# City of Detroit

## Report to Financial Review Commission

Office of the Chief Financial Officer

May 13, 2019

# Detroit's Finances Have Materially Improved Since Waiver was Granted

1. Positive FY 2017-18 financial results
2. Ongoing FY 2018-19 actions
3. Adopted FY 2019-20 budget

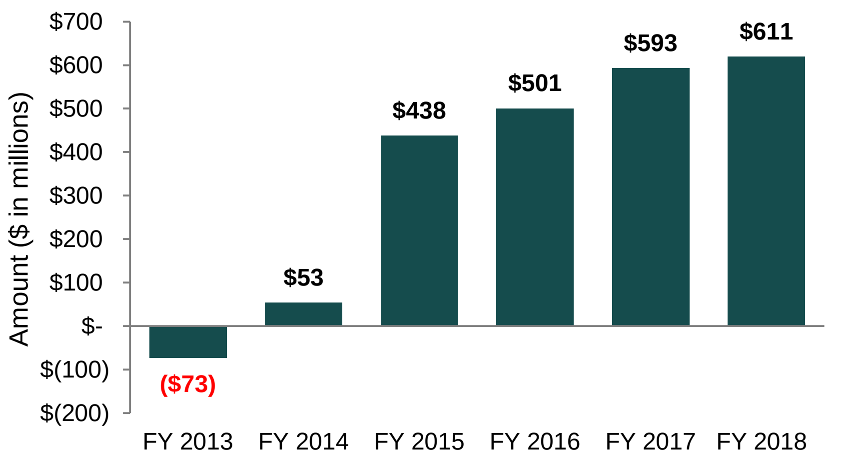
All conditions of the FRC waiver continue to be met.

# Audited FY 2017-18 Financial Results

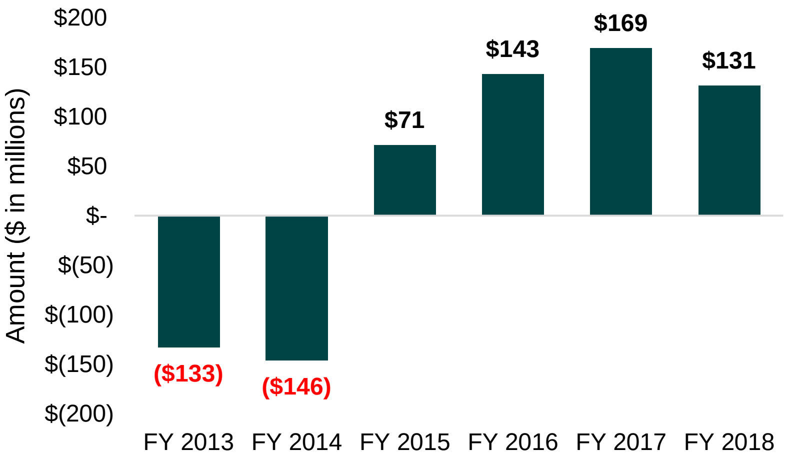
# Audited FY 2017-18 Financial Results

- FY 2017-18 marks four straight years of balanced budgets and operating surpluses
- Growing general fund balance, reaching over $600 million in FY 2017-18
- FY 2017-18 results outperformed the budget

**General Fund Balance**




**Unassigned Fund Balance (Deficit)**



# FY 2018-19 Accomplishments & Projected Financial Results

# FY 2018-19 OCFO Accomplishments

***July 2018:*** The City selects new banking institutions to improve financial operations. The selection is led by Chemical Bank, First Independence Bank, J.P. Morgan Chase Bank, and Fifth Third Bank.

***October 2018:*** OCFO participates in the initial launch of UltiPro, the City's new all-in-one payroll and HR system. The system continues to function well, and City departments are gradually being added.

***November 2018:*** The Detroit Supply Schedule ordinance is adopted and designed to achieve greater procurement efficiencies, lower City costs, and provide a mechanism to engage Detroit businesses.

***December 2018:*** The City sells $135M in general obligation bonds to support capital projects and $176M in DSA refunding bonds to eliminate the FY 2024-25 debt cliff.

***December 2018:*** The City files its Comprehensive Annual Financial Report (CAFR), the first on-time filing in 5 years.

***December 2018:*** The City completes the commercial reappraisal, concluding the Citywide property reappraisal. Proposed assessed values show property value increases in more than 90% of Detroit's neighborhoods.

***February 2019:*** S&P Global Ratings raises the City's General Obligation credit rating to 'BB-' from 'B+'.

# FY 2018-19 OCFO Accomplishments - Debt

***LTGO Refunding***

- Strengthen long-term fiscal stability by smoothing debt service costs
- Much like the creation of the Retiree Protection Fund, the transaction underscores the City's focus on risk mitigation and long-term planning

***UTGO***

- Provides capital to make further investments that improve the quality of life for Detroiters and spur City's economic growth
- Pays for projects otherwise funded from the General Fund
- Improved the City's fund balance and free up money for other City needs
- Demonstrated access to the capital markets on the City's own credit

*Key Project Areas:*

- ✓ *Public Safety Infrastructure Improvements and Expansions*
- ✓ *Parks and Recreation Assets*
- ✓ *City Fleet*
- ✓ *City computers*
- ✓ *IT infrastructure enhancements*
- ✓ *Future industrial development projects*

# Annualized Projection v. Budget – General Fund

| ANNUAL ANALYSIS | | | | |
|---|---|---|---|---|
| | BUDGET | PROJECTION | VARIANCE (BUDGET VS. PROJECTION) | |
| SUMMARY CLASSIFICATIONS | ANNUAL AMENDED | ANNUAL ESTIMATED | ANNUAL ESTIMATED | |
| A | B | C | ($) D = C-B | % E = (D/B) |
| **REVENUE:** | | | | |
| Municipal Income Tax | $ 299.4 | $ 317.5 | $ 18.1 | 6.1% |
| Property Taxes | 129.3 | 125.8 | (3.5) | (2.7%) |
| State PPT Reimbursement | 4.5 | – | (4.5) | (100.0%) |
| Wagering Taxes | 180.8 | 182.5 | 1.7 | 1.0% |
| Utility Users' Tax | 40.0 | 42.4 | 2.4 | 5.9% |
| State Revenue Sharing | 201.3 | 203.2 | 1.9 | 0.9% |
| Other Revenues | 215.8 | 209.7 | (6.1) | (2.8%) |
| **Sub-Total** | **$ 1,071.0** | **$ 1,081.0** | **$ 10.0** | **0.9%** |
| Budgeted Use of Prior Year Fund Balance | 2.6 | 2.6 | – | 0.0% |
| Carry forward-Use of Assigned Fund Balance | 49.1 | 49.1 | – | 0.0% |
| Transfers from Other Funds | 5.9 | 5.9 | – | 0.0% |
| Budget Amendments | 180.6 | 180.2 | (0.4) | (0.2%) |
| **TOTAL (F)** | **$ 1,309.2** | **$ 1,318.7** | **$ 9.6** | **0.9%** |
| **EXPENDITURES:** | | | | |
| Salary and Wages (Incl. Overtime) | $ (453.3) | $ (440.9) | $ 12.4 | (2.7%) |
| Employee Benefits | (139.5) | (128.3) | 11.2 | (8.0%) |
| Legacy Pension Payments | (38.6) | (38.6) | – | – |
| Retiree Protection Fund | (20.0) | (20.0) | – | – |
| Debt Service | (248.6) | (248.6) | – | – |
| Other Expenses | (409.1) | (394.9) | 14.2 | (3.5%) |
| **TOTAL (G)** | **$ (1,309.2)** | **$ (1,271.4)** | **$ 37.8** | **(2.9%)** |
| **VARIANCE (H=F+G)** | | | **$ 47.4** | |

Note: Projected annual revenues are based on the February 2019 Revenue Estimating Conference.
* Property Taxes and Utility Users’ Tax revenue projections are presented as gross totals to align with FY19 budget presentation.

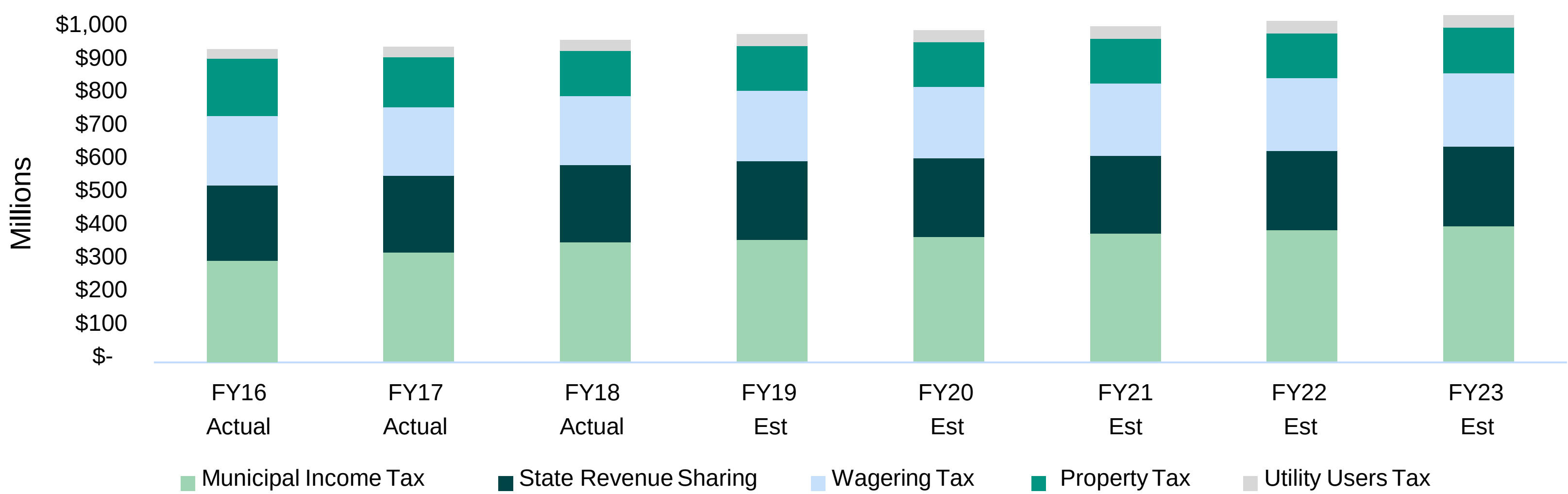
# Adopted FY 2019-20 Budget Overview

# Revenue Estimating Conference Results

The Revenue Estimating Conference concluded in February and updated revenue estimates for FY 2018-19 through FY 2022-23

- FY 2019-20 Total Budget is $2.3B which includes $1.1B for the General Fund
- Total General Fund revenues increase 3.5% from FY 2018-19 projections (2.2% from the FY 2019 adjusted budget), with a similar trend projected throughout the forecast period
- Income tax has driven growth in General Fund revenues, while other major revenues remain relatively flat

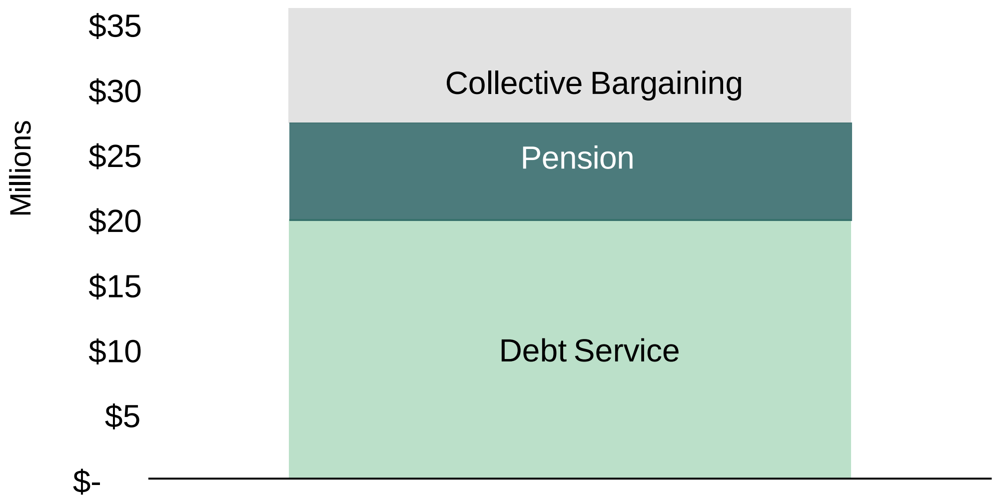
**Major Tax Revenue History and Projections: FY 2016 – FY 2023**



# Growing Costs, But Operating Tighter

While the City's General Fund revenue is increasing by $34M over the FY 2018-19 Adjusted Budget,* the ability to invest is constrained by growing fixed and collective bargaining costs

- Debt service alone is growing by $20 M (33%)
- Pension investment will increase by $5M pursuant to the adopted funding strategy for the Retiree Protection Fund
- The City projects collective bargaining will increase salaries and fringes by an additional $10M on the basis of those that have been ratified




**Fixed Cost & Bargaining Grow by $35M**

Through the budget process, the City identified opportunities to tighten the GF budget to allow for new investments and city improvements:

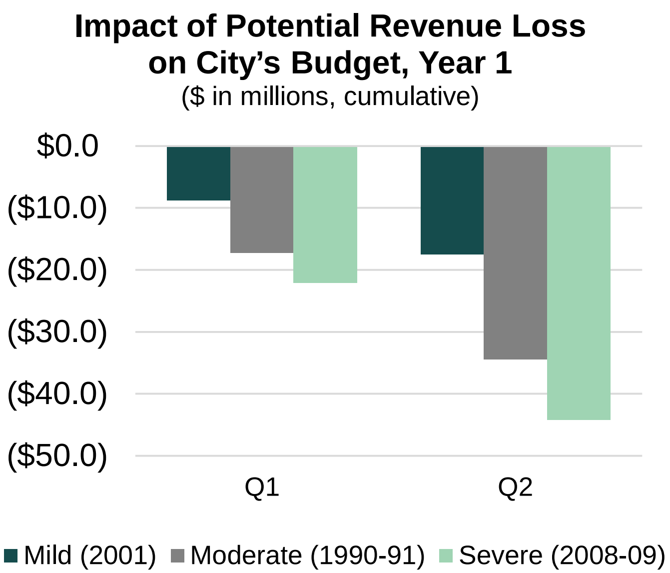
- $2.35 M in reductions generated by efficient capital investments in fleet, facilities, and equipment
- $7.10 M in reductions through an improved procurement planning process
- $7.50 M in salary savings through an analysis of turnover trends

*Based on presentation in the CAFR, the Budget no longer reflects Property Tax Increment Financing Capture and Public Lighting Authority's Utility User Tax as a General Fund revenue and expenditure. The "FY 2019 Adjusted Budget" removes those revenues and expenditures for ease of comparison.

# Building the Rainy Day Fund

If the country were to experience an economic downturn, Detroit needs to be nimble enough to protect City services for Detroiters without returning to FRC oversight

- State law requires the City of Detroit to maintain a 5% minimum budget reserve, which Detroit currently exceeds by $8 million




- Abrupt Income Tax withholding losses would be early warning sign
- Year 1 losses mount over just two quarters of the fiscal year
  - $17.5M revenue loss (mild recession - 2001)
  - $34.3M revenue loss (moderate recession - 1990-91)
  - $44.2M revenue loss (severe recession - 2008-09)
- Revenues remain below baseline forecast for future years
- Property Tax could also see losses from defaults on monthly payments plans and future losses from increased delinquencies

# Recommended Recession Scenario Recovery Plan

- **Utilize Budget Reserve Fund to absorb immediate first-year revenue loss**
  - ➢ Not enough time to rebalance spending when first-year loss occurs
  - ➢ Labor and fixed charges comprise 70% of General Fund spending
- **Concern**: The City falls below 5% minimum reserve but cannot immediately replenish it due to ongoing revenue losses from a recession
  - ➢ City fails to comply with State law
  - ➢ Permits Financial Review Commission the ability to impose a budget on the City
- **Solution**:
  - ➢ The adopted budget deposits nearly **$45 million** into the "Rainy Day Fund" to increase the City's reserves from 5% of the General Fund Budget expenditures to nearly 10% in FY 2019-20
  - ➢ Fiscal Sustainability Working Group will work on contingencies to maintain balanced budgets in future years

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MOODY'S

**"City's 2020 budget passage continues positive financial momentum"**

➢ "The credit-positive budget reflects sound financial practices, including conservative revenue assumptions and long-range projections, a significant capital investment and continues to set aside funds for a scheduled pension cost spike in fiscal 2024."

# General Fund Capital and Blight

**The FY 2019-20 Budget includes $105.5 million of prior years' fund balance for capital projects and blight remediation, an $8 million increase over prior year**

**Capital**

- Continue technology improvements and stabilize technology infrastructure
    - New equipment purchased in 2014 is reaching the end of its useful life
- Repairs for parking garage and meters
- Funding for implementation of neighborhood planning recommendations
- Economic development investment to bring jobs to Detroit
- Fleet replacement for non-public safety vehicles

**Blight Remediation**

- $50M for demolition aligned with Plan of Adjustment
    - HHF program funds will be exhausted;
    - Increased City oversight for demolition with HRD financing, OCP procurement, Council approval of demolition contracts, and BSEED inspection
- Board-up program
- Mural program will continue to reflect the character of our neighborhoods

# Retiree Protection Fund & Legacy Pension Funding Analysis

# Legacy Pension Plans – Retiree Protection Fund

- In 2017, the City adopted a funding strategy for its frozen legacy pension plan obligations
  - Set aside $335M more in funding by FY 2022-23 than required by the Plan of Adjustment
  - Deposit funding into an irrevocable trust (the Retiree Protection Fund, "RPF")
  - Build up RPF assets plus investment earnings to be used to partially offset annual required legacy pension contributions that resume in FY 2023-24
  - Allows the City to begin gradually building up its budget capacity now to meet the annual required contributions in the future
  - Review the funding plan annually based on updated information and revise if needed during the annual budget and planning process

- In 2017, the City enacted an ordinance to establish the RPF as an irrevocable Internal Revenue Code Section 115 trust fund exclusively for satisfying its legacy pension obligations.

- As of June 30, 2018, RPF assets totaled $103.3M. The City deposited an additional $20M appropriated in FY 2018-19 as planned.

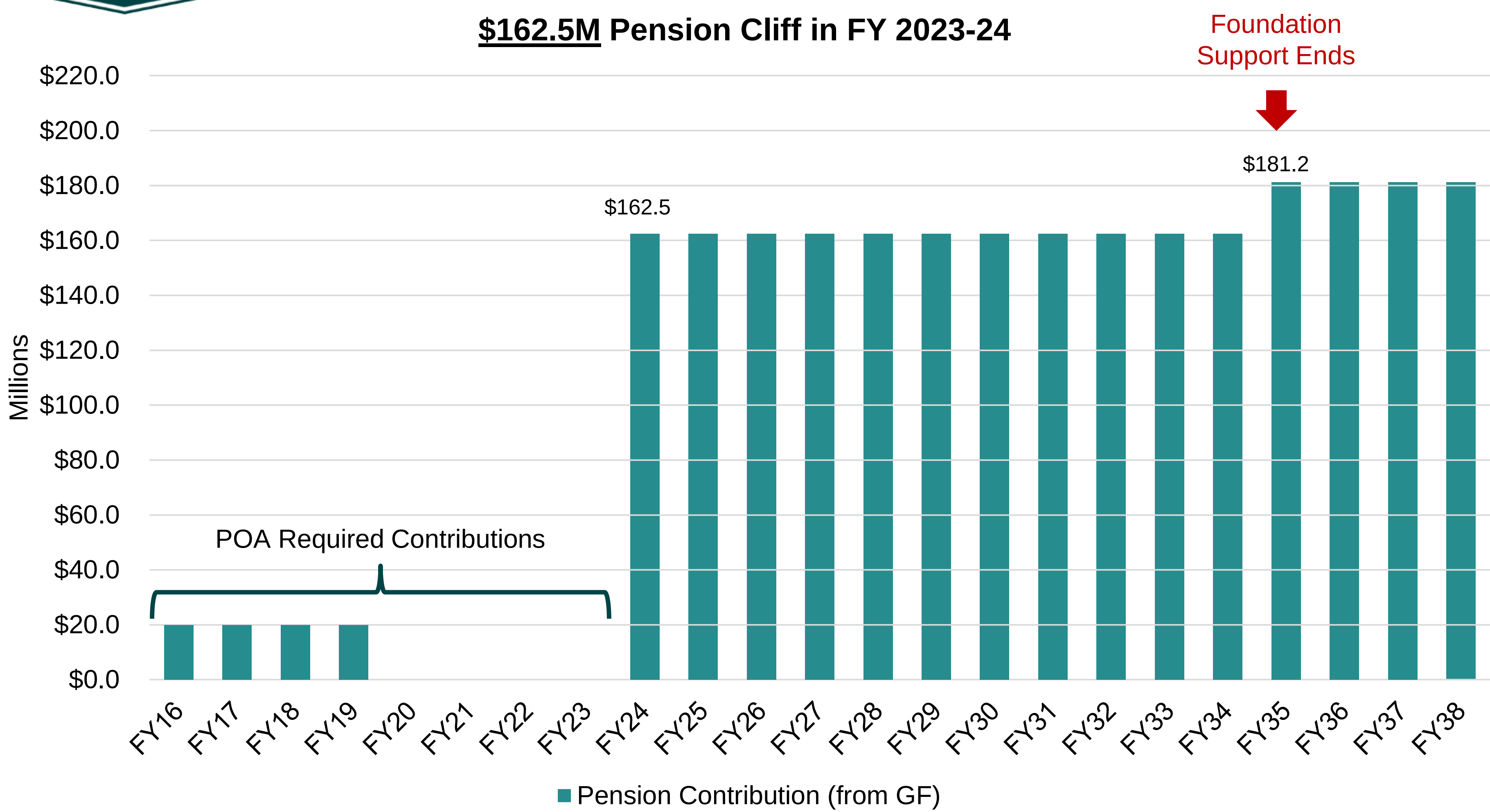
# Pension Plan Actuarial Valuation Results

| | Legacy GRS | | | Legacy PFRS | | |
|---|---|---|---|---|---|---|
| | FY 2015-16 | FY 2016-17 | FY 2017-18 | FY 2015-16 | FY 2016-17 | FY 2017-18 |
| Assets | $1,933.5M | $1,966.7M | $1,940.6M | $2,950.5M | $2,922.1M | $2,866.3M |
| Liabilities | $3,032.3M | $2,995.8M | $2,929.0M | $4,001.7M | $3,967.9M | $3,907.4M |
| UAAL | ($1,098.8M) | ($1,029.1M) | ($988.4M) | ($1,051.2M) | ($1,045.8M) | ($1,041.1M) |
| Funded Ratio | 63.8% | 65.6% | 66.3% | 73.7% | 73.6% | 73.4% |
| Contributions | $104.8M | $91.2M | $68.3M | $37.8M | $18.3M | $18.3M |
| Investment Return | 1.4% | 14.1% | 6.5% | 2.6% | 12.0% | 8.2% |

Source: Retirement System Actuarial Valuation Reports, Retirement System Audit Reports for investment returns

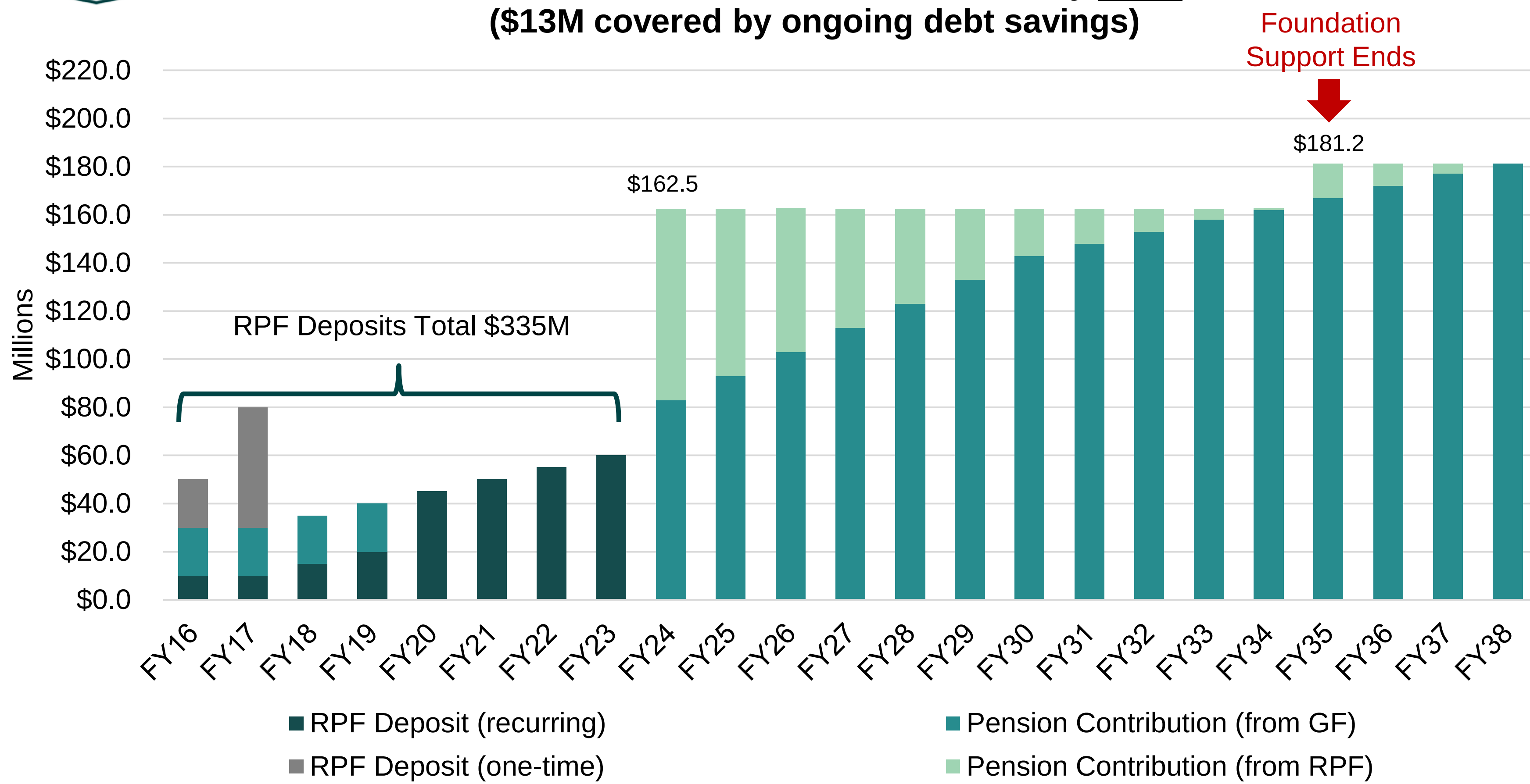
- Assumed future rate of return is 6.75% per Plan of Adjustment (POA)
- FY 2015-16 contributions include DIA prepayment of $52.4M at 6.75% present value discount
- FY 2016-17 GRS contributions include $18.4M accelerated UTGO payment due to bond refunding
- FY 2016-17 investment gains were partially offset by actuarial losses from liability data clean-up

# POA Required Contributions



# FY 2019-20 RPF Funding Plan

**General Fund Contribution for Pension Increases only <u>$23M</u> in FY 2023-24**
**($13M covered by ongoing debt savings)**




Make additional deposits directly to Pension Funds instead of RPF?

- Still leaves a **<u>$75M</u>** pension cliff in FY 2023-24

# FY 2019-20 RPF Funding Plan

- Maintain FY 2018-19 funding plan's recurring RPF deposits from General Fund:
  – FY 2019-20 - $45M
  – FY 2020-21 - $50M
  – FY 2021-22 - $55M
  – FY 2022-23 - $60M

- Increase General Fund share of FY 2023-24 pension contribution by an extra $13M, to address the increase in the estimated amortization, for a $23M year-over-year increase
  – Debt service decreases by $13M in FY 2023-24 and became an ongoing savings once FY 2025 debt cliff was eliminated by refunding bonds issued in December 2018
  – FY 2023-24 already included a $10M increase in last year's funding plan

- General Fund share of ongoing pension contributions continues to grow $5M to $10M per year until General Fund covers the full contribution in FY 2037-38 without RPF or foundation support

# RPF Updated Assumptions / Inputs

| Input | FY 2018-19 Funding Plan | FY 2019-20 Funding Plan |
|---|---|---|
| Actuarial Valuation | FY 2016 | FY 2017(1) |
| Latest Plan Returns | FY 2017 (14.1% GRS, 12% PFRS) | FY 2018 (6.5% GRS, 8.2% PFRS) |
| Future Plan Returns | 6.75% | 6.75% |
| Amortization(2) | 30-year level dollar | 30-year level dollar |
| FY 2024 Contribution | \$166.6M gross<br>(\$23.2M) foundations/non-GF<br>\$143.4M net from GF | \$188.0M gross<br>(\$25.5M) foundations/non-GF<br>\$162.5M net from GF |
| Latest RPF Returns | Not yet established | FY 2018: (-1.8%) |
| Future RPF Returns | 3% | 3% |

- Pursuant to the latest Quarterly Report, submitted to the Commission on May 10, 2019, the PRF has earned \$5,598,998, which is an effective rate of return of 3.08%.

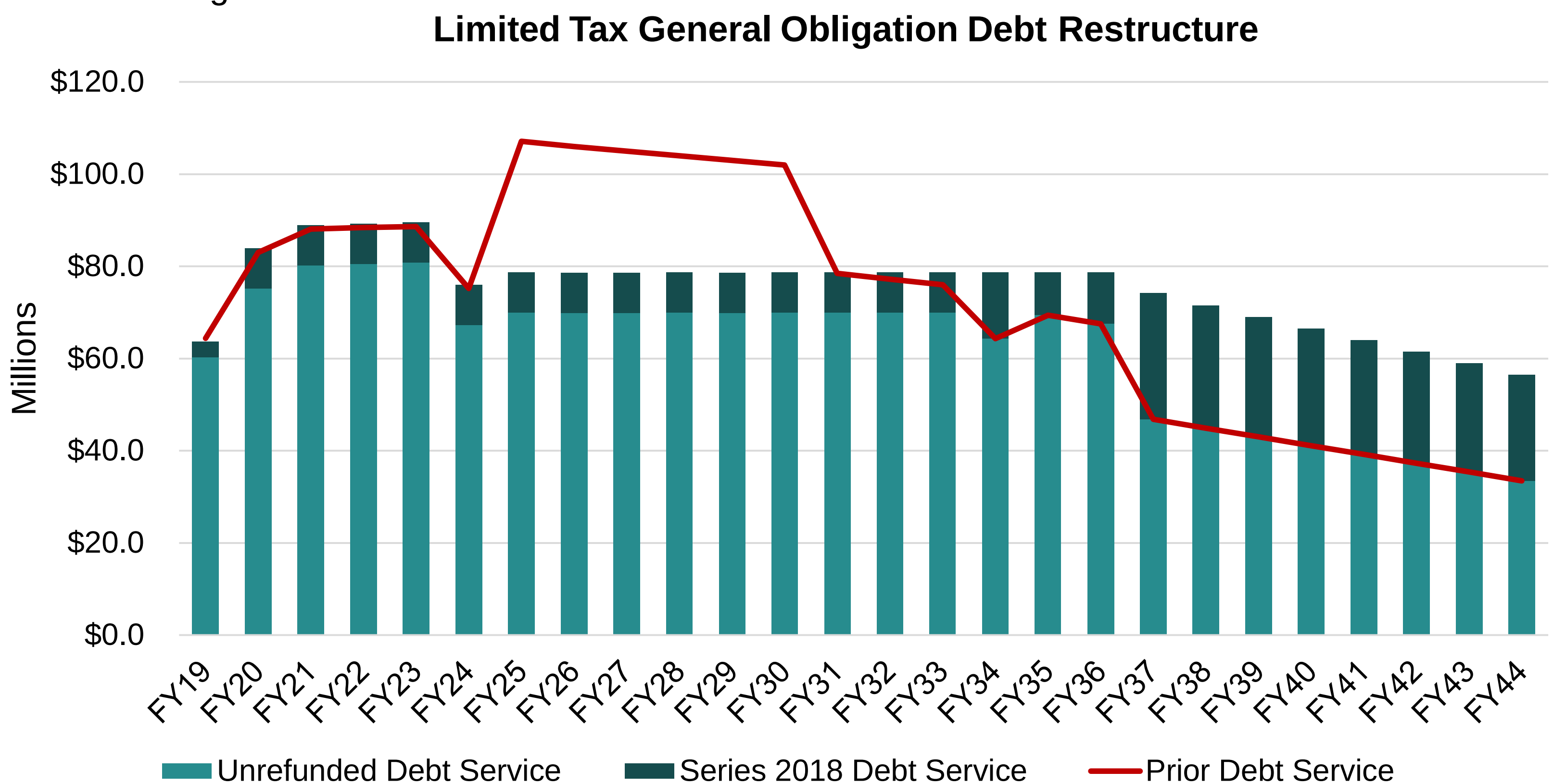
(1) FY 2018 Valuation was not completed until after FY 2020 Budget. The City's model factors in FY 2018 investment returns to approximate the updated FY 2024 General Fund contribution (\$162.5M used above vs. the FY 2018 valuation result of \$164.3M).

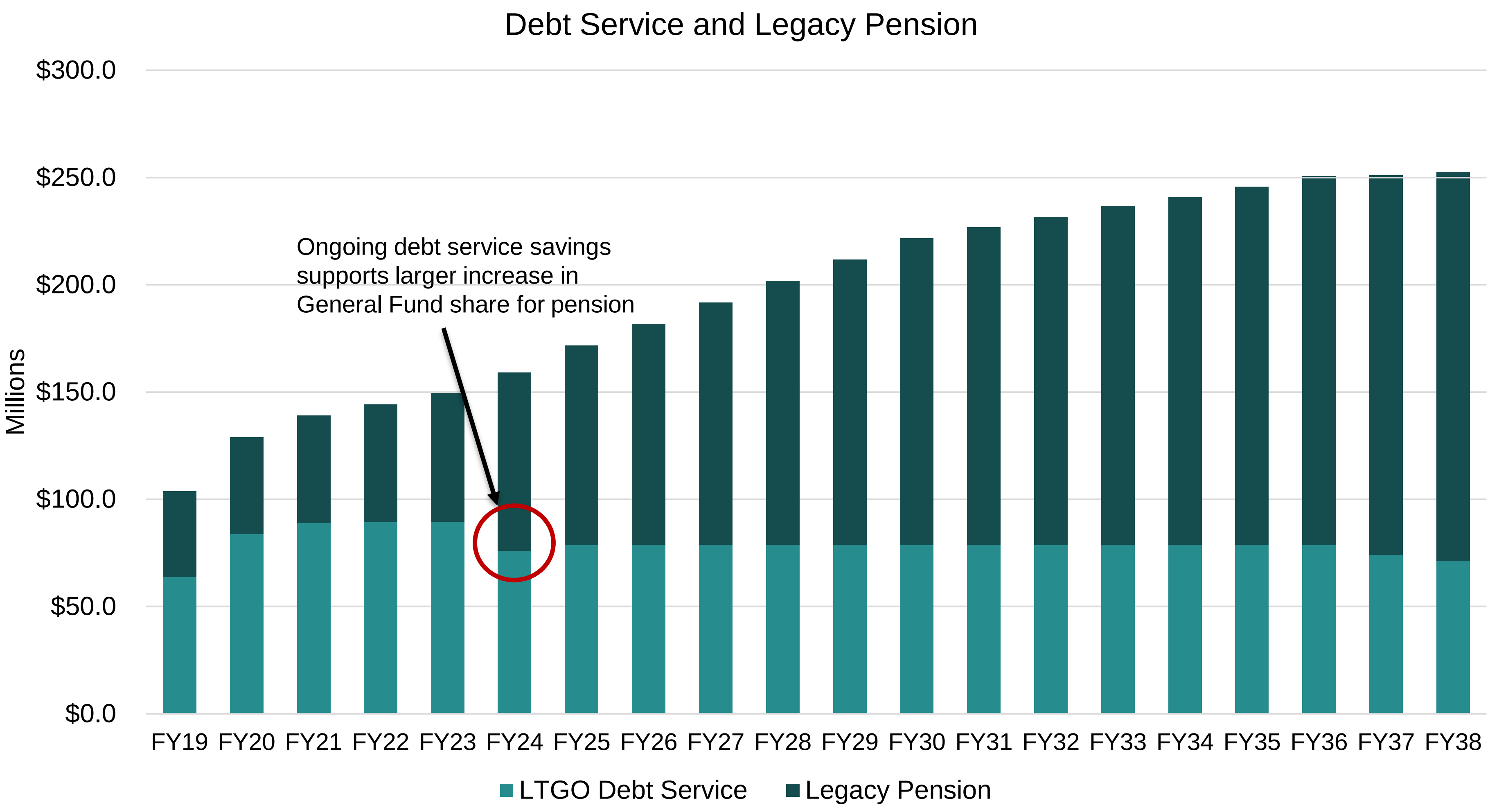
(2) The Retirement Systems have not yet established funding policies for the annual required contributions that resume in FY 2024.

# Long-Term Forecast

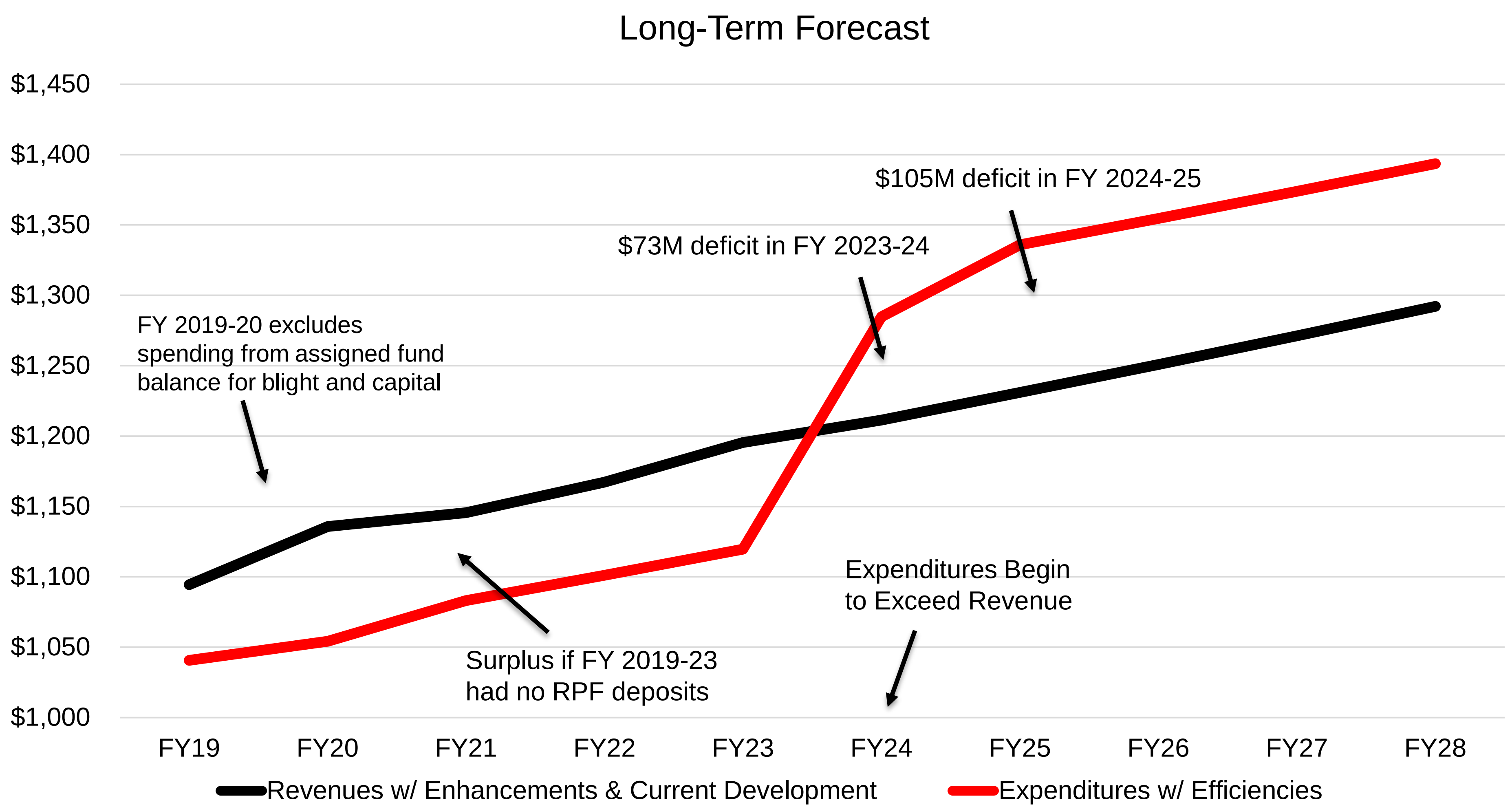
# Debt Service

- The City's LTGO Debt Services will increase by almost $20 million over FY 2018-19. Debt service would have been $5.9 M more if the City had not refinanced the C notes and B notes
- The December 2018 restructuring removed the FY 2024-25 debt cliff and achieved $10 million in present value savings

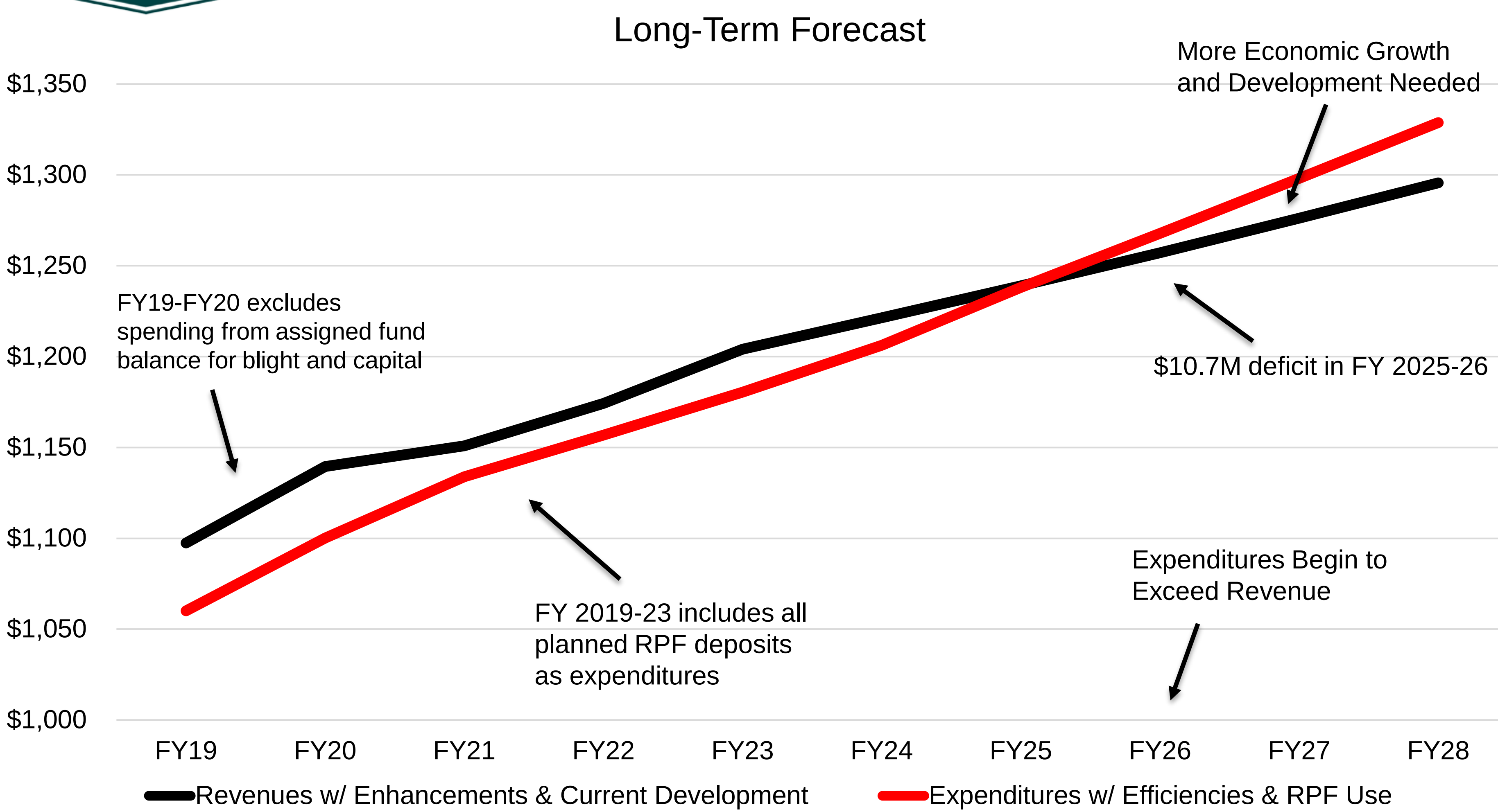



Debt Service and Legacy Pension
$300.0
$250.0
$200.0
$150.0
$100.0
$50.0
$0.0
Millions
Ongoing debt service savings supports larger increase in General Fund share for pension
FY19 FY20 FY21 FY22 FY23 FY24 FY25 FY26 FY27 FY28 FY29 FY30 FY31 FY32 FY33 FY34 FY35 FY36 FY37 FY38
LTGO Debt Service
Legacy Pension

# Long-Term Forecast: Pre-RPF and Debt Restructuring



# Long-Term Forecast: RPF and Debt Restructuring



# Waiver Requirements

# Considerations for Waiver for the City

| FRC Act Section | Requirement/ Response | Compliance |
|---|---|---|
| 8(2)(a) | **Requirement**: The commission certifies that the City has adopted and adhered to deficit-free budgets for 3 consecutive years that comply with generally accepted accounting principles and are in accordance with the uniform budgeting and accounting act, 1968 PA 2, MCL 141.421 to 141.440a. | ✓ |
| | **Response**: The City's FY 2016, 2017, and 2018 CAFRs show positive unrestricted fund balances at year-end. | |
| 8(2)(b) | **Requirement**: The State treasurer and the City's chief financial officer, if applicable, certify that both of the following are met: (i) all municipal securities or debt obligations sold by or for the benefit of the City in the general public market during the immediately preceding fiscal year and current fiscal year satisfied the capital and other financial requirements of the City during that period, and (ii) there is a substantial likelihood that municipal securities or debt obligations can be sold by the City in the general public market during the remainder of the current fiscal year and the immediately succeeding fiscal year in amount sufficient to substantially satisfy all of the capital and other financial requirements of the City during those periods in accordance with the City's financial plan, as applicable. | ✓ |
| | **Response**: In December 2018, the City closed the sale of two bond issuances. The City closed a sale of $135 million of general obligation bonds to support the Five-Year Capital Agenda. The City also closed a sale of $176 million of Distributable State Aid Fifth Lien Bonds to refinance approximately $201 million par amount of Financial Recovering bonds. The transaction generated a net present-value savings of approximately $10 million and reduced a major increase in debt service payments anticipated to begin in FY 2024-25. | |

# Considerations for Waiver for the City *(continued)*

| FRC Act Section | Requirement/ Response | Compliance |
|---|---|---|
| 8(2)(c) | **Requirement:** The City's financial plan projects a balanced budget for the current and succeeding 3 fiscal years using generally accepted accounting principles and in accordance with the uniform budgeting and accounting act, 1968 PA 2, MCL 141.421 to 141.440a and section 4t of the home rule city act, 1909 PA 279, MCL 117.4t. | ✓ |
| | **Response:** The City submitted its approved FY 2020-FY 2023 four-year financial plan to the FRC on April 30, 2019. The financial plan projects a balanced budget for the current and succeeding 3 fiscal years. Additionally, the approved FY 2020-FY 2023 financial plan contains the following: a) certification from the CFO that the approved budget complies with the applicable provisions of the uniform budget and accounting act, and b) a checklist of the financial plan requirements under MCL 117.4t and a response to each requirement. | |
| 8(2)(d) | **Requirement:** The City has demonstrated to the commission's satisfaction that the City has sufficient ability to borrow in the municipal securities market. | ✓ |
| | **Response:** See response to section 8(2)(b). In February 2019, S&P Global Ratings raised the City's General Obligation credit rating to 'BB-' from 'B+'. | |
| 8(2)(e) | **Requirement:** The City did not violate the plan for adjustment in the immediately preceding fiscal year, as applicable, and is not in violation in the current fiscal year. | ✓ |
| | **Response:** The City did not violate the plan of adjustment in the immediately preceding fiscal year or the current fiscal year. | |

| FRC Act Section | Requirement | Compliance |
| --- | --- | --- |
| 8(2)(f) | **Requirement:** The State treasurer certifies that the City is in compliance with the uniform budgeting and accounting act, 1968 PA 2, MCL 141.421 to 141.440a.<br><br>**Response:** The CFO has certified that the approved FY 2020-FY 2023 four-year financial plan complies with the applicable provisions of the uniform budgeting and accounting act. The City is managing the current year budget in compliance with the act by monitoring revenues and expenditures and amending the budget if appropriation or fund deficits are projected. | ✓ |
| 8(2)(g) | **Requirement:** The commission certifies that the City is in substantial compliance with the act.<br><br>**Response:** The City has timely submitted the information and reports required under FRC Resolution 2018-13, which granted the City its current waiver pursuant to section 8 of the act. | ✓ |
| 8(2)(h) | **Requirement:** The City has established as part of a system of compensation for employees retirement plans in which the City contributes no more than 7% of an individual's base pay, excluding payment for overtime services, 1-time lump-sum payments, and the cost of fringe benefits, to an employees' retirement account.<br><br>**Response:** The City offers the same retirement plan as provided for in the plan of adjustment. | ✓ |
| 8(2)(i) | **Requirement:** The City has implemented a program in which all contracts awarded by the City are posted on the City's public website within 30 days of the contract award, including the identity of the parties to the contract, the dollar amount of the contract, and a brief description of the goods or services provided in the contract.<br><br>**Response:** The program is available on the City's Open Data Portal and can be viewed here. | ✓ |

# Detroit FRC Resolution 2018-13 Requirements

"That this waiver, and any subsequent waivers, will be reviewed and acted upon by the Commission upon timely submission of the following information and reports to the Commission:"

| Waiver Section | Requirement | Compliance |
|---|---|---|
| 3(a) | **Requirement:** Within 45 days after the end of each month, in the form provided to the Commission by the City during the twelve months prior to the commencement of the waiver period, as may be modified after consultation and approval by the Commission's Executive Director and the City's Chief Financial Officer, the following: (i) current fiscal year-to-date actuals to budget and annualized projections, (ii) monthly headcount analysis, and (iii) current fiscal year-to-date net cash flows, including a current ratio analysis<br><br>**Response:** The City has timely submitted all required monthly financial reports to the Commission and has archived them on the City's Financial Reports webpage. | ✓ |
| 3(b) | **Requirement:** Within 45 days of the end of each quarter, a report on the current status of bond debt, payments made to the City's pension plans, and payments made to the City's Section 115 Trust for its legacy pension obligations.<br><br>**Response:** The City has timely submitted all required quarterly financial reports to the Commission and has archived them on the City's Financial Reports webpage. | ✓ |

| Waiver Section | Requirement | Compliance |
|---|---|---|
| 3(c)(i) | **Requirement:** On an annual basis, by March 31st of each year, (A) analysis and forecasts for the legacy pension plans in the form substantially similar to those previously provided to the Commission by the City prior to the waiver period, as may be modified after consultation and approval by the Commission's Executive Director ad the City's Chief Financial Officer; and (B) analysis that confirms the City's ability to pay its debt obligations through the period of time the City is subject to the Commission's oversight.<br>**Response:** The City timely submitted this report titled "FY 2020 Long-Term Forecast Report for Legacy Pension Plans and Debt Obligations" on March 29, 2019. | ✓ |
| 3(c)(ii) | **Requirement:** On an annual basis, by April 30th of each year, the City's adopted budget and 4-Year Financial Plan.<br>**Response:** The City timely submitted its adopted budget and 4-Year Financial Plan on April 30, 2019. It is available online. | ✓ |

CITY OF DETROIT
OFFICE OF THE CHIEF FINANCIAL OFFICER

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**TO:** Detroit Financial Review Commission Subcommittee on Finance (City of Detroit)
**FROM:** David P. Massaron, Chief Financial Officer, City of Detroit DPM
**SUBJECT:** Response to "Questions for the City (2019) for the May 13 Finance Subcommittee Mtg"
**DATE:** May 10, 2019

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The May 13, 2019 agenda for the Detroit Financial Review Commission Subcommittee on Finance (City of Detroit) includes Questions for the City of Detroit (2019). Please see responses to the questions below.

1. Do you agree or disagree with the summary review attached to this Memorandum as Exhibit B? If not, please explain why.

   **Response:** Disagree. Pursuant to Section 3 of Detroit Financial Review Commission Resolution 2018-13 ("Resolution 2018-13"), the City submitted an analysis and forecast for the legacy pension plans and an analysis that confirms the City's ability to pay its debt obligations (FY 2019-20 Long-Term Forecast Report). Please review this report and OCFO presentation dated May 13, 2019 – Retiree Protection Fund and Pension Funding Analysis section.

2. Please prepare an analysis substantially similar to the analysis prepared by Cheiron titled "Legacy Pension Contribution Scenario" and, except as provided below, based on the same assumptions contained in Appendix C to Exhibit A. The analysis should be based on the FY 2017-18 results of the GRS and PFRS as found in the Component II Valuation Funding Reports for each system as well as information needed from the 2018 Audited Reports for each plan. The gross contribution beginning in FY 2023-24 should reflect the amount set forth in the latest Gabriel Roeder Valuation Reports.

   **Response:** Please see OCFO presentation dated May 13, 2019 – Retiree Protection Fund and Pension Funding Analysis section. Per CFO Directive No. 2018-101-015: Responsibilities Related to City Pension Obligations, the City updates its RPF funding plan annually during the budget development process based on information that is complete and available at that time. The FY 2018 Valuation was not completed until after the FY 2019-20 Budget. However, the City's model factors in FY 2017-18 investment returns to approximate the updated FY 2023-24 General Fund contribution ($162.5M used in the City's funding plan vs. the FY 2017-18 valuation result of $164.3M).

   Furthermore, the GFOA's Best Practice on "The Role of the Actuarial Valuation Report in Plan Funding" indicates, "The key purpose of an actuarial valuation is to inform plan sponsors of the amount that needs to be contributed each year to adequately fund benefits." Further, the GFOA's Best Practice on Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits (OPEB) states, "contributions are to be made at regular intervals, with the contribution amount determined by the results of a recent actuarial valuation of the system." Thus, reacting to mid-year changes before actual results are measured and reported is not an appropriate approach to pension funding.

In addition, the Michigan Department of Treasury's Community Engagement and Finance Division has frequently cited Detroit's RPF strategy as an example for other local governments of working ahead on long-term pension funding challenges.

3. What has been the annual return on the Retiree Protection Fund since its creation? Please run a separate Legacy Pension Contribution Scenario changing the assumed 4% return on the Retiree Protection Plan to that actually achieved since its inception.

   **Response:** Pursuant to the latest Quarterly Report, submitted to the Commission on May 10, 2019, the RPF has earned $5,598,998, which is an effective rate of return of 3.08%.

4. Going forward, what is the city's plan to address the -1.8% initial loss in the RPF in FY 2018?

   **Response:** Please see Response to Item 3 as well as FY 2019-20 Long-Term Forecast Report. Furthermore, the City's investment of the RPF-related assets are governed by CFO Directive 2018-101-009: RPF Investment Advisory Committee; CFO Directive 2018-101-008: Investments & Investment Management, and CFO Directive No. 2018-101-015: Responsibilities Related to City Pension Obligations.

5. Referencing Exhibit B, please explain the difference in the investment return on that document and the "latest plan returns" under "FY 2020 Funding Plan" column on page 5 of the FY 2020 Long-Term Forecast report, March 29, 2019.

   **Response:** The source for this information is the retirement systems' audits, which can be found online for both the General Retirement System and Police & Fire Retirement System.

6. Please create a table similar to that contained on p. 4 on Exhibit A.

   **Response:** Please see FY 2019-20 Long-Term Forecast Report.

7. Please provide a copy of the City's four-year financial plan for FY 2020-2023, and provide a bridge from the four-year financial plan from FY 2019-2022. In additional, please specifically note the amounts transferred to the Retiree Protection Plan from the General Fund through FY2023 and from the Retiree Protection Plan annually thereafter.

   **Response:** Pursuant to Resolution 2018-13, on April 30, 2019, the City submitted via email the Four Year Financial Plan for FY 2020-23 to the Commission. In addition, please see OCFO presentation dated May 13, 2019 – Adopted FY 2019-2020 Budget Overview section.

8. Please provide a copy of the City's 10 year plan for FY 2019-2029, setting forth, among other things, annual debt service requirements and annual contributions to the Component II pension plans from the City's general fund, and noting the amounts transferred to the Retiree Protection Plan from the General Fund through FY2023 and from the Retiree Protection Plan annually thereafter.

**Response:** Pursuant to Section 3 of Resolution 2018-13, the City has timely submitted the following information and reports to the Commission, and are all available here on the City's Financial Reports webpage:

- Within 45 days after the end of each month:
  - Current fiscal year to date budget to actuals and annualized projections
  - Monthly headcount analysis
  - Current fiscal year to date net cash flows
- Within 45 days of the end of each quarter, a report on the current status of bond debt, payments to the city's pension plans and legacy pension obligations
- Annually, an analysis and forecast tor the legacy pension plans and an analysis that confirms the city's ability to pay its debt obligations (FY 2019-20 Long-term Forecast Report), and the City's adopted Budget and 4-Year Financial Plan.

9. If the contributions to the Component II pension plans from the City's General Fund are greater or less than that shown under the line of the Legacy Pension Contribution Scenario titled "General Fund Recurring Total" in any year, please explain why the City believes it can meet the increased requirements or why the amount decreased.

   **Response:** Pursuant to Section 3 Resolution 2018-13, the City has timely submitted the FY 2019-20 Long-term Forecast Report. As reflected in that report, the City's current plan continues the same RPF contributions through FY 2022-23 and increases the General Fund share for pensions beginning in FY 2023-24, which is possible due to a reduction in recurring debt service expense that resulted from the debt restructuring completed in December 2018.

10. Please provide a detailed schedule of debt service requirements for FYs 2018-2029.

    **Response:** Pursuant to Section 3 Resolution 2018-13, the City has timely submitted each quarter, a report on the current status of bond debt, payments to the City's pension plans and legacy pension obligations, available on the City's Financial Reports webpage.

11. Do each year of the four-year plan include a 5% of expenditures reserve? If not, why?

    **Response:** Yes, and the City's FY 2019-20 budget increases the budget reserve to nearly 10%. Please see "Budget Reserve Schedule" in the City's FY 2020-2023 Approved Four-Year Financial Plan (page A29.) Also see CFO Directive No. 2018-101-004: General Fund Budget Reserve.

12. What are the material risks in the four-year financial plan?

    **Response:** Please see the Revenue Section in the City's FY 2020-23 Approved Four-Year Financial Plan (page A27) and the February 2019 Revenue Estimating Conference Report (pages 3 and 14.)

13. Are the revenues shown in the four-year plan identical to the result of the most recent Revenue Conference? If not, why?

    **Response:** Yes. Please also see CFO Directive No. 2018-101-016: Budget Development, Execution & Monitoring.

14. How much does the City need to fund both blight and capital expenditures during the four-year plan period?

    **Response:** Please see OCFO presentation dated May 13, 2019 – Adopted FY 2019-20 Budget Overview. There is a sub-section titled "Capital and Blight."

15. Please provide a bridge between the previous 10-year plan and the current 10-year plan.

    **Response:** Please see response to Item 8 above.

16. Are the first four years of the 10-year plan identical to the current four-year plan? If not, please describe the differences.

    **Response:** Please see response to Item 8 above, as well as the Overview Section in the City's FY 2020-2023 Approved Four-Year Financial Plan (pages A1 – A4.), emailed to the Commission on April 30, 2019.

17. Concerning "FY 2020 Long-Term Forecast Report", March 29, 2019.

    a. Page 10, Long-Term Forecast chart; Perhaps an explanation of the chart can transpire during the finance subcommittee meeting.

    **Response:** At the will of the subcommittee.

CITY OF DETROIT
OFFICE OF THE CHIEF FINANCIAL OFFICER

Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 1100
Detroit, MI 48226
Phone: (313) 628-2535
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E-Mail: OCFO@detroitmi.gov

May 10, 2019

Detroit Financial Review Commission
Cadillac Place
3062 West Grand Boulevard
Detroit, MI 48202

Re: Quarterly Financial Report for the Three Quarters ended March 31, 2019

Dear Commissioners:

The Office of the Chief Financial Officer (OCFO) respectfully submits its quarterly City of Detroit Financial Report for the Three Quarters ended March 31, 2019.

This report is provided in accordance with the requirements included in Detroit Financial Review Commission (FRC) Resolution 2018-13, which granted the City its waiver of active FRC oversight through June 30, 2019. The OCFO has separately submitted this report to the Mayor, Detroit City Council and posted it on the City's website.

Best regards,

David P. Massaron
Chief Financial Officer

Att: City of Detroit Quarterly Financial Report for the Three Quarters ended March 31, 2019

Cc: Patrick Dostine, Executive Director, Detroit Financial Review Commission

CITY OF DETROIT
OFFICE OF THE CHIEF FINANCIAL OFFICER

Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 1100
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E-Mail: OCFO@detroitmi.gov

May 14, 2019

Detroit Financial Review Commission
Cadillac Place
3062 West Grand Boulevard
Detroit, MI 48202

Re: Monthly Financial Report for the Nine Months ended March 31, 2019

Dear Commissioners:

The Office of the Chief Financial Officer (OCFO) respectfully submits its monthly City of Detroit Financial Report for the Nine Months ended March 31, 2019.

This report is provided in accordance with the requirements included in Detroit Financial Review Commission (FRC) Resolution 2018-13, which granted the City its waiver of active FRC oversight through June 30, 2019. The OCFO has separately submitted this report to the Mayor, Detroit City Council and posted it on the City's website.

Best regards,

David P. Massaron
Chief Financial Officer

Att: City of Detroit Financial Report for the Nine Months ended March 31, 2019

Cc: Patrick Dostine, Executive Director, Detroit Financial Review Commission

# FY 2019 Financial Report

For the 9 Months ended March 31, 2019

Office of the Chief Financial Officer

Submitted on May 14, 2019

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# Executive Summary

- On March 26, the City refinanced six Housing and Urban Development (HUD) 108 Notes at a present value savings of approximately $2.4 million.
- On April 10, following the Detroit City Council's approval of the FY 2019-20 Budget and FY 2020-2023 4-Year Financial Plan, Moody's Investors Service noted in a issuer comment that the budget passage "continues positive fiscal momentum" and that "The credit-positive budget reflects sound financial practices, including conservative revenue assumptions and long-range projections, a significant capital investment and continues to set aside funds for a scheduled pension cost spike in fiscal 2024."
  - The adopted FY 2019-20 Budget and 4-Year Financial Plan is available to view on the OCFO's Financial Reports webpage.
- On April 25, the OCFO-Office of the Assessor participated in a City announcement that residents with expiring NEZ Homestead property tax reductions can apply for new certificates to continue their tax reduction. The Office of the Assessor is notifying those homeowners whose certificates will expire in the next five years as well as homeowners who live in NEZ Districts but have not yet applied for a certificate.
- On April 30, the Detroit City Council confirmed the Mayor's appointment of David P. Massaron to serve as the Chief Financial Officer for the City of Detroit, effective immediately.
- Within the City's active grants portfolio, the most significant new awards in March were $1.0 million from the Knight Foundation to support mobility innovation pilot projects, and the annual allocation for the Ryan White HIV Emergency Relief Program of $9.7 million. (page 9)
- Total accounts payable as of March 2019 had a net increase of $11.4M compared to February 2019. This was primarily due to the payment timing of 5 invoices over $1M (benefits and DWSD). The number of open invoices not on hold decreased by 612. In March 2019, 1,451 new invoices were processed that are not on hold. (page 15)

# YTD Budget Amendments – General Fund

| FY 2018-2019 GENERAL FUND BUDGET AMENDMENTS (Through March 2019) | | |
|---|---|---|
| **Department** | **Reason for Amendment** | **Amount** |
| **FY 2018 - 2019 Adopted Budget** | | **$ 1,073,598,491** |
| **Carry Forward Use of Assigned Fund Balance** | | |
| City Council | City Planning Commission Project[1] | 699,975 |
| Non Departmental | Restructuring Projects[2] | 1,697,194 |
| Recreation | Wayne County Millages / Parks | 1,660,548 |
| Non-Departmental | Capital PO Encumbrances | 13,216,435 |
| Non-Departmental | P.E.G Fees | 1,890,580 |
| Non-Departmental | Blight Reinvestment | 7,900,000 |
| Non-Departmental | PLD Decommission | 22,000,000 |
| | **Total** | **49,064,732** |
| **Budget Amendment** | | |
| Non-Departmental | Refunding LTGO Bonds | 179,213,699 |
| General Services | Wayne County Parks Millage | 270,000 |
| Law / Non-Departmental | Funding For Outside Legal Services | 746,210 |
| Parks & Recreation | Pistons Basketball Court Improvements - Year 2 | 416,667 |
| | **Total** | **180,646,576** |
| **Transfer From Other Funds** | | |
| Non-Departmental | Blight Reinvestment[3] | 5,863,366 |
| | **Total** | **5,863,366** |
| **FY 2018 - 2019 Amended Budget (Through March 2019 )** | | **$ 1,309,173,165** |

(1) Multi-year, multi-phase project which will result in an updated Zoning Ordinance.
(2) EM appropriated.
(3) The bond amendment approved by City Council in the amount of $13.1M, included the transfer / increase of $5.8M for blight reinvestment.

# YTD Budget vs. YTD Actual – General Fund

| YTD ANALYSIS 9 MONTHS ENDED MARCH 31, 2019 | BUDGET | ACTUAL + ADJUSTMENTS + ENCUMBRANCES | | | VARIANCE (BUDGET VS. ACTUAL) | |
|---|---|---|---|---|---|---|
| MAJOR CLASSIFICATIONS | YEAR TO DATE | ACTUAL | ADJUSTMENTS + ENCUMBRANCES | TOTAL | | |
| A | B | C | D | E = C + D | ($) F = E-B | % G = (F/B) |
| **REVENUE:** | | | | | | |
| Municipal Income Tax | $ 220.5 | $ 226.2 | – | $ 226.2 | $ 5.7 | 2.6% |
| Property Taxes | 118.6 | 102.6 | 8.3 | 110.9 | (7.7) | (6.5%) |
| Wagering Taxes | 136.7 | 140.0 | - | 140.0 | 3.3 | 2.4% |
| Utility Users' Tax | 30.0 | 19.5 | 9.4 | 28.9 | (1.1) | (3.7%) |
| State Revenue Sharing | 100.8 | 103.1 | - | 103.1 | 2.3 | 2.3% |
| Other Revenues | 154.9 | 113.3 | - | 113.3 | (41.5) | (26.8%) |
| **Sub-Total** | **$ 761.5** | **$ 704.7** | **$ 17.7** | **$ 722.4** | **$ (39.1)** | **(5.1%)** |
| Budgeted Use of Prior Year Fund Balance | 2.6 | 0.0 | 2.6 | 2.6 | 0.0 | 0.0% |
| Carry forward-Use of Assigned Fund Balance | 49.1 | 0.0 | 49.1 | 49.1 | 0.0 | 0.0% |
| Transfers from Other Funds | 5.9 | 0.0 | 5.9 | 5.9 | 0.0 | 0.0% |
| Budget Amendments | 180.6 | 178.2 | 0.3 | 178.5 | (2.2) | (1.2%) |
| **TOTAL** | **$ 999.7** | **$ 882.9** | **$ 75.6** | **$ 958.5** | **$ (41.3)** | **(4.1%)** |
| **EXPENDITURES:** | | | | | | |
| Salary and Wages (Incl. Overtime) | $ (341.8) | $ (321.3) | – | (321.3) | $ 20.4 | (6.0%) |
| Employee Benefits[1] | (91.4) | (81.1) | – | (81.1) | 10.3 | (11.3%) |
| Legacy Pension Payments | (20.0) | (20.0) | – | (20.0) | – | – |
| Retiree Protection Fund | (20.0) | (20.0) | – | (20.0) | – | – |
| Debt Service | (231.3) | (217.6) | – | (217.6) | 13.6 | (5.9%) |
| Other Expenses[2] | (322.5) | (245.4) | (44.0) | (289.4) | 33.1 | (10.3%) |
| **TOTAL** | **$ (1,027.0)** | **$ (905.4)** | **$ (44.0)** | **$ (949.4)** | **$ 77.4** | **(7.5%)** |

(1) Monthly Employee Benefits reclassified across categories.
(2) Includes contribution to DDOT, transfer to PLA, Prior Year carry/balance forwards, contribution to Risk Management Fund, contribution to DBLA, plus all purchases of goods and services.

# Annualized Projection vs. Budget – General Fund

| ANNUAL ANALYSIS | | | | |
|---|---|---|---|---|
| | BUDGET | PROJECTION | VARIANCE (BUDGET VS. PROJECTION) | |
| SUMMARY CLASSIFICATIONS | ANNUAL AMENDED | ANNUAL ESTIMATED | ANNUAL ESTIMATED | |
| A | B | C | ($) D = C-B | % E = (D/B) |
| **REVENUE:** | | | | |
| Municipal Income Tax | $ 299.4 | $ 317.5 | $ 18.1 | 6.1% |
| Property Taxes | 129.3 | 125.8 | (3.5) | (2.7%) |
| State PPT Reimbursement | 4.5 | – | (4.5) | (100.0%) |
| Wagering Taxes | 180.8 | 182.5 | 1.7 | 1.0% |
| Utility Users' Tax | 40.0 | 42.4 | 2.4 | 5.9% |
| State Revenue Sharing | 201.3 | 203.2 | 1.9 | 0.9% |
| Other Revenues | 215.8 | 209.7 | (6.1) | (2.8%) |
| **Sub-Total** | **$ 1,071.0** | **$ 1,081.0** | **$ 10.0** | **0.9%** |
| Budgeted Use of Prior Year Fund Balance | 2.6 | 2.6 | – | 0.0% |
| Carry forward-Use of Assigned Fund Balance | 49.1 | 49.1 | – | 0.0% |
| Transfers from Other Funds | 5.9 | 5.9 | – | 0.0% |
| Budget Amendments | 180.6 | 180.2 | (0.4) | (0.2%) |
| **TOTAL (F)** | **$ 1,309.2** | **$ 1,318.7** | **$ 9.6** | **0.9%** |
| **EXPENDITURES:** | | | | |
| Salary and Wages (Incl. Overtime) | $ (453.3) | $ (440.9) | $ 12.4 | (2.7%) |
| Employee Benefits | (139.5) | (128.3) | 11.2 | (8.0%) |
| Legacy Pension Payments | (38.6) | (38.6) | – | – |
| Retiree Protection Fund | (20.0) | (20.0) | – | – |
| Debt Service | (248.6) | (248.6) | – | – |
| Other Expenses | (409.1) | (394.9) | 14.2 | (3.5%) |
| **TOTAL (G)** | **$ (1,309.2)** | **$ (1,271.4)** | **$ 37.8** | **(2.9%)** |
| **VARIANCE (H=F+G)** | | | **$ 47.4** | |

Note: Projected annual revenues are based on the February 2019 Revenue Estimating Conference.
* Property Taxes and Utility Users' Tax revenue projections are presented as gross totals to align with FY19 budget presentation.

# Employee Count Monitoring

| | MONTH-OVER-MONTH ACTUAL[1] | | | BUDGET VS. ACTUAL | | |
|---|---|---|---|---|---|---|
| | Actual Feb. 2019 | Actual Mar. 2019 | Change Mar. 2019 vs. Feb. 2019 | Adjusted Budget FY 2019[2] | Variance Under/(Over) Budget vs. March 2019 | |
| **Public Safety** | | | | | | |
| Police | 3,060 | 3,101 | 41 | 3,322 | 221 | 7% |
| Fire | 1,200 | 1,200 | 0 | 1,274 | 74 | 6% |
| Total Public Safety | **4,260** | **4,301** | **41** | **4,596** | **295** | **6%** |
| **Non-Public Safety** | | | | | | |
| Office of the Chief Financial Officer | 422 | 420 | (2) | 479 | 59 | |
| Public Works - Full Time | 364 | 362 | (2) | 423 | 61 | |
| Health and Wellness Promotion | 89 | 92 | 3 | 119 | 27 | |
| Human Resources | 98 | 100 | 2 | 106 | 6 | |
| Housing and Revitalization | 98 | 100 | 2 | 101 | 1 | |
| Innovation and Technology | 127 | 123 | (4) | 136 | 13 | |
| Law | 112 | 109 | (3) | 120 | 11 | |
| Mayor's Office (includes Homeland Security) | 78 | 78 | 0 | 79 | 1 | |
| Planning and Development | 32 | 35 | 3 | 41 | 6 | |
| General Services - Full Time | 536 | 534 | (2) | 535 | 1 | |
| Legislative [3] | 186 | 190 | 4 | 190 | 0 | |
| 36th District Court | 323 | 323 | 0 | 326 | 3 | |
| Other [4] | 116 | 116 | 0 | 133 | 17 | |
| Total Non-Public Safety | 2,581 | 2,582 | 1 | 2,788 | 206 | 7% |
| **Total General City-Full Time** | **6,841** | **6,883** | **42** | **7,384** | **501** | **7%** |
| **Seasonal/ Part Time[5]** | 335 | 469 | 134 | 904 | 435 | 48% |
| **Enterprise** | | | | | | |
| Airport | 4 | 4 | 0 | 4 | 0 | |
| BSEED | 271 | 271 | 0 | 280 | 9 | |
| Transportation | 934 | 931 | (3) | 927 | (4) | |
| Municipal Parking | 79 | 82 | 3 | 90 | 8 | |
| Water and Sewerage | 547 | 543 | (4) | 618 | 75 | |
| Library | 302 | 300 | (2) | 322 | 22 | |
| **Total Enterprise** | **2,137** | **2,131** | **(6)** | **2,241** | **110** | **5%** |
| **Total City** | **9,313** | **9,483** | **170** | **10,529** | **1,046** | **10%** |

Notes:
(1) Actuals are based on active employees only (both permanent and temporary) and include full-time, part-time, seasonal employees and PSCs if funded by vacant budgeted positions.
(2) Adjusted Budget reflects amendments and other adjustments impacting approved position counts compared to the original budget. It excludes personal services contractors (PSCs). The FY19 Budget increased the total FTE appropriation by 464 over the FY18 Budget.
(3) Includes: Auditor General, Inspector General, Zoning, City Council, Ombudsperson, City Clerk, and Elections.
(4) Includes: Civil Rights Inclusion & Opportunity, Administrative Hearings, Public Lighting Department, and Non-departmental.
(5) Includes DPW, General Services, Recreation and Elections

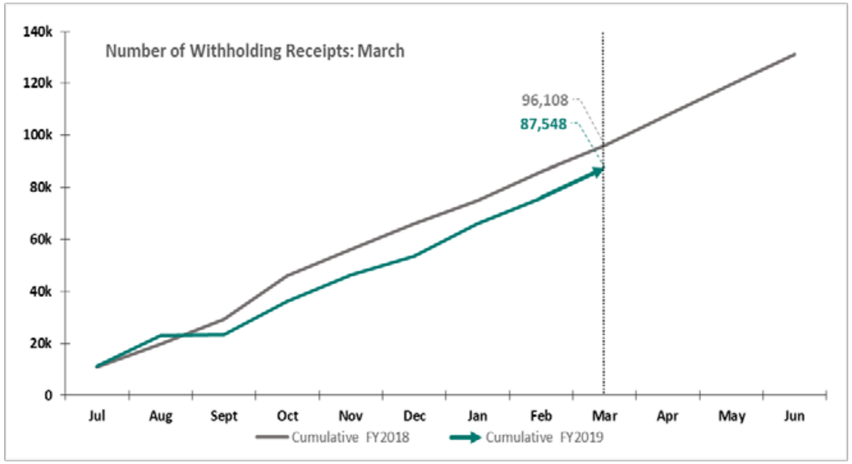
# Income Tax - Collections

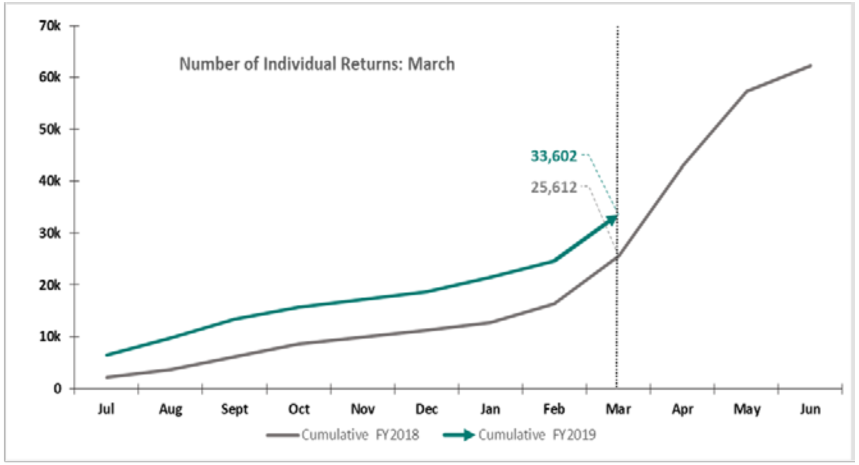
**Fiscal Year 2019**

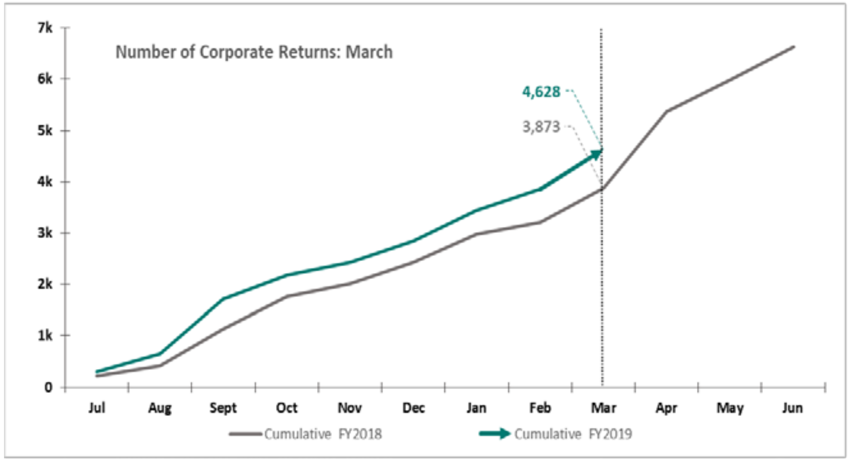
| Municipal Income Tax Collections | March 2019 YTD | | March 2018 YTD | |
|---|---|---|---|---|
| Withholdings | $ | 208,075,075 | $ | 200,576,638 |
| Individuals (1099/1040 Filers) | | 15,975,037 | | 12,666,832 |
| Corporations | | 18,222,494 | | 15,138,539 |
| Partnerships | | 3,180,571 | | 1,625,647 |
| Assessments | | 3,889,904 | | 4,263,651 |
| **Total Collections** | **$** | **249,343,081** | **$** | **234,271,307** |
| **Refunds/ Disbursements[1]** | | **(23,166,595)** | | **(13,239,972)** |
| **Collections Net of Refunds/Disbursements** | **$** | **226,176,486** | **$** | **221,031,336** |

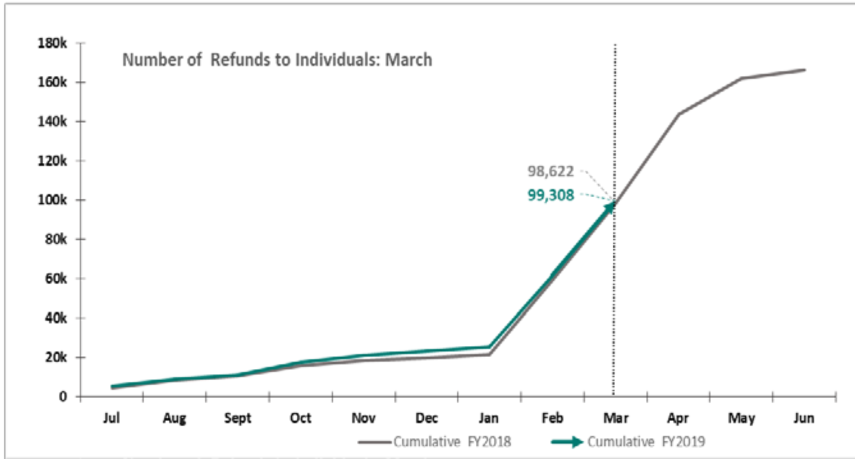
[1] The State holds an estimated amount of municipal income tax for potential refunds, and has in the past disbursed funds to the City that were not ultimately refunded.

# Income Tax – Volume of Returns and Withholdings



## Active Grants and Donations as of March 31, 2019 ***($ in millions)***

| | | |
|---|---|---|
| | | |
| Net Change from last month[3] | $6.6 | |

## New Funds – January 1 to April 23, 2019 ***($ in millions)***

| | |
|---|---|
| | |
| Committed[4] | |
| **Total New Funding** | **$34.5** |
| Net New to the City[5] | $1.5 |

(1) Reflects public and private funds directly to City departments.

(2) Reflects public and private funds for City projects via fiduciaries, and to third-party partners and agencies for projects prioritized by the City for which the OCFO-Office of Development and Grants has provided active support.

(3) The most significant new awards so far in March are those highlighted on the Executive Summary.

(4) Reflects verbal and informal commitments which are secure, but for which formal agreements have not yet been finalized.

(5) Reflects new funds to the City from organizations which have not given to the City of Detroit before.

New Funds – January 1 to April 23, 2019 – By Priority Category

| Priority Category | Documented | Committed | Total |
| --- | --- | --- | --- |
| Administration/General Services | $ 150,000 | $ 197,000 | $ 347,000 |
| | $ 400,000 | | $ 553,848 |
| | $ 800,000 | | $ 2,300,000 |
| | $ 10,504,064 | | $ 10,504,064 |
| | $ 50,000 | | $ 1,324,300 |
| | $ 88,795 | | $ 88,795 |
| | $ 1,266,847 | | $ 1,613,060 |
| | - | | $ 225,000 |
| | $ 2,652,768 | | $ 2,752,768 |
| | $ 250,000 | | $ 250,000 |
| Transit | $ 1,905,000 | | $ 8,286,420 |
| | | | $ 6,216,003 |
| **Grand Total** | **$ 20,583,477** | **$ 13,877,781** | **$ 34,461,258** |

New Funds and City Leverage[1] – January 1 to April 23, 2019 – By Priority Category

| | | |
|---|---|---|
| **Grand Total** | **$ 34,461,258** | **$ 61,480,437** |

[1] Leverage includes both match and parallel investment by the City that help make the case to external funders to co-invest.

[2] This $59M has leveraged all Strategic Neighborhood Fund funding to date which includes funds raised in 2018.

[3]There is an additional $50M in HUD funding allocated to the Affordable Housing Leverage Fund that has been critical to securing these commitments.

# Cash Position

($ in millions)

| | Unrestricted | Restricted | March 2019 Total |
|---|---|---|---|
| **Bank Balance** | **$ 230.5** | **$ 940.1** | **$ 1,170.6** |
| **Plus/minus: Reconciling items** | **(7.1)** | **15.4** | **8.3** |
| **Reconciled Bank Balance** | **223.4** | **955.5** | **1,178.9** |
| **General Ledger Cash Balances** | | | |
| **General Fund** | | | |
| General Accounts | $ 135.3 | 136.4 | $ 271.7 |
| Self Insurance Escrow | - | 18.7 | 18.7 |
| Undistributed Delinquent Taxes | - | 36.2 | 36.2 |
| Other | 5.4 | 6.5 | 11.9 |
| **Other Governmental Funds** | | | |
| Risk Management | - | 77.0 | 77.0 |
| Capital Projects | - | 156.3 | 156.3 |
| Street Fund | - | 80.3 | 80.3 |
| Grants | 2.4 | 49.1 | 51.5 |
| Solid Waste Management Fund | 39.5 | - | 39.5 |
| Debt Service | - | 41.2 | 41.2 |
| Gordie Howe Bridge Fund | - | 20.2 | 20.2 |
| Quality of Life Fund | - | 23.5 | 23.5 |
| Other | 22.4 | 11.3 | 33.7 |
| **Enterprise Funds** | | | |
| Enterprise Funds | 3.1 | 33.1 | 36.2 |
| **Fiduciary Funds** | | | |
| Undistributed Property Taxes | - | 73.3 | 73.3 |
| Fire Insurance Escrow | - | 9.5 | 9.5 |
| Retiree Protections Trust Funds | - | 128.9 | 128.9 |
| Other | - | 54.2 | 54.2 |
| **Component Units** | | | |
| Component Units | 15.2 | - | 15.2 |
| **Total General Ledger Cash Balance** | **$ 223.4** | **$ 955.5** | **$ 1,178.9** |

Note: This schedule reports total City of Detroit (excludes DSWD) cash in the bank

# Operating Cash Activity: YTD Actual vs Forecast

**For 9 Months Ending March 31, 2019**

| *$ in Millions* | YTD Forecast | YTD Actual | YTD Variance | Prior YTD Actual |
|---|---|---|---|---|
| ***Cash Receipts*** | | | | |
| Property Taxes | $ 113.4 | $ 113.7 | $ 0.3 | $ 105.7 |
| Income Taxes | 219.9 | 219.9 | 0.0 | 217.9 |
| Wagering | 137.4 | 139.5 | 2.1 | 134.7 |
| State Shared Revenue | 135.3 | 136.2 | 0.9 | 134.1 |
| Utility Taxes | 18.3 | 17.5 | (0.8) | 20.1 |
| Other Revenue | 169.5 | 156.7 | (12.8) | 188.4 |
| **Total Cash Receipts** | $ 793.8 | $ 783.5 | $ (10.3) | $ 800.9 |
| ***Cash Disbursements*** | | | | |
| Salaries & Wages | $ (344.2) | $ (348.5) | $ (4.3) | $ (323.1) |
| Benefits | (125.8) | (125.3) | 0.5 | (82.0) |
| Accounts Payable | (312.4) | (326.3) | (13.9) | (277.2) |
| Debt Service | (65.3) | (65.3) | 0.0 | (54.3) |
| **Total Cash Disbursements** | $ (847.7) | $ (865.4) | $ (17.7) | $ (736.6) |
| **Net Cash Flow** | $ (53.9) | $ (81.9) | $ (28.0) | $ 64.3 |

# Operating Cash Activity: Actual vs. Forecast to Year End

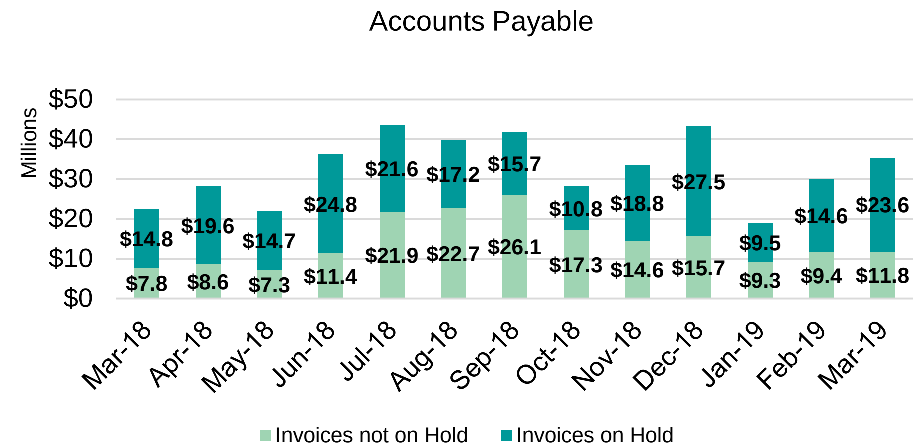
**For 9 Months Ending March 31, 2019**

| *$ in millions* | 2018 | | | | | | 2019 | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **July Actual** | **August Actual** | **September Actual** | **October Actual** | **November Actual** | **December Actual** | **January Actual** | **February Actual** | **March Actual** | **April Forecast** | **May Forecast** | **June Forecast** | **FY2019 Total** |
| ***Cash Receipts*** | | | | | | | | | | | | | |
| Property Taxes | $ 24.3 | $ 7.0 | $ 40.4 | $ 5.6 | $ 1.5 | $ 1.0 | $ 3.0 | $ 28.7 | $ 2.1 | $ 1.7 | $ 2.4 | $ 12.8 | $ 130.5 |
| Income Taxes | 35.1 | 23.7 | 23.5 | 30.8 | 19.0 | 25.6 | 31.2 | 16.9 | 13.9 | 36.0 | 31.4 | 30.2 | 317.5 |
| Wagering | 15.1 | 18.1 | 13.4 | 15.6 | 18.5 | 16.0 | 14.3 | 13.2 | 15.4 | 16.7 | 16.4 | 15.9 | 188.6 |
| State Shared Revenue | - | 33.9 | - | 34.4 | - | 34.3 | - | 33.6 | - | 32.9 | - | 32.9 | 202.0 |
| Utility Taxes | 2.3 | 1.8 | 1.9 | 1.8 | 1.5 | 1.2 | 2.6 | 0.9 | 3.6 | 3.0 | 2.0 | 2.0 | 24.6 |
| Other Revenue | 13.1 | 31.0 | 10.0 | 27.9 | 16.8 | 12.2 | 15.7 | 22.5 | 7.5 | 27.4 | 36.1 | 44.8 | 265.0 |
| **Total Cash Receipts** | **$ 89.9** | **$ 115.5** | **$ 89.2** | **$ 116.1** | **$ 57.3** | **$ 90.3** | **$ 66.8** | **$ 115.8** | **$ 42.5** | **$ 117.7** | **$ 88.3** | **$ 138.6** | **$ 1,128.0** |
| ***Cash Disbursements*** | | | | | | | | | | | | | |
| Salaries & Wages | $ (39.1) | $ (49.7) | $ (37.7) | $ (37.7) | $ (37.5) | $ (32.1) | $ (47.1) | $ (28.9) | $ (38.9) | $ (36.1) | $ (40.7) | $ (37.9) | $ (463.4) |
| Benefits | (33.8) | (26.6) | (5.5) | (12.7) | (6.5) | (13.6) | (12.6) | (6.0) | (8.1) | (16.1) | (6.5) | (23.8) | (171.8) |
| Accounts Payable | (39.3) | (46.5) | (33.8) | (55.5) | (38.4) | (30.1) | (31.8) | (21.6) | (29.4) | (22.9) | (35.2) | (26.4) | (410.9) |
| Debt Service | (2.0) | (4.5) | (14.7) | (6.9) | (2.8) | (11.2) | (2.8) | (9.0) | (11.4) | (8.2) | (2.7) | (9.0) | (85.2) |
| **Total Cash Disbursements** | **$ (114.2)** | **$ (127.3)** | **$ (91.7)** | **$ (112.8)** | **$ (85.2)** | **$ (87.0)** | **$ (94.3)** | **$ (65.5)** | **$ (87.8)** | **$ (83.3)** | **(85.1)** | **$ (97.1)** | **$ (1,131.3)** |
| **Net Cash Flow** | $ (24.3) | $ (11.8) | $ (2.5) | $ 3.3 | $ (27.9) | $ 3.3 | $ (27.5) | $ 50.3 | $ (45.3) | $ 34.4 | 3.2 | $ 41.5 | **$ (3.3)** |

# Accounts Payable and Supplier Payments

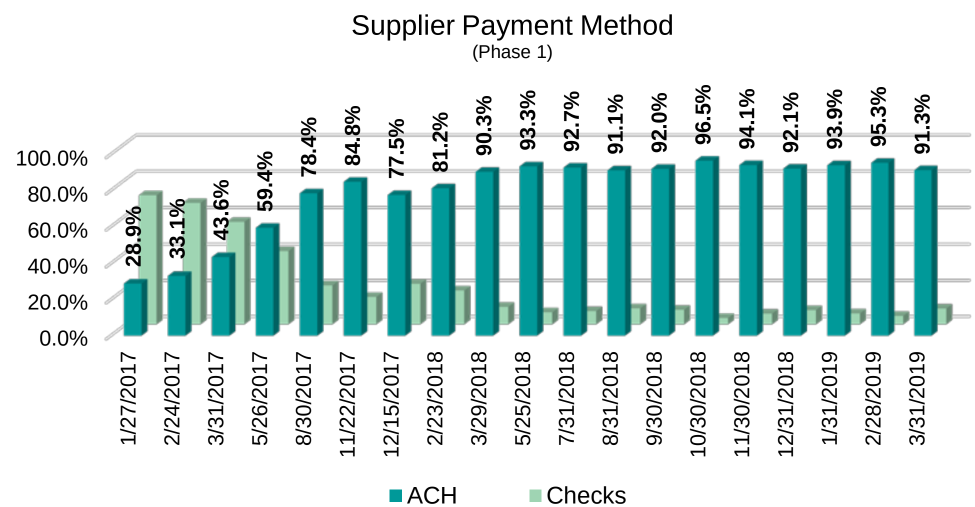
**City of Detroit**
**Accounts Payable Analysis**
*$ in millions*

| Accounts Payable (AP) as of Mar-19 | | |
|---|---|---|
| Total AP (Feb-19) | $ | 24.0 |
| Plus: Mar-19 invoices processed | $ | 92.9 |
| Less: Mar-19 Payments made | $ | (81.5) |
| Total AP month end (Mar-19) | $ | 35.4 |
| Less: Invoices on hold[(1)] | $ | (11.4) |
| Less: Installments/Retainage Invoices[(2)] | $ | (0.4) |
| Net AP not on hold | $ | 23.6 |




**AP Aging**
(excluding invoices on hold)

| | Net AP | Current | Days Past Due 1-30 | Days Past Due 31-60 | Days Past Due 61+ |
|---|---|---|---|---|---|
| **Mar-19. Total** | $ 23.6 | $ 15.0 | $ 7.8 | $ 0.2 | $ 0.7 |
| *% of total* | *100%* | *63%* | *33%* | *1%* | *3%* |
| *Change vs. Feb-19* | *$ 9.0* | *$ 7.5* | *$ 1.5* | *$ (0.0)* | *$ 0.0* |
| Total Count of Invoices | 1,510 | 1,269 | 122 | 22 | 97 |
| *% of total* | *100%* | *84%* | *8%* | *1%* | *6%* |
| *Change vs. Feb-19* | *(612)* | *(114)* | *(510)* | *3* | *9* |
| **Feb-19. Total** | $ 14.6 | $ 7.4 | $ 6.3 | $ 0.2 | $ 0.6 |
| *% of total* | *100%* | *51%* | *43%* | *1%* | *4%* |
| Total Count of Invoices | 2,122 | 1,383 | 632 | 19 | 88 |
| *% of total* | *100%* | *65%* | *30%* | *1%* | *4%* |




Notes:
(1) Invoices with system holds are pending validation. Some reasons include: pending receipt, does not match purchase order quantity/price, and legal holds
(2) Invoices on retainage are on hold until the supplier satifies all contract obligations
All invoices are processed and aged based on the invoice date

S&P Global Ratings

130 East Randolph Street
Suite 2900
Chicago, IL 60601
tel 312-233-7000
reference no.: 40447745

February 7, 2019

City of Detroit
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 1126
Detroit, MI 48226
Attention: Mr. John Naglick, Chief Deputy CFO/Finance Director

Re: ***Detroit, Michigan***

Dear Mr. Naglick:

S&P Global Ratings has reviewed the rating on the above-listed issuer. Based on our review, we have raised our credit rating from "B+" to "BB-" while affirming the stable outlook. A copy of the rationale supporting the rating and outlook is enclosed.

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Please send hard copies to:
S&P Global Ratings
Public Finance Department
55 Water Street

New York, NY 10041-0003

The rating is subject to the Terms and Conditions, if any, attached to the Engagement Letter applicable to the rating. In the absence of such Engagement Letter and Terms and Conditions, the rating is subject to the attached Terms and Conditions. The applicable Terms and Conditions are incorporated herein by reference.

S&P Global Ratings is pleased to have the opportunity to provide its rating opinion. For more information please visit our website at www.standardandpoors.com. If you have any questions, please contact us. Thank you for choosing S&P Global Ratings.

Sincerely yours,

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enclosure

## S&P Global Ratings
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S&P Global
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**Summary:**

# Detroit; General Obligation

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**Summary:**

# Detroit; General Obligation

| Credit Profile | | |
|---|---|---|
| Detroit | | |
| *Long Term Rating* | BB-/Stable | Upgraded |

## Rationale

S&P Global Ratings raised its issuer credit rating (ICR) on Detroit to 'BB-' from 'B+'. At the same time, we raised our long-term rating to 'BB-' from 'B+' on Detroit's series 2018 unlimited-tax general obligation (GO) bonds. The outlook for both ratings is stable.

The series 2018 bonds are secured by Detroit's full faith and credit unlimited-tax GO pledge.

The rating improvement reflects our view of the city's stabilizing financial position, whereby we feel it is well situated to absorb increasing pension commitments and scheduled increases in debt service in the coming years, as well as possible revenue setbacks, while still sustaining year-to-year budget balance and very strong reserves. In our view, Detroit's recent unlimited-tax GO issuance, its first post-bankruptcy financing backed solely by its GO pledge, demonstrated its ability to access capital markets at competitive borrowing rates. Market access is a significant stabilizing factor for the city's financial trajectory. This type of access can help the city more effectively generate funds for needed public investment, while also helping alleviate some burden on the operating budget, which is still funding pay-as-you-go capital. The rating movement to the 'BB' category from the 'B' category reflects our view that exposure to adverse business, financial, or economic conditions could impair the city's ability to meet financial commitments, but is not likely to.

Detroit is demonstrating the ability to meet its budget demands, while also providing a strong reserve cushion against unexpected events or stagnating revenues. The city is experiencing good economic growth (though mostly centered in the downtown area) and population declines are moderating. At the same time, it continues to post budget surpluses, grow reserves, and meet objectives as defined in the Plan of Adjustment (POA) and subsequent planning documents. In the past year, Detroit shed the regular oversight of the Financial Review Commission (FRC), allowing it to operate more independently (see "Detroit's Momentum Continues With Latest Fiscal Plan And Financial Review Commission Oversight Waiver," published May 2, 2018, on RatingsDirect). We note that much of the improved performance was made possible by shedding fixed costs during bankruptcy, although many other changes can also be traced to improved management practices. Detroit established and remains on track with a long-term plan to phase in increasing pension costs over time, when it could have taken a pension holiday instead, as per the POA. However, in our view, despite the longer-term planning involved, there remains a pension funding gap that constitutes a structural imbalance, resulting in a management score of weak under our local GO criteria, which caps the rating.

The city still faces substantial credit pressures, both in the near and longer term. It operates within a very limited revenue-raising framework tied to economic activity. Therefore, continued stabilization of the population and tax base will be key to future budgetary performance and long-term viability. To support this stabilization, the city must continue investing in public infrastructure and economic development initiatives, while also managing increasing annual pension and debt service burdens. Though beyond the two-year outlook horizon, its very large unfunded pension obligation will continue to grow, and there remains risk that projected funding requirements, starting in fiscal 2024, could be larger than anticipated. Many of these risks that Detroit faces are shared by other cities across the nation (though on a varying scale), as highlighted in our 2019 "U.S. Local Government Sector Outlook" (published Jan. 9, 2019).

Factors for further rating improvement will include ongoing access to capital markets, tax base stabilization, maintenance of very strong reserves, and remaining on track to meet both near- and medium-term increasing budget obligations. The latter factor will be particularly key as the fiscal 2024 actuarial determined pension requirements inch closer and become clearer, especially if the projected costs increase significantly.

Additional factors supporting the 'BB-' rating include our view of Detroit's:

- Very weak economy, with very low incomes and property wealth and declining population, yet serves as the anchor of a broad and diverse metropolitan statistical area (MSA);
- Weak management, reflecting an ongoing structural imbalance, but financial policies and practices that we consider good under our Financial Management Assessment (FMA) methodology;
- Weak budgetary performance, with operating results that we expect could deteriorate (but remain positive) in the near term relative to fiscal 2018, which closed with operating surpluses in the general fund and at the total governmental fund level albeit without meeting the full actuarially determined contribution (ADC);
- Strong budgetary flexibility, with an available fund balance in fiscal 2018 of 42% of operating expenditures, but limited capacity to raise revenues given the economic and political environment;
- Very strong liquidity, with total government available cash at 72% of total governmental fund expenditures and 8x governmental debt service, and improved access to external liquidity that we consider strong;
- Very weak debt and contingent liability profile, with high debt service carrying charges, high overall net debt as a percent of market value, below-average amortization, and a large unfunded pension obligation that will worsen for years before seeing improvement; and
- Strong institutional framework score.

### Large pension obligation will remain a weakness

Pensions were at the center of the conversation during bankruptcy, and despite the changes negotiated through that process, the obligation remains significant and future budget burdens will be large. The city established a long-term plan that would allow it to phase in increasing costs at an annual clip of $5 million to $10 million. It remains on track with the plan, notably through the creation and funding of the Retiree Protection Fund (RPF), but there is still uncertainty in regard to how high the future costs will grow. If the pension funded level declines more than anticipated, leading to a higher ADC, the city could face higher increases than planned for.

The POA set out funding requirements for the legacy pension plans, to be paid from various sources. The specific general fund requirement was $20 million in annual payments through fiscal 2019. There are no general fund payment requirements from 2020 through 2023. During this period, annual payments will continue from the library fund and Great Lakes Water Authority/Detroit Water and Sewerage Department, as well as from outside sources (e.g., Foundation for Detroit's Future, Detroit Institute of Arts). Payments to retirees have been uninterrupted and will continue during this time, and requirements to meet a full ADC begin in 2024. Recent estimates place the general government component of the 2024 ADC at more than $170 million.

The city is already making annual contributions to the RPF on a voluntary basis, and will increase these amounts in fiscal 2020 when the required legacy payments stop. The RPF currently has more than a $120 million balance, and the city plans to contribute another $215 million by fiscal year-end 2023, growing it to $335 million (not including estimated interest earnings). Starting in fiscal 2024, the city will begin drawing down portions of the RPF each year, to help it meet the full ADC. The plan estimates that the RPF would be exhausted by 2035, at which point the city will make the full ADC out of the operating budget. If projections hold true, the city could increase the general fund appropriations for legacy pension costs, which stand at $40 million in fiscal 2019, by $5 million each year through fiscal 2026 and then between $5 million and $10 million through 2035, and meet its obligations. However, as noted, if the ADC increases above current amounts, the annual increases to the budget could rise considerably. The city continues to monitor and update projections, and we expect that it will revise its ramp-up strategy as needed if the pension plans do not perform as expected. Although voluntary contributions of this kind are generally thought to be optional, given the nature of the FRC and the city's planning requirements, once this kind of line item is put in the financial plan, the city will be required to fund it, or could risk falling back under the direct control of the FRC. We view this as a significant incentive for the city to make the payments, given that it does not want to revert to the more rigorous FRC reporting and oversight requirements it was subject to in the years following the exit from bankruptcy.

### Very weak economy is rebuilding, but will take time

We consider the city's economy very weak, due to very low incomes and property wealth and a declining population. Projected per capita effective buying income is at 53% of the national level and market value per capita (MVPC) is $24,103. Our rating and economy assessment negatively factor for declining population and very low MVPC, recognizing the limited and declining base that supports the budget and debt. At the same time, the assessment positively factors for Detroit's role as the anchor of the Detroit-Warren-Dearborn MSA, which we still consider to be broad and diverse. The city is experiencing good development activity and job creation, but the growth remains mostly concentrated in the downtown area. If the recent favorable development and population trends continue, the economy assessment could improve. However, in our view, both the city and wider region still face increased exposure to possible economic setbacks, given above-average reliance on manufacturing and trade exports.

Detroit's population has been eroding for nearly 70 years, but declines are moderating. The 2018 population of 672,795 was up 2.2% (based on Nielson (Claritas) data), which followed a five-year period with average annual declines slightly below 1%. This was the first population increase in years, but it still remains 30% below the 2000 U.S. Census level and is less than half of the 1.5 million population in 1970. While Detroit has made efforts to reform itself to manage a much lower population within the same footprint, the falling population could have even bigger implications for its state shared revenue following the upcoming 2020 U.S. Census, given that the city has been losing population while the state's population has been growing. The mayor's office has been mobilizing to make sure everyone is counted, but the effect could still be negative for Detroit.

Similarly, taxable value (TV) and market value (MV) have declined significantly, but are recovering. TV was $6.66 billion in 2018, and MV $16.22 billion. These figures were down 33% and 43% compared to ten years ago. Both figures have still been declining annually, but at a slower rate. Detroit recently finished a complete citywide reappraisal. In the short term, this resulted in some lower assessments and likely delayed the return to growth, but will be a positive impact over the longer term as it more accurately portrays the base. The preliminary figures of the completed reappraisal show both TV (5.6%) and MV (27%) increasing in 2019 for the first time in years. We note that much of the increases are reported outside of the downtown area, indicating that growth is beginning to spread into neighborhoods outside of the downtown core, which is a positive development. TV growth will still lag MV growth, however, given the state's taxing framework that only allows incremental increases in TV, unless there is a land sale, in which case the TV is reset at current MV.

There are over 2 million jobs in the Detroit MSA and employment is growing. It averaged 1.8% annual growth over the past four years, in line with national trends. City unemployment dropped to 9.3% in 2017. While still above both state and U.S. levels (4.6% and 4.1%, respectively), it is down from nearly 25% in 2010. The county unemployment rate was 5.4% in 2017. Much of the growth is in the construction industry, but also in leisure and hospitality, mostly reflecting a boom in downtown residential and commercial development. The region is also experiencing strong gains in the transportation industry; however, at the same time, it remains susceptible to volatility given its heavy reliance on manufacturing, which could be nearing a growth maturity, and exports, which are at more risk of negative consequences stemming from international trade tensions (see "For U.S. State And Local Governments, Winter Is Coming, But Maybe Not Yet," published Oct. 24, 2018). Manufacturing jobs still make up 12.5% of total employment, which exceeds the national rates. Given a projected slowdown in manufacturing, employment growth is projected to temper over the next four years, and fall behind national trends.

While the downtown continues to receive significant private investment (more than $1 billion of new investment announced since the start of 2018), city officials are dedicating significant public resources to spur economic revitalization from within, with an eye toward generating sustainable growth. Achievements to date include reduced response time for emergency medical services and police calls; new buses and more frequent service; new street lights; and nearly 30,000 vacant or abandoned homes either demolished, boarded up, or rehabbed for occupation. In addition, the city created a comprehensive Strategic Neighborhood Fund plan that targets 10 neighborhoods, leveraging city, state, and philanthropic contributions to coordinate long-term solutions for revitalization and affordability. The primary components for the program include planning with neighborhoods to address streetscapes, parks, single-family housing, and commercial corridors.

These public and private efforts have already contributed to the better population and tax base trends. We feel that stabilizing these neighborhoods will be key to long-term stability. A major factor still holding back this progress continues to be the struggling state of the Detroit public school system. The state intervened in 2016 with a restructuring of the district, effectively giving its operations a clean balance sheet. However, it still faces major long-term uncertainties. Reports indicate the district needs immense capital improvements, but options to fund them are limited. Until residents feel there is better access to quality education, population recovery will likely remain a challenge.

### Weak management due to structural imbalance

We consider Detroit to have good financial policies and practices under our FMA methodology, although the management score remains weak as it is still constrained by our view of the ongoing structural imbalance. We revised the FMA to good from standard in November 2018, reflecting new policies regarding investment management and debt. We expect the city's management practices to remain good, particularly given Detroit's long-term forecasting practices and active budget monitoring, but the management profile will likely remain limited to weak over the near-to-medium term due to our view of the ongoing structural imbalance.

Throughout the bankruptcy process and for a period afterwards, the city relied heavily on outside consultants; we recognize that Detroit has centralized its management since then and that key decisions and resultant implementation are now internally driven. Further, we feel that the city is demonstrating its commitment to, and is thus far executing on, its long-term plans and reform efforts, which is a strength and reflective of management's cohesion and discipline.

### FMA: Good

The good FMA indicates that we currently consider practices good, but not comprehensive. As the city continues to evolve post-bankruptcy, an administrative order from the CFO's office states that policies will be reviewed annually unless the CFO determines a review is not necessary.

Detroit performs a formal historical trend analysis--encompassing both revenues and expenditures--that is updated annually, and also has a biannual revenue-estimating conference to help it stay on track with projections and remain disciplined in budgeting. Budget-to-actual results are provided to the FRC and city council monthly, and a new investment policy requires quarterly reporting to city council on investment holdings. The city also recently adopted a comprehensive debt policy that provides parameters for the issuance and use of debt, as well as limitations/ranges for the amount of debt. In accordance with the Home Rule City Act, Detroit annually updates a four-year financial projection. The city reinstated its five-year capital planning in 2016 and is now undergoing an update to the plan (with sources and used identified) as per the requirement to update every two years. It also maintains a policy to be in in compliance with the requirement of the Home Rule City Act to keep a budget reserve of at least 5% of appropriations.

### Financial Review Commission and the Home Rule City Act

The FRC was created as the city emerged from bankruptcy, charged with providing oversight for the city, including review and approval of budgets and the long-term financial plan; review of revenue estimates; approval of contracts and collective bargaining agreements; monitoring the issuance and payment of debt; and ensuring adherence to the POA, statutory requirements, and overall sound fiscal practices.

In April 2018, following the adoption of and adherence to deficit-free budgets for three consecutive years, a long-term financial plan that projected four years of balanced budgets (including the current year), adherence to all statutes and provisions of the POA, and timely servicing of debt, the FRC scaled back its oversight. Under scaled-back oversight, the FRC meets monthly, but Detroit does not need its approval for budgeting and planning documents. The reduced oversight will remain in place for another 10 years, but if Detroit does not meet the requirements that originally reduced the oversight, the FRC would return to full oversight.

The terms of the amendments to the Home Rule City Act (adopted in 2014) designated Detroit as a "Qualified City." These laws place certain requirements on the city that remain in place regardless of FRC oversight. Notable requirements include adoption of an Office of the CFO and appointment of a CFO, annual adoption of a four-year plan (as part of the annual budget), a budget reserve that equals 5% of appropriations, and biannual revenue forecasting conferences. We consider it a strength that these requirements are set in statute and are not tied to active or inactive FRC oversight.

### Weak budgetary performance given structural mismatch

Detroit's budgetary performance remains weak, in our opinion. It maintains positive year-to-year operating results, but these do not account for annual pension costs that are significantly below what would otherwise be actuarially sound levels. The city had operating surpluses of 4.8% of expenditures in the general fund and 2.1% across all governmental funds in fiscal 2018. These ratios include recurring transfers out as expenditures, exclude from both revenue and expenditures outside contributions to the pension plans, and exclude the use of fund balance for early debt redemption.

Detroit ended fiscal 2018 with an operating surplus (as adjusted) of $45.4 million, and projects about a $35 million operating surplus for fiscal 2019. These operating results are bolstered by the phase-in of pension contributions, and our assessment accounts for the fact that results would be markedly worse if a full ADC was being paid. The full projected ADC for the legacy plans (to be paid from general operations) has grown to over $190 million. Comparatively, the general fund contributed $20 million toward this plan in fiscal 2018, and deposited $15 million of its surplus into the RPF. We recognize that the increasing pension requirements are still several years away, they will be aided by draws on the RPF, and that the city is aligning its budget to incrementally absorb this cost. However, looking at the operating surplus without considering the pension holiday neglects the looming weight of this obligation. This is factored into our weak budgetary performance assessment, as we expect the annual operating surpluses to soften as debt and pension burdens increase.

The city's most recent four-year plan (which will be updated this spring) projected balanced results, including these increasing costs. It was based on only modest increases in revenue, and does not yet factor most of the growth to come from the $1 billion-plus in recent economic expansion, nor growth from the projected strong TV increase. The city recently addressed one of its most pressing near-term challenges: spiking debt service on its 2014 financial recovery bonds. Detroit redeemed a portion of these bonds in December 2018 and issued refunding bonds, which smoothed the amortization. Many of the collective bargaining agreements expire this year, though most of the police and fire run through fiscal 2020.

At this time, we feel the city's budget can absorb its near-term increasing costs, but near-term challenges remain. The city is still funding a large amount of its capital program through the general fund, and still faces difficulties filling hundreds of vacant police and fire positions. These vacancies lead to positive budget-to-actual results, but still push up overtime costs. The current administration has prioritized public safety and staff development, and remains highly committed to this. On the other side of the equation, the city's primary revenue sources remain highly tied to economic performance, with little flexibility to be increased. Recognizing this, the city is already discussing strategies to counteract potential revenue declines or stagnation. This is important, given the previously noted potential peaking and maturation of economic growth. In our view, the city's strong reserve position is important and can afford it some flexibility to adjust in the event of an economic downturn. The city also has shown an increased ability the access the capital market, which could provide it an opportunity to finance certain capital spending if needed, which would have otherwise come from the budget.

The city's revenue mix remains diverse. In fiscal 2018, total general fund revenues of $987 million (as adjusted) were led by income taxes (31.4%) and state-shared revenues (generated from Detroit's proportionate share of a statewide sales tax; 20.2%), followed by wagering taxes (generated from three local casinos; 18.1%) and property taxes (12.1%). The city is levying all of its major taxes at maximum levels, and thus, declining or stagnant TV and wages have a direct effect on revenues, as do population trends. We also consider there to be a risk in such a significant reliance on inherently volatile and sensitive wagering taxes, and, to a lesser extent, heavy reliance on sales and income taxes, which can be more prone to volatility than property taxes.

### Strong budgetary flexibility with ongoing growth in reserves

Detroit's budgetary flexibility is strong, in our view, and has been improving. Fiscal 2018 ended with an available general fund balance of $399.1 million, or 42% of operating expenditures. While we still consider the city to have a limited ability to raise revenues given both the economy and the limitation on tax increases, it has thus far shown an ability to adjust expenditures as needed to keep pace with operating revenues.

The fiscal 2018 available general fund reserve includes $131.5 million in unassigned reserves, $62.3 million in the assigned budget reserve (which is currently above the state-required 5% of appropriations), and another $205 million in assigned reserves with various designations. These figures do not include the balance in the RPF, which has been reclassified in the general fund as restricted. As a whole, the assigned fund balance declined $43 million in fiscal 2018, due to the RPF being transferred out, and the unassigned balance declined $38 million, due to the use of cash on hand for early debt redemption. The actual available balance still went up by about $10 million, however.

We anticipate the city will maintain positive operating results in fiscal 2019 as well as in the near future, including RPF deposits. In the last three years alone, Detroit's strong reserve position has afforded it the ability to contribute $90 million in one-time contributions to the RPF (above scheduled recurring amounts, combined fiscal years 2016 and 2017) and to fully redeem its 2014C notes ahead of schedule ($67 million, in fiscal 2018); and it still grew the reserve. Moving forward, we expect management to weigh alternative strategies such as increasing the budget reserve, making excess contributions to the RPF, and further advancing its blight removal and capital plans. Management has indicated a desire to build its available reserves (as a safeguard against a potential recession), but we also anticipate that portions will come down, notably $100 million that is assigned for capital and blight. Overall, we anticipate the reserve position will remain strong, which is a rating strength considering the cushion this can provide against the economically sensitive revenue streams and increasing fixed costs. The lack of revenue flexibility and subsequent reliance on economic development for growth, combined with still slim expenditure margins, will continue to limit our assessment of budgetary flexibility from improving. We also recognize that the ratio of reserves to expenditures may moderate in the coming years, as expenditures grow due to the increasing pension phase-in.

### Very strong liquidity and improvement in payment delays

In our opinion, Detroit's liquidity is very strong, with total government available cash at 72% of adjusted total governmental fund expenditures and 8.8x adjusted governmental debt service in 2018.

We have revised our liquidity assessment to very strong, from strong, based on our revised view of Detroit's access to external liquidity, which we now consider as strong, as opposed to limited. During and after bankruptcy, the city continued to have access to capital markets, though each issuance featured a designated priority-lien revenue source or state intercept. However, Detroit successfully issued unlimited-tax GO bonds in December 2018, with no additional credit enhancements or secondary pledges, and at competitive interest rates. Based on our expectation that the city's economic and financial progress will continue, we feel that it will be able to access capital markets at competitive prices. This is a significant stabilizing factor for the city, as market access affords it additional flexibility to finance needed public improvements, and can lessen the burden on the annual budget.

We also note the city's increased liquidity has helped it become more timely with payments, as there are no longer delays to vendors.

### Very weak debt and contingent liability profile while high debt and high fixed costs

In our view, Detroit's debt and contingent liability profile is very weak. Total governmental fund debt service (adjusted for one-time redemption costs) was 8% of total governmental fund expenditures in fiscal 2018, and net direct debt is 170% of total governmental fund revenue. Negatively affecting our view of the city's debt profile is its high overall net debt above 25% of market value.

The city has approximately $3 billion in direct debt outstanding, with less than 45% amortizing in ten years. This includes $1.6 billion in GO-backed debt, $830 million of net water and sewer revenue-secured debt, and about $360 million in debt solely supported by tax-increment revenue. The city does not have direct-purchase debt.

The city still has $151 million in voter-approved unlimited-tax GO debt capacity, which it could issue over the next five years. This bond capacity was approved during elections in 2004 and 2009, to be used for public safety, recreational/cultural, economic development, and transportation purposes. The projects to be financed with the future debt fall in line the current administration's priorities and are part of the long-term capital improvement plan. The city expects to take a conservative approach to issuing this debt, considering how it fits in with projected millage rates and an already significant amount of ongoing capital projects. The next issuance is currently anticipated for fiscal 2020.

The city's limited-tax GO debt issuance in December 2018 smoothed out what would have been spikes between 2025 and 2030, thereby making the burden on the general fund more manageable. This slowed amortization slightly, but did not extend maturities.

Given the size of the debt burden, slow amortization schedules, and low market value relative to debt, as well as our consideration of the large unfunded pension obligation that will lead to accelerating costs and budget stress, we do not anticipate any improvement in the debt and contingent liability score in the near term.

### Large unfunded pension liability remains a pressure

Detroit's pension plans are poorly funded and represent a significant unfunded long-term liability and looming source of budgetary pressure. While steps were taken during the bankruptcy to reduce benefits, the unfunded obligation (and future funding requirements) continues to rise, notably due to an extended period in which the city will not be contributing at an actuarially determined level. We expect pension pressures will be a long-term budget challenge for Detroit, even if it fully executes its strategy to pre-fund and layer in increasing costs.

The city made its required $20 million deposit to the General Retirement System (GRS) legacy plan in fiscal 2018, in addition to $34 million in contributions to the hybrid plan. Combined, these costs were 3% of total governmental funds expenditures (as adjusted). Using fiscal 2024 ADC estimates (the first year ADC is required), funding requirements from governmental funds (for all plans, but excluding outside contributions) could be more than $190 million, which would be in excess of 12% of current governmental funds expenditures.

The city historically managed two single-employer, defined-benefit pension plans, the GRS and the Police and Fire Retirement System (PFRS). Detroit froze both plans effective July 1, 2014. Active and retired employees will continue to receive benefits, but at a reduced level, accrued up until this date under the old plan (legacy plan), and benefits accrued thereafter are dictated by the new hybrid GRS and PFRS plans. Revisions to the GRS legacy plan include the elimination of cost-of-living adjustments (COLAs), a 4.5% reduction in benefits, and requirement to repay certain payouts from 2003 to 2013, while revisions to the PFRS legacy plan were limited to a 55% reduction in COLAs. Both plan revisions contain provisions that allow for adjustments to benefits based on overall plan performance.

The POA outlined how the two legacy plans would be funded, notably with several years of pension holiday whereby the city can realign spending and gradually phase into its budget increasing contribution costs. Along with the previous noted required general fund contributions, there are also required contributions from the library fund and Great Lakes Water Authority. In the meantime, the plans are receiving contributions through committed revenues from the Foundation for Detroit's Future and the Detroit Institute of Arts, and from bond proceeds in escrow. On the whole, these annual contributions will remain below what actuarially sound levels would be, which will continue to weaken the plan's funded position.

Although it is budgeting to continue to make payments to the RPF, should the city fail to contribute to the RPF at currently projected levels, it will face a significantly larger burden on its general fund than is currently expected. Also, if the ADC amounts in fiscal 2024 are higher than currently anticipated, Detroit will face a steeper climb in finding an ability to fully fund it.

Using figures reported as of the June 30, 2018 audit date, the PFRS legacy plan had a net pension liability of $859.2 million, funded at 76.9%. The GRS legacy plan had an $832.7 million net pension liability and 69.9% funded ratio (54% of liability is governmental fund related). Based on recent planning documents, the combined funded ratio is projected to continually decline to as low at 41% in 2045 before returning to growth. These projections were based on a level-dollar, 30-year amortization, and 6.75% discount rate. In our view, there is significant risk of the plan weakening further than anticipated, especially considering the long 30-year amortization schedule after the contribution holiday and a relatively higher discount rate where the vast majority of the liability is tied to the closed plans with declining payroll and an increasing ratio of retired to active employees. We note that the city is actively reviewing its funding strategy and these figures remain fluid.

The city is also not required to contribute to the newer hybrid plans at actuarially determined levels until fiscal 2024. As per the POA, it is required to contribute 5% of compensation to the GRS plan and between 11.2% and 12.25% to the PFRS plan. These costs combined to about $39 million in fiscal 2018, and the city anticipates that this will increase marginally, and track fairly close to what an ADC would be. We consider this plan to have many positive features, notably eliminating COLAs, increasing employee contributions, and even reducing benefits if certain funded ratios are not met. The two plans as a whole were overfunded at June 30, 2018.

As part to the bankruptcy and POA, the city effectively eliminated its entire other postemployment benefit liability, leaving only a minimal supplemental death benefit plan.

### Strong institutional framework

The institutional framework score for Michigan municipalities with a population greater than 600,000 is strong.

## Outlook

The stable outlook reflects our view of Detroit's demonstrated improvements to operations since bankruptcy, which have led to better capacity to meet both operating needs and debt obligations. In our view, the city has positioned the budget to be able to absorb increasing pension and debt service costs in the near term, while relying on conservative revenues estimates, and still remain balanced. The city has built up a very strong reserve and recently demonstrated an ability to access capital markets at competitive rates, both of which are significant stabilizing factors that we expect will continue. Although a structural imbalance persists due to the pension funding gap, in our view, Detroit's current budget and reserve position provide cushion against possible near-term revenue volatility or other unexpected events. This cushion will decrease, however, as pension contributions and debt service costs ramp up, or if revenue growth falls short of projections.

### Upside scenario

We could raise the rating if Detroit continues to have balanced operating results while remaining adequately positioned to assume long-term increases in pension commitments and debt service, and at the same time preserving its very strong reserve levels. As costs increase, continued stabilization of the tax base will play a key role in potential rating improvement, as will ongoing access to capital markets. Potential revisions to the 2024 full ADC, and the city's ability to quickly adjust and prepare for cost increases (should they materialize), will also be a major factor. In addition to the preceding factors, rating improvement would also depend on continued compliance with provisions of the Home Rule City Act, thereby allowing for more financial independence and less oversight.

### Downside scenario

If the city veers from its current balanced operations or becomes less vigilant in budget and operational oversight and resolution, we could take a negative action. In addition, should pressures arise to which the city does not respond with a long-term, comprehensive solution, we could lower the rating. Possible sources of pressure could include economic setbacks that challenge revenue generation or poor pension performance that increases future funding obligations.

## Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.