RISK MANAGEMENT

Conclusion

The Mayor's 2012-2013 Proposed Budget for the Risk Management Fund is reasonable. The budget is based on an average of five years of payouts for claims, workers' compensation, and lawsuits.

Analysis of the Risk Management Fund

The Risk Management Fund is a self-insurance fund established by Section 18-8 of the City Code in 1995 to cover liability to third parties for any loss or damage arising out of negligence, tort, contract or otherwise accruing, payable by the City from and after July 1, 1994. The City may be liable under Workers' Compensation or Disability Benefits Law, or under any similar laws, or for damage to property or personal injury.

The Risk Management Fund premium included in the Mayor's 2012-2013 Proposed Budget is compared to the fiscal year 2011-2012 Budget in the following schedule:

	In Millions		
	Mayor's 2012-2013 Proposed Budget	2011-2012 Budget	Increase (Decrease)
General Fund Premium	$ 71.1	$ 68.1	$ 3.0
DDOT Premium	22.4	19.6	2.8
Annual Premium	$ 93.5	$ 87.7	$ 5.8

Current Year Premium

Risk Management Fund revenues are premiums paid by the General Fund and Detroit Department of Transportation (DDOT), earnings from the investment of fund assets, and reimbursements from the State.

The calculation of the Risk Management Fund premium in the Mayor's 2012-2013 Proposed Budget is based on a five-year running average of actual payouts for damage claims, lawsuits, and other general and administrative expenditures from fiscal year 2006-2007 through fiscal year 2010-2011. The five-year historical average for the General Fund increased $1.2 million from $40.3 million to $41.5 million from fiscal year 2009-2010 to fiscal year 2010-2011. The five-year historical average for DDOT increased $1.0 million during the same time period.

The overall premium requirement increase is due in large part to a $34.0 million increase in the debt service requirement in 2012 and 2013.

Fund Balance
This fund was established to cover the cost of claims and lawsuit payouts and workers compensation costs.

The following table shows the Risk Management Fund balance as of June 30, 2008. The table also includes the actual expenditures, revenues, and fund balance for the fiscal years ending June 30, 2009, 2010 and 2011, the balance of the Risk Management Fund as of April 21, 2012, the contributions to the fund (excluding debt service costs) included in the Mayor's 2012-2013 Proposed Budget.

In Millions

Fiscal Year Ended June 30		City Contributions	Expenditures		Fund Balance[1]
2008				(A)	22.4
2009		$ 62.1	$ 50.1		34.4
2010		58.5	53.7		39.2
2011		52.7	65.1		26.8
2012	(B)	48.1	68.1		6.8
2013	(C)	54.6			

(A) The fiscal year ended 2008 Fund Balance was taken from the 2008 Comprehensive Annual Financial Report.
(B) Contributions, expenditures and fund balance as of April 21, 2012.
(C) The proposed budget amount (less debt service requirement) is the only figure available for fiscal year 2012-2013.

Per City of Detroit Ordinance the City's Risk Management Fund is required to maintain a balance of $20.0 million. However, the balance fell below that level as of April 21, 2012 with a balance of $6.8 million. The City received a short-term Bond Anticipation Note (BAN) of $80.0 million in March 2012 from Bank of American Merrill Lynch to refinance Risk Management Debt Service Bonds of $30.5 million and finance $42.6 million to the Risk Management premium. Therefore, the fund balance will meet the minimum requirement.

[1] In previous Office of the Auditor General Analyses of the Mayor's Proposed Budget this chart showed the entire history of the Risk Management Fund beginning with the initial $100 million in bonds, the excess or deficit for each year, and the balance of the funds remaining. It was determined that a more accurate picture of the Risk Management Fund position would be achieved by showing a five-year snapshot of the Risk Management Fund including the City contributions (less debt service requirements) and the expenditures. The Risk Management Fund Balances shown are in agreement with those stated in the City's Comprehensive Annual Financial Statements for the shown fiscal year.

Debt Service

In fiscal year 2003-2004, the City issued an additional $98.9 million in self-insurance bonds primarily to fund the fiscal year 2003-2004 Risk Management Fund premium, and to refinance the remaining balance of the original $100.0 million self-insurance bond issue. Financing the claims premium, a current operating expenditure, with long-term debt was to be a one-time occurrence. However, in fiscal year 2004-2005 the City again issued $62.3 million in self-insurance bonds to cover the annual premium amount for claims and litigation.

The following table shows the annual budgeted premiums for each of the previous five fiscal years, from fiscal years 2006-2007 through 2010-2011, the budgeted premium and debt service for 2011-2012 and the Mayor's Proposed 2012-2013 Budget, for claims and lawsuits against the City related to General Fund agencies and DDOT, and debt service (bond principal and interest) on the self-insurance bonds.

General Fund and DDOT

Fiscal Year		Premium	Debt Service	Budgeted or Actual Appropriations
2006-2007		$ 62.0	$ 21.4	$ 83.4
2007-2008		62.5	9.6	72.1
2008-2009		61.3	12.2	73.5
2009-2010		60.5	30.5	91.0
2010-2011		52.6	29.5	82.1
2011-2012	(A)	86.0	1.7	87.7
2012-2013	(B)	62.1	32.3	94.4
Total		$ 447.0	$ 137.2	$ 584.2

(A) Budgeted premium and debt service for fiscal year 2011-2012.
(B) The proposed budget amounts for fiscal year 2012-2013.

As shown in the preceding table, the total Risk Management Fund appropriations for both premiums and debt service have ranged from a low of $72.1 million in fiscal year 2007-2008, to a high of the proposed budget of $93.5 million for fiscal year 2012-2013.

As of June 30, 2011, the current balance of the 2003 and the 2004 self-insurance bond issues totaled $72.0 million. Each bond issue matures over a ten-year period and should be paid off in fiscal years 2012-2013 and 2013-2014, respectively. The principal payment nearly quadrupled from fiscal year 2008-2009 to 2009-2010 indicating that the principal payments were backloaded to the end of the bond repayment period, which cost the City more in interest.

The debt service requirements have decreased substantially in fiscal year 2011-2012 due to refinancing of 2003, 2004 self-insurance bonds matured in May 1, 2012 by the Bank of America $80.0 million BAN, which must be refinanced within 90 days by long-term bonds.

To refinancing the Bank of America BAN and provide funding for the Risk Management Fund, the City through the Michigan Finance Authority (MFA) may issue long-term bonds on behalf of the City to provide $137.0 million of General Fund cash flow relief in fiscal year 2012-2013. The Executive Summary states as follows:

- Refunds $36.9 million of Limited Tax General Obligation debt service payments coming due April 1st and May 1st, 2012. Out of $36.9 million, $6.4 million is to refinance General Obligation Bonds, which is unrelated to Risk Management Fund, therefore, only $30.5 million refunds Self-Insurance Bonds for Risk Management Fund.
- Deposit $100.0 million into the City's Risk Management Fund to reimburse the General Fund for fiscal year 2012 claims paid to date and forward fund anticipated self-insurance needs through fiscal year 2012-2013.
- Debt issued by the MFA under its Local Government Loan Program and secured by the City's Distributable State Aid receipts under the existing indenture and statutory protections.
- The transaction is contingent upon the execution of a Consent Agreement between the City and the State or the appointment of an Emergency Manager.
- As a condition of Michigan Department of Treasury approval of the financing, the State and the City will enter into an escrow agreement governing the use of funds raised from this financing.
- An amount equal to the net proceeds of the financing will be deposited by the City into an escrow account.
- Disbursements from the escrow account shall only be made upon requisition by the City for eligible purposes permitted under the agreement and with approval of the State Treasurer.
- The term of the loan will be twenty years.
- Interest rate is to be decided.

Future Liabilities
The estimated total future liabilities of the Risk Management Fund included in the Notes to Basic Financial Statements of the June 30, 2010 Comprehensive Annual Financial Report (CAFR) were $187.5 million. The estimated total future liabilities of the Risk Management Fund included in the Notes to Basic Financial Statements of the June 30, 2011 CAFR were $172.1 million. This is a decrease of $15.4 million from the previous year.

The City's Current Risk Management Budgeting Approach

Costs associated with workers' compensation claims, settlements and lawsuits are charged to the risk fund rather than to the budgets of the departments causing the losses. Therefore, departments are not held financially accountable for their actions or lack of actions resulting in workers' compensation payments, legal costs, and settlements. Currently, the budget for workers' compensation, claims, and lawsuits is included in the non-departmental budget. The budget is based on an average of five years of payouts for claims, lawsuits, and workers' compensation. The ordinance that established the risk management fund requires City departments to contribute to the fund.

Ordinance No. 16-95 states:

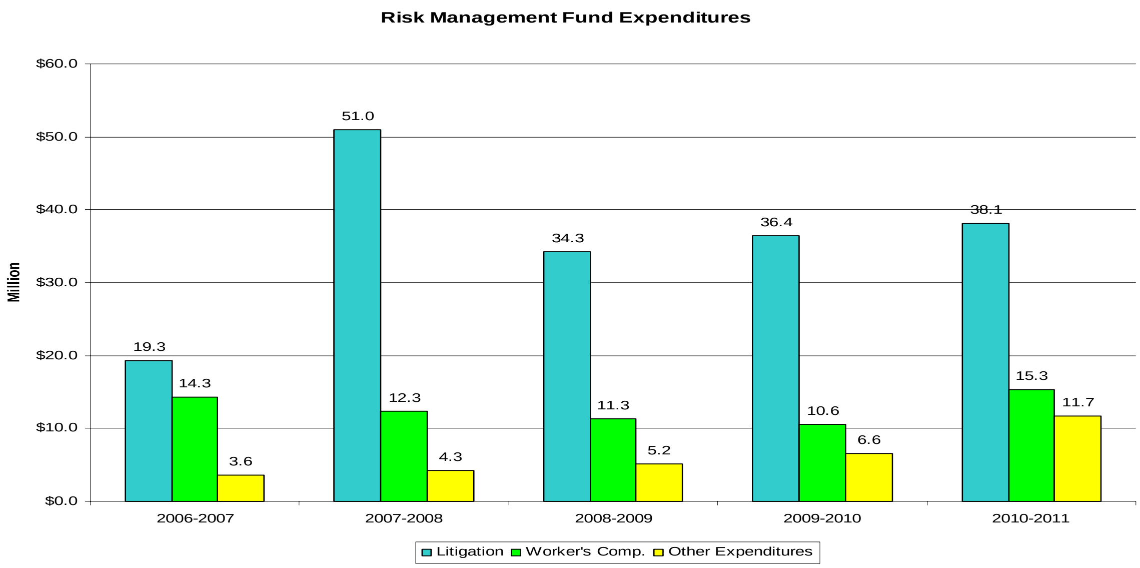
> The Finance Director shall annually make a recommendation for inclusion in the budget…of the amounts to be contributed to the risk management fund by the departments, respectively, to the end that such contributions will be sufficient to carry out the purposes of the risk management fund. …the finance director is authorized to develop and administer guidelines, policies and procedures for risk management by the departments, which guidelines, policies and procedures shall be applied in a nondiscriminatory manner to, and shall be adhered to by, the departments…in as cost effective a manner as possible and to preserve the risk management fund for the purposes for which it has been established.

The budget should reflect the ordinance requiring each department to make a contribution to the Risk Management Fund based on the historical five-year average for actual payouts for which the department is responsible. Budgeting in this manner would allow the City Council and the Administration to hold each department director more accountable for losses experienced by the City based on the actions, or inactions of the department.

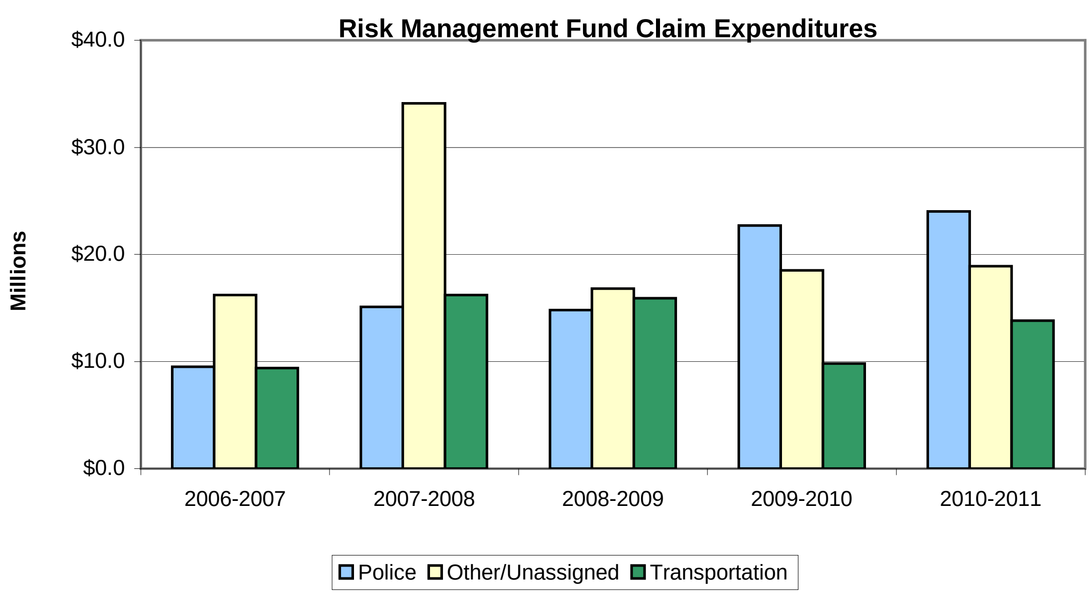
Litigation payouts make up the largest portion of risk management expenditures. In the past five years, the highest overall litigation payout was in 2007-2008 when the litigation payout was $51.0 million. The lowest was in fiscal year 2006-2007 when the litigation payout was $19.3 million. The litigation payouts for 2008-2009 decreased to $34.3 million, a decrease of $16.7 million from 2007-2008. Litigation payouts for fiscal year 2010-2011 were $38.1 million, a $1.7 million increase from the prior year of $36.4 million. Litigation payouts from departments other than those usually associated with large payouts (Police, Department of Public Works, Fire, and Department of Transportation) decreased from $23.6 million in 2007-2008 to $5.3 million in 2008-2009, $2.8 million in 2009-2010 and $3.8 million in 2010-2011. Litigation payouts for the Detroit Police Department increased from $19.2 million in 2009-2010 to $19.5 million in 2010-2011.

Expenditures

The following chart shows the trend in total Risk Management Fund expenditures over the past five years. Total expenditures were $65.1 million in fiscal year 2010-2011.



The following chart illustrates the trend in Risk Management Fund claim expenditures only, which excludes any general or administrative expenditures, and shows the expenditures broken into three groups, Police, DDOT and all other agencies.



GENERAL FUND SUBSIDY PAYMENTS

Conclusion

The Mayor’s 2012-2013 Proposed Budget does not include subsidies for the Detroit Transportation Corporation, Airport, and the Detroit Institute of Arts.

General Fund Subsidy Payments

The Mayor’s 2012-2013 Proposed Budget includes $54.7 million in general fund subsidy payments to the following City departments or entities:

	In Millions		
	Mayor’s 2012-2013 Proposed Budget	2011-2012 Budget	Increase (Decrease)
Department of Transportation	$ 52.3	$ 52.4	$ (0.1)
Detroit Transportation Corporation	0.0	0.0	0.0
Charles H. Wright Museum of African American History	1.3	1.5	(0.2)
Detroit Zoological Society	0.5	0.6	(0.1)
Airport	0.0	0.7	(0.7)
Detroit Institute of Arts	0.0	0.4	(0.4)
Detroit Historical Society	0.3	0.3	0.0
Detroit/Wayne County Port Authority	0.3	0.3	0.0
Total	$ 54.7	$ 56.2	$ (1.5)

We analyzed trends of the general fund subsidy payments for fiscal years 2007-2008 through 2010-2011, to determine the percentages of the organizations’ operational revenue are supported by general fund subsidies, and which entities rely on the subsidy payments to support operating activities.

The tables included in this analysis show the general fund subsidy, the entities’ total operating (unrestricted) revenue, and percentage of subsidy to revenue, for fiscal years 2007-2008 through 2010-2011, and the budgeted subsidy for fiscal year 2011-2012. Actual revenue is not available (N/A) for fiscal year 2011-2012.

Detroit Department Of Transportation (DDOT)
One of DDOT's initiatives is to continue reorganization, emphasizing cost savings and increased revenue. From fiscal years 2007-2008 through 2010-2011, the budget for DDOT's general fund subsidies have averaged $69.3 million annually. On average, 44.5% of DDOT's operating revenue is supported by subsidy. The Mayor's 2012-2013 Proposed Budget includes a $52.3 million subsidy for DDOT, which is a decrease of $0.1 million from fiscal year 2011-2012 subsidy of $52.4 million. The following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
DDOT:					
Subsidy	$ 73.5	$ 78.9	$ 73.8	$ 50.9	$ 52.4
Operating (Unrestricted) Revenue	$ 157.5	$ 158.5	$ 152.6	$ 153.6	N/A
Percentage of Subsidy to Revenue	46.7%	49.8%	48.4%	33.1%	N/A

Detroit Transportation Corporation (The People Mover)
The People Mover is the City's only local rail system and is operated by the Detroit Transportation Corporation (DTC). Currently, the People Mover's operation is dependent upon receiving the general fund subsidy. From fiscal years 2006-2007 through 2009-2010 the People Mover's annual subsidy was $6.2 million. The general fund subsidy averaged approximately 55.0% of the People Mover's operating revenue. The Mayor's 2012-2013 Proposed Budget does not include a subsidy for DTC. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
The People Mover:					
Subsidy	$ 6.2	$ 6.2	$ 6.2	$ 4.5	$ 0.0
Operating (Unrestricted) Revenue	$ 11.4	$ 11.0	$ 10.8	$ 8.7	N/A
Percentage of Subsidy to Revenue	54.4%	56.4%	57.4%	51.7%	N/A

Charles H. Wright Museum of African-American History (MAAH)

The City has a long-term operating agreement with the MAAH to manage and operate the facility, which also includes management and maintenance of the artifacts collection and presentation of exhibitions and other events. Under the terms of the agreement, the MAAH petitions the City for operating funds each year. For fiscal years 2007-2008 through 2010-2011, the general fund subsidy comprised an average of 42.7% of the MAAH's operating revenue. In fiscal year 2010-2011, the MAAH was budgeted to receive $2.0 million from the City for general operations, which accounted for 42.6% of the MAAH's operating revenue. The fiscal year 2011-2012 subsidy was reduced to $1.5 million. The Mayor's 2012-2013 Proposed Budget has reduced the subsidy to $1.3 million. The following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
MAAH:					
Subsidy	$ 2.0	$ 2.5	$ 2.5	$ 2.0	$ 1.5
Operating (Unrestricted) Revenue	$ 6.1	$ 5.5	$ 5.0	$ 4.7	N/A
Percentage of Subsidy to Revenue	32.8%	45.5%	50.0%	42.6%	N/A

Detroit Zoological Society (Zoo)

The Zoo receives an operating subsidy for insurance and security costs totaling $0.6 million. The subsidy comprises an average of 3.2% of the Zoo's operating revenue. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Zoo:					
Subsidy	$ 0.9	$ 0.9	$ 0.8	$ 0.8	$ 0.6
Operating (Unrestricted) Revenue	$ 19.3	$ 28.3	$ 37.8	$ 29.0	N/A
Percentage of Subsidy to Revenue	4.7%	3.2%	2.1%	2.8%	N/A

Airport

The Mayor's 2012-2013 Proposed Budget does not include a subsidy for the Airport. The subsidy for fiscal year 2011-2012 was reduced by $0.1 from fiscal year 2010-2011. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Airport:					
Subsidy	$ 0.6	$ 0.9	$ 0.8	$ 0.8	$ 0.7
Operating (Unrestricted) Revenue	$ 2.2	$ 2.0	$ 1.7	$ 1.5	N/A
Percentage of Subsidy to Revenue	27.3%	45.0%	47.1%	53.3%	N/A

Detroit Historical Society (Society)
The Society is an independent, Michigan non-profit Corporation. Under an agreement with the City, the Society manages the daily operations of the Detroit Historical Museum, the Dossin Great Lakes Museum, and the Collections Resources Center. The City will contribute $0.3 million to subsidize operational expenses. An average of 15.1% of the Society's operating revenue is from the general fund subsidy. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Society:					
Subsidy	$ 0.5	$ 0.5	$ 0.5	$ 0.5	$ 0.3
Operating (Unrestricted) Revenue	$ 3.1	$ 2.8	$ 3.2	$ 4.6	N/A
Percentage of Subsidy to Revenue	16.1%	17.9%	15.6%	10.9%	N/A

Detroit/Wayne County Port Authority (Authority)
The Authority was created to enter into contracts for the acquisition, improvement, enlargement, or extension of port facilities. The Authority has a contract with the City that is renewed annually unless a notice to terminate is requested by either party. The amount of funding is also negotiated annually. From fiscal year 2007-2008 through 2010-2011, the annual general fund subsidy has been $0.3 million, which averages to approximately 5.5% of the Authority's operating revenue. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2007-2008 through 2011-2012.

	Dollars In Millions				
	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012
Authority:					
Subsidy	$ 0.3	$ 0.3	$ 0.3	$ 0.3	$ 0.3
Operating (Unrestricted) Revenue	$ 2.6	$ 8.6	$ 8.0	$ 9.1	N/A
Percentage of Subsidy to Revenue	11.5%	3.5%	3.8%	3.3%	N/A

GENERAL FUND SURPLUS/ (DEFICIT)

Conclusion

In our opinion, the Mayor's 2012-2013 Proposed Budget estimate of $75.0 million for the 2011-2012 prior year deficit is optimistic. Based on our analysis of the projected major revenues, the revenue estimate is overstated by $130.2 million; however, taking into account a probability factor of 50%, we estimate the overstatement of revenues to be $65.1 million. In addition, the Mayor's deficit estimate does not include an estimated additional $24.6 million in the DDOT general fund subsidy.

Estimated Deficit - Fiscal Year 2011-2012

The Mayor's estimated deficit for fiscal year 2011-2012 includes the accumulated deficit of $196.6 million from fiscal year 2010-2011, an anticipated operating deficit of $67.4 million from fiscal year 2011-2012, and estimated appropriation reimbursements of $68.1 million. The following table provides a high-level view of our computation using the information from the Budget Department's surplus/deficit report of the fiscal year 2011-2012 prior year's deficit:

	In Millions	
Fiscal Year 2010-2011 Accumulated Deficit		$ (196.6)
Estimated Fiscal Year 2011-2012 Revenue Deficit	$ (90.1)	
Estimated Fiscal Year 2011-2012 Appropriation Surplus	22.7	
Fiscal Year 2011-2012 Operating Deficit		(67.4)
Reimbursements:		
Bond Payment Reimbursement	$ 35.8	
Self-insurance Reimbursement	32.3	
Total Reimbursements		68.1
Undefined Deficit		(7.0)
Total Proposed Accumulated Deficit		$ (202.9)
Proposed Deferment of Prior Year's Deficit		127.9
Fiscal Year 2011-2012 Prior Year's Deficit		$ (75.0)

The Mayor's Proposed Budget indicates the estimated prior year deficit of $75 million comprised of the accumulated deficit for fiscal year 2011-2012 of $202.9 million with $127.9 million of the deficit deferred.

The schedule below documents our estimate for the deficit for fiscal year 2011-2012:

	In Millions
Fiscal Year 2010-2011 Accumulated Deficit	$ (196.6)
OAG Net Operating Deficit	(89.7)
Bond Payment Reimbursement	35.8
Self-insurance Reimbursement	32.3
Estimated Fiscal Year 2011-2012 Accumulated Deficit per OAG computations	$ (218.2)

The OAG operating deficit amount according to our computations noted in the above schedule is based on the OAG's projected actual revenues for fiscal year 2011-2012 compared to the amounts contained in the adopted budget for fiscal year 2011-2012. The following schedule notes our projected revenues:

	Difference
Property Taxes	$ (5.4)
Municipal Income Tax	(28.7)
Utility Users Tax	0.6
State Revenue Sharing	4.6
Casino Related Revenue	(12.6)
Other Revenues	(88.7)
Total	$ (130.2)
Probability Factor	x 50%
Estimated OAG Revenue Deficit	$ (65.1)
OAG Estimate of Additional FY 2011-12 DDOT Subsidy	(24.6)
OAG Net Operating Deficit	$ (89.7)

We assumed a probability factor of 50% because the projected total of $130.2 million is considered a worst case scenario. In addition, we did not have sufficient evidence to verify our assumptions. We did not include estimates for subsidies to support the Human Services Department, which is totally grant funded, and the Buildings and Safety Engineering and Environmental Department for the fiscal year 2011-2012. The deficit could increase by an additional $10.0 million. We did not include the additional deficit because we lacked sufficient evidence.

<u>Estimated Accumulated Deficit – Fiscal Year 2012-2013</u>

The City Council Fiscal Analysis Division noted in its April 30, 2012 report to City Council that the consensus group composed of members from City Council Fiscal Analysis Division, the Mayor's administration, and the Office of the Auditor General agreed that the General Fund revenues in the Mayor's 2012-2013 Proposed Budget were $6.4 million too high. Under the Financial Stability Agreement, the City's appropriations cannot exceed its estimated revenues.

DEPARTMENT OF TRANSPORTATION

Conclusion

Based on our analysis, the revenues and appropriations included in the Mayor's 2012-2013 Proposed Budget for the Detroit Department of Transportation (DDOT) are optimistic. Farebox revenue is overestimated by $7.0 million based on historical, estimated, and the proposed data. State operating assistance, overtime and the General Fund subsidy to the DDOT are underestimated.

The following table compares the Mayor's 2012-2013 Proposed Budget appropriations and revenues for DDOT operations to the fiscal year 2011-2012 Budget:

	In Millions		
	Mayor's Proposed 2012-2013 Budget	2011-2012 Budget	Increase (Decrease)
Appropriations:			
DDOT Operations	$ 128.3	$ 138.9	$ (10.6)
Claims Fund	14.7	19.6	(4.9)
Total Appropriations	$ 143.0	$ 158.5	$ (15.5)
Revenues:			
State Operating Assistance	$ 41.5	$ 52.0	$ (10.5)
Farebox Revenue	25.0	30.0	(5.0)
General Fund Contribution to DDOT	52.3	52.4	(0.1)
Other Operating Revenue	21.0	21.1	(0.1)
Claims Fund Revenue	3.2	3.0	0.2
Total Revenues	$ 143.0	$ 158.5	$ (15.5)

The Mayor's 2012-2013 Proposed Budget is $15.5 million less than the fiscal year 2011-2012 budget. The $10.6 million decrease in DDOT Operations is mainly due to the elimination of full-time equivalent employee positions. The $4.9 million decrease in the Claims Fund reflects the Budget Department's anticipation of fewer claims payments in fiscal year 2012-2013, based on a five-year average of claims payouts.

State Operating Assistance

Act 51, P.A. 1951 restricts State Operating Assistance for urban public transit agencies, with a population greater than 100,000, to an amount up to 50.0% of their eligible operating expenses, as defined by the State of Michigan Department of Transportation (MDOT). An eligible expense reimbursement formula is used to compute the amount of operating assistance that urban transit agencies receive from the State. An adjusted amount of eligible expenses is multiplied by a percentage, determined by the State, to calculate the amount of the distribution to transit agencies.

The Mayor's 2012-2013 Proposed Budget amount for State Operating Assistance is $41.5 million, down $10.5 million from the fiscal year 2011-2012 budget of $52.0 million. Based on the Detroit Department of Transportation's (DDOT) calculations, at April 12, 2012, DDOT will receive $41.8 million in State Operating Assistance in fiscal year 2012-2013. The actual amount DDOT will receive is based on DDOT's actual eligible expenses. DDOT received $53.8 million in assistance in fiscal year 2010-2011. Based on historic, actual, and proposed data, the Mayor's 2012-2013 Proposed Budget amount for State Operating Assistance is underestimated by $5.7 million.

The following table shows budgeted and actual State Operating Assistance for fiscal years 2007-2008 through 2010-2011, budgeted and estimated state operating assistance for fiscal year 2011-2012, and the Mayor's 2012-2013 Proposed Budget amount for State Operating Assistance.

		Dollars In Millions					
				Actual Over/(Under) Budget		Increase/(Decrease) in Actual Revenue From Prior Year	
Fiscal Year		Budgeted Revenue	Actual Revenue	Amount	Percentage	Amount	Percentage
2007-2008		$ 53.3	$ 55.1	$1.8	3.4 %	$1.0	1.8 %
2008-2009		52.3	51.6	(0.7)	(1.3)	(3.5)	(6.5)
2009-2010		51.9	53.0	1.1	2.1	1.4	2.7
2010-2011		51.9	53.8	1.9	3.7	0.8	1.5
2011-2012	(A)	52.0	47.2	(4.8)	(9.2)	(6.6)	(12.3)
2012-2013	(B)	41.5	N/A	N/A	N/A	N/A	N/A

(A) The amount shown in the table as actual revenue for fiscal year 2011-2012 is an Office of the Auditor General estimate, based on actual year-to-date farebox revenue as of March 31, 2012 annualized through the end of the fiscal year 2011-2012. .

(B) The proposed budget is the only amount available for fiscal year 2012-2013.

Farebox Revenue

The Mayor's 2012-2013 Proposed Budget for farebox revenue is $25.0 million, down $5.0 million from the fiscal year 2011-2012 Budget of $30.0 million. In the most recent completed fiscal year (2010-2011), DDOT collected $16.8 million in farebox revenue. DDOT projects that decreased farebox revenue will be the result of the implementation of limited bus routes and service.

DDOT projects 32,000,000 persons will ride buses in fiscal year 2012-2013, and 38,219,136 in fiscal year 2011-2012. The actual number of passengers was 37,469,741 in fiscal year 2010-2011. Based on historical data and estimated farebox collections for fiscal year 2011-2012, the Mayor's 2012-2013 Proposed Budget for farebox revenue is optimistic. The OAG estimates that the DDOT will collect $18.0 million in fiscal year 2011-2012.

The following table shows budgeted and actual farebox revenue for fiscal years 2007-2008 through 2010-2011, budgeted and estimated farebox revenue for fiscal year 2011-2012, and the Mayor's Proposed 2012-2013 Budget amount for farebox revenue.

		Dollars In Millions					
				Actual Over/(Under) Budget		Increase/(Decrease) in Actual Revenue From Prior Year	
Fiscal Year		Budgeted Revenue	Actual Revenue	Amount	Percentage	Amount	Percentage
2007-2008		$ 27.2	$ 21.7	$ (5.5)	(20.2) %	$ 1.4	6.9 %
2008-2009		30.0	19.1	(10.9)	(36.3)	(2.6)	(12.0)
2009-2010		30.1	15.6	(14.5)	(48.2)	(3.5)	(18.3)
2010-2011		30.1	16.8	(13.3)	(44.2)	1.2	7.7
2011-2012	(A)	30.0	18.0	(12.0)	(40.0)	1.2	7.1
2012-2013	(B)	25.0	N/A	N/A	N/A	N/A	N/A

(A) The amount shown in the table as actual revenue for fiscal year 2011-2012 is an Office of the Auditor General estimate, based on actual year-to-date farebox revenue as of March 31, 2012 annualized through the end of the fiscal year 2011-2012.

(B) The proposed budget is the only amount available for fiscal year 2012-2013.

General Fund Contribution – DDOT

The budgeted General Fund Contribution (Subsidy) to the DDOT is $52.3 million for fiscal year 2012-2013, an increase of $9.0 million from the fiscal year 2011-2012 budget of $43.4 million. The average budgeted subsidy to the DDOT in the most recent completed five fiscal years (2006-2007 through 2010-2011) is $75.4 million.

A representative from the Budget Department indicated that the budgeted amount for the General Fund Contribution (Subsidy) to the DDOT for 2012-2013 contain an error. At the time of this analysis the Budget Department and the Detroit Department of Transportation were in the process of correcting the error. The Budget Department indicated that other budgeted amounts maybe effected in the process of correcting the error in the General Fund Contribution (Subsidy) amount. Because corrected amounts were not available at the time of our analysis, we are using the Mayor's General Fund Contribution (Subsidy) Proposed amount for 2012-2013.

Based on past subsidies, overestimates of farebox revenue and state operating assistance in the 2012-2013 budget, and underestimates of claims payments and overtime in the 2012-2013 budget, the Mayor's Proposed 2012-2013 Budget for the subsidy to the DDOT is underestimated.

The following table shows budgeted and actual General Fund contributions to DDOT for fiscal years 2006-2007 through 2010-2011, the budgeted and estimated general fund contribution to the DDOT for fiscal year 2011-2012, and the Mayor's Proposed 2012-2013 Budget amount for the general fund contribution to DDOT.

		Dollars In Millions					
				Actual Over/(Under) Budget		Increase/(Decrease) in Actual Revenue From Prior Year	
Fiscal Year		Budgeted Revenue	Actual Revenue	Amount	Percentage	Amount	Percentage
2006-2007		$ 76.8	$ 76.8	$ 0.0	0.0 %	$ 24.2	14.1 %
2007-2008		79.7	104.1	24.4	30.6	27.3	35.5
2008-2009		85.1	79.3	(5.8)	(6.8)	(24.8)	(23.8)
2009-2010		80.0	80.0	0.0	0.0	0.7	0.9
2010-2011		55.3	77.0	21.7	39.2	(3.0)	(3.8)
2011-2012	(A)	52.4	(A) 77.0	24.6	47.0	(0.0)	(0.0)
2012-2013	(B)	55.5	N/A	N/A	N/A	N/A	N/A

(A) The amount shown in the table as actual revenue for fiscal year 2011-2012 is an Office of the Auditor General estimate, based on actual year-to-date general fund contributions to the DDOT as of March 31, 2012 annualized through the end of the fiscal year 2011-2012.

(B) The proposed budget is the only amount available for fiscal year 2012-2013.

DDOT Operations

The Mayor's 2012-2013 Proposed Budget includes $8.5 million in overtime. As of March 31, 2012, the DDOT spent $11.4 million on overtime pay. Based on actual overtime to date, overtime is underestimated by $9.0 million.

The DDOT indicated that the department is allowed to hire bus drivers and mechanics to fill the positions of employees who are on workers' compensation, long-term disability, and leave of absence. These are the reason the DDOT believes the budget for overtime is sufficient.

Based on our analysis, the Mayor's 2012-2013 Proposed Budget amount for DDOT overtime is underestimated.

Net Operating Losses

The pattern of the DDOT's net operating losses is well documented, as are the public policy reasons underlying continued subsidies to transit operations. The following schedule details the DDOT's actual and expected net operating losses over recent years. The data for this schedule was obtained from the City's Comprehensive Annual Financial Report (CAFR) for fiscal years ended June 30, 2007 through June 30, 2011, Budget Department data for fiscal year ending June 30, 2012 and the Mayor's 2012-2013 Proposed Budget.

Fiscal Year		In Millions Operating Revenue (A)	Operating Expense (B)	Net Operating Loss	General Fund Transfers
2006-2007		$ 26.5	$ 193.1	$ 166.6	$ 70.8
2007-2008		27.2	212.7	185.5	97.8
2008-2009		30.0	206.7	176.7	73.1
2009-2010		30.1	201.0	170.9	73.8
2010-2011		30.1	209.0	178.9	72.6
2011-2012	(C)	30.0	(D)149.4	119.4	(D) 52.4
2012-2013	(E)	46.0	(E)143.0	97.0	52.3

(A) Operating revenue consists primarily of farebox revenue.
(B) Operating expenses do not include the subsidies.
(C) Operating revenue for fiscal year 2011-2012 is a budget estimate.
(D) Operating expense and subsidy for fiscal year 2011-2012 are the budget amounts.
(E) Operating revenue, operating expense, net operating loss, and transfers from the general fund are the Mayor's Proposed 2012-2013 Budget amounts.

The fiscal years 2011-2012 and 2012-2013 budgets for operating expense do not include expenses that will be funded with federal capital grant revenues. The DDOT does not include revenue from federal capital grants in its budgets, nor does DDOT include amounts in its appropriation that will be funded with federal capital grant revenue.

Financial Trend Analysis

The OAG analyzed the DDOT farebox revenue and operating expenses for fiscal years 2008-2009, 2009-2010, and 2010-2011. Amounts for fiscal year 2011-2012 were annualized. The revenue and expense data were analyzed to determine if trends indicate that the DDOT is increasing its revenues and reducing its costs. The trend for farebox revenue indicates the revenue is relatively stable, but a decrease in revenue is expected because of limited routes and service. The trend for salaries and wages is rising, but is expected to fall because of the full-time equivalent employee position eliminations. The trend for operating expenses is expected to fall. In summary, the trends indicate operating revenues and expenses are falling and salaries and wages are rising.

DDOT indicated that its cost reduction initiatives for fiscal year 2011-2012 include facility improvements to make maintenance more efficient, ensure that all buses have operable wheelchair lifts, monitor ADA services for improvement, and improve customer service. The DDOT's revenue initiatives for fiscal year 2011-2012 are senior and disabled fare, online sales of passes, and tightening controls over fares and collections.

The DDOT indicated that its main cost reduction initiatives for fiscal year 2012-2013 are reorganizing the DDOT to improve management and supervision, improve efficiency of operations by managing resources, update processes and technology, and institute Just In Time inventory management. Revenue initiatives for fiscal year 2012-2013 include increasing the number of pass sale outlets, developing marketing and sales strategies to increase sales in sluggish or declining markets, developing a mailing list for direct mail passes, and installing pass vending machines at the Rosa Parks Transit Center to provide passengers convenient access to passes.

SOLID WASTE MANAGEMENT FUND

Analysis of Solid Waste Management Fund

The Solid Waste Management Fund is a Special Revenue Fund. The City of Detroit uses the Solid Waste Management Fund to account for local revenue collected for curbside rubbish pick-up and discard. The total revenue for the Solid Waste Management Fund contained in the Mayor's 2012-2013 Proposed Budget is $11.2 million less than the amount budgeted for fiscal year 2011-2012. The following table compares the total Solid Waste Management Fund revenues in the Mayor's 2012-2013 Proposed Budget to the fiscal year 2011-2012 budget:

	In Millions		
	Mayor's 2012-2013 Proposed Budget	2011-2012 Budget	Increase (Decrease)
Sales and Charges for Services	$ 38.9	$ 50.1	$ (11.2)
Ordinance Fines and Forfeitures	0.1	0.1	0.0
Other Revenues	0.1	0.1	0.0
Total	$ 39.1	$ 50.3	$ (11.2)

Concerns

The City of Detroit established the Solid Waste Management Fund in fiscal year 2007-2008. The majority of the Solid Waste Management Fund revenue comes from the Solid Waste Fee. The Solid Waste Fee is included as a line on the City's property tax bills as an additional charge. However, residents are choosing not to pay the Solid Waste Fee when they pay their property tax bills.

The City is reviewing its options to compel residents to pay the Solid Waste Fee. One method under consideration is to add the Solid Waste Fee to the resident's water bill. The City attaches a lien to the property for any unpaid water bills. The Mayor's administration would like to have the unpaid Solid Waste Fee attached as a lien to the property. The Mayor's administration is also considering both changing applicable ordinances and any State legislation necessary to compel residents to pay the solid waste fee.

The Mayor's administration is considering increasing the Solid Waste Fee in the future. Presently, residential customers pay $240, and senior customers pay $120.

EMERGING ISSUES

Background
The City of Detroit is currently in a transition period. Because of the recent approval of the consent agreement between the City and the State of Michigan, it is anticipated that there will be structural changes to the composition of the City's government. Because of anticipated cuts to the City's workforce and funding to City agencies, the way services are delivered will need to change.

Below are issues that will affect the City as it moves forward in the coming year.

ISSUES

Consent Agreement
The consent agreement requires the City of Detroit to create two new positions, Chief Financial Officer (CFO) and Program Management Director (PMD). These positions will be tasked with achieving many of the goals and requirements of the consent agreement. Both positions are to be appointed by the Mayor from a list of three candidates (for each position) agreed to by the Mayor and the State Treasurer. Both positions are considered director level positions and both are to be housed in the Mayor's Office. Both positions are for five-year terms and the inhabitant can only be removed for cause.

The CFO and the PMD are tasked with assisting those already in the Mayor's administration and City Council with carrying out the reforms required by the Consent Agreement listed in Annex B of the agreement.

Annex B, City's Operational Reform Program Phase I

1. Public Safety Initiatives;
2. Lighting Department Changes;
3. Detroit Department of Transportation Changes;
4. Income Tax collection;
5. Implementation of payroll system upgrade if needed – following a review of other options that streamline payroll process and implement;
6. Implementation of a new grants management system to streamline requisition and monitoring process of grants;
7. Integration of budgeting, accounting and financial reporting system with appropriate process mapping;
8. Demolition of structures;
9. Implementation of medical and pension changes;
10. Labor reform to streamline and consolidate number of collective bargaining agreements into a single template and evaluating integration with statewide plans as available;
11. Health and Wellness Department changes;
12. Human Services Department changes;
13. Real estate management;
14. Workers Compensation Reform;

15. Employee Training;
16. Bank Project to improve AR and AP processes;
17. Fire Authority review;
18. Permits;
19. Planning and Development to Detroit Economic Growth Corporation;
20. Claim/Risk Management for reducing claims costs;
21. Long-term Liability Restructuring.

The Annex B Phase I Reform Program does not offer any details on the implementation of the reforms, including how they are to be carried out or a timeline, other than that the reforms should be achieved in fiscal years 2012 and 2013.

Concerns

Concern lies with not only how to pay the cost of both the CFO and Project Manager positions, but more so with paying for the cost of implementing the Annex B Reform Program Phase I. Many of the reforms listed are both time and capital intensive. In fact, it could be argued that many of these reforms are things the City has attempted to achieve prior to the consent agreement but have been unable to implement because of cost and organizational impediments.

In the coming weeks the two created positions will be filled and the make-up of the Financial Advisory Board will be completed. This will better allow the City's decision-makers to formulate a more concrete plan than what is outlined in the consent agreement.

Consequences if tenets of the Financial Stability Agreement Are Not Met

If the Financial Advisory Board finds that there is a material breech in the agreement and the breech is not cured the Treasury Department of the State can suspend distributable state aid and other loans. Also, court proceedings can be filed against the City in Circuit Court.

Possibility of Emergency Manager

Under the currently enacted consent agreement and Public Act 4 of 2011 an Emergency Manager can be put in place if there is a material, uncured breech of the consent agreement.

Bankruptcy

Municipal bankruptcy can only be filed for by the City with the State's permission. This is because municipalities are a creation of the state and not recognized in the U.S. Constitution and bankruptcy is a federal procedure. Normally, municipalities would ask the State for permission to file; but because of Public Act 4 the State requires an Emergency Manager before bankruptcy is an option for a municipality. The Emergency Manager is the one to recommend to the State (the Governor and State Treasurer) that permission be granted and that the municipality enter into Chapter 9 bankruptcy.

What Would Municipal Bankruptcy Mean for the City?
According to municipal bankruptcy law experts municipal bankruptcy is more like individual bankruptcy than corporate bankruptcy. Municipal bankruptcy is based on the idea of the fresh start rather than the efficient reconfiguration of assets. The theory is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual: it will sap initiative and depress money generating activity. The debt-ridden individual will cease to work if all the gains go to the creditor; the taxpayers of a city will cease to pay taxes if rates are too high and the citizens get none of the benefits. In both contexts, bankruptcy is premised on the idea that the debtor will become more productive if freed from the burden of debt, but the law presumes that the debtor will survive bankruptcy in essentially the same form that it went in. This all means that it would not be reorganization like the one GM went through but rather it would result in the discharging of debt to free the City from some of its debt burden.

It is also believed that a legal fight would be mounted by the unions and perhaps retirees if the City were to file for Chapter 9 bankruptcy protection. Which would cost the City in legal fees and would drag out any proceedings.

Federal Monetary Assistance
The federal government agreed to assist the City of New York during a period of financial turmoil in 1975. The assistance came because of concerns of foreign leaders that the bankruptcy of New York City could lead to an international banking crisis. President Ford stepped in, but in order to ensure that other public agencies did not ask for federal monetary assistance the conditions attached to the funds were such that other public agencies would not want to go to the federal government.

It appears to be the belief that federal monetary assistance is unlikely to materialize other than in the form of grants. It is important to determine when accepting grants that will allow for the hiring or maintaining of workforce if both the cost salary and benefits are included in the grant and if the City is required to maintain those employees once the grant has been exhausted.

Possible Repeal of Public Act 4
If Public Act 4 is repealed by a vote of the citizens of Michigan than Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, the act which allowed for the placement of an emergency manager prior to the establishment of Public Act 4, which was repealed by Public Act 4 would go back into effect. The emergency manager under the previous law did not have the same breadth of power which is included in Public Act 4.

On Thursday, April 26, 2012 the Michigan Board of State Canvassers voted to not put the possibility of repeal of Public Act 4 on the November 2012 ballot. The group that put forth the petition plans to appeal to the Michigan Court of Appeals.

Determination of Core Services
There has been a great deal of discussion concerning the City only providing core services. A consensus must be reached as to what makes-up those core services. The Proposed 2012-2013 lists core services as:

- Public Safety – Police, Fire, EMS
- Transportation – Bus and Detroit People Mover
- Public Lighting
- Garbage Collection
- Parks and Recreation
- Streets, Sidewalks and Landscaping
- Permits

There has been a great deal of discussion recently as to the City reducing the services it provides to core services. What the core services consist of has not been agreed to by the City Council, or the Financial Advisory Board.

Public lighting is included as one of the core services, but the City is spinning off the provision of street lighting to a City-owned authority and moving the power grid to a third party supplier.

Organized Labor

1. *<u>Tentative Agreements with Coalition Unions</u>*
   A coalition of City unions negotiated what were called historic labor agreements with the City's Administration. The Administration did not bring the tentative agreements to City Council for approval because the State felt that agreements were in conflict with the consent agreement should not be voted on.

2. *<u>Imposition of Contract on Workforce</u>*
   Through the consent agreement there can be an imposition of labor agreements. It is believed that labor agreements that are in line with the requirements of Annex D – Required Provisions of Collective Bargaining Agreements of the consent agreement will be imposed in July of 2012.

Competing Casinos in the Region
In 2009 the State of Ohio voters approved a measure allowing casinos. In May 2012 casinos in both Cleveland, Ohio and Toledo, Ohio are expected to open. In November of 2012 a casino in Columbus is expected to open and in February 2013 a casino in Cincinnati is expected to open. The expansion of casinos into the neighboring state could adversely affect the revenues of the Detroit casinos. Tax revenue from the Detroit casinos has been of great importance to the City over the last several years.

Bill Eadington, Director of the Institute for the Study of Gaming and Commercial Gaming at the University of Nevada-Reno stated that he has found that location and convenience of access to casinos are important factors in determining the volume of visitors and gaming revenues for casinos. He stated that in Reno, Nevada and Lake Tahoe, 2/3 of tourist gaming revenues have disappeared since tribal gaming was established in neighboring California 20 years ago. And Atlantic City has lost one third of its total gaming revenue since neighboring Pennsylvania introduced casinos in 2006.

The City of Detroit should be extremely conservative in its casino revenue projections as the Ohio casinos come on-line over the next year.