the County is projecting a $171.4 million deficit by fiscal year 2019.

  Other funds that had deficits in 2014 were the Health Fund of $5 million, the Nutrition Fund of $3.2 million, the Community and Economic Development Fund of $2.3 million, the Wetlands Mitigation Fund of $1,000, and the Regional Jobs and Economic Growth Fund of $1,000.

  County officials had not filed an adequate or approved deficit elimination plan with the Department of Treasury for fiscal years 2010, 2011, and 2012. For fiscal year 2013, County officials' plan to transfer $81 million from the Delinquent Tax Revolving Fund ($91.6 million was actually transferred) and the creation of a Waste Water Authority[2] to realize a one-time payment of $121 million from participating communities was not certified by the Department of Treasury. No plan has been submitted for 2014 which was due when the audit was submitted at the end of March 2015.

- On May 29, 2015, the Circuit Court of Wayne County issued a judgment in favor of the retirement system for more than $49 million without the prior approval of the County's governing body. On June 4, the County Board of Commissioners voted to pay the levy with Delinquent Tax Revolving Fund money. However, the County executive vetoed the action. Consequently, a judgment levy will be placed on the County's tax rolls.

  As stated by County management in the most recent audit report, "[c]ost pressures, particularly in the healthcare and pension area, continue to challenge County finances. Pensions, retiree healthcare and other postemployment benefits (OPEB) make up 70% of the County's long-term liabilities. The defined benefit plan is 45% funded, and no significant effort has been made to prefund OPEB liabilities."

- The County's primary pension plan is 45% funded and has a liability of $910.5 million based on the last actuarial valuation performed dated September 30, 2013. This is contrasted with a 94.8% funded ratio in 2004 and a total liability of $49.6 million at that time.

  Over the past 10 years, the County's funded ratio has been cut by 49.7% while its unfunded liability has increased to more than 18 times its 2004 balance. This decline in funding was caused by reopening plans to new members in 2002 and 2008, underperforming investments, increasing payrolls, and generous incentives including those for early retirement that waived the age requirements and enabled plan members to buy years of service at discounted rates.

- Recently, the County's credit rating was downgraded by the three major credit rating services. Moody's rating is now at Ba3, the Fitch rating is at B, and the Standard and Poor's rating is now at BB+. On June 24, 2015, Standard and Poor's placed the County on CreditWatch with negative implications. The Fitch and the Standard and Poor's ratings are classified as non-investment grade, speculative, or junk and the Moody's rating is only slightly better. (See enclosed reports.)

- Total long-term obligations of the County including component units, but not including pension obligations, amounted to $3.3 billion for the fiscal year ended September 30, 2014. Total obligations compared to total Net Position (i.e., debt to equity ratio) is 2.2 (i.e., long-term obligations are 2.2 times the size of the County's Net Position). A ratio of less than 1.0 may be considered acceptable by the Department of Treasury.

- Over the past several years, taxable values within the County declined approximately 24% reducing the amount of property taxes received. Since 2007, the property tax revenues in the General Fund declined by over $156 million while total expenditures increased by over $50 million.

[2] The Waste Water Authority has not yet been created.

- For the last several years, County officials have issued tax anticipation notes to meet cash flow shortages. The amounts borrowed for these purposes were $60 million in 2009, $100 million in each of the years of 2010 through 2012, $90 million in 2013, and $75 million in 2014. This prolonged use of short term borrowing provides evidence of a declining cash position. The County has projected significant cash shortages of over $100 million in its General Fund until September when the summer tax levy is collected. There also appears to be borrowing from the restricted Roads Fund in 2012 and 2013 for at least $27 million and $8 million, respectively.

- Total interfund loans in fiscal year 2012 were $110.9 million, an increase of $95.5 million from the prior year. The majority of these interfund loans, $87.4 million, was borrowed by the General Fund. In 2013, total interfund amounts increased to $148.8 million. The General Fund owed $106 million of this to other funds. The Juvenile Justice Fund owed $21.4 million of the $148.8 million to other funds. In fiscal year 2014, the total interfund balance improved by decreasing to $64.7 million. The General Fund owed roughly $39.5 million of this amount to the Delinquent Tax Revolving Fund. Large interfund borrowing may be indicative of cash flow concerns.

- County officials made significant recurring transfers between funds. For the past five years, County officials transferred out of the General Fund to other funds an average of $109.5 million annually. Sixty-seven percent ($74 million) of these transfers were to the Juvenile Justice Fund and 13% ($14.5 million) were to Non-major Governmental funds. Over the same period, the Delinquent Tax Revolving Fund's average transfer out was $35.7 million. The majority of the transfers from the Delinquent Tax Revolving Fund were to the General Fund increasing from $4 million in 2010 to $91.6 million in 2014. Large interfund transfers may be indicative of cash flow concerns.

- In September 2011, the County began construction of a $300 million jail to replace and consolidate three aging jail facilities. In June 2013, construction was halted when estimates put the cost of completion at $391 million. From May 1, 2014 to April 30, 2015, County officials spent roughly $14.3 million on servicing the debt related to the construction and $725,000 for site preservation costs. It remains unclear whether the County will sell the site or finish the partially built jail.

Enclosure
cc: Wayne Workman, Deputy State Treasurer
Ed Koryzno, Director, Bureau of Local Government Services

MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
27 FEBRUARY 2015

Rate this Research

RATINGS

Wayne County	
General Obligation Limited Tax	Ba3 negative

KEY METRICS:

	2012	2013	2014
Full valuation ($ billions)	$87.1	$85.8	$85.0
Available fund balance as a percentage of revenues	-9.7%	-4.1%	-5.6%

	2000	2010	2012
Median family income (% of US)	91.3%	87.7%	81.6%
Population (millions)	2.1	1.8	NA

ANALYST CONTACTS

David Levett 312-706-9990
Analyst
david.levett@moodys.com

Matthew Butler 312-706-9970
AVP-Analyst
matthew.butler@moodys.com

Henrietta Chang 312-706-9960
VP-Sr Credit Officer
henrietta.chang@moodys.com

Jack Dorer 212-553-1332
MD-Public Finance
jack.dorer@moodys.com

Wayne County, MI - Local Government

County Grapples with Rapidly Declining Tax Base and Limited Financial Flexibility

Wayne County's ability to combat a declining tax base and persistent operating deficits is hindered by its limited revenue-raising flexibility and barriers to reducing expenditures. Without significant budget adjustments, the ongoing structural imbalance raises the likelihood of impaired cash flows and increased state intervention. On February 6, we downgraded the county to Ba3 from Baa3. Key factors driving the county's rating below investment grade:

» **Wayne County's narrow liquidity is propped up by its Delinquent Tax Revolving Fund (DTRF).** The county is increasingly reliant on transfers from the DTRF, which is not sustainable as the fund's available cash is being depleted. Exhaustion of DTRF liquidity would impair county cash flows given the General Fund's net cash position of negative $5.3 million at the close of fiscal 2013.

» **The county has yet to substantially reduce expenditures or make other structural changes.** Growing demand for services such as public safety has limited the county's ability to cut costs. The county's new management team is planning substantial adjustments, but any significant reductions in payroll or retiree benefits will need to go through a collective bargaining process.

» **Tax caps stymie Wayne County's ability to offset tax base declines.** Property taxes are an important revenue source for the county, comprising over half of General Fund revenues. The county's taxable values have declined 24% since 2007. The county's property tax rates are capped, which results in revenue losses as taxable values decline and limits how quickly revenues can grow once values begin to recover.

» **Weak demographic trends pose barriers to economic revitalization.** The county's population continues to decline, led by migration out of Detroit (issuer rating B3 stable). Population trends are more stable in suburban parts of the county. The county is experiencing some economic recovery, though unemployment remains high and the labor force continues to shrink.

Narrow liquidity propped up by Delinquent Tax Revolving Fund (DTRF)

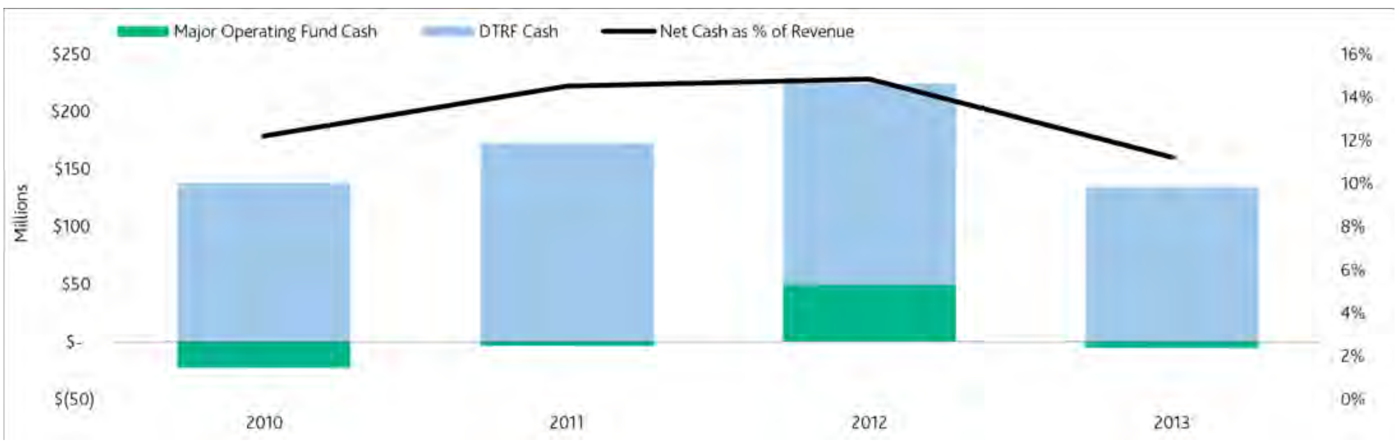
The county is increasingly reliant on transfers from the DTRF, which is not sustainable as the fund's available cash is being depleted. The reliance is rooted in an ongoing operating imbalance driven by a declining revenue base and expenditure pressures. Property taxes, the county's largest source of operating revenue, declined over 20% since 2007. During that same period, General Fund expenditures increased by 5%, or 1.5% annually. This structural imbalance has led to significant General Fund operating deficits in each of the last five years, net of transfers, reducing available operating net cash position from $13.3 million in fiscal 2010 to a negative $5.3 million at the close of fiscal 2013.

The fiscal 2013 net cash position consisted of a $57 million deficit in the General Fund, net of tax anticipation notes (TANs) outstanding at year-end, offset by a positive cash balance in the Mental Health Fund, from which the county has relied on internal borrowings to support general cash flow. We also consider unrestricted cash from the county's DTRF in our assessment of its total operating liquidity. Including unrestricted cash from the DTRF, fiscal 2013 operating liquidity was a positive $77.2 million, or a still slim 6% of core operating revenue.

The DTRF is an enterprise administered by the county treasurer, who has discretion to release available resources from the reserve to fund general county operations. In recent years, the treasurer has designated increasing amounts of the reserve as unrestricted and available. Exhibit 1 shows the county's available operating cash trend, including all DTRF cash, both restricted and unrestricted. Beginning in 2014, the majority of the accumulated cash will have been transferred to the General Fund. Going forward, the treasurer will still be able to transfer any current year net revenues from the DTRF to the General Fund, which have averaged $42 million annually from 2009 through 2013. The net income increased in recent years as delinquencies increased; going forward, they are projected to decline in line with delinquencies.

Exhibit 1

Wayne County's Total Operating Liquidity Declining, Despite Increasing DTRF Support



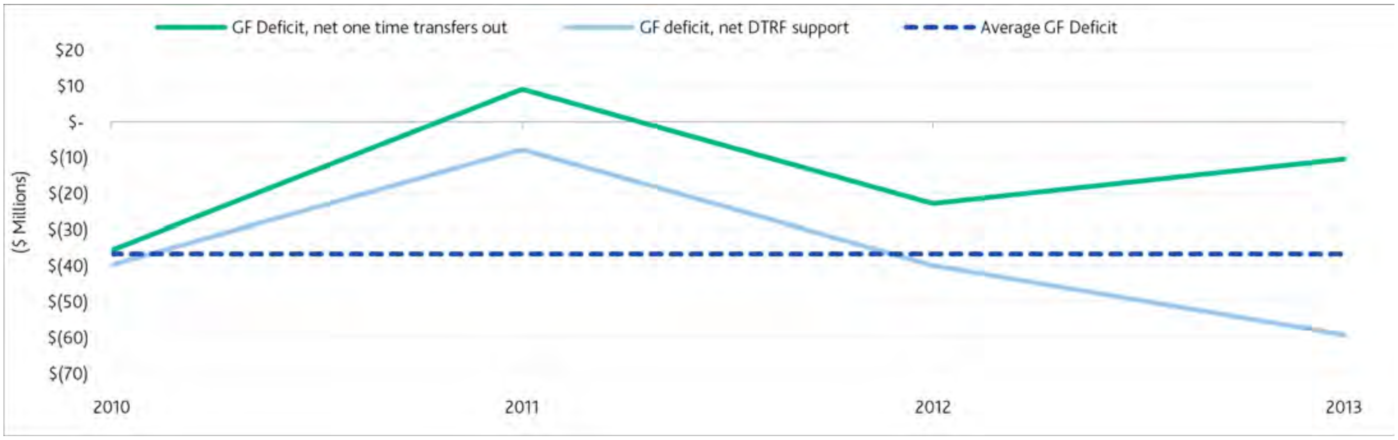
Source: County CAFR (2010-2013)

Projected DTRF annual net income is not likely to be sufficient to close the county's General Fund operating deficit. Exihibit 2 shows the increasing annual operating deficit, which has reached $60 million as of the most recent audited fiscal year. While the county's fiscal 2014 CAFR is not yet available, it is likely to depict a further operational shortfall, partially offset by a transfer from the DTRF.

Exhibit 2

Wayne County General Fund Operating Deficit Reached $60 Million in Fiscal 2013

Annual Deficits Averaged $36.6 Million from 2010-13



Source: County CAFR (2010-2013)

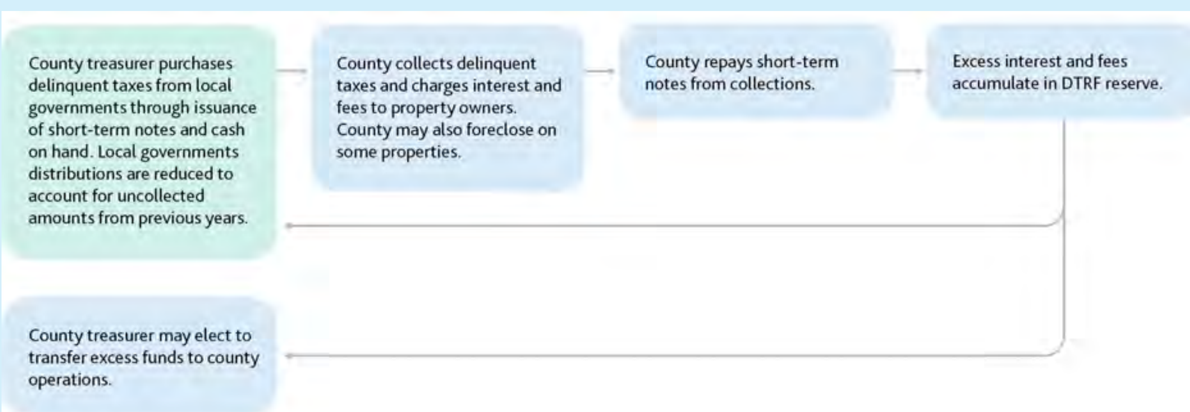
Delinquent Tax Funds Benefit Michigan Counties

Most Michigan counties maintain a Delinquent Tax Revolving Fund (DTRF) to manage the flow of delinquent tax collections, which are typically collected over two to three years following the tax year in which bills are due. Counties take on the responsibility for collecting all delinquent property taxes within their jurisdiction after purchasing the delinquencies from all of its underlying municipalities. It then recoups the proceeds from collecting the delinquencies, plus any accumulated fees and interest due on the delinquencies. In some cases, the counties pursue foreclosures and auctions to recoup the value of the delinquencies.

At the end of the collection period, any delinquencies that remain unpaid are due from the underlying municipality. This typically does not require a payment from the municipality as the county will simply deduct the outstanding amount from the new delinquencies it will purchase from that municipality. The excess revenues earned are available for the county's general operations. Some counties will issue short-term notes to fund the purchase of delinquencies. Exhibit 3 shows the process flow of the DTRF and distributions to local governments, from the county treasurer purchasing delinquent tax rights to the generation of net income.

Exhibit 3

DTRF Purchases Collection Rights from Local Governments and Keeps Interest and Fees

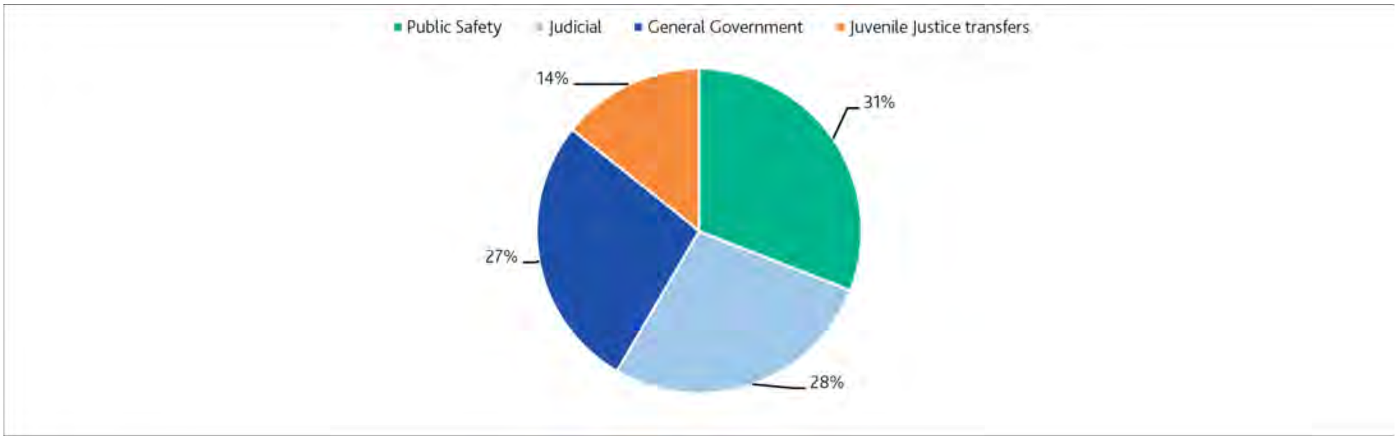


Source: Moody's Investors Service

Wayne County has yet to substantially reduce expenditures or make other structural changes

The county's capacity to reduce expenditures has remained limited by growing service demands, especially for public safety in economically challenged areas, including Detroit and its neighboring communities. Combined public safety and judicial services comprise nearly 50% of the county's General Fund budget, with the addition of juvenile justice services bringing total social service expenses to 61% (see Exhibit 4). While the county has successfully reduced expenditures for juvenile justice services, costs for public safety and judicial operations increased a cumulative 27% from 2009 through 2013. The county has faced hurdles reducing wages and benefits through collective bargaining. In addition, the county sheriff and county prosecutor, who are separately elected officials, have successfully challenged budget cuts in their respective departments by filing lawsuits against the county.

Exhibit 4
Key Social Services Comprise the Majority of Wayne County's Budget
Fiscal 2013 Expenditures



Source: Wayne County FY13 CAFR

Wayne County has a new management team in place, which is planning for substantial adjustments in county operations and expenditure structure. Any significant reductions in payroll or benefits will require the support of various employee groups. Non-wage personnel costs in the General Fund include approximately $54 million of combined pension and retiree health care expenditures. The county could reduce normal pension costs through wage or personnel reductions, but has little flexibility to cut accrued benefits. Trimming retiree health care expenditures carries more legal flexibility. A 2012 circuit court decision affirmed reductions the county implemented in 2009, providing likely support for future adjustments. Still, cuts to health care benefits will likely be a target for litigation, which at the very least could delay implementation and provide the county with little help in addressing its budget imbalance.

The county has submitted a Deficit Elimination Plan to the state. Should the county fail to adequately reduce expenditures, the state could increase its oversight under Public Act 436. If the state were to declare a financial emergency under the act, the county would have several options, including requesting an emergency manager appointment, or seeking authorization to file for Chapter 9 protection.

Tax caps stymie Wayne County's ability to offset tax base declines

The county's ability to eliminate operating deficits with tax increases is limited. The county's full valuation remains sizable, but declined by a cumulative 36% in the seven years since 2007, falling from a peak of $132 billion to the current $85 billion. Detroit accounts for 19% of the county's full valuation. The county's property taxes are based on taxable valuation, which declined by 24% since 2007, driving a corresponding 23% drop in the county's property tax levy through 2013.

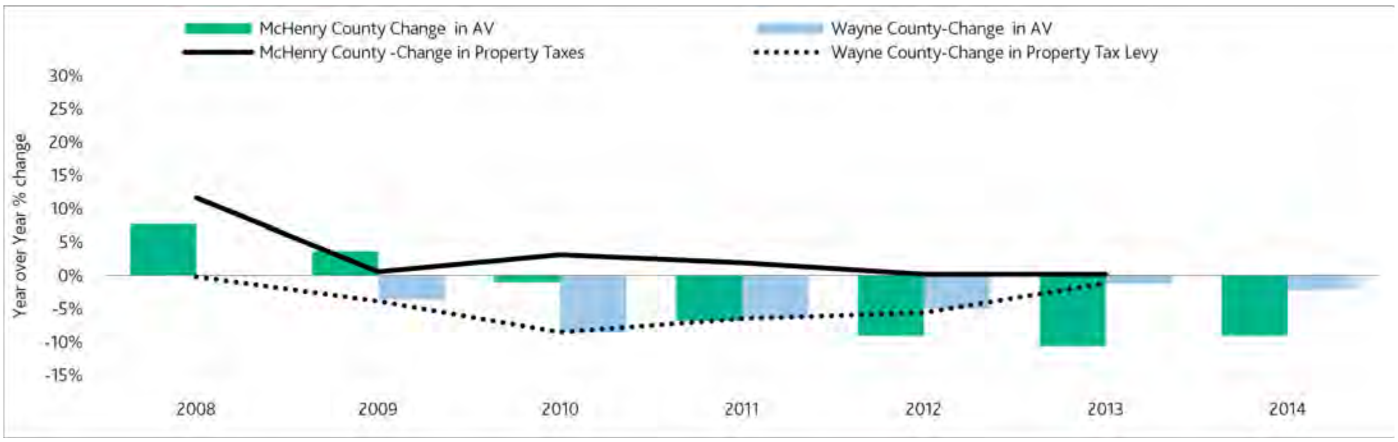
The maximum millage rate for Wayne County is established in its charter though voters can approve additional levies, last done in the late 1990s. The property tax levy is further restricted by provisions in the state constitution and state statute, commonly known as the Headlee Amendment and Proposal A. The Headlee Amendment limits revenue growth generated from existing property to the rate of growth in the Consumer Price Index (CPI). The limit creates a permanent reduction in the allowable tax rates, so the impact continues even when values are depreciating. Proposal A limits growth in taxable valuations. Since the county is levying at the maximum millage rates permissible under the caps and there were no voter overrides in recent years, the county saw substantial drops in property tax receipts from declining taxable valuation.

There are large variations in taxing limitations among states. For example, Exhibit 5 illustrates the impact of rate limitations on property tax revenues through a comparison of Wayne County to McHenry County, IL (Aaa). Illinois counties are generally subject to much less onerous rate limits than those in Michigan. McHenry, a rapidly growing county near Chicago, has experienced a greater decline in assessed values than Wayne County. However, McHenry is not subject to any rate limitation for its Corporate Fund tax rate and its operating levies can grow up to the greater of 5% or the Consumer Price Index (CPI). Despite steep declines in assessed values, McHenry County's rate raising flexibility has allowed property tax revenues to continue to grow, albeit at a slower pace.

Exhibit 5

Valuation Declines Have Disparate Impact on Government Revenues

Change in Revenues and Valuations for Wayne County, MI and McHenry County, IL



Source: Continuing disclosures, offering statements, CAFRs

While most of the taxable valuation in southeast Michigan is showing signs of stabilization or recovery, Wayne County's overall values continue to depreciate, most recently with a 2.2% decline in 2014. The decline is largely driven by Detroit, however, and the county's valuation outside of Detroit is showing signs of stabilization with a 2.3% increase in 2014.

Even when values do begin to recover, the limitations posed by Headlee and Proposal A will substantially slow the recovery of property tax revenues. Regardless of how far taxable and market values fall and how fast they recover, municipal property tax revenues in Michigan can generally only grow by CPI, absent voter approval or new development.

Weak demographic trends pose barriers to economic revitalization

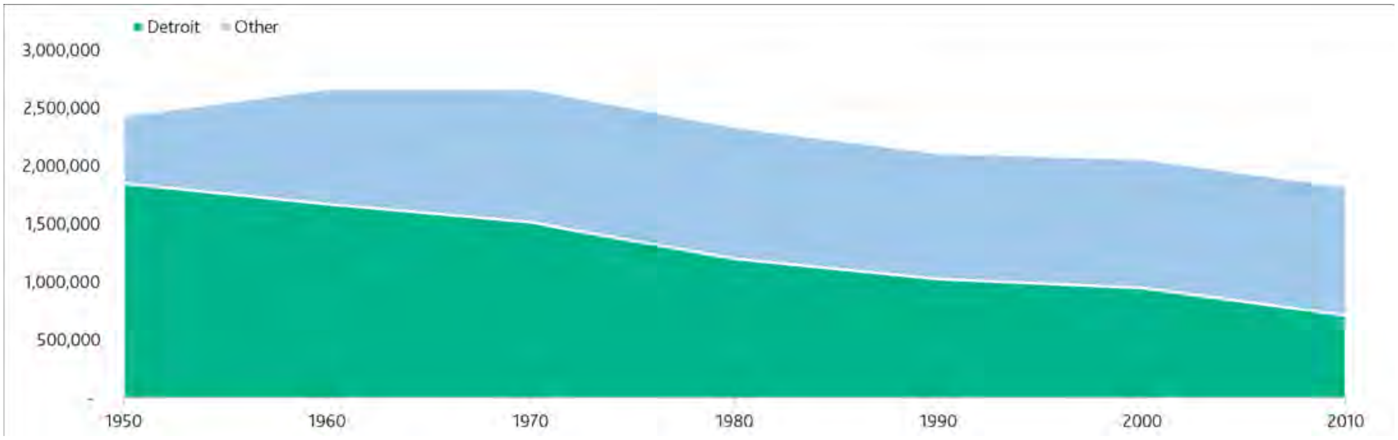
A weak demographic profile and struggling economy are major drivers of not only expenditure pressure, but revenue declines. The county has suffered from decades of population loss led by the City of Detroit. Migration out of the city, as well as other neighboring suburbs, has contributed to a steady decline in county population since 1970 and was the principal factor in a 12% loss in the 2010 census.

Detroit comprised just 38% of the county's population in 2010, down from 52% in 1980. Population outside of Detroit (see Exhibit 6) has remained relatively stable. The state's population has also declined over the last decade, albeit at a slower rate.

Exhibit 6

Detroit Losses Lead to a Shrinking Wayne County Population Base

Wayne County Population 1950-2010



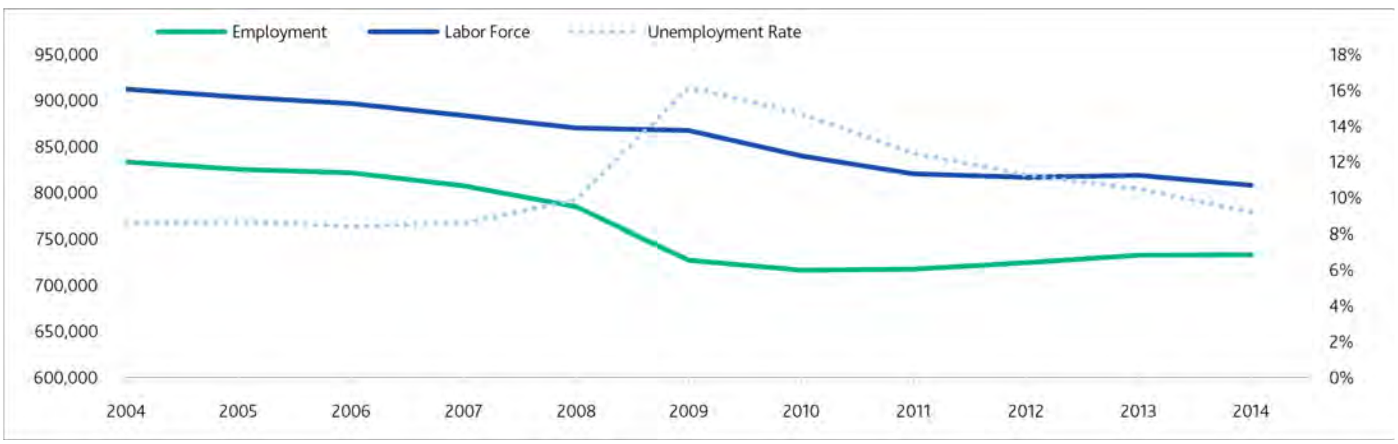
Source: US Census Bureau

Median family income (MFI) in the county is estimated at a modest 82% of the national figure. The county's December 2014 unemployment rate is well above the national average at 7.4%. While this is much improved from monthly rates that exceeded 16% in 2009 (see Exhibit 7), it also reflects a 7% decline in the labor force over the same time period. Favorably, total employment in the county has grown modestly in each of the past few years.

While the overall economic profile is weak, the county has pockets of affluence, including Livonia (Aa2, MFI 128% of the US), Northville Township (unrated, MFI 178% of the US), and Grosse Pointe (Aa2, MFI 208% of the US).

Exhibit 7

Wayne County's Unemployment Rate Improves, but the Labor Force Continues to Contract



Source: US Department of Labor

Moody's Related Research

- Moody's downgrades Wayne County, MI's GOLT to Ba3 and maintains negative outlook
- Michigan Tax Caps Limit Benefit of Real Estate Gains

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

AUTHORS
David Levett
Hetty Chang
Matt Butler

EDITOR
David Goetzl

DATA VISUALIZATION
Lisa Mahapatra

STANDARD & POOR'S
RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Summary:

Wayne Charter County, Michigan; General Obligation; General Obligation Equivalent Security; Note

Primary Credit Analyst:
Jane H Ridley, Chicago (1) 312-233-7012; jane.ridley@standardandpoors.com

Secondary Contact:
John Sauter, Chicago (1) 312-233-7027; john.sauter@standardandpoors.com

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Summary:

Wayne Charter County, Michigan; General Obligation; General Obligation Equivalent Security; Note

Credit Profile		
US$186.9 mil GO ltd tax nts (federally taxable oblig) ser 2015 due 12/01/2017		
Short Term Rating	SP-1	New
Wayne Charter Cnty GO		
Long Term Rating	BB+/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'SP-1' rating to Wayne Charter County, Mich.'s limited-tax general obligation (GO) delinquent tax notes series 2015. At the same time, Standard & Poor's affirmed its 'BB+' rating on the county's limited-tax GO bonds.

The rating on the notes is based on our assessment of the following credit factors:

- A lien on pledged tax revenues in favor of the trustee on behalf of note holders;
- The requirement to place collected tax revenues in a segregated enterprise fund, separate from the county's general operations;
- A note reserve fund held by the trustee and funded at 10% of par;
- A prohibition in state statute for the county to use tax collections for any other purpose than for the payment of notes (e.g., general fund purposes);
- Adequate projected coverage that improves when incorporating the note reserve account; and
- Limited-tax GO pledge.

The 2014 real property taxes due to Wayne County, outstanding and uncollected as of June 1, 2015, and the county's limited-tax GO pledge secure the series 2015 notes. Pledged revenues securing the notes include $192.1 million of 2014 delinquent property taxes, plus statutory interest and fees estimated to be delinquent after June 1, 2015. The notes can be issued as fixed or variable rate, and the structure considered in this rating is fixed rate notes. Should the notes be sold as variable rate, we understand there would be no put feature, and we expect coverage would be similar to coverage on the fixed rate notes.

On a weekly basis, the county will transfer collections to the trustee. Wayne County has also created a note reserve of $18.7 million to be held with the trustee as alternate liquidity (10% of par). For all notes issued, all delinquent taxes, plus statutory interest and fees (including chargebacks from local governments on amounts that are uncollectible) and cash on hand in the delinquent tax fund provide coverage of note debt service by pledged revenues on the five maturity dates (December 2015, June and December 2016 and 2017) of 1.20x, 1.20x, 2.43x, 2.18x, and 1.61x, respectively. Coverage with the note reserve goes up to 1.67x, 1.65x, 3.12x, 2.72x, and 1.95x at each of the maturity dates.

Wayne County's full faith and credit, limited-tax GO pledge provides additional security to the extent that collections are insufficient to make debt service payments. Historically, delinquent tax collections have been sufficient to pay debt service when due, and the county expects the same for the 2015 notes. After starting to slow in 2008, the collection pace in recent years has improved, and the county reports that this year tax payments have been picking up speed.

The county has covenanted in the indenture that as long as these notes are outstanding it will not issue additional notes secured by the 2014 delinquent taxes.

In conjunction with the sale of the notes, Wayne County's special bankruptcy counsel has issued an opinion regarding their expectations as to treatment of the notes should the county file for bankruptcy. Although these opinions provide us with additional comfort regarding the legal constructs that protect the enterprise funds from invasion by the county in a bankruptcy context, they do not, in our opinion, fully mitigate concerns related to treatment of the notes should the county file for bankruptcy. As we have observed in other bankruptcy proceedings, including that of Detroit, Mich., municipal bankruptcy is an inherently unpredictable and messy process where settlements rather than expected legal treatment often drive recoveries. Nevertheless, given statements made by the county regarding its restructuring plan and its current trajectory, the county does not appear to be poised to file for bankruptcy; we have factored these statements into our analysis.

The 'BB+' rating on the county's GO limited-tax bonds is constrained by Wayne County's chronic structural imbalance and persistent negative unassigned general fund balance; these two circumstances have led to pressures on the management score that result in a rating cap of 'BBB-' for unlimited-tax bonds; a one-notch differential is made between the unlimited- and limited-tax ratings based on the county's weak financial position and ongoing budgetary challenges. The county's series 2012 limited-tax bonds are also secured by tourism taxes, but the rating is based on the strength of the GO pledge.

The rating reflects our understanding that the process of contract negotiations and other adjustments planned by the county will make meaningful progress in closing the county's structural budget gap and eliminating the accumulated deficit in the near term. The negative outlook reflects the magnitude of this undertaking, and our opinion that the time frame for making the changes could be drawn out beyond the county's current expectations. The county has made progress on these goals and indicates it remains largely on track with its original time frame. However, the magnitude of the changes remains significant, and their outcome will have a major impact on the county's long-term financial health and stability.

Other rating factors include:

- Very weak economy, with significant population decline, but access to a broad and diverse metropolitan statistical area (MSA);
- Very weak management, with "good" financial policies and practices under our Financial Management Assessment methodology, but the lack of a plan in place that is sufficient to address the county's ongoing structural imbalance;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2014; the county closed 2014 with an operating surplus in the general fund but a slight operating deficit at the total governmental fund level;

- Very strong liquidity, with total government available cash of 18.3% of total governmental fund expenditures and 3.3x governmental debt service;
- Weak debt and contingent liability profile, with debt service carrying charges of 5.6% of expenditures and net direct debt that is 64.6% of total governmental fund revenue; and
- Strong institutional framework score.

Very weak economy

We consider the county's economy very weak. Wayne Charter County, with an estimated population of 1.8 million, is located in the Detroit-Warren-Dearborn, Mich. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 80.9% of the national level and per capita market value of $48,719. Overall, the county's market value fell by 1.6% to $85.8 billion in 2014, but rebounded a bit to $88.8 billion in 2015. Weakening Wayne Charter County's economy is its demographic profile, which includes significant population decline of 7%. The county unemployment rate was 10.0% in 2014.

Despite being part of a broad and diverse MSA, Wayne County's economy continues to struggle, brought down by falling taxable values, as well as high unemployment and a declining population. However, after seven straight years of declining taxable value, the figures for 2015 show growth of 0.5%, for a total value of $40.2 billion. The county's unemployment rate dropped to 10.0% for 2014, putting it just on the other side of the cutoff for high unemployment under our criteria (for rates over 10%).

Very weak management

We view the county's management as very weak, although it has "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Despite the existence of a wide range of policy and planning documents, the county's management score remains very weak due to the chronic structural imbalance. This assessment is based on the county's inability to date to implement meaningful changes that would cure the structural imbalance. The nature of this challenge has prompted an adjustment to the management score regarding the existence of political gridlock; in turn, gridlock has led to an inability to make structural reforms for two consecutive years. The combination of these conditions results in an overall management score of very weak, which constrains the rating at 'BBB-'.

Although these long-standing conditions haven't been cured to date, the new county executive has continued to move his recovery plan forward, addressing many of these issues. However, in our view it is still too soon to see if the kind of major changes necessary to transform the operating structure will occur.

The county uses historical data to build its budget and zero-based budgeting for both revenues and expenditures. The budget is monitored through monthly reporting to the board on year-to-date, as well as projections for year-end. To facilitate long-term financial planning, the county produces a two-year budget as well as a formal five-year budget projection designed to address its goal of structural balance. Wayne County also annually updates a formal five-year capital improvement plan that identifies sources of funding. It has its own investment policy and provides quarterly updates to the board on holdings and earnings, and also a comprehensive debt management policy. It also has a formal fund balance policy of two months' reserves; however, it has not met that standard for some time.

Adequate budgetary performance

Wayne Charter County's budgetary performance is adequate in our opinion. The county had surplus operating results in the general fund of 1.8% of expenditures, but a slight deficit result across all governmental funds of 0.8% in fiscal 2014. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2014 results in the near term. Additionally, we expect Wayne Charter County's structural imbalance will continue and while it has been making progress, management still does not have an executed plan in place that is sufficient to address the imbalance, which is a negative credit factor.

Following higher transfers in from the Delinquent Tax Revolving Fund in the past several years, the county's operating performance has improved, although not structurally. Wayne County continues to address its structural imbalance through cost-cutting, particularly on large obligations. Although the new administration's cuts have not been finalized or demonstrated results, there is clearly movement toward making the changes. However, current projections for 2015 do not result in an improvement in the score, so potential deterioration has been factored in to the score.

Very weak budgetary flexibility

The available fund balance includes negative $82.8 million (negative 14.0% of expenditures) in the general fund and $85.5 million (14.5% of expenditures) that is outside the general fund but legally available for operations.

Under current projections, the county believes it could end fiscal 2015 with a slight positive balance in the general fund should all of the proposed cuts and adjustments be implemented. Although the improvement is unlikely to move the score to weak from very weak, if the county ends the year with a positive general fund balance it would be the first time since 2007.

After ending any fiscal year with a negative unreserved balance in the general fund, municipalities in Michigan are required to file a deficit elimination plan with the state. The county has filed several versions of this in the past, and does not have a current plan on file. However, it has created a Recovery Plan to address the accumulated deficit and regain structural balance. The Recovery Plan includes key restructurings of pension and other postemployment benefit (OPEB) obligations as well as other adjustments, and is the day-to-day road map the county is using as it proceeds with its transformation.

Very strong liquidity

In our opinion, Wayne Charter County's liquidity is very strong, with total government available cash of 18.3% of total governmental fund expenditures and 3.3x governmental debt service in 2014. In our view, the county has satisfactory access to external liquidity if necessary.

The strength of Wayne County's liquidity position is derived from pooled cash. In our view, access to external liquidity and the capital markets remains only satisfactory due to the mention of bankruptcy by the county earlier this year. Projections for cash shortfalls show cash levels to be sufficient through the fiscal year, particularly when incorporating planned operating cost adjustments.

Weak debt and contingent liability profile

In our view, Wayne Charter County's debt and contingent liability profile is weak. Total governmental fund debt service is 5.6% of total governmental fund expenditures, and net direct debt is 64.6% of total governmental fund revenue.

The county continues to struggle with the bond-funded jail project that was put on hold last year due to significant cost overruns and remains in limbo while the county determines the next steps. The jail bonds carry the county's long-term GO pledge and Wayne County has indicated it will continue to make debt service payments even while the project is stalled.

One of the county's primary objectives in its restructuring plan is to structurally adjust its long-term liabilities for pensions and OPEB. Negotiations with unions are currently underway and Wayne County believes they should yield significant operational savings over time. Although the county has received the adjustment for a large pension obligation, we believe the changes it is pursuing to fund that obligation indicate it has a plan to try to contain long-term retiree costs. However, should the plan not be implemented in its entirety or have fewer long-term benefits than projected, this adjustment will be reversed.

Wayne Charter County's combined pension and OPEB contributions totaled 11.7% of total governmental fund expenditures in 2014. Of that amount, 7.2% represented contributions to pension obligations and 4.5% represented OPEB payments. The county made 104% of its annual required pension contribution in 2014.

A recent settlement with retirees regarding the inflation equity reserve (commonly known as the 13th check) has resulted the county making a one-time payment of $49.8 million. The county plans to fund this through a one-year judgment levy as well as non-general fund reserves, and does not anticipate further 13th check-related payments.

Strong institutional framework

The institutional framework score for Michigan counties with a population greater than 4,000 is strong.

Outlook

The negative outlook on the bonds reflects Standard & Poor's expectation that making the significant, meaningful adjustments necessary could be a long and challenging process for the county, and could take longer than anticipated. Without clear, demonstrable progress in the next year to regain structural balance and reduce the county's sizable pension and OPEB burden, we could lower the rating. In addition, should Wayne County's liquidity position deteriorate significantly, we would lower the rating. An outlook revision to stable over the one-year outlook horizon is possible if there is evidence of meaningful changes to the county's operations, specifically with regard to structural balance. However, without Standard & Poor's seeing clear evidence of the ability to execute structural reforms and the elimination of political gridlock within the county's operations, the rating is precluded from going any higher, and could well be lowered.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Special Tax Bonds, June 13, 2007

- USPF Criteria: Short-Term Debt, June 15, 2007
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

Institutional Framework Overview: Michigan Local Governments

Ratings Detail (As Of June 11, 2015)		
Wayne Charter Cnty GO ltd tax nts (federally taxable oblig) ser 2015 due 12/01/2017		
Short Term Rating	SP-1	Affirmed
Wayne Charter Cnty GO (AGM)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Wayne Cnty downriver swg disp sys rfdg bnds ser 1999 A dtd 08/10/1999 due 11/01/1999-2013		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Detroit-Wayne Cnty Stadium Auth, Michigan		
Wayne Charter Cnty, Michigan		
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) stadium (AGM)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) GO		
Long Term Rating	BB+/Negative	Affirmed
Michigan Fin Auth, Michigan		
Wayne Charter Cnty, Michigan		
Michigan Fin Auth (Wayne Charter County) GO		
Long Term Rating	BB+/Negative	Affirmed
Michigan Mun Bnd Auth (Wayne Charter Cnty) local govt ln prog (ASSURED GTY)		
Unenhanced Rating	BB+(SPUR)/Negative	Affirmed
Wayne Cnty Bldg Auth, Michigan		
Wayne Charter Cnty, Michigan		
Wayne Cnty Bldg Auth (Wayne Charter Cnty) GO equiv		
Long Term Rating	BB+/Negative	Affirmed

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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Summary:

Detroit-Wayne County Stadium Authority
Wayne Charter County; General Obligation; General Obligation Equivalent Security

Primary Credit Analyst:
Jane H Ridley, Chicago (1) 312-233-7012; jane.ridley@standardandpoors.com

Secondary Contact:
John Sauter, Chicago (1) 312-233-7027; john.sauter@standardandpoors.com

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Summary:

Detroit-Wayne County Stadium Authority Wayne Charter County; General Obligation; General Obligation Equivalent Security

Credit Profile		
Wayne Charter Cnty GO		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative

Rationale

Standard & Poor's Ratings Services has placed its 'BB+' rating on Wayne Charter County, Mich.'s limited-tax general obligation (GO) bonds on CreditWatch with negative implications. The CreditWatch placement reflects Standard & Poor's expectation that, with the onset of actions under Michigan Act 436, the county could lose some of the autonomy currently held by the CEO and his staff.

On June 17, Wayne County's CEO Warren Evans submitted a letter to the treasurer of the State of Michigan requesting a preliminary financial review of the county, as described in Michigan Act 436. If the governor accepts the county's request for a financial review and the process continues as described in Act 436, the Wayne County board could choose one of four possible outcomes: (1) a consent agreement; (2) an emergency manager; (3) a neutral evaluation; or (4) a move to file for Chapter 9 bankruptcy.

In our previous GO analysis, we stated that starting with negotiations and using all other actions allowable Michigan law, Wayne County plans to use all of its possible negotiating power to close the structural imbalance and address the low pension funding levels and outstanding other postemployment benefits unfunded accrued actuarial liability. In our view, the county's request for financial review does not signal the start of filing for bankruptcy, but rather a step in its stated goal of using all possible tools to regain structural balance.

However, given the uncertainty associated with these four options--as well as the potential for a prolonged time frame to make additional meaningful structural changes while this process is underway--we have placed the rating on CreditWatch.

Although we don't currently believe that bankruptcy is an option under consideration, uncertainties associated with the potential appointment of an Emergency Manager are significant enough that we believe a rating action could be warranted should that be the outcome. This is primarily due to the autonomy an Emergency Manager has under Act 436, and the possibility that the restructuring plan as developed by the CEO's staff would be changed significantly, and include fewer long-term structural adjustments.

For additional information on our GO rating on Wayne County, please see the summary analysis published June 11, 2015, on RatingsDirect.

The negative CreditWatch reflects Standard & Poor's expectation that with the onset of actions under Michigan Act 436, the county's autonomy to self-direct its restructuring could be diminished if an emergency manager is ultimately selected. In our view, this could mean that making the significant, meaningful adjustments necessary could be delayed or adjusted, which would have an impact on the county's long-term financial health. Should the county retain control over its restructuring--such as via a consent agreement--we could remove the rating from CreditWatch and assign a negative outlook, reflecting the long-term budget pressures the county is facing. In our view, the appointment of an emergency manager would not leave as much control with the county staff--and potentially could open the possibility for the county to veer off course to regaining structural balance--in which case, we could lower the rating. Regardless, if the timeframe of changes slows markedly, we could lower the rating.

Notwithstanding the uncertainty of the county's near-term management control, without the county's clear, demonstrable progress in the next year to regain structural balance and reduce its sizable pension burden, we could lower the rating. In addition, should Wayne County's liquidity position deteriorate significantly, we could lower the rating. Without Standard & Poor's seeing clear evidence of the county's ability to execute structural reforms and the elimination of political gridlock within the county's operations, the rating is precluded from going any higher, and could well be lowered.

Standard & Poor's expects to resolve the CreditWatch within the next 90 days.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Limited-Tax GO Debt, Jan. 10, 2002
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of June 23, 2015)		
Wayne Charter Cnty GO (AGM)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Wayne Cnty downriver swg disp sys rfdg bnds ser 1999 A dtd 08/10/1999 due 11/01/1999-2013		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Detroit-Wayne Cnty Stadium Auth, Michigan		
Wayne Charter Cnty, Michigan		
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) stadium (AGM)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Detroit-Wayne Cnty Stadium Auth (Wayne Charter Cnty) GO		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative
Michigan Fin Auth, Michigan		
Wayne Charter Cnty, Michigan		
Michigan Fin Auth (Wayne Charter County) GO		

Ratings Detail (As Of June 23, 2015) (cont.)		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative
Michigan Mun Bnd Auth (Wayne Charter Cnty) local govt ln prog (ASSURED GTY)		
Unenhanced Rating	BB+(SPUR)/Watch Neg	On CreditWatch Negative
Wayne Cnty Bldg Auth, Michigan		
Wayne Charter Cnty, Michigan		
Wayne Cnty Bldg Auth (Wayne Charter Cnty) GO equiv		
Long Term Rating	BB+/Watch Neg	On CreditWatch Negative

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Schafer, Suzanne K. (Treasury)

Subject: FW: more follow up....

From: Tony Saunders [mailto:tsaunders@waynecounty.com]
Sent: Monday, June 29, 2015 12:11 PM
To: Schafer, Suzanne K. (Treasury)
Cc: Workman, Wayne (TREASURY)
Subject: Re: more follow up....

Just the executive branch. I will ask the commission chair

Sent from my BlackBerry 10 smartphone.

From: Schafer, Suzanne K. (Treasury)
Sent: Monday, June 29, 2015 12:09 PM
To: Tony Saunders
Cc: Workman, Wayne (TREASURY)
Subject: FW: more follow up....

Hi Tony,

Wayne asked that I verify with you – are you speaking on behalf of both the executive branch and the commission? Or, should we be expecting a separate notification from the Commission Chair?

Thanks,

Suzanne

From: Workman, Wayne (TREASURY)
Sent: Monday, June 29, 2015 11:56 AM
To: Schafer, Suzanne K. (Treasury); Headen, Frederick (Treasury); Steven Liedel; Koryzno, Edward (Treasury)
Subject: Fwd: more follow up....

Sent from my iPad

Begin forwarded message:

> **From:** Tony Saunders <tsaunders@waynecounty.com>
> **Date:** June 29, 2015 at 11:43:17 AM EDT
> **To:** "Saxton, Thomas (Treasury)" <SaxtonT@michigan.gov>, Richard Kaufman <rkaufman@waynecounty.com>
> **Cc:** "Workman, Wayne (TREASURY)" <WorkmanW@michigan.gov>
> **Subject: Re: more follow up....**
>
> We have no recommended changes.

Wayne County Commission
Office of the Chairman

Gary Woronchak
Commissioner District 13
and
Chairman of the
Wayne County Commission

WAYNE COUNTY COMMISSION
500 GRISWOLD, 7TH FLOOR
DETROIT, MICHIGAN 48226

Commission Office:
(313) 224-0934
Fax: (313) 967-6940
Gworonch@waynecounty.com

June 30, 2015

Mr. Nick A. Khouri
State Treasurer
Michigan Department of Treasury
P. O. Box 30728
Lansing, MI 48909-8228

Re: Interim Report – Preliminary Review of Charter County of Wayne – June 25, 2015

Dear Mr. Khouri:

With respect to the captioned matter, accompanying are Comments of the Wayne County Commission to the Interim Report-Preliminary Review of Charter County of Wayne dated June 25, 2015.

Thank you for your attention.

Sincerely,

GARY WORONCHAK
Chairman
Wayne County Commission

Enclosure

Cc: Edward B. Koryzno, Jr. KoryznoE@Michigan.gov
Suzanne K. Schafer SchaferS7@Michigan.gov
Warren C. Evans, Wayne County Executive
Wayne County Commissioners

Comments of the Wayne County Commission to the Interim Report-Preliminary Review of Charter County of Wayne dated June 25, 2015

The Interim Report states: "County officials violated requirements of Section 17 of Public Act 2 of 1968, the Uniform Budgeting And Accounting Act;" MCL 141. 437 (1); MCL 141.1544 (1) (j)

Comments: The Interim Report (IR) references select financial information disclosed in the Comprehensive Annual Financial Report (CAFR) for the fiscal year that ended September 30, 2014. Reference is made to three activities that went over budget (County Jail, Prosecuting Attorney, Sheriff's Department) and several revenue line items that did not meet expectations.

It is acknowledged that the Adopted Budget FY 2013-2014 provides in pertinent part:

> "It is the responsibility of County Departments and Elected Offices to monitor their budgets and advise the Chief Financial Officer (CFO) of any necessary budgetary changes between accounts contained in their budgets. This is accomplished with the submission of a budget adjustment (sic) to the Department of Management and Budget, Budgeting and Planning Division, which reviews and approves all budget adjustments for the CFO. This process includes reviewing the appropriateness of the budget adjustment, sufficiency of funds in transfers between accounts and a programmatic assessment of appropriateness.
>
> "If it is determined that a budget adjustment will require an amendment to the Enrolled Appropriations Ordinance, Commission approval is required. A proposed amendment to the Enrolled Appropriations Ordinance is prepared by Management and Budget and transmitted to the County Commission under the signature of the CEO." (at pages 2-7, 2-8)

During FY 2013-2014, the County Commission acted upon all requests for budget adjustments and amendments to the appropriations ordinance received from the administration of the former CEO. The referenced CAFR reflects that "[d]uring the year, there were several significant changes from the original to the final amended budget," and many of those are detailed. (at page 32) Further, the "Final Amended Budget Comparison to Actual Expenditures" is provided. (at page 73)

It is also acknowledged that MCL 141.437 (1) provides in part that:

> "...the legislative body of the local unit shall amend the general appropriations act <u>as soon as it becomes apparent</u> that a deviation from the original general appropriations act is necessary and <u>the amount of the deviation can be determined</u>." (emphasis added)

The select financial information cited in this section of the IR was disclosed in the CAFR for the fiscal year that ended September 30, 2014. It was not transmitted and published until March 26, 2015. The County Commission, and presumably the CEO's administration, does not interpret this statutory provision to require amendment of the appropriations act based upon precise amounts of financial information disclosed nearly six months after the end of the fiscal year covered by that appropriations act. However, if authoritative interpretation of this statutory requirement exists to the contrary, the County Commission, and presumably the CEO's administration, stands ready to review and consider it going forward.

It is also noted in passing that if a technical failure to comply with this statutory provision is deemed to exist because the appropriations act was not amended based upon information disclosed nearly six months after the end of the fiscal year in question, it is without prejudice to this pending review. As the select financial information referenced in this section of the IR was disclosed in the CAFR, it is not a question of relevant information being concealed or otherwise unavailable for the purpose of this preliminary review.

With respect to expenditures for activities of the Sheriff (including jail) and Prosecuting Attorney being over budget during FY 2013-2014, it should also be observed that the Uniform Budgeting and Accounting Act also provides, at MCL 141.438 (5) that: "[t]he enforcement of a general appropriations act approved by the legislative body of a county is a power vested in the chief administrative officer of that county."

With regard to the cited net budgeted change in fund balance of negative $18.9 million, this was a result of Delinquent Tax Revolving Fund (DTRF) monies having been included in the budget, but subsequently not transferred at the request of the incoming administration (see discussion below on Deficit Condition). Had the $78.7 million in DTRF funds been transferred in 2014, the net budgeted change in fund balance would have been a positive $13 million for FY 2013-14.

****

The Interim Report states: "County officials failed to file an audit report that conforms with the minimum procedures and standards of the Michigan Department of Treasury and is required for local governments under the Public Act 2 of 1968, Uniform Budgeting And Accounting Act;" MCL 141.1544 (1) (k)

Comments: Although the specific audit and fiscal year covered thereby is not expressly identified, given various references in the IR to specific financial data and a characterizing reference ("the most recent audit report," at page 3), it is assumed this section implicates the CAFR for the fiscal year that ended September 30, 2014, transmitted and published on March 26, 2015.

The IR asserts that local governments are required to pass budgets on an activity level or lower (for example Prosecuting Attorney or Sheriff), and that the county's audit does not comply with this requirement by reporting its budget on a higher function level (for example, Public Safety). The transmittal letter from the CEO's representatives is cited: "[t]he appropriated budget for the General Fund is adopted by function (e.g., general government, public safety, public works, etc)." (at page 2)

This section of the IR was forwarded to Rehmann Robson of Jackson, Michigan, the firm that audited the CAFR in question. According to Mark Kettner, the firm's Principal and Executive responsible for supervising this engagement with the county:

> "The state inaccurately quotes the audit report when it says... "the appropriated budget for the General Fund is adopted by function." What it actually says is that (CAFR page 148, second paragraph):
> "The appropriated budget for the general fund is adopted by function (legislative, Judicial, general government, public safety, public work, etc.), activity, revenue or expenditures and account generally."
>
> "Clearly, this states BOTH <u>function</u> and <u>activity</u>, therefore complying with the Uniform Act." (Kettner, June 27, 2015, emphasis in original, attached)

In addition, Mr. Kettner also states that:

> "[i]n the notes to the financial statements (page 73 of the 9/30/14 CAFR) is the disclosure regarding budgetary compliance AT THE ACTIVITY LEVEL. We have audit workpapers to support that both the County adopted the budget at the prescribed level and we performed audit procedures thereon at that level." (Kettner, June 27, 2015, emphasis in original, attached)

Further, within the Notes to the Financial Statements in this CAFR, the General Fund schedule provides a "Final Amended Budget Comparison to Actual Expenditures." Within this presentation and under the function captions, county departments or activities and related financial data are reported for:
General Government: Corporation Counsel, Office of the County Executive, Personnel, and Prosecuting Attorney;
Public Safety: County Jail and Sheriff;
Health and Welfare: Jail Medical (at page 73)
Therefore, the representation of the CEO's representatives notwithstanding, a fair reading of the CAFR in its totality leads to the conclusion that financial data in the audit is reported both by function and activity.

With regard to the requirements of the Uniform Budgeting And Accounting Act, the scope of the duty on local governments is not confined to reporting at an activity level. Rather, in the definitional section of the Act,

> " "Budgetary Center" means a general operating department of a local unit or any other department, institution, court, board, commission, agency, office, program, activity, or <u>function</u> to which money is appropriated by the local unit." (MCL 141.422b (1), emphasis added)

With respect, it is curious that an allegation of this nature is raised by Treasury at this time within the context of a request for a preliminary review of the county's finances by the CEO. The Commission is unaware of a concern about or criticism of the form of the county's budget or audit having been communicated at any time previously. Mr. Kettner observes:

> "We reviewed County audit reports back to fiscal 2003. That included one year of Rehmann, eight years of Plante (& Moran) and three years of KPMG; the County prepared the financial statements for each of those years. Every one of those 12 years showed exactly the same presentation (budgetary compliance note at the activity level and budget schedules in the RSI section at the function level for the general fund). Since there was never any change, it would be a fair assumption that none of these esteemed firms ever took exception to the County's budgetary compliance (but would certainly have performed procedures thereon), nor apparently did anyone at the State ever take note or exception (although it is likely they never looked at it until now)." (Kettner, June 27, 2015, attached)

According to Mark J. Abbo, Wayne County's Chief Financial Officer during most of FY 2013-14, the period covered by the CAFR transmitted March 26, 2015, with respect to any concerns on the form of the county's budget, appropriations ordinance and audit:

> "We did not receive any communication from the state Treasurer's Office on any of these. During our regular communications with Treasury representatives, county finances were an open book. They received anything they requested." (oral statement, June 27, 2015)

Further, with respect to previous years, the CAFR states:

> "The Government Finance Officers Association (GFOA) of the United States and Canada awarded a Certificate for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report (CAFR) for the year ended September 30, 2013. This was the 15th award in the last 18 years and the eighth consecutive. In order to be awarded a Certificate of Achievement, the County published an easily readable and effectively organized CAFR, <u>containing the elements required by generally accepted accounting principles</u>. The Certificate of Achievement is a prestigious national award recognizing conformation with the highest standards for preparation of state and local government financial reports.
>
> A Certificate of Achievement is valid for a period of one year only. The County received the Certificate of Achievement for its 2013 CAFR. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.
>
> In addition, for the twentieth year in a row, the County received the GFOA's Award for Distinguished Budget Presentation for its annual budget dated October 1, 2013." (at page 6, emphasis added)

Rehmann Robson provided a "clean" opinion in the CAFR for the fiscal year that ended September 30, 2014, indicating in part that; "the financial statements...present fairly, in all material respects, the respective financial position of the governmental activities..." (at page 16)

Again, if authoritative interpretation of the statutory requirements and Treasury policy would better inform the County on the form of its budget and audit, the County Commission, and presumably the CEO's administration, stands ready to review and consider it going forward.

****

The Interim Report states: "On May 29, 2015 the Circuit Court of Wayne County issued a judgment in favor of the retirement system for more than $49 million without the prior approval of the County's governing body...a judgment levy will be placed on the County's tax rolls;" MCL 141.1544 (1) (o)

Comments: As a factor of probable financial distress, MCL 141.1544 (1) (o) provides: "A court has ordered an additional tax levy without the prior approval of the governing body of the local government."(emphasis added)

The Judgment in question, entitled The Judgment On Counts I-IV of Plaintiffs' Complaint On Remand From The Michigan Supreme Court, entered May 29, 2015 by Judge Lita M. Popke of the Wayne County Circuit Court, did not contain any order for a tax levy to satisfy that Judgment.

In fact, the CEO's letter of June 17, 2015 explicitly represents that "counsel for the plaintiff filed the judgment with the County assessor pursuant to section 6093(3) of the Revised Judicature Act."

Therefore, the threshold prerequisite under the statute- that a court has ordered the tax levy- has not been satisfied, and the statute therefore does not apply to this situation.

Apart from this fatal legal deficiency, this situation is an example of the administration's creation of a condition to demonstrate probable financial distress. As the CEO's letter acknowledges, the Commission voted to pay and satisfy the Judgment from available unallocated DTRF monies to avoid the levy. However, also as acknowledged, the CEO vetoed that measure and the veto was not over-ridden.

After the administration identified some available resources to partially satisfy the Judgment, $39.2 million has been levied on county summer tax bills. However, it should be observed that this amount has not created an additional financial burden on the county, but will be paid by this new, additional revenue stream generated through the use of MCL 600.6093 (3).

****

The Interim Report states: "The County has ended a fiscal year in a deficit condition;" MCL 141.1544 (1) (p)

Comments: The IR indicates the Unrestricted General Fund deficits peaked at $156.4 million in 2013 and were reduced to $82.8 million in 2014. Reductions in the accumulated deficit are primarily due to transfers from the DTRF.

The amount of the accumulated deficit reflects a conscious choice by the administration. Before the end of 2014, the Wayne County Treasurer declared a surplus (excess of unrestricted retained earnings) of approximately $78.7 million from the DTRF, and the previous administration proposed that it be applied to the accumulated deficit, and in fact it was placed in the budget approved by the Commission. At the request of the incoming administration in mid-December, 2014, this revenue was not certified or allocated at that time. Had it been applied as proposed, the CAFR would have reflected that the FY 2013-14 general fund accumulated deficit would have been $4.1 million, and not $82.8 million.

When compared to the FY 2012-13 general fund accumulated deficit of $156.4 million cited in the IR, had these DTRF funds been applied as proposed, this would have represented a decrease of nearly 97.4% in one year, an accomplishment of stunning proportion.

Even at the artificially maintained $82.8 million, compared to the previous year it represented a decrease in the general fund accumulated deficit of $73.6 million, or 47%, still a noteworthy measure of progress.

With respect to the projection that the accumulated deficit will rise to $171.4 million in FY 2019-20, it is difficult to respond to that in the absence of any explanation and calculation how that number was arrived at. Further, what assumptions is that projection based on?

In short, the CEO's discussion of the accumulated deficit, upon which this section of the IR is substantially based, lacks persuasive value in the context of fulfilling the statutory requirement of financial distress, because the current deficit has been maintained on the books at an exaggerated number resulting almost solely because of a conscious choice by the administration. The clear trend has been to substantially reduce the accumulated deficit in the last two years, and a more accurate reflection of the situation is that in 2015 it should be almost completely eliminated, but in any event, be less than a modest $10 million.

This represents a de facto execution of a deficit reduction plan.

Conspicuously absent from the CEO's letter and the IR is a review of the actions already taken in less than half a year by the administration to reduce the structural deficit- measures which clearly demonstrate the ability of the county to self-govern. As reflected in published announcements by the administration and in the news media, these measures include:

1. a reduction in the number of administration appointees and imposition of a 5% pay reduction for appointees, resulting in savings of $1.2 million annually;

2. a consensual reduction in the appropriation to the circuit court, resulting in savings of nearly $1.1 million annually;

3. a commission-approved reorganization and consolidation of administration departments and supervisory personnel, resulting in savings of roughly $3 million annually;

4. a spending freeze by executive order, resulting in savings in an amount to be determined;

5. a Recovery Plan with projected general fund savings of $230 million over the next four years ($57.5 annually on average);

In further demonstration of the partnership between the commission and administration to address the structural deficit, at the Full Board meeting on June 18, <u>the day after the CEO's letter to the state Treasurer</u>, Commission approval was given for:

6. settlement of a lawsuit resulting in retiree health care revisions with savings of $20 million annually;

7. amendment of a county ordinance eliminating the Inflation Equity Fund (IEF) in the pension system and the so-called "13th checks" that previously were issued to retirees from the IEF, which will result in the transfer of $33.3 million to the general retirement fund, with an expected reduction in the annual required contribution (ARC) to the pension fund from the county's general fund, in an amount to be determined.

****

<u>**The Interim Report states: "The recent reduction in the deficit is primarily due to a transfer of $91.6 million from the Delinquent Tax Revolving Fund... to the General Fund...Large interfund transfers may be indicative of cash flow concerns; "MCL 141.1544 (1) (s)**</u>

Comments: It is significant that the IR apparently does not adopt the characterization by the CEO in his letter that these DTRF transfers are "extraordinary" and should only be considered "one time revenue." Rather, the IR reflects a concern that borrowing costs are increased for the county associated with the DTRF process.

It should be clear at the outset that the transfer and use of DTRF funds is legally authorized. The General Property Tax Act, which empowers the County Commission to create a delinquent tax revolving fund, also provides: "Any surplus in the fund may be transferred to the county general fund by appropriate action of the county board of commissioners." (MCL 211.87b (7))

As a local government striving to work its way out of the hole occasioned by the recession of 2008-2009, with many thousands of tax delinquencies and foreclosures during the past few years, the county should not be penalized for achieving revenue through foreclosure sales and the DTRF process. It is entirely appropriate that transfer of DTRF proceeds to the general fund be recognized under the circumstances without penalty. In any event, the county eventually is held harmless on the costs associated with the borrowing. These transfers certainly compensate for cash flow distress occasioned in part from unpaid property taxes.

Far from being "one time revenue" it is expected that substantial DTRF monies will become available going forward. The IR indicates that according to the county, $153 million more in DTRF funds will be transferred in 2015, which is a very positive factor worthy of emphasis.

Although it is expected that with an improving economy, the numbers of foreclosures and therefore expected foreclosure sales revenue may start to trend downward, this would not be a unique loss because of the expectation that this also means more people are staying in their homes and paying taxes, which should lead to increased property tax revenue.

****

The Interim Report states: "Recently, the County's credit rating was downgraded by the three major credit rating services...The Fitch and the Standard and Poor's ratings are classified as non-investment grade, speculative, or junk and the Moody's rating is only slightly better;" MCL 141.1544 (1) (r)

Comments: The referenced reductions by the credit rating agencies occurred on February 6, February 13 and March 12, 2015, respectively. It is acknowledged that ratings have been dropping in recent years, in recognition primarily of the fiscal challenges confronting the county, but also because of other factors, including the Detroit bankruptcy, etc. However, the former CFO in particular had maintained regular and candid communication with the rating agencies and had effectively managed the situation in defense of the county's credit rating by stressing the progress in deficit reduction. As a result, the bond markets remained available to the county during that period, and for example, the taxable yield on TANS issued in 2013 was at 1.5%.

So what changed shortly after the start of 2015? On February 5, 2015, the CEO and his team revealed and discussed the Ernst and Young (Project Myers) Report dated January, 2015, which summarized the county's financial condition from the perspective of the new administration. Without an extensive discussion of the numbers in that report, it is a fair conclusion that with few exceptions, they were not all that different than previously reported numbers. What was different was the characterization of those numbers and the county's financial condition by the CEO and his administration.

> "Evans presented a dire picture of the Wayne County's finances Thursday, saying Michigan's largest county faces a deficit of nearly $70 million and 'financial Armageddon' in the second half of next year unless spending cuts are made." (Detroit Free Press, February 5, 2015)

Predictably, those remarks produced headlines: "Wayne County budget deficit jolts bondholders" per Crain's Detroit Business, and "Wayne County Exec. Warns of State Takeover, Bankruptcy" in The Bond Buyer, among others. Christa McClellan, Deputy Wayne County Treasurer-Financial Services later observed:

> "The bond community is kind of on edge (wondering) is the county going to go bankrupt? There was just a lot of reaction to the comments... (Bond markets are) very sensitive to what's in the papers." (Detroit Free Press, May 26, 2015)

The "Financial Armageddon" characterization was linked to a claim that the county would "run out of cash" by August, 2016. However, projected short periods of cash flow challenges have been common in the county for some years (and for other municipalities as well) because of lost revenue, and typically have been bridged by bonding. The "dire" characterization of the county's financial condition in early February almost immediately precipitated the decline in the county's credit rating.

****

The Interim Report states: "The County's primary pension plan is 45% funded and has a liability of $910.5 million based on the last actuarial valuation performed dated September 30, 2013. This is contrasted with a 94.8% funded ratio in 2004 and a total liability of $49.6 million at that time;" MCL 141.1544 (1) (s)

Comments: To update modest improvement in the system, Gabriel Roeder Smith & Company, the WCERS actuary, as of September 30, 2014 indicated the plan in total is 47% funded. This number will be improved when the $33.3 million from the eliminated IEF (including $32 million from the Judgment), is paid into the general pension fund.

In addition, unfunded system liability as of September 30, 2014 is reported by GRS at $870 million. But for the "smoothing" policy of reporting net fund assets and liabilities, the true liability may actually be less by approximately $30 million. Admittedly, this still represents a huge challenge for the county to address.

The IR identifies "causes" for "this decline in funding." For purposes of a more complete reflection of history, Gabriel Roeder Smith & Company in their annual actuarial report as of September 30, 2010 stated that:

> "We estimate that the Wayne County Employees Retirement System would be approximately 90% funded on a funding basis as of the last actuarial valuation (September 30, 2009) if there had never been a 13th check program."

The Commission adopted an ordinance amendment in late 2010 that capped the IEF fund at $12 million, with a cap of $5 million available annually for 13th check payments. As indicated, the Commission voted to totally eliminate the IEF and 13th checks on June 18, 2015.

ATTACHMENT

From: Mark Kettner <Mark.Kettner@rehmann.com>
Date: June 27, 2015 at 8:42:11 AM EDT
To: Marcella Cora <Mcora@waynecounty.com>
Cc: Will Hamner <WHAMNER@waynecounty.com>, Stephen Blann <Stephen.Blann@rehmann.com>
Subject: RE: Wayne County External Audit

Marcella -

The State is wrong in several ways (and certainly overstates the situation when is says "County officials failed to file an audit report that conforms..."). In support of this we note the following:

1. The State inaccurately quotes the audit report when it says... "the appropriated budget for the General Fund is adopted by function." What it actually says is that (CAFR page 148, second paragraph):

"The appropriated budget for the general fund is adopted by function (legislative, judicial, general government, public safety, public work, etc.), activity, revenue or expenditures and account generally."

Clearly this states BOTH <u>function</u> and <u>activity</u>, therefore complying with the Uniform Act.

2. In the notes to the financial statements (page 73 of the 9/30/14 CAFR) is the disclosure regarding budgetary compliance AT THE ACTIVITY LEVEL. We have audit workpapers to support that both the County adopted the budget at the prescribed level and we performed audit procedures thereon at that level.

3. We reviewed County audit reports back to fiscal 2003. That included one year of Rehmann, eight years of Plante and three years of KPMG; the County prepared the financial statements for each of those years. Every one of those 12 years showed exactly the same presentation (budgetary compliance note at the activity level and budget schedules in the RSI section at the function level for the general fund). Since there was never any change, it would be a fair assumption that none of these esteemed firms ever took exception to the County's budgetary compliance (but would certainly have performed procedures thereon), nor apparently did anyone at the State ever take note or exception (although it is likely they never looked at it until now).

Let me know if you have further questions or needs regarding this matter.

Mark