



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: December 2, 2011

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: City of Detroit Financial Condition

As summarized below, based upon information received and considered as part of this analysis including the inability of the City to operate within budgets and to avoid fund deficits, recurrent accumulated deficit spending, severe cash flow shortages resulting in an improper reliance on inter-fund borrowing and appropriations, the lack of funding of the City's other post-retirement benefits, and the increasing debt load of the City -- I conclude that the City is under considerable financial stress. Therefore, I recommend that a preliminary review under Public Act 4 of 2011 be initiated.

The analysis found the following:

- The City has violated requirements of section 17 of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, as amended, which states that the "the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined." For example, for the year ending June 30, 2010, the Human Resources Apprentice Training program went over budget by over \$2.3 million, the Insurance Premium line item went over budget by over \$12 million and the Police Operations budget went over budget by \$15.8 million. Consequently, the general fund had line items that went over budget by almost \$58 million.
- The City has not filed an adequate or approved deficit elimination plan with the Department of Treasury for the fiscal year ending June 30, 2010. On December 20, 2010, the City filed their audit report that reflected a \$155 million deficit in the general fund, a \$1.4 million deficit in the airport fund, and a \$3.5 million deficit in the local street fund. As of November 2011, the City has not filed a plan that would reduce the general fund deficit. In fact, new data estimate the general fund's deficit increasing to \$195 million for 2011 (the 2011 audit report has not yet been filed).

There have been deficits that exceed \$100 million dating back to 2005. These deficits have fluctuated between over \$155 million and over \$300 million. One of the primary methods the City has used to reduce the deficits has been to issue more debt. Total general fund debt and other long term liability proceeds for the years between 2005 and 2010 was over \$600 million, temporarily reducing the deficits by an equal amount. Debt proceeds reduce the deficit

in the year the debt is issued, but reduce fund balance over time as debt service payments increase. In 2010, annual debt service requirements exceeded \$539 million.

- The City has a mounting debt problem. In June of 2010, the long-term debt of the City exceeded \$5.9 billion excluding pension and other postemployment benefit (OPEB) liabilities. However, if one includes the unfunded pension liability of \$552 million (offset by an almost \$1.4 billion pension asset) and the unfunded other postemployment benefit liability of over \$4.9 billion, the City's total long-term debt amounts to over \$10 billion.
- The City's long-term bond ratings fell below the BBB category and are considered "junk", speculative or highly speculative. According to a Thomson Reuters June 24, 2011 article, "Fitch downgraded the rating on about \$453 million of Detroit's unlimited-tax general obligation bonds to BB-minus from BB-plus, and dropped the rating on the city's approximately \$486 million of limited-tax GO bonds to B-plus from BB. The rating on about \$1.5 billion of pension bonds was cut to BB-minus from BB-plus. The lower unlimited-tax GO rating from Fitch matches the Ba3 rating with a negative outlook from Moody's Investors Service. Standard & Poor's Ratings Services rates Detroit's GO bonds BB with a stable outlook."
- Not only does the City have large external debts, but it also has large debts due to itself in the form of interfund loans. As of June 30, 2010, the City had net interfund balances amounting to over \$188 million.
- Audit reports for FY09-10 show that the City's poor financial management impacts the City's administration of Federal grant programs and poses likely threats to the City's continued receipt of Federal funds for social service programs. Eighty pages of a KPMG audit for the FY 09-10 fiscal year site numerous findings and offer the following examples of questioned and potentially disallowed costs:
 - Nutrition for Women, Infants and Children – Approximately \$1.0 million in questioned costs in addition to accounting, eligibility and fund reconciliation issues.
 - CDBG – Approximately \$12.7 million in questioned salary costs.
 - HOME (Home investment partnership program) – Approximately \$846K in salary costs; \$273K in questioned indirect planning costs.
- The City is experiencing significant cash flow shortages. Based on projections made available by the City, the general fund had a forecasted ending cash balance of \$115,500,000 as of October 28, 2011. The actual cash balance as of that date was \$96,100,000, an overestimation of \$19,400,000. The City revised its cash forecast based on a series of new assumptions and it is projected that the City will experience a cash shortage starting in April 2012, of (\$1,600,000) and will end its fiscal year in June 2012 with a cash shortage of (\$44,100,000).

The negative cash balance in the transportation fund was originally estimated to be (\$25,000,000) by the end of the fiscal year. The new projection reduces the negative balance to (\$18,200,000), which will occur in June 2012 when there is a large expenditure for benefits and miscellaneous disbursements.

Please understand that this is not an exhaustive list of the City's financial difficulties, but appear more than sufficient to justify a financial review. The formal notice to Detroit will provide the specific violations of Public Act 4 of 2011.

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