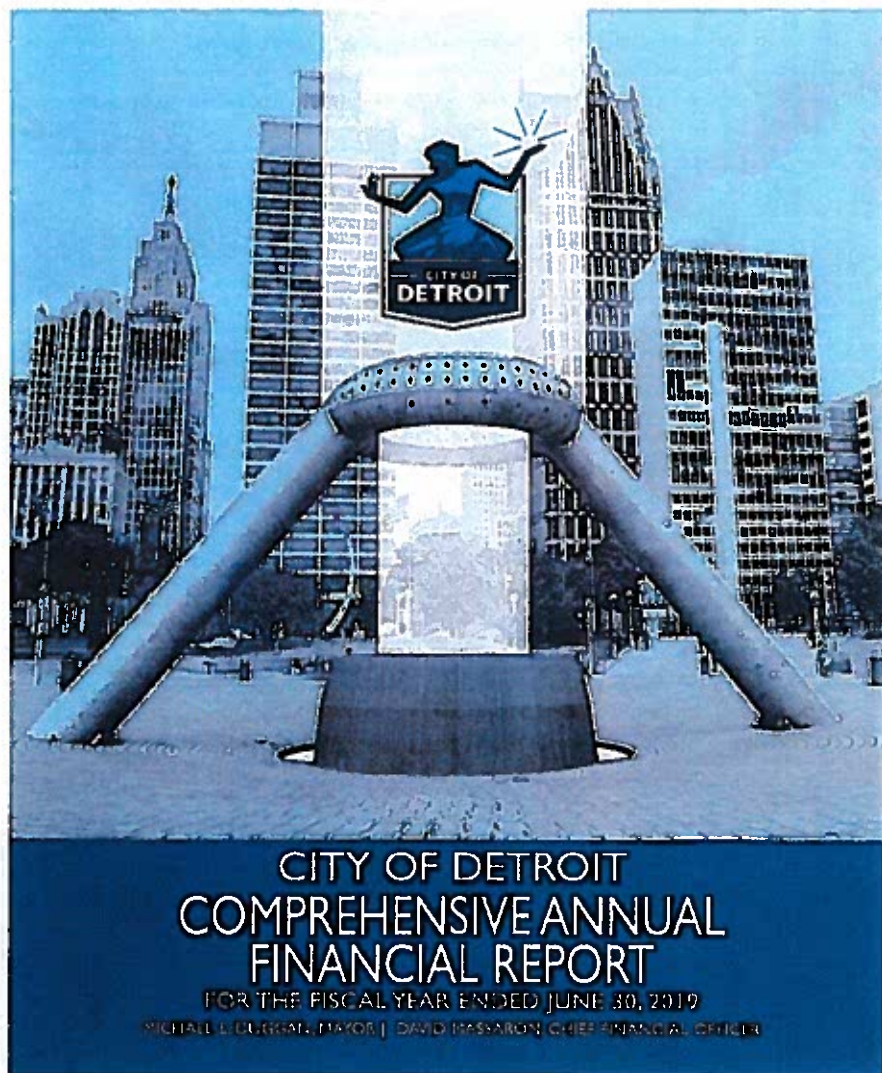


**LEGISLATIVE POLICY DIVISION  
ANALYSIS OF THE 2018 CITY OF DETROIT CAFR  
(COMPREHENSIVE ANNUAL FINANCIAL REPORT)**

**DETROIT CITY COUNCIL  
BUDGET FINANCE AND AUDIT COMMITTEE**

**COUNCIL MEMBER JANEY AYERS, CHAIRPERSON  
COUNCIL MEMBER ANDRE SPIVEY, VICE CHAIRPERSON  
COUNCIL PRESIDENT PRO-TEM MARY SHEFFIELD, MEMBER  
COUNCIL PRESIDENT BRENDA JONES, (EX-OFFICIO)**

**February 5, 2020**



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## Introduction

- Purpose of this presentation is to provide the City Council a brief report on the Comprehensive Annual Financial Report for the Fiscal Years Ending June 30, 2018 and June 30, 2019, or the 2018 CAFR and 2019 CAFR .
- A copy of this presentation will be posted on the City of Detroit's website (put 'Legislative Policy Division Reports' in search bar and click on 'Division Reports')
- Both the 2018 and 2019 CAFRs contain over 200 plus pages that provide a wealth of financial information regarding the financial condition of the City of Detroit.
- Citizens can obtain a copy of the 2018 CAFR and 2019 CAFR on the City of Detroit's website (put in 'City of Detroit financial reports' in search bar and click on 'Financial Reports' and 'CAFR').
- We acknowledge and commend the efforts of the Office of the Chief Financial Officer (OCFO) staff to complete the 2018 and 2019 CAFRs before the State of Michigan's December 31<sup>st</sup> deadline.
- We also applaud the OCFO for receiving the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association, which is a significant accomplishment.
- In a report dated July 23, 2019, the Legislative Policy Division (LPD) raises a host of financial issues based on our review of the 2018 CAFR. Also, in a report dated February 4, 2020, we raise a host of financial issues based on our review of the 2019 CAFR. These reports are posted on LPD's website.
- But in the interest of time, this presentation will focus on the following major issues: surplus, fund balance, liquidity, pension liability, debt, water and sewer financial issues.

## Brief Description of the CAFR Document

### Major Components of a Comprehensive Annual Financial Report (CAFR)

Component	Contents of Component
Introductory section	General information on the government structure, services, financial condition, and environment
+	
Financial section	<ul style="list-style-type: none"> <li>*Managements' Discussion and Analysis</li> <li>*Financial Statements: Government-wide, Governmental Fund, Proprietary Fund, Fiduciary Fund</li> <li>*Notes to the Financial Statements</li> <li>*Additional Required Supplementary Information</li> <li>*Information on individual funds, discretely presented component units and other supplementary information not required by GAAP</li> </ul>
+	
Statistical section	Trend data and nonfinancial data

LPD highly recommends that the non-financial person read the introductory and the Management's Discussion Analysis sections of the CAFR to gain a good understanding of the City's financial condition.

- The CAFR provides a comprehensive picture of the government's financial condition over the course of year.
- The CAFR reflects what the government has received in revenue, what it has spent, and what its status of assets and liabilities is at the end of a fiscal year.
- The CAFR's government wide statements combines the governmental and business type activities and are similar in style to those used in the private sector.
- Both the 2018 and 2019 CAFRs indicate that as of June 30, 2018 and June 30, 2019, the City had approximately \$6 billion in total assets and generated about \$2 billion in total revenue.
- In all, both the 2018 and 2019 CAFRs contain financial information for 50 plus entities, including governmental funds (e.g. general fund), enterprise or business type funds (e.g. water and sewage disposal), internal service funds (e.g. employee benefits), fiduciary funds (e.g. general and policy & fire retirement systems), component units (e.g. Downtown Development Authority) and blended component units (e.g. Detroit Building Authority).
- Our focus today will be on a few key short term issues as they relate to the general fund, and a few long term issues as they relate to the governmental wide and water and sewage disposal financial statements.
- Before moving forward, it is important to note that both the 2018 and 2019 CAFRs received an unqualified ("clean") opinion from Plante & Moran, the City's independent auditor. Essentially a "clean" opinion means that the City's CAFRs were fairly presented in all material aspects. As a result, investors, creditors, rating agencies and other interested parties reading the CAFRs can rely on the audited financial statements and the information contained therein. A clean opinion, however, does not mean that the City's financial condition is satisfactory.

## **General Fund (short-term perspective)**

- The City of Detroit's general fund is the chief operating fund for the City that receives the City's major revenues such as income taxes, property taxes, state revenue sharing (a portion of State's sales taxes), casino (wagering) taxes, and utility users taxes. These major revenues comprise of about 80% of the general fund's total FY 2018 and 2019 revenue.
- The general fund's revenue sources are used to provide essential City services for the citizens, such as police and fire protection, housing and revitalization, recreation, general services (such as grass and tree cutting, fleet and facilities maintenance), administrative services (such as OCFO, human resources, information technology, law) and legislative services (such as City Council, Auditor General and City Clerk).
- So, the general fund provides the most important short-term view of the City's financial health.
- Council adopted a general fund budget totaling \$1.07 billion for both FY 2018 and FY 2019. Of course, these budget were passed with general fund budgeted revenues equaling budgeted expenditures.
- The CAFRs show how we ended up. The 2018 CAFR indicates the general fund ended up with a \$18.4 million operating surplus for FY 2018; the 2019 CAFR shows a \$80.9 million general fund operating surplus for FY 2019. This means that actual revenues for the general fund exceeded actual expenditures for both fiscal years. FY 2019's general fund operating surplus was higher due to larger income tax revenue and net bond proceeds from a bond refinancing.
- The General Fund had an accumulated unassigned fund balance (surplus) of \$131.5 million at June 30, 2018.

## **General Fund (short-term perspective, cont'd)**

- The City has used the General Fund accumulated unassigned surplus for important expenditures. Of the FY 2018 \$131.5 million accumulated unassigned surplus, \$73 million was budgeted in FY 2020 for blight remediation; \$32.5 million for capital improvements; and \$12.1 million for risk management.
- The general fund had an accumulated unassigned fund balance (surplus) of \$123.2 million at June 30, 2019, a \$8.2 million decrease from FY 2018. Mayor Duggan will probably recommend appropriating most of the \$123.2 million for increasing general fund reserves, blight remediation and capital projects in the upcoming FY 2021 budget he will present to Council on Friday, March 6<sup>th</sup>.
- The City has now achieved a balanced budget for the fifth consecutive year.
- However, it appears \$100 million plus accumulated unassigned fund balances may be disappearing. The OCFO's November 2019 monthly financial report projects a \$57 million surplus for the current FY 2020.
- The City's general fund assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$692.1 million. As a result, the general fund had a total fund balance of \$692.1 million at June 30, 2019, a \$80.9 million increase from FY 2018.
- Most of the General Fund total fund balance of \$692.1 million at June 30, 2019 is allocated: a) \$77.3 million for Budget Reserve; b) \$76.6 million for Risk Management Fund; c) \$129.5 million for contribution to the Retiree Protection Fund; and d) \$105.5 million for blight and capital.

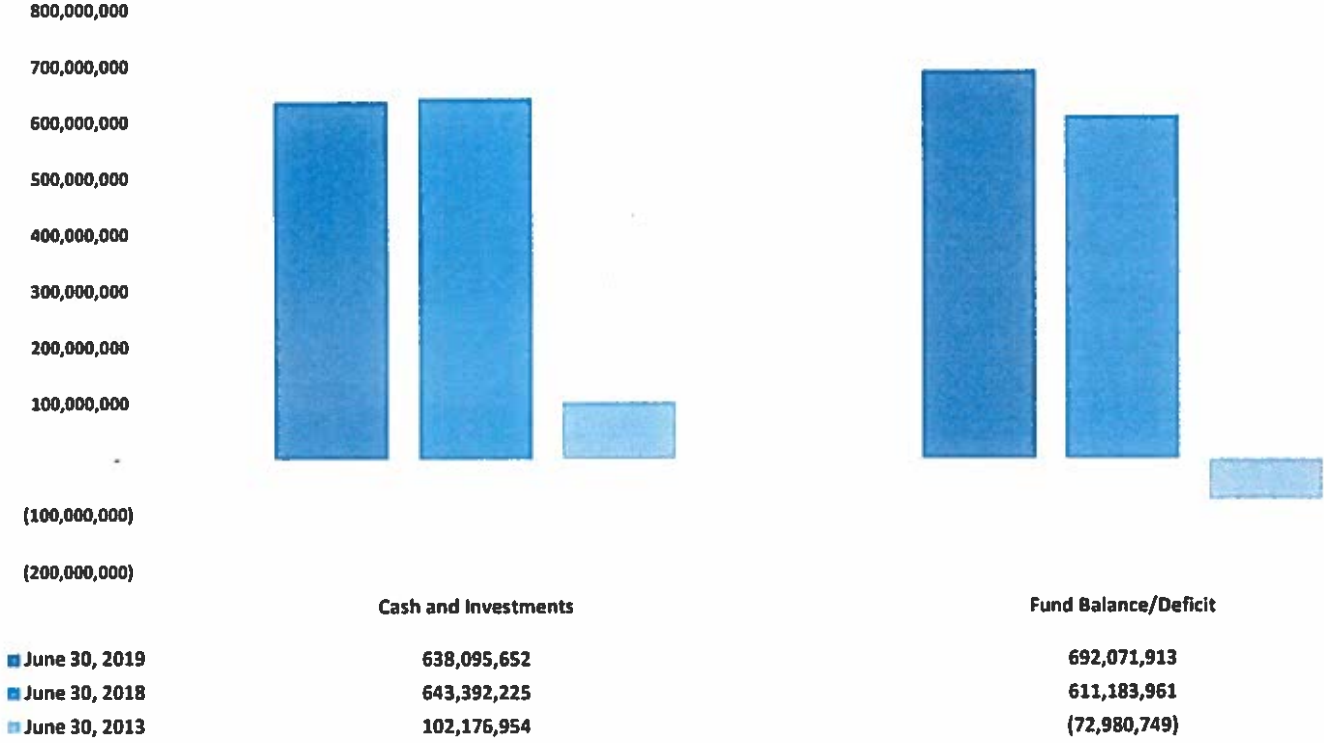
## General Fund (short-term perspective, cont'd)

- The General Fund's cash and investments and restricted cash at June 30, 2019 totaled \$638.1 million. The main reason for the General Fund's improved liquidity was the significant reduction of certain obligations (especially pension and retiree health care costs) from the bankruptcy. The graph below details the General Fund's improved liquidity per cash and investments and total fund balance for fiscal years 2019, 2018, and 2013.
- Although the General Fund is now able to pay its bills on time, and its financial health is improving, cautionary notes are warranted. First, the City still has looming increases in pension and debt obligations. Secondly, although \$638.1 million in General Fund cash and investments is sizable, the lion share of it is either obligated, restricted or assigned to a specific purpose.

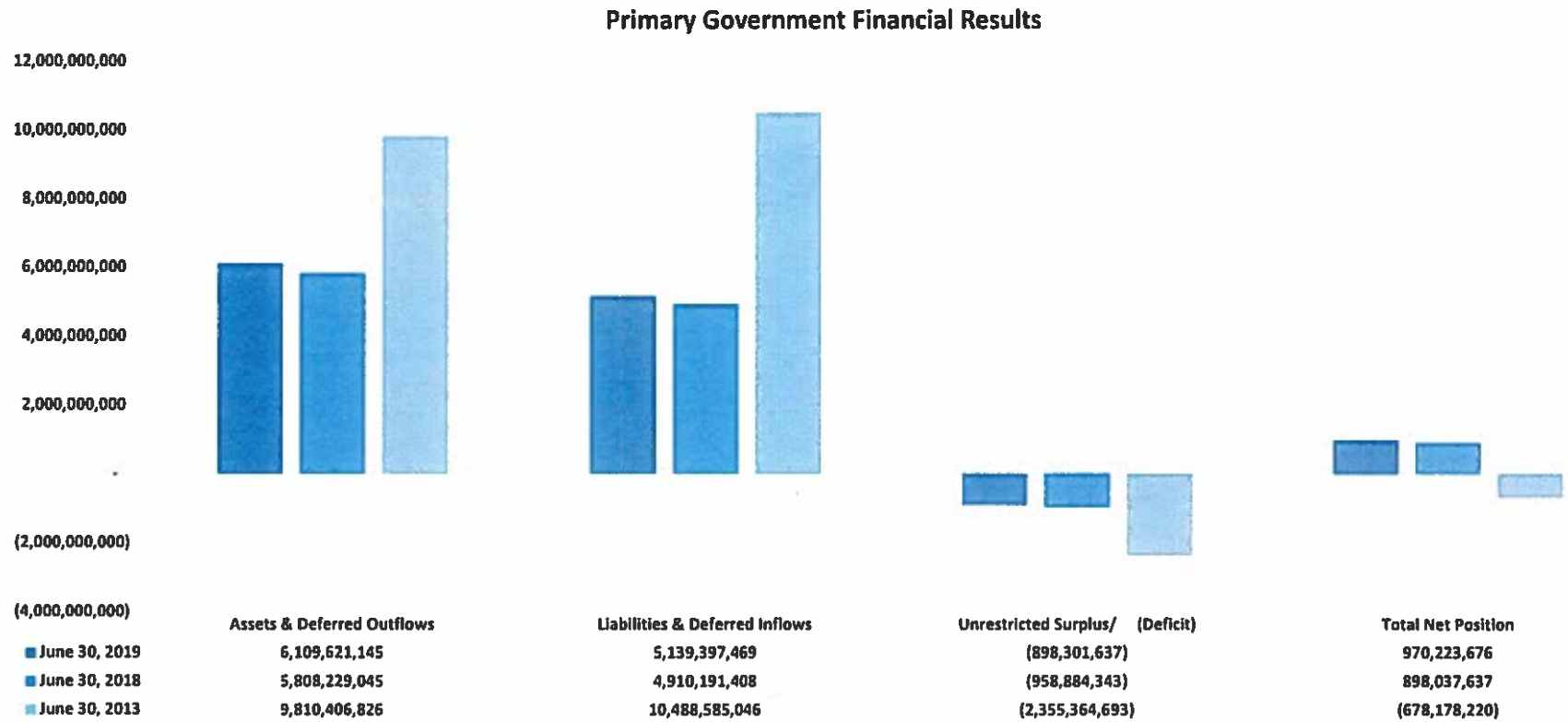


# General Fund (short-term perspective), continued

## General Fund Liquidity



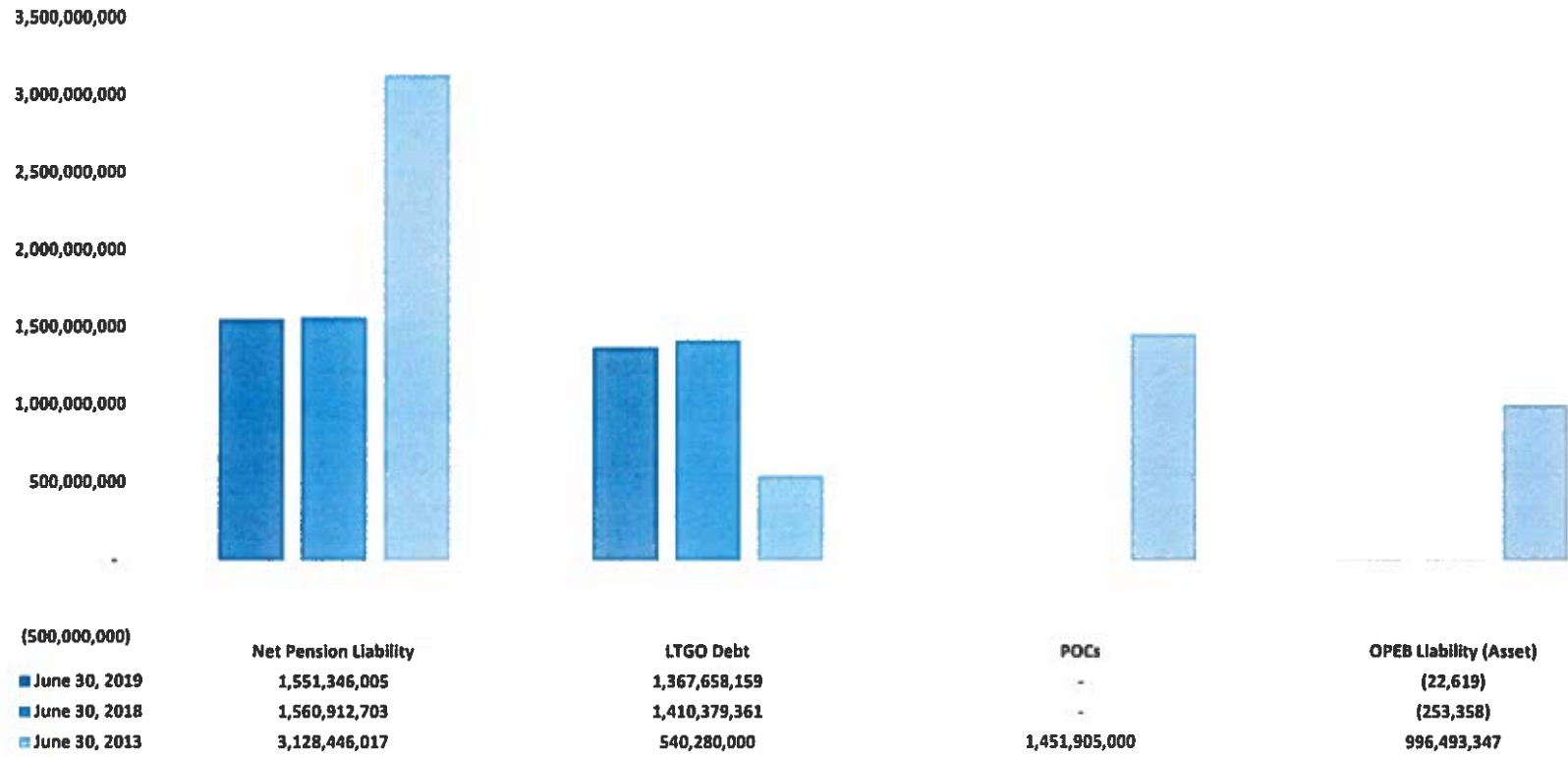
## Primary Government (long-term perspective)



## Primary Government (long-term perspective), continued

- As the graph above indicates, the primary government's (citywide) net position (net worth) was \$970.2 million at June 30, 2019, an increase of \$72.2 million from FY 2018.
- The graph above also indicates the primary government's unrestricted net position deficit was \$898.3 million, which means there was a shortage of assets available to meet all the City's obligations if they were immediately due and payable on June 30, 2019, rendering the total government insolvent over the long term (up to 30 years). This was mainly due to the City's huge legacy pension and debt obligations which are detailed in the graph below for fiscal years 2019, 2018, and 2013.

### Primary Government Legacy Debt Burden



## **Primary Government (long-term perspective), continued**

- The increases in net pension liability and LTGO (Limited Tax General Obligation) debt is of concern. While the bankruptcy reduced or eliminated pension, retiree health care (OPEB), and POC (Pension Obligation Certificate) long-term debt, the City still has substantial obligations for the legacy pension and LTGO debt. The LTGO debt increased due to the exit financing and other debt issued per the City's Plan of Adjustment. This debt will mostly be paid from the revenues of the General Fund which will leave less funding available for City services.
- The City's net pension liability of \$1.551 billion and \$1.368 billion of LTGO debt are 30% and 27%, respectively, of the primary government's total liabilities of \$5.1 billion on June 30, 2019. These large pension and debt obligations threaten the financial health of the City moving forward.
- Of the primary government's \$1.551 billion net pension liability at June 30, 2019, \$692 million was attributable to the General Retirement System (GRS), and \$859 million was attributable to the Police and Fire Retirement System (PFRS). The primary government's net pension liability decreased \$10 million from the June 30, 2018 balance of \$1.561 billion.

## Primary Government (long-term perspective), continued

- Beginning in 2024, the pension “cliff” issue looms. The Plan of Adjustment assumed that the UAAL would be funded over 30 years and projected an annual General Fund contribution of \$111 million beginning in fiscal year 2024. Based on the latest actuarial valuation as of June 30, 2016, the anticipated General Fund contributions starting in FY 2024 are projected to be \$164.3 million. The OCFO, with Council’s approval, has taken steps through the use of General Fund surpluses to reduce the future burden of these obligations by setting aside \$129.5 million for future pension obligations and paying off certain LTGO debt.
- This upcoming budget process is critical in that the last year of the four-year financial plan will be FY 2024. So City Council will receive from the Mayor on March 6th how the City will plan to accommodate this pension “cliff” in FY 2024.
- The OCFO has taken commendable steps to reduce the LTGO debt and gross debt service for fiscal years 2025-2030 by redeeming certain bond obligations. In FY 2018, the OCFO, with Council’s approval, paid off \$52.3 million of the 2014 C bonds with surplus funds. In FY 2019, the City, with Council’s approval, refunded \$197.7 million of the 2014 B Notes with proceeds from the issuance of \$176.0 million. The refunding was done to reduce the gross debt service for fiscal years 2025-2030 by approximately \$155.0 million. Debt service beginning in fiscal year 2025 would have increased by approximately \$31 million per year through fiscal year 2030 in absence of this transaction.
- In addition, to the reduced debt service, the City will also save approximately \$21.7 million (\$11.7 million interest savings on 2014 C Bonds and \$10 million on 2014 B(1) and 2014 B(2) Bonds) as a result of these transactions.

## **Enterprise Fund (long-term perspective), continued**

### **Water and Sewage Disposal Funds**

- In FY 2019 Water and the Sewage Disposal Funds had unrestricted net positions of \$456.9 million and \$543.1 million, respectively, mainly due to the bifurcation which exchanged the water and sewer regional systems assets and liabilities including long term debt to GLWA for \$50.0 million in annual lease payments over 40 years effective January 1, 2016. The unrestricted net positions increased \$23.1 million (\$10.4 million Water and \$12.7 million Sewage) in FY 2019 from FY 2018.
- While the Water and Sewage Disposal Funds have large unrestricted net positions at June 30, 2019, both funds have large capital and infrastructure repair and replacement needs and debt obligations to GLWA that will require a large share of that unrestricted net position. A benefit of the net unrestricted net position is that water and sewer rate increases to Detroit customers will be mitigated, as the unrestricted net position through the annual \$50 million lease payment from GLWA, will provide a significant amount of the funding for both Funds' capital, infrastructure, and debt obligation needs.
- In FY 2019, both the Water and the Sewage Disposal Funds had positive income before capital contributions, transfers, and special item of \$15.7 million and \$24.8 million respectively.

## Enterprise Fund (long-term perspective), continued

### Water and Sewage Disposal Funds

- It is important to note that as of June 30, 2019, the Sewage Disposal Fund shows a balance of \$44.0 million in a liability account entitled "shortfall loan payable to Great Lakes Water Authority". This appears to be attributable to a negative balance caused by a budget shortfall of \$47.8 million for the DWSD sewer fund which exceeds the two percent threshold (i.e., actual receipts falling short of budget for either the water fund or sewer fund by greater than two percent) per the 2018 MOU. The budget shortfall not cured by the end of the fiscal year following the year in which they arise shall be repaid in full, in installments over a period not to exceed three fiscal years. The installment payments will include a surcharge based on the three-year U.S. Treasury note plus 150 basis points.
- The City needs to closely observe the financial performance of the Water and Sewage Disposal Funds after the bifurcation to ensure revenues cover expenses and essential services are provided.
- Of concern is the GLWA \$200.8 million net position deficit on June 30, 2019 and the potential impact it will have on rates to DWSD's customers. GLWA is technically insolvent as its liabilities and deferred inflows exceed its assets and deferred outflows. GLWA will need to increase its rates to its wholesale customers including DWSD to meet its obligations.



## Benchmark Comparison of the City of Detroit's 2019 CAFR with Other Comparable Cities

City	Liquidity	Solvency	Asset Maint.	Pension Burden	Debt Burden	Tax Burden	Taxable Value	Pension Turnover	Taxes Abated
Detroit	399.7%	89.6%	64.1%	1,880.1	2,798.6	1,157.3	9,380.6	14.6%	10.2%
Lansing	218.8%	34.0%	69.8%	2,341.9	389.5	670.5	17,706.3	14.2%	12.1%
Memphis	199.2%	110.4%	49.0%	638.2	2,474.0	1,113.4	19,501.2	8.6%	3.8%
Louisville	242.8%	107.8%	72.0%	1,348.5	1,037.5	784.3	97,092.5	N/A	6.9%
Grand Rapids	823.3%	122.7%	72.5%	1,085.8	545.8	732.5	24,274.3	8.3%	6.2%
Baltimore	228.4%	87.4%	55.4%	2,746.0	3,587.0	2,644.6	60,028.2	9.0%	3.0%
Boston	289.4%	68.7%	52.3%	2,525.6	2,584.0	3,865.7	N/A	10.2%	0.5%
Portland	362.0%	61.9%	78.8%	6,055.9	1,805.0	1,109.4	92,640.0	N/A	2.0%
Oklahoma City	559.9%	204.0%	39.3%	453.4	1,449.9	1,067.5	9,133.3	5.0%	4.3%
Kansas City	163.9%	173.0%	30.6%	1,437.3	3,397.4	1,581.4	16,374.9	6.5%	7.2%

- Detroit's liquidity is good but most of its cash at June 30, 2019 is obligated, restricted or assigned to a specific purpose.
- Detroit's solvency ranked low since it does not have sufficient assets to meet obligations on a long term basis.
- Detroit's asset maintenance ratio is relatively high due to its large amount of infrastructure and older assets.
- Even after bankruptcy, which reduced some of the City's pension and debt obligations, Detroit still maintains large amounts of pension and debt liability that is a challenge to fund with its limited tax and other revenue sources. Detroit's general retirement system assets are depleting at a faster rate than other cities.
- Detroit's taxable property tax values are extremely low as compared to other cities. Meanwhile, the City had the largest amount of property taxes abated as compared to the other cities.
- The comparative analysis reveals the City of Detroit has a long way to go in matching the fiscal health of other comparable cities.