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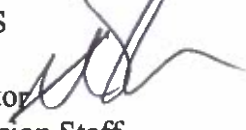
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TO: COUNCIL MEMBERS

FROM: David Whitaker, Director 
Legislative Policy Division Staff

DATE: July 29, 2019

RE: Benchmark Comparison of the City of Detroit's 2018 Comprehensive Annual
Financial Report (CAFR) With Other Cities

Executive Summary

The Legislative Policy Division (LPD) compared the City's fiscal year 2018 Government Wide Statement of Net Position (i.e., balance sheet) and Statement of Activities for Governmental Activities (i.e., income statement) with other Cities including: Flint, Michigan; Memphis, Tennessee; Louisville, Kentucky; Grand Rapids, Michigan; Boston, Massachusetts; Portland, Oregon; Charlotte, North Carolina; and Kansas City, Missouri. Most of the cities chosen were comparable in size to Detroit. Grand Rapids was chosen because it is the State of Michigan's second largest City and in good financial condition. Flint was chosen because it has similar challenges as Detroit. We also chose a mix of cities that were either in good or poor fiscal health for comparative purposes.

The City of Detroit's fiscal health, has improved since the exit from bankruptcy on December 10, 2014. However, even with the benefits from the bankruptcy exit, the City has a way to go to match fiscally healthy cities such as Grand Rapids. The City has a high Pension and Debt burden (e.g., Legacy Costs) that will mostly be paid out of future General Fund revenues lessening amounts available to provide essential services such as public safety. In addition, the City is among the lowest in total assessed property value (taxable value) and this combined with the low median income for the City's population adversely impacts the City's collection of tax revenue to provide funding to pay for both the large debt burden and provide satisfactory services. While the bankruptcy eliminated the City's retiree health care obligations, the City still has a significant obligation for retiree pensions, which for the City's civilian retirement system (General Retirement

System) is of great concern because it has the highest turnover ratios among the cities compared and is in risk of exhausting its assets and becoming a greater burden on the City's General Fund¹. Furthermore, the City of Detroit's infrastructure (Capital Assets) is aged and depreciated and the City will need funds to replace it². Also, the City has the highest amount of tax abatements of the cities compared.

The results of our comparison of the City of Detroit's FY 2018 Governmental Activities financial statements with other cities are detailed below.

City	Liquidity	Solvency	Asset Maint.	Pension Burden	Debt Burden	Tax Burden	Taxable Value	Pension Turnover	Taxes Abated
Detroit	344.5%	85.5%	64.6%	1,894.4	2,514.2	999.6	9,140.4	13.2%	19.6%
Flint	371.7%	40.5%	79.9%	2,697.7	312.8	356.6	7,535.8	N/A	N/A
Memphis	236.4%	113.4%	48.7%	398.0	2,526.5	1,119.6	19,313.6	8.4%	3.8%
Louisville	399.0%	111.7%	72.7%	1,260.5	926.0	753.8	95,285.4	N/A	7.3%
Grand Rapids	689.2%	131.3%	70.4%	785.7	539.6	696.4	23,283.6	8.4%	5.8%
Boston	279.2%	69.9%	50.4%	2,011.2	2,565.4	3,724.1	N/A	9.3%	0.4%
Portland	362.8%	62.4%	76.7%	5,618.2	1,744.0	1,054.6	90,427.5	N/A	1.9%
Charlotte	715.3%	283.5%	40.9%	451.9	1,754.5	865.1	109,534.1	N/A	N/A
Kansas City	184.7%	177.1%	40.2%	1,498.1	3,561.6	1,454.8	16,328.7	6.3%	7.7%

- Detroit's liquidity has improved and it has the ability to pay all its current obligations. However, most of the City's cash and investments at June 30, 2018 are either obligated, restricted or assigned to a specific purpose.
- Detroit was essentially insolvent in FY 2018 as the City's Governmental Activities unrestricted net position on June 30, 2018 was a \$1.756 billion deficit and the net position was a \$341.9 million deficit. The deficit was primarily due to the net pension liability total of \$1.275 billion and the \$1.112 billion of debt that will have to be paid from the General Fund.³ Other cities such as Boston

¹ It is important to note, however, that City Council approved the establishment of the retirement protection trust fund to help finance a huge looming pension obligation in 2024 and help stabilize pension obligations thereafter. In March 2017, Moody's Investors Service considered the establishment of this trust fund a "credit positive".

² In FY 2019 the City was able to issue \$135.0 million of Unlimited Tax General Obligation (UTGO) bonds to finance capital projects and improve the City's infrastructure. This was a huge accomplishment considering the Plan of Adjustment (POA) assumed the City would be unable to issue general obligation bonds to finance capital projects for quite some time. It is also important to note that the City in recent years has allocated significant General Fund surplus dollars for capital projects in accordance with the POA. The City's FY 2019 budget included \$52.2 million for capital projects from General Fund surplus dollars, and the FY 2020 budget included \$32.5 million for capital projects from surplus dollars.

³ While the City eliminated a substantial amount of its obligations with the bankruptcy settlements, it did incur additional debt to provide for some of the settlements and restructuring/Quality of Life projects. Much of the new debt such as the 2014 B(1) and B(2) bonds was limited tax general obligation (LTGO) debt and will have to be paid from the general revenues of the City. This along with other "secured" LTGO bond debt issued before the bankruptcy will divert the City's General Fund's revenues, which could have been used for core City services such as police and fire, to pay off the debt service. Of the City's governmental activity's \$1.380 billion of General Obligation bond debt at June 30, 2018, a total of \$1.112 billion is LTGO debt which will ultimately have to be paid from the general revenue (source: page 80 of City of Detroit's FY 2018 CAFR). Furthermore, much of the debt issued for the bankruptcy settlements was structured to defer principal payments for several years and will have a greater adverse impact on the General Fund in the years (2025-2030) the principal becomes due. For example, the City is not required to make a payment on the 2014 B (1) bonds principal totaling \$616.6 million until June 30, 2025 when the first principal payment will be \$30.8 million. 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 redeemed \$52.3 million of the 2014 C bonds with surplus funds. Recently (FY 2019), on December 13, 2018, the City purchased and canceled, at a discount from par, \$197,652,356 of its Financial Recovery bonds, Series 2014 B (\$192,227,454 Series 2014 B (1) at a purchase price of \$87 per \$100 in principal amount and \$5,424,902 Series 2014 B (2) at a purchase price of \$85 per \$100 in principal amount) in exchange for the proceeds from the 2018 DSA Bonds. The OCFO estimates the debt service for FY 2025-2030 will be reduced by \$155 million because of these redemptions. Debt

and Portland reported a negative net position in their governmental activities for FY 2018, primarily due to their pension and OPEB (Other Postemployment Benefit) liabilities.

- Detroit's capital assets (infrastructure) are older (more depreciated) and likely in need of replacement.
- Detroit's pension burden is lower due to reductions achieved in the bankruptcy. However, the pension obligations are still high and a challenge, as the City has been setting aside funding (\$105.0 million as of June 30, 2018) to meet them.
- Detroit's debt burden is higher than most other cities.
- Detroit's tax revenue collected per population decreased in FY 2018 as collections of property taxes were down due to reductions in tax assessments and UTGO debt service.
- Detroit's taxable value per population is significantly lower than cities of similar size because of the low assessed value of its property.
- Detroit's civilian retirement system's payout of benefits is a higher percentage of its available assets than most other cities that we compared.⁴
- Detroit's property taxes abated are higher than any other City that we compared⁵.

This comparative analysis reveals the City of Detroit has a long way to go in matching the fiscal health of other comparable cities. Detroit will be paying for its legacy costs (pension and debt) long into the future. Detroit needs to: increase its tax and revenue base; improve and maintain its revenue collections and liquidity; reduce its debt burden on the General Fund; raise its property value; attract new residents and businesses without incentivizing them abatement programs; improve its infrastructure; and ensure that pension system assets are properly managed and maintained.

Background

The Legislative Policy Division made a comparative study of the City of Detroit's 2018 CAFR Government Wide Statement of Net Position (i.e., income statement) and Statement of Activities for Governmental Activities (i.e., income statement) with other Cities including: Flint, Michigan; Memphis, Tennessee; Louisville, Kentucky; Grand Rapids, Michigan; Boston, Massachusetts; Portland, Oregon; Charlotte, North Carolina; and Kansas City, Missouri. Most of the cities chosen were comparable in size to Detroit. Grand Rapids was chosen because it is the State of Michigan's second largest City and in good financial condition. Flint was chosen because it has similar challenges as Detroit. We also chose a mix of cities that were either in good or poor fiscal health.

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 (source: pages 117-118 of City's FY 2018 CAFR).

⁴ Many other cities pension plans were combined with their State pension plans or with an independent retirement services company who administers the retirement plan for local units of government on a not-for-profit basis and we cannot fairly compare them to Detroit's pension plan.

⁵ Charlotte and Flint did not report any tax abatements. Charlotte did footnote large amounts of direct expenditures for sports arena and other public projects that it owned.

Many cities that we would have liked to include in the analysis had not completed or posted their FY 2018 CAFR at the time we prepared this report.⁶

Not all the cities we reviewed are truly comparable to the City of Detroit. Portland and Louisville don't have pension systems that are comparable to Detroit's. We also found that many cities had vibrant tourism and businesses that contributed significant revenue to the City which boosted their revenue per population totals. Some of these cities were allowed to have other taxing sources such as sales tax. We tried to select measures that we could fairly compare and draw reliable conclusions from.

Detailed below are the measures and formula (Ratio Equation) we used to compare Detroit and the other cities.

Measure	Ratio Equation
Liquidity	Cash & investments/current liabilities
Liquidity/Solvency	Total assets/total liabilities
Asset Maintenance	Accum. depreciation/capital assets
Pension Burden	Net pension liability/population
Debt Burden	Long-term debt/population
Tax Burden	Taxes/population
Community Well Being	Taxable value/population
Pension Turnover GRS	Total expenses/net position
Taxes Abated	Tax abatements/property tax revenues

We also analyzed the City of Detroit data from 2011 to 2018 for these measures to show the performance trend over the past 8 years. Listed below is the City of Detroit trend data for the fiscal years 2011 to 2018.

Measure	Fiscal Year							
	2011	2012	2013	2014	2015	2016	2017	2018
Liquidity	40.6%	25.8%	40.1%	59.6%	222.3%	268.4%	359.8%	344.5%
Solvency	85.7%	83.0%	79.3%	99.1%	65.9%	88.4%	82.1%	85.5%
Asset Maintenance	62.7%	63.3%	64.6%	64.7%	65.8%	61.5%	63.4%	64.6%
Debt Burden	4,369.0	4,370.6	4,616.5	3,524.5	2,796.8	2,687.6	2,578.7	2,514.2
Tax Burden	995.8	969.7	941.7	936.3	990.3	1,048.3	1,140.9	999.6
Taxable Value	15,168.1	14,182.4	13,221.8	12,583.1	10,800.8	9,608.0	8,974.6	9,140.4
Pension Turnover	14.0%	18.3%	18.2%	20.3%	14.3%	15.3%	13.8%	13.2%
Tax Abatement							12.7%	19.6%

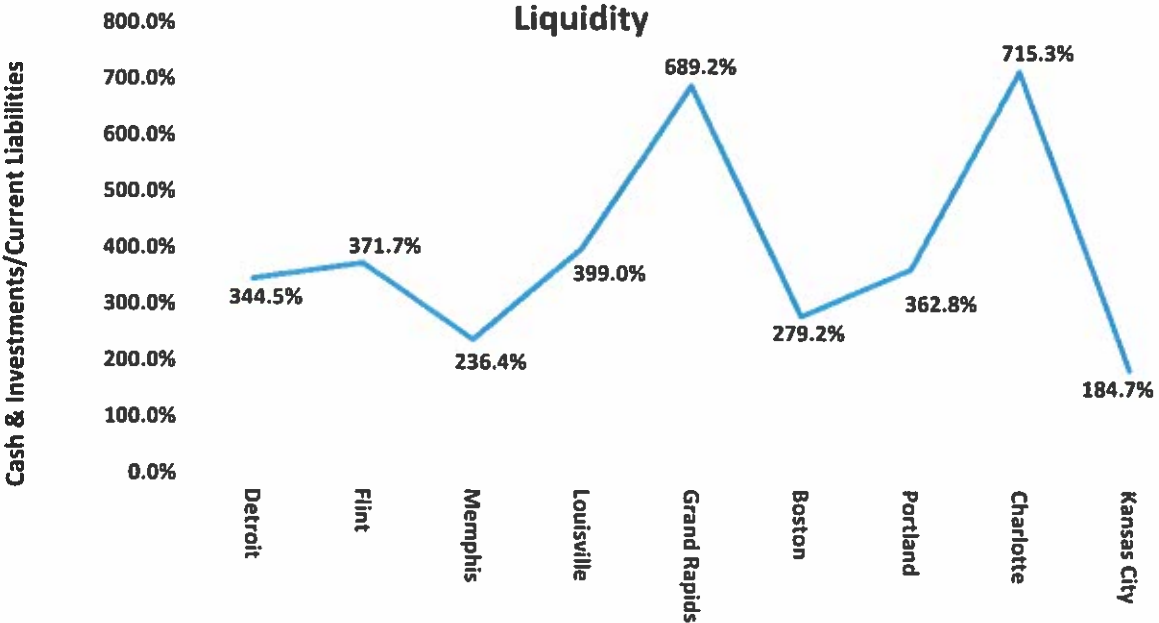
Comparative Analysis

Liquidity

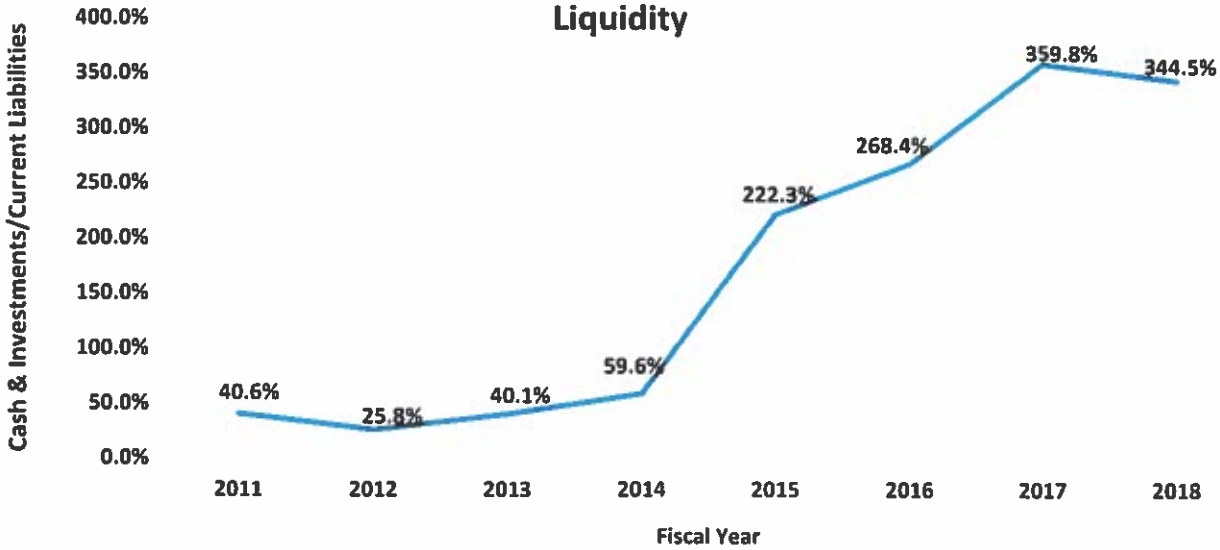
Liquidity measures the City's cash and investments and ability to meet its current obligations. In the past (pre-bankruptcy) when the City's liquidity was poor it had insufficient cash to meet its current obligations such as pension annual required contributions and payments to vendors. The

⁶ Detroit produced its 2018 CAFR before the December 31st deadline, which creates benchmarking issues when other cities haven't finished or posted their CAFRs.

graph below shows that Detroit's liquidity is in the middle of the cities we compared. The City has the ability to more than meet its current obligations.



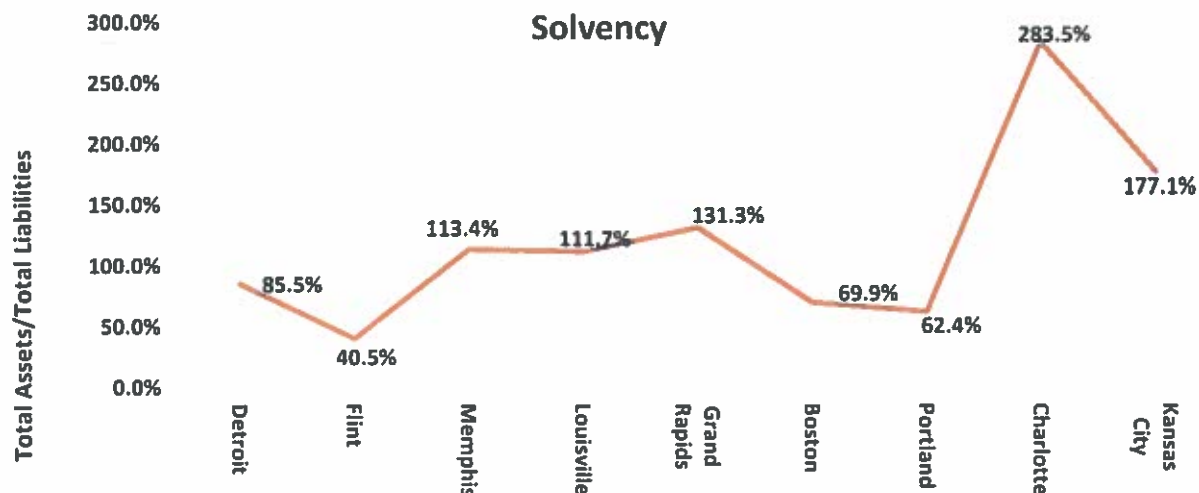
The graph below shows Detroit's liquidity trend over the past eight years and shows significant improvement. The City's liquidity was lowest during the period before it entered bankruptcy. The liquidity improvement was mainly due to the elimination of obligations and receipt of bond proceeds for Quality of Life projects through the Plan of Adjustment.



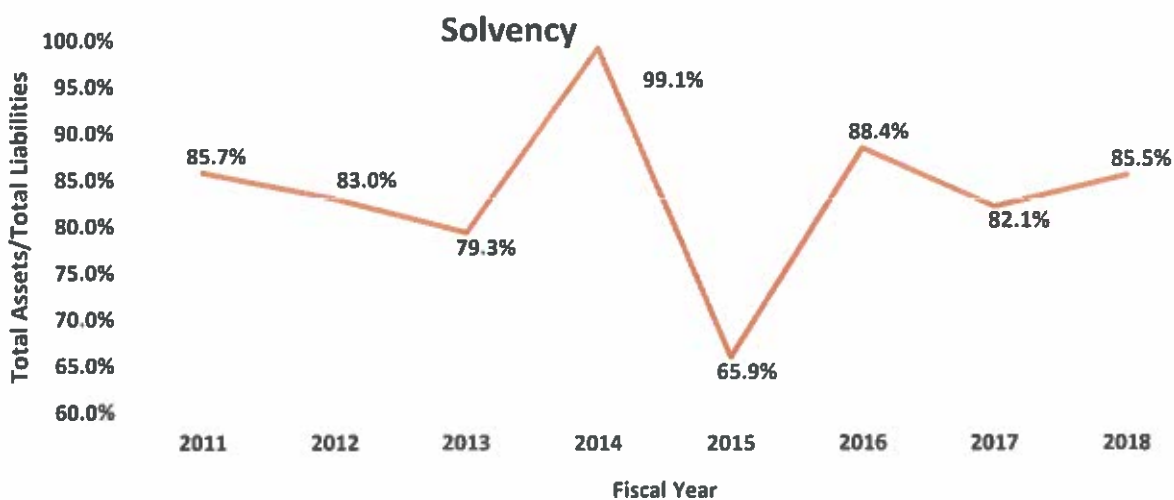
The City needs to maintain its liquidity over 200% to ensure it has sufficient cash and investments to meet its current obligations. Although the City's liquidity position has significantly improved coming out of bankruptcy, cautionary notes are warranted. First, the City still has looming increases in pension and debt obligations, as will be discussed below. Secondly, although \$643.4 million in General Fund cash and investments as of June 30, 2018 is sizable, the lion share of it is either obligated, restricted or assigned to a specific purpose.

Solvency

Solvency measures all the City's assets available to meet all its obligations. A ratio of less than 100.0% is unsatisfactory and means the City has a net position deficit and is insolvent. The graph below shows that even with Detroit's exit from bankruptcy it is insolvent. Flint, Boston and Portland had lower ratios than Detroit. All the insolvent cities have large pension and debt burdens and a net position deficit. Many cities are having difficulty with solvency due to the implementation of the Governmental Accounting Standards Board Statement (GASB) No. 68, *Accounting and Financial Reporting for Pensions* and GASB No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*⁷.



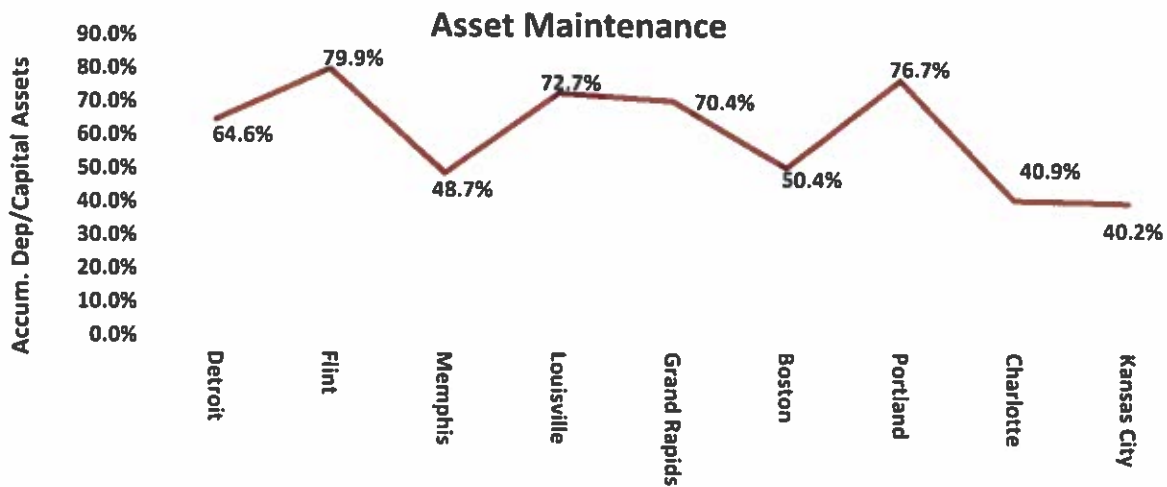
The graph below details Detroit's solvency over the past eight years and shows improvement in 2014 but a sharp decline in FY 2015. This was primarily due to the implementation of GASB 68 which added the net pension liability to the Governmental Activities Statement of Net Position in FY 2015 and the large amount had an adverse impact on the City's net position. The improvement in FY 2016- FY 2018 was due to the pension settlements in bankruptcy which reduced the net pension liability by \$1.1 billion. Detroit still needs significant reductions in its long-term debt and net pension liability to be solvent financially on a long-term basis.



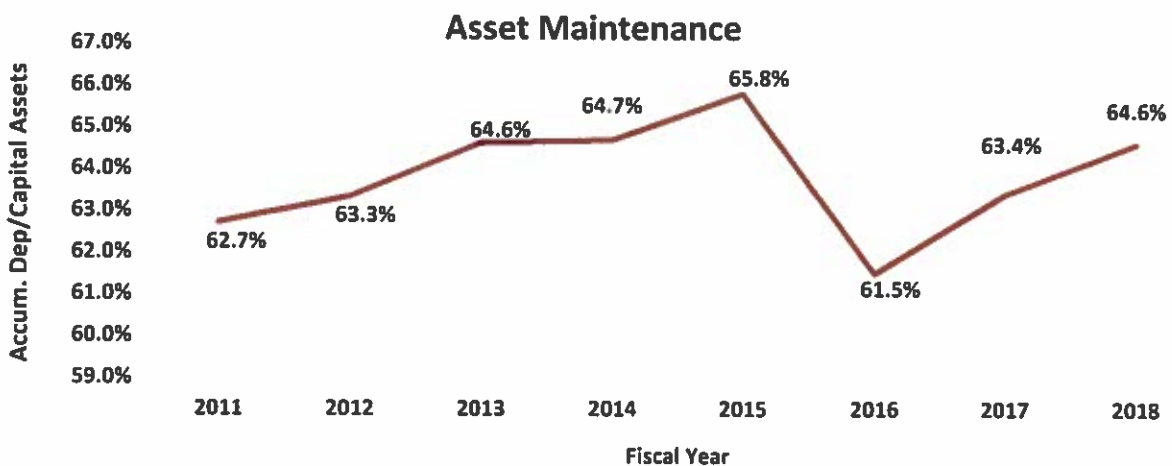
⁷ The City eliminated its retiree health care plan in bankruptcy which greatly reduced its postemployment benefits other than pensions long-term obligations.

Asset Maintenance

Asset maintenance compares the City's accumulated depreciation to depreciable capital assets. It shows the age of assets and infrastructure. A higher percentage indicates that assets are more depreciated and older. Detroit maintains a huge amount of infrastructure and assets for a large area that is much greater than its population needs⁸. As a result, the maintenance and replacement costs are more than the City with its depressed population and tax base can currently afford. The graph below shows a high asset maintenance ratio for those cities that are struggling financially such as Flint and Portland. Detroit's asset maintenance ratio is relatively high. Detroit infrastructure and assets such as streets, water pipes and mains, buildings, and vehicles will likely need to be replaced or renovated soon or maintenance costs will increase. The normal process is to find grants or issue debt to fund such replacements. As noted above, In FY 2019 the City was able to issue \$135.0 million of Unlimited Tax General Obligation (UTGO) bonds to finance capital projects and improve the City's infrastructure. This was a huge accomplishment considering the Plan of Adjustment assumed the City would be unable to issue general obligation bonds to finance capital projects for quite some time.



The following graph details Detroit's asset maintenance percentage over the past eight years. The ratio declined in FY 2016 because of a large write-off of fully or nearly fully depreciated capital assets resulting from a comprehensive inventory conducted in FY 2016. The City still has a high asset maintenance percentage and consideration needs to be given to improving the aging City infrastructure through replacement, and renovations.

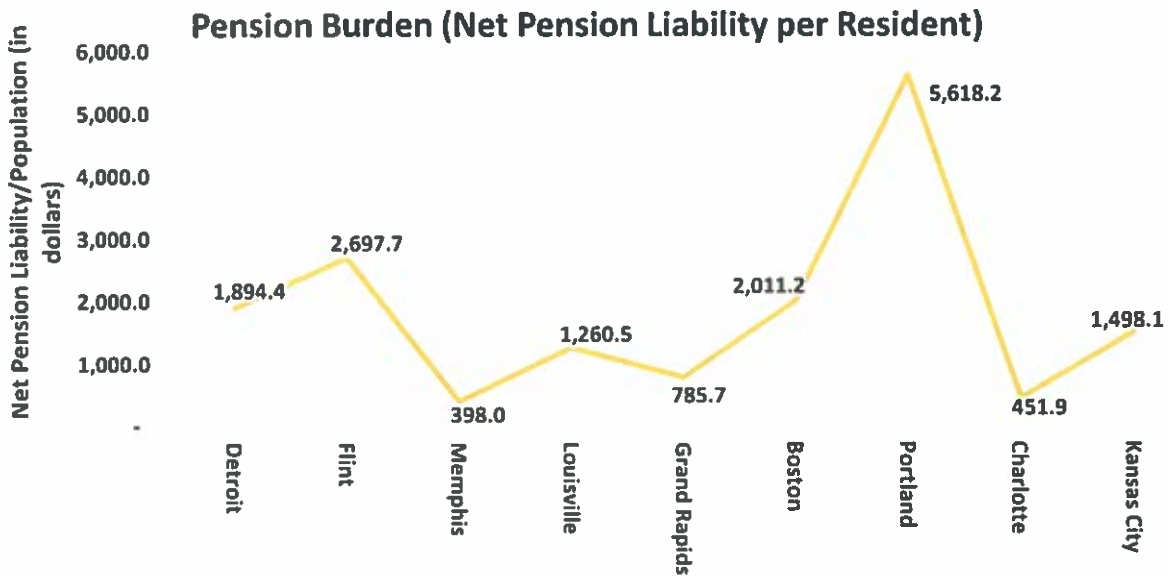


⁸ The Cities of Boston, San Francisco and the borough of Manhattan could fit inside the land area of Detroit. The City once had nearly 2 million in population in 1950 and now has approximately 670,000.

Pension Burden

Pension Burden measures the City's Net Pension Obligation per the population. A large Net Pension Liability is a burden to a governmental entity as it represents legacy obligations that must be paid out of the current resources of the government.

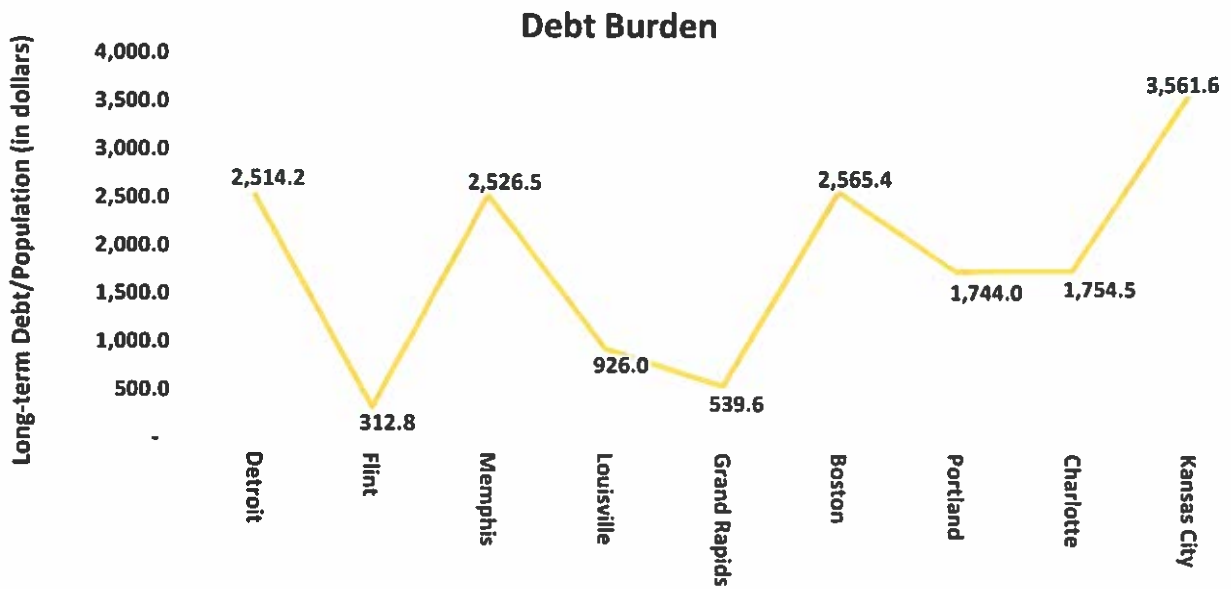
In FY 2015 the City and most other governments implemented the provisions of GASB No. 68, *Accounting and Financial Reporting for Pensions* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. As a result, the government-wide statements and the proprietary funds now include a Net Pension Liability for the City's unfunded legacy pension costs. The City recorded a \$1.275 billion Net Pension Liability on the June 30, 2018 City's Governmental Activities' Statement of Net Position. Detroit's pension burden is not as high as the other cities that are struggling financially such as Flint and Portland in FY 2018 because the pension settlements in bankruptcy allowed Detroit to reduce its net pension liability. However, Detroit still has a significant net pension liability that is a challenge to fund with its limited tax and other revenue sources.



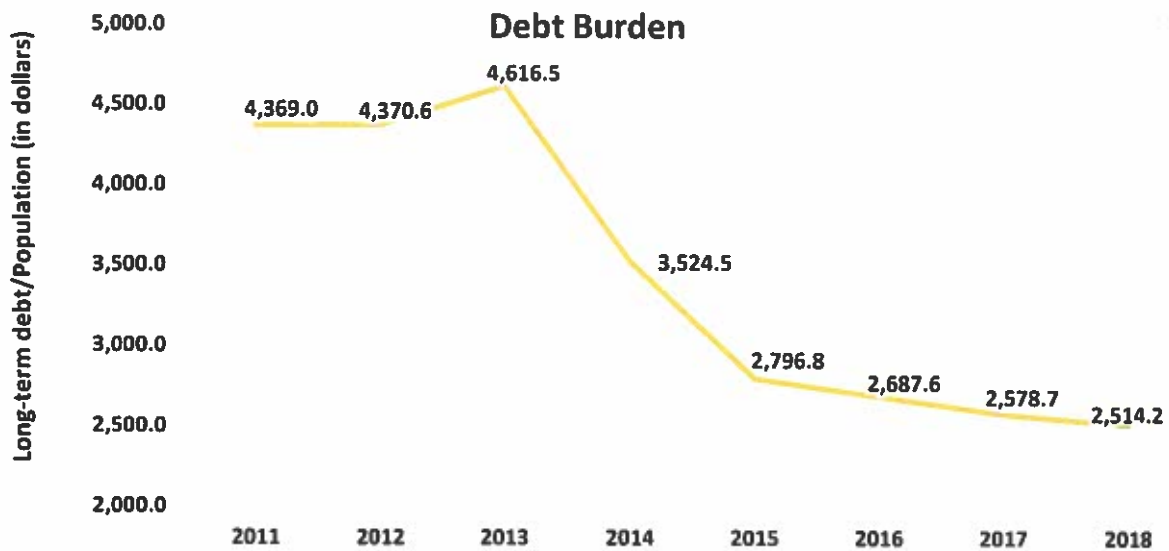
Debt Burden

Debt burden measures the City's long-term debt to population. A large debt burden is a concern when there are insufficient assets available to cover it. It is more likely funds for debt payments will have to come out of future revenues, which will decrease revenues to pay for essential services such as public safety.

As detailed in the graph below, Detroit had a higher debt to population ratio than the other cities except for Memphis, Boston, and Kansas City. Memphis, Boston and Kansas City have higher debt burdens, but also had higher assessed property values and the ability to raise more tax revenues to fund the debt as it comes due.



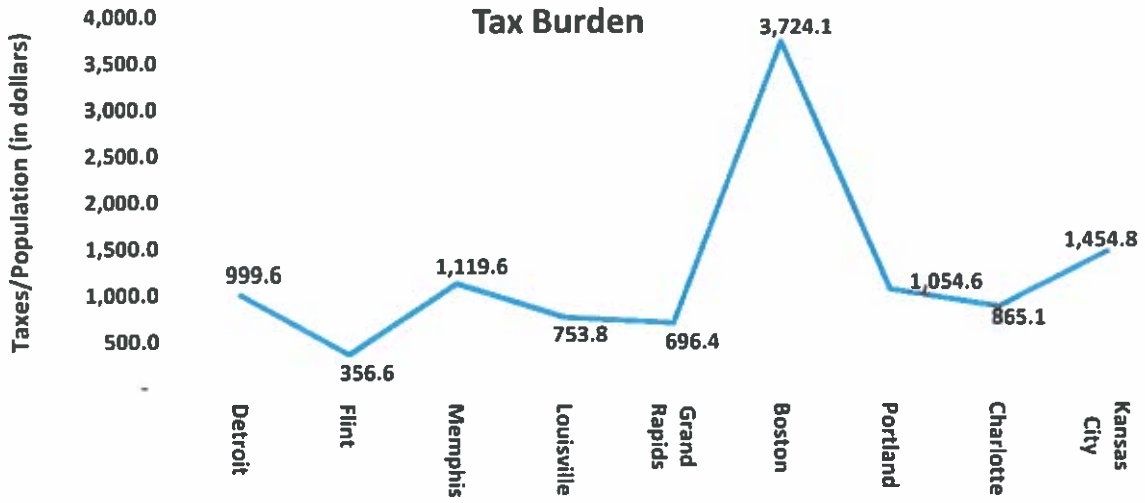
The following graph details Detroit's debt burden over the past eight years. Detroit's debt burden decreased significantly in FY 2014 mainly because of the elimination of \$766.1 million of retiree health benefits (OPEB) liabilities. In FY 2015 the debt burden decreased due to the elimination of debt, mainly POCs, through the Bankruptcy's Plan of Adjustment. The FY 2016 reduction was due to the retirement of debt including \$30 million of the bankruptcy exit financing. As noted previously (see footnote 3), the OCFO has done its best over the past three years to lower the City's debt obligations by refunding and retiring certain debt.



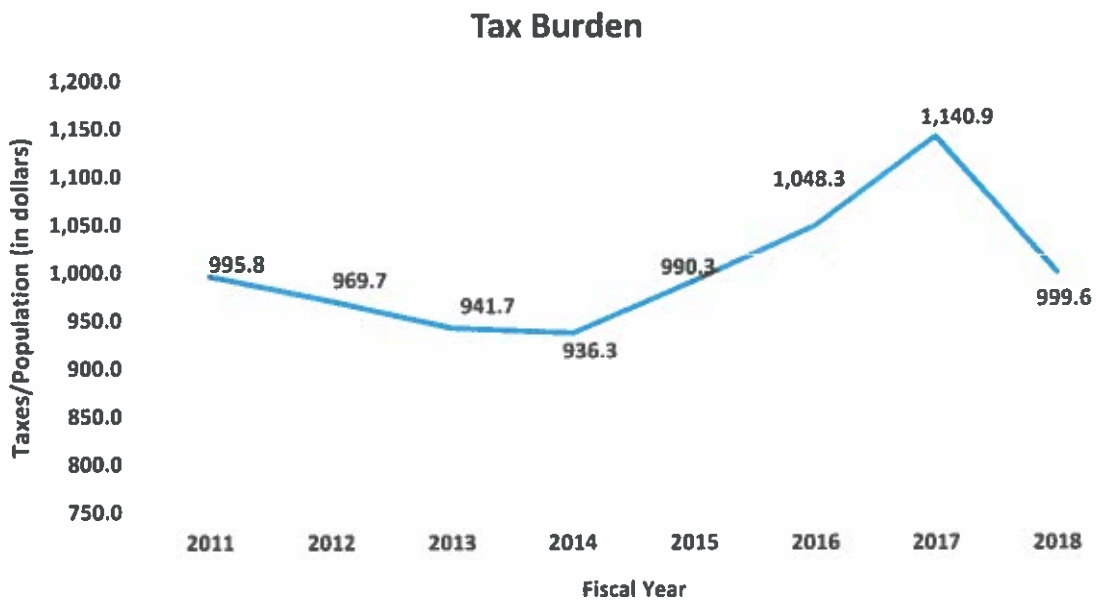
Detroit's debt burden will continue to be a drain on General Fund revenues well into the future. Most of the City's debt lacks a dedicated revenue source like the property tax millage that pays for the debt service on the unlimited tax general obligation bonds. The newer Limited Tax General Obligation bond debt issued per the Plan of Adjustment was secured and will be paid off with revenues from income tax and State revenue sharing. Such debt will always impair a City's fiscal health.

Tax Burden

Tax burden measures the tax revenues per the population. A high tax burden can mean many things. The obvious is that the citizen taxpayers may be paying a high rate of taxes. On the positive side it may mean that tourists, businesses and other sources are providing tax revenue and the rate is high because it is only spread over the City's population. The graph below shows Detroit's tax burden is in the middle range of the cities we benchmarked. Detroit has a high millage property tax rate and other taxes such as income, utility and casino taxes. The tax burden would be even higher if the City's assessed property values and the median income level wasn't so low. Also, other cities derive more tax revenues from non-citizens such as tourists and businesses.



Detroit needs to increase its tax base and revenues. The following graph shows Detroit's tax burden over the past eight years.

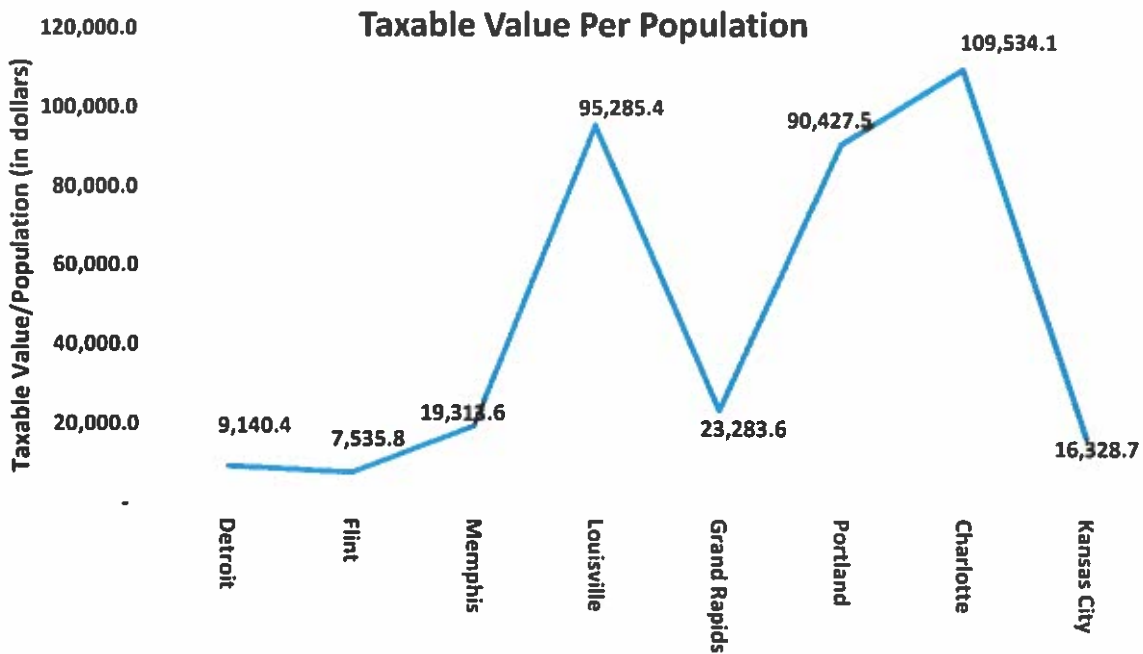


The Tax Burden increased in FY 2016 and FY 2017, mainly because property, income and wagering taxes were much higher than the prior years and the City’s population continued to decline per the Census Bureau estimate on July 1, 2017. Detroit’s property tax revenue collected decreased in FY 2018 as collections of property taxes were down due to reductions in tax assessments and UTGO debt service.

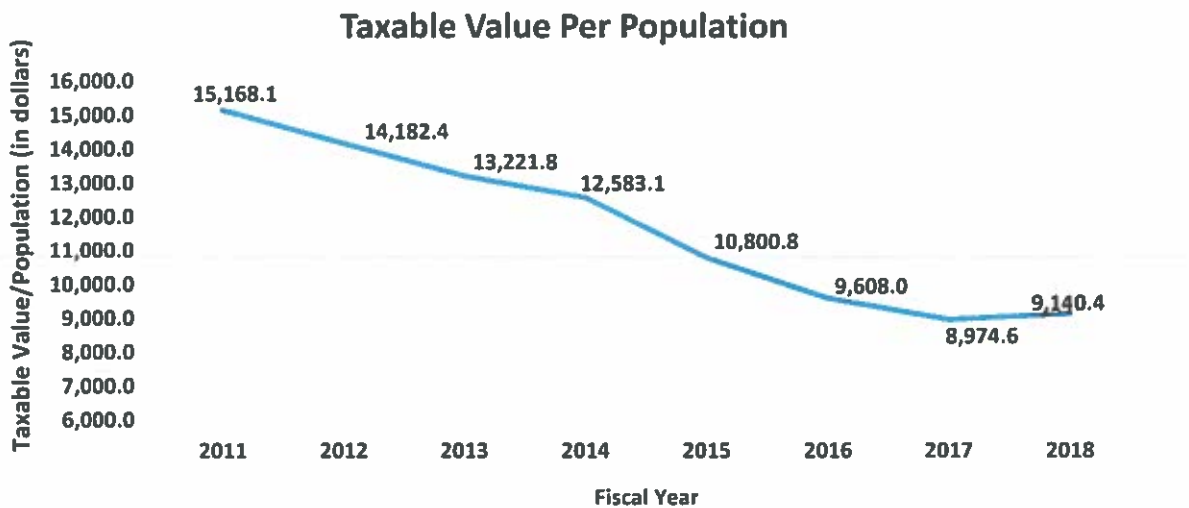
Detroit’s tax burden declined from 2010 to 2014 due to reduced tax revenue collections, primarily property and wagering taxes. Also, assessed property values have fallen in the City contributing to the decline in property tax revenues. The Headlee amendment of 1978, which restricts property tax revenues a city can collect, has adversely impacted tax revenues to Michigan cities. This contributes to the low tax burdens for cities in Michigan.

Taxable Value

Taxable Value measures the taxable property values including residential, commercial, industrial and personal property, per the population. The graph below shows that the fiscally healthy cities have higher taxable values per their population than Detroit. As a result, they are able to generate higher tax revenues.



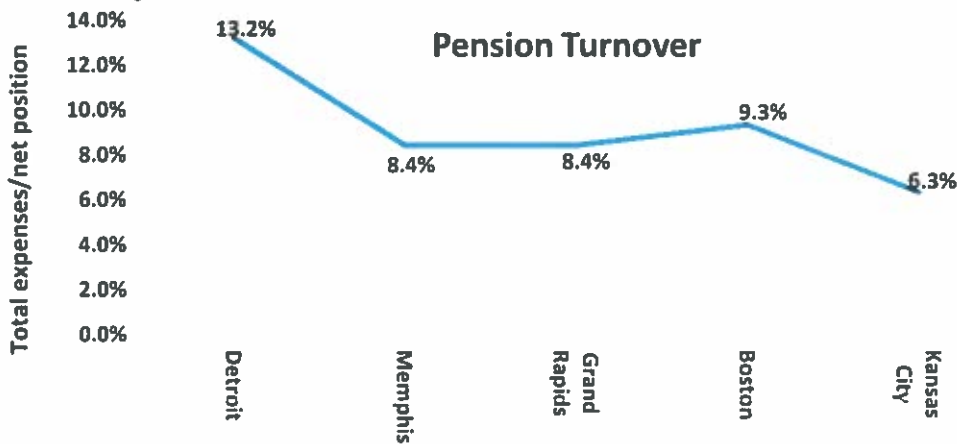
The graph below shows Detroit’s taxable value trend over the past eight years. Detroit’s taxable value increased in FY 2018, for the first time in eight years. The City still has a low taxable value because of the poverty, foreclosures, and reductions in assessed values due to the city-wide reappraisal of residential and commercial properties and improvements in the City’s assessors division.



Detroit’s property values and tax base needs to increase in order for it to obtain tax revenues sufficient to provide satisfactory services and maintain infrastructure for its residents.

Pension Turnover

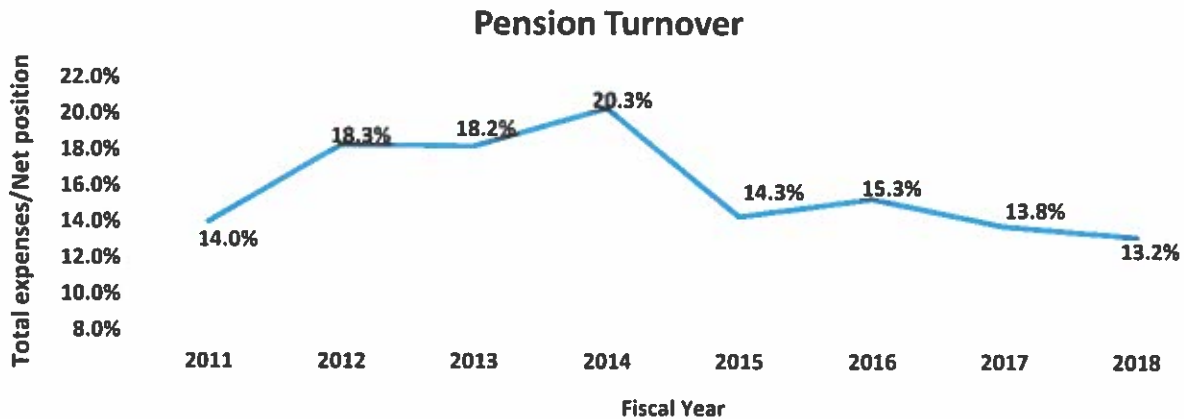
Pension Turnover measures the City’s General Retirement System (GRS – Civilian Retirees Legacy System Component II) total annual expenses divided by the net position (assets less liabilities) of the Fund. It measures the turnover/depletion of the pension fund’s assets. The graph below shows Detroit’s GRS assets are turning over much quicker than the other cities. If the City’s pension fund assets were depleted there would be a greater burden on the City’s general fund to pay for retiree pensions.



If the City’s legacy general retirement pension assets (\$1,953,261,347) on June 30, 2018 did not increase and the annual payment/deductions (\$258,290,329) remained the same, than the assets would be fully depleted in 7.6 years ($1,953,261,347 / 258,290,329$ or $100\% / 13.2\%$). Flint, Louisville, Portland and Charlottes’ general retirement pensions were not comparable and we did not include them in the analysis⁹.

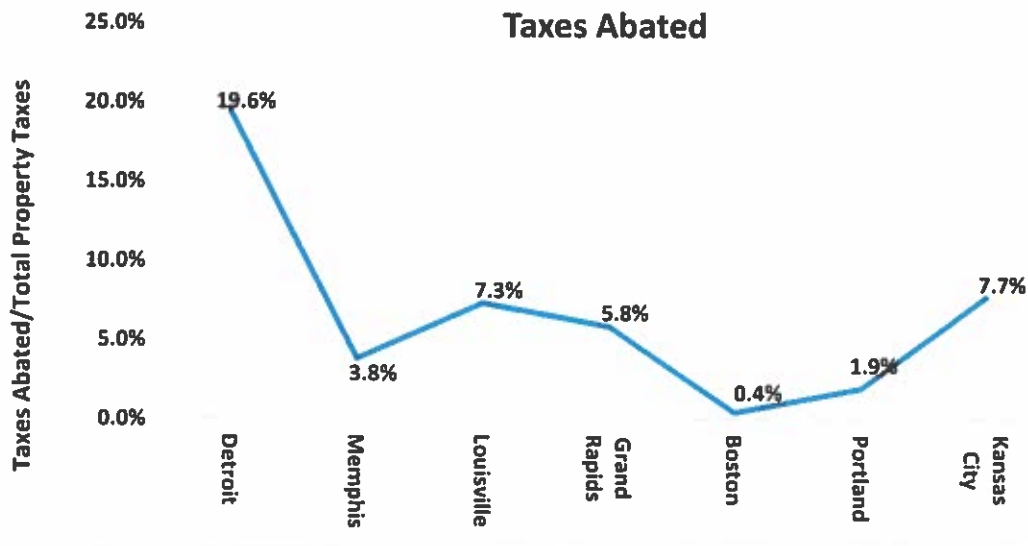
⁹ Flint, Louisville, Portland and Charlottes’ general retirement pensions were not comparable to Detroit’s since their pension plans were either combined with their State pension plans or were a part of an independent retirement services company who administers the retirement plan for local units of government on a not-for-profit bases.

The graph below shows Detroit’s pension turnover rate over the past eight years. The rate increased from 2012 to 2014, as the City had a larger number of retirees and benefits and expenses paid out due to the bankruptcy. The rate decreased in FY 2015 due the reduction of benefits and expenses and contributions made per the “Grand Bargain” in accordance with the Plan of Adjustment. The bankruptcy resulted in the: (1) freezing of the GRS pension plan; (2) 4.5% cut to retiree benefits; (3) Annuity clawback; (4) elimination of the cost of living adjustment; and (5) “Grand Bargain” proceeds, which will increase the GRS pension fund assets and lower the turnover rate.



Taxes Abated

Taxes abated measures the City’s property tax revenues foregone, as a percentage of property tax revenues¹⁰, to encourage economic development or some other special purpose that benefits the City. The City of Detroit has granted a large amount of tax abatements over the years in an effort to facilitate economic development in the City and to enhance the City’s economic well being. Tax Abatements were reported for the first time for FY 2017, as required by GASB Statement No. 77, “Tax Abatement Disclosures”¹¹. The graph below details that Detroit had the largest amount of property taxes abated of the cities we compared.



¹⁰ Property tax revenues plus tax abatements

¹¹ Pages 119-120 of the 2017 CAFR, Note 14 and pages 116-117 of the 2018 CAFR, Note 13

In FY 2018, Detroit had \$38.7 million of tax abatements or 19.6% of the property tax revenues and abatements combined. Detroit had \$36.0 million of tax abatements per the 2017 CAFR or 12.7% of the property tax revenues and abatements combined. The increase in the percentage of tax abatements in FY 2018, as previously noted, was due to the reductions in tax assessments and UTGO debt service property tax revenue.

Other cities reported much less in taxes abated than Detroit. Memphis had the next largest amount at \$16.7 million but was only 3.8% of its property tax revenues and abatements combined because of the larger amount of property tax revenue collected. Kansas City had the second highest percentage at 7.7%. The City of Detroit needs to carefully manage abatements to ensure that the benefits are greater than the loss of property tax revenue.