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TO: COUNCIL MEMBERS

FROM: David Whitaker, Director
Legislative Policy Division Staff

DATE: February 10, 2021

RE: Benchmark Comparison of the City of Detroit's 2020 Comprehensive Annual Financial Report (CAFR) With Other Cities

Executive Summary

The Legislative Policy Division (LPD) compared the City's fiscal year 2020 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: Lansing, Michigan; Memphis, Tennessee; Louisville, Kentucky; Grand Rapids, Michigan; Flint, Michigan; Baltimore, Maryland; Boston, Massachusetts; Portland, Oregon; Oklahoma City, Oklahoma; 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. Lansing and Flint were chosen because they have 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 Fund[1]. Furthermore, the City of Detroit's infrastructure (Capital Assets) is aged and depreciated and the City will need funds to replace it. 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 2020 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	363.8%	84.4%	65.8%	2,217.6	2,729.7	983.4	9,417.4	15.3%	17.1%
Flint	479.5%	39.9%	82.5%	3,267.7	335.5	395.5	7,743.3	NA	1.4%
Lansing	154.6%	28.0%	71.5%	2,606.5	298.4	669.3	24,003.3	15.8%	11.0%
Memphis	125.3%	103.5%	50.1%	689.6	2,499.3	1,148.6	19,497.4	9.3%	3.7%
Louisville	318.2%	110.2%	72.6%	1,510.5	1,040.1	780.9	100,332.6	N/A	4.6%
Grand Rapids	675.4%	146.9%	73.0%	932.6	519.6	735.1	25,697.7	8.7%	7.0%
Baltimore	212.9%	83.7%	55.3%	2,943.1	4,137.1	2,451.0	62,956.5	9.5%	3.2%
Boston	256.7%	73.9%	53.3%	2,527.4	2,322.0	4,082.1	N/A	9.1%	1.0%
Portland	321.4%	58.2%	77.9%	7,507.9	1,888.0	1,207.9	96,820.2	N/A	1.9%
Oklahoma City	362.5%	198.2%	39.8%	424.3	1,486.4	1,047.9	9,486.9	5.4%	4.3%
Kansas City	182.3%	164.3%	36.8%	1,581.7	3,317.4	1,519.5	19,129.3	7.5%	6.6%

- 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, 2020 are either obligated, restricted or assigned to a specific purpose.

- As of June 30, 2020, City of Detroit was technincally insolvent as the City's Governmental Activities unrestricted net position on June 30, 2020 was a $1.786 billion deficit and the net position was a $439.2 million deficit. The deficit was primarily due to the net pension liability of $1.486 billion and a $1.078 billion of debt that will eventually have to be paid from the General Fund.[2] Other cities such as Boston, Portland, Baltimore and Lansing reported a negative net position in their governmental activities for FY 2020, 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. Recent and planned capital bond sales over the next ten years should add newer capital assets, however.

[1]It is important to note, however, that City Council and the Administation worked toghether and established the retiree protection trust fund to help finance a huge looming pension obligation in 2024 and help stabilize pension obligations thereafter. The City contributed $170 million through FY 2020 and with interest earnings, the Fund has $184.7 millon balance as June 30, 2020.

[2]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. As of June 30, 2020, the City has $1.408 billion general obligation bonds of $1.078 billion is limited general obligation bonds (LTGO) that will ultimately have to be paid from the general revenue (Source: Page 90 of City of Detroit's FY 2020 CAFR)

- 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 ($184.7 million as of June 30, 2020) to meet them.

- Detroit's debt burden is higher than most other cities and an October 2020 $80 million bond sale and the soon to be issued $175 million in Neighborhood Improvement bonds in February 2021 will further increase it.

- Detroit's tax revenue collected per population decreased in FY 2020 due to impacted the COVID-19 pandemic had on income tax and casino wagering tax revenues.

- 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 of other cities that we compared.[3]

- Detroit's property taxes abated was the highest of the cities that we compared.

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 through abatement programs; improve its infrastructure; and ensure that the pension system assets are properly managed and maintained.

Background

The Legislative Policy Division made a comparative study of the City of Detroit's 2020 CAFR 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: Lansing, Michigan; Memphis, Tennessee; Louisville, Kentucky; Grand Rapids, Michigan; Flint, Michigan; Baltimore, Maryland; Boston, Massachusetts; Portland, Oregon; Oklahoma City, Oklahoma; 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. Lansing and Flint were chosen because they are in the State of Michigan and have similar challenges as Detroit. We also chose a mix of cities that were either in good or poor fiscal health.

Not all the cities we reviewed are truly comparable to the City of Detroit. Flint, 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 significantly contributed to their revenues and 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.

[3] Some of the 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.

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

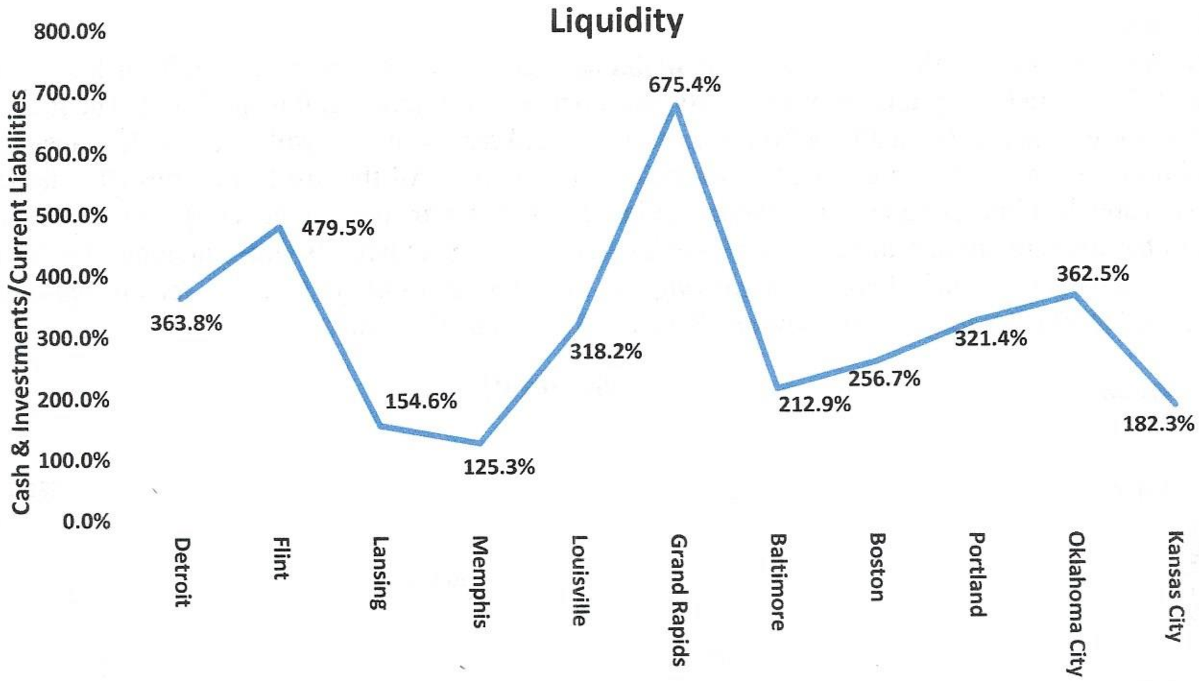
We also analyzed the City of Detroit data from 2011 to 2020 for these measures to show the performance trend over the past ten years. Listed below is the City of Detroit trend data for the fiscal years 2011 to 2020.

	Fiscal Year									
Measure	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Liquidity	40.6%	25.8%	40.1%	59.6%	222.3%	268.4%	359.8%	344.5%	399.7%	363.8%
Solvency	85.7%	83.0%	79.3%	99.1%	65.9%	88.4%	82.1%	85.5%	89.6%	84.4%
Asset Maintenance	62.7%	63.3%	64.6%	64.7%	65.8%	61.5%	63.4%	64.6%	64.1%	65.8%
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	2,798.6	2,729.7
Tax Burden	995.8	969.7	941.7	936.3	990.3	1,048.3	1,140.9	999.6	1,157.3	983.4
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	9,380.6	9,417.4
Pension Turnover	14.0%	18.3%	18.2%	20.3%	14.3%	15.3%	13.8%	13.2%	14.6%	15.3%
Tax Abatement							12.7%	19.6%	10.2%	17.1%

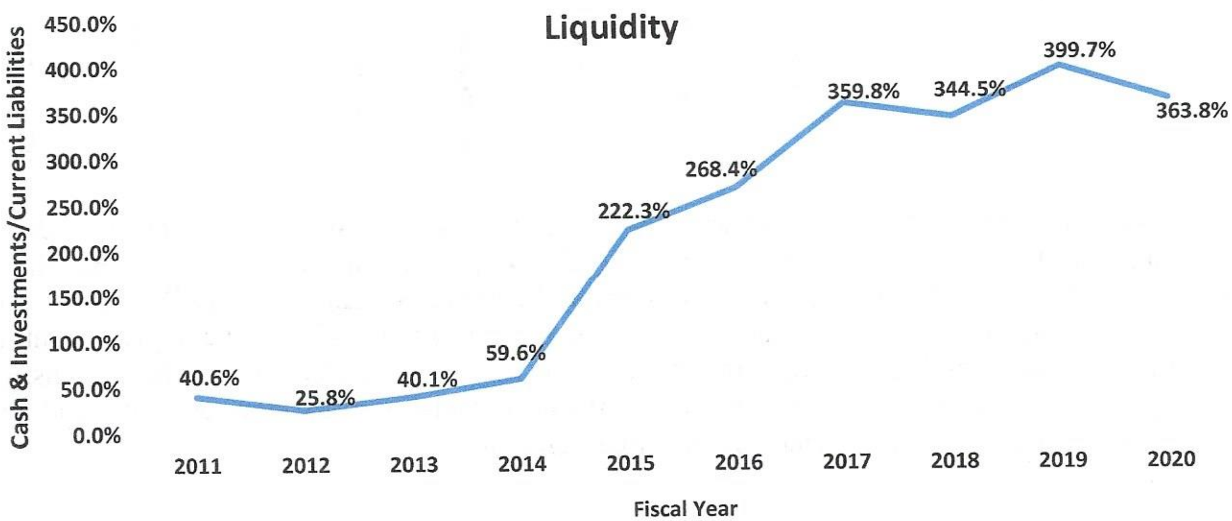
Comparative Analysis

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 annual pension contributions and payments to vendors. The graph below shows that Detroit's liquidity is higher than most 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 ten years and shows significant improvement with slight decrease in FY 2020. 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.

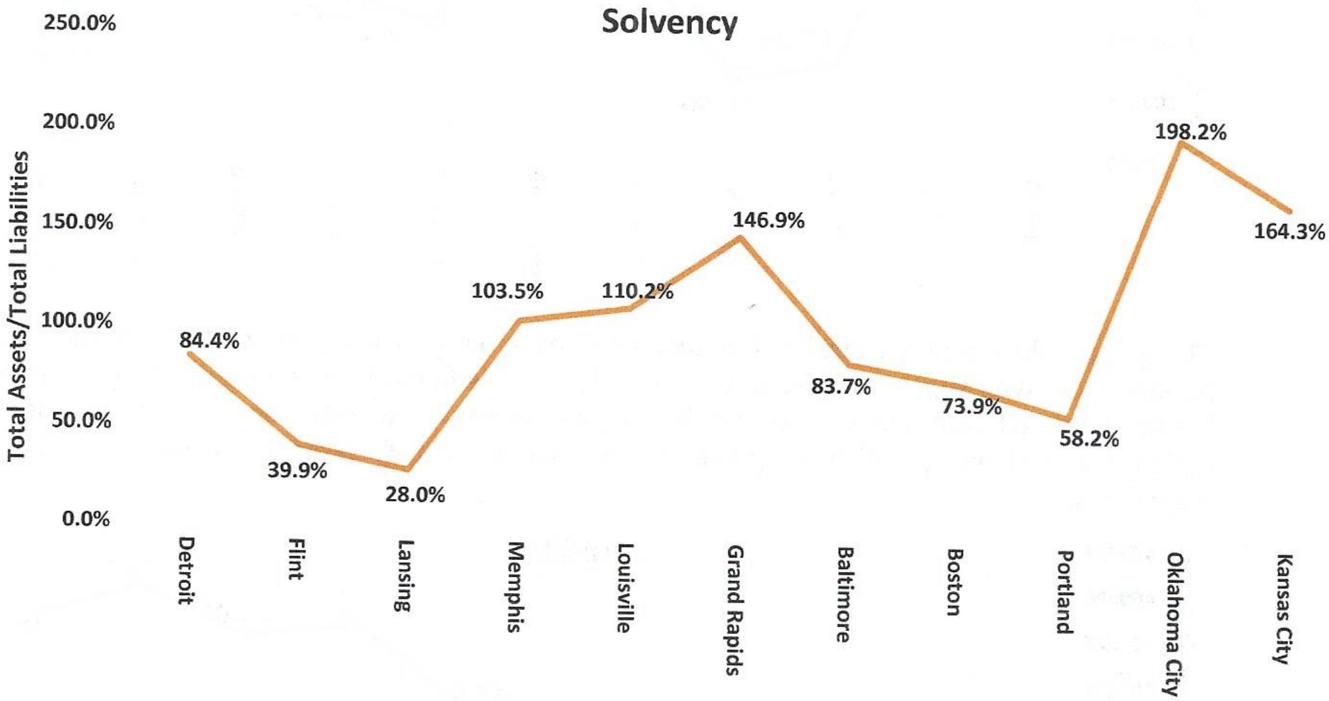


The City needs to maintain its liquidity over 200% to ensure it has sufficient cash and investments to meet its current obligations. Although the City's liquidity position has significantly improved coming out of bankruptcy, cautionary notes are warranted. First, the City still has looming increases in pension and debt obligations, as will be discussed below. Secondly, although the \$621.3[4] million in General Fund cash and investments as of June 30, 2020 is sizable, the lion share of it is either obligated, restricted or assigned to a specific purpose.

[4] Page 23 of the FY 2020 CAFR

Solvency

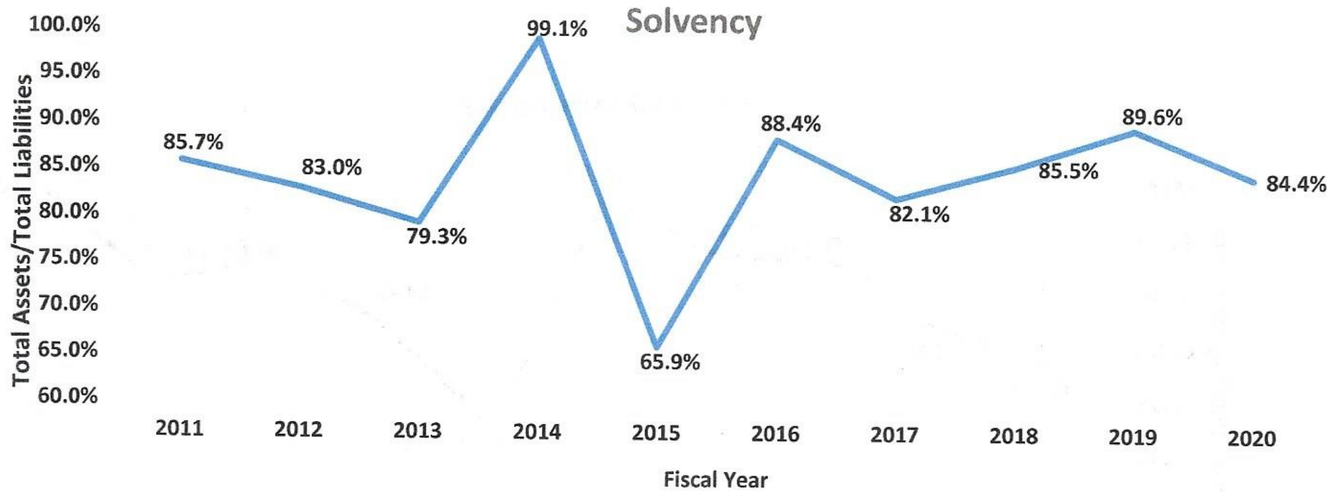
Solvency measures all the City's assets available to meet all its obligations. A ratio of less than 100.0% is unsatisfactory and means the City has a net position deficit and is insolvent. The graph below shows that even with Detroit's exit from bankruptcy it is insolvent. Flint, Lansing, Baltimore, 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*[5].



The graph below details Detroit's solvency over the past ten 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 2020 was due to the pension settlements in bankruptcy which reduced the net pension liability by $1.1[6] billion. Detroit still needs significant reductions in its long-term debt and net pension liability to be solvent financially on a long-term basis.

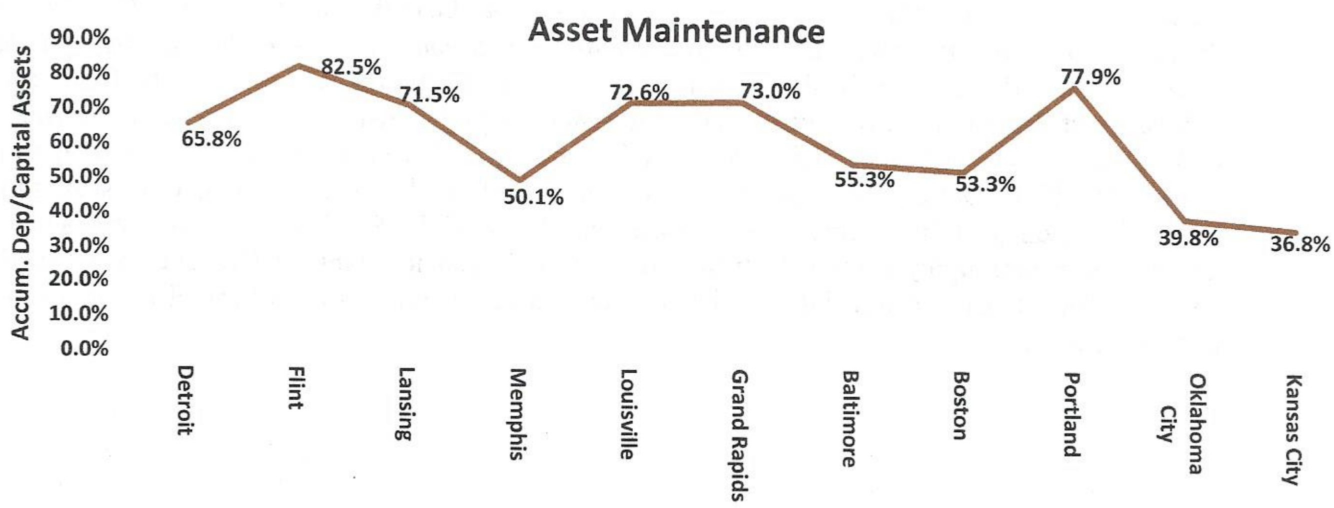
[5] The City eliminated its retiree health care plan in bankruptcy which greatly reduced its postemployment benefits other than pensions long-term obligations.

[6] Page 19 of the FY 2016 and page 22 of the FY 2015



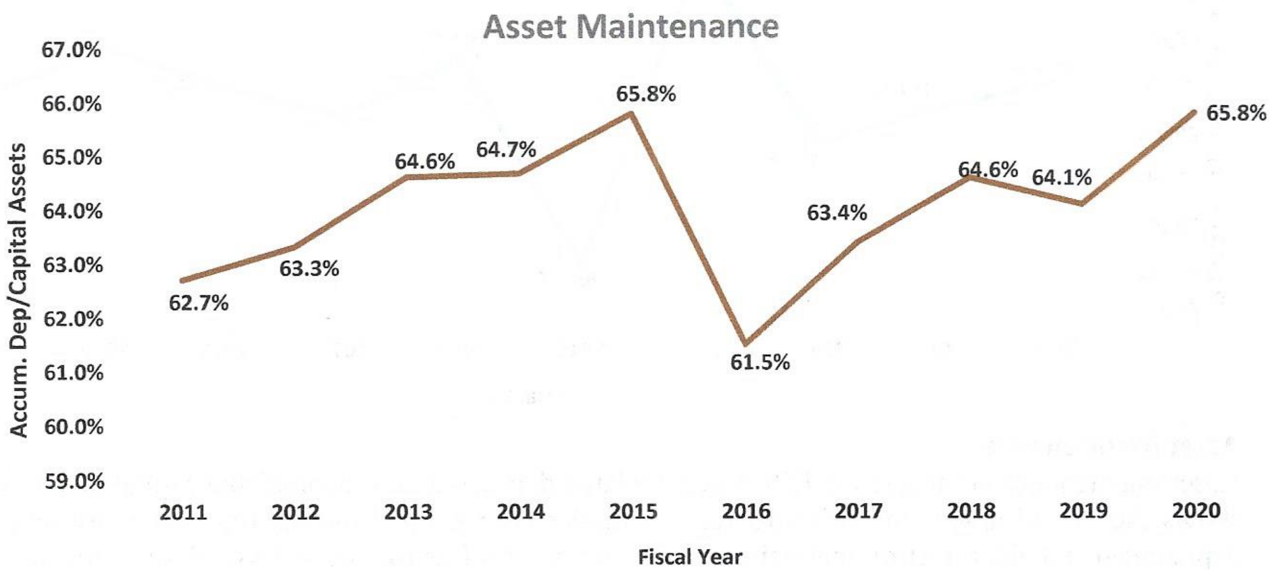
Asset Maintenance

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 needs[7]. 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.



The following graph details Detroit's asset maintenance percentage over the past ten 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.

[7] 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.

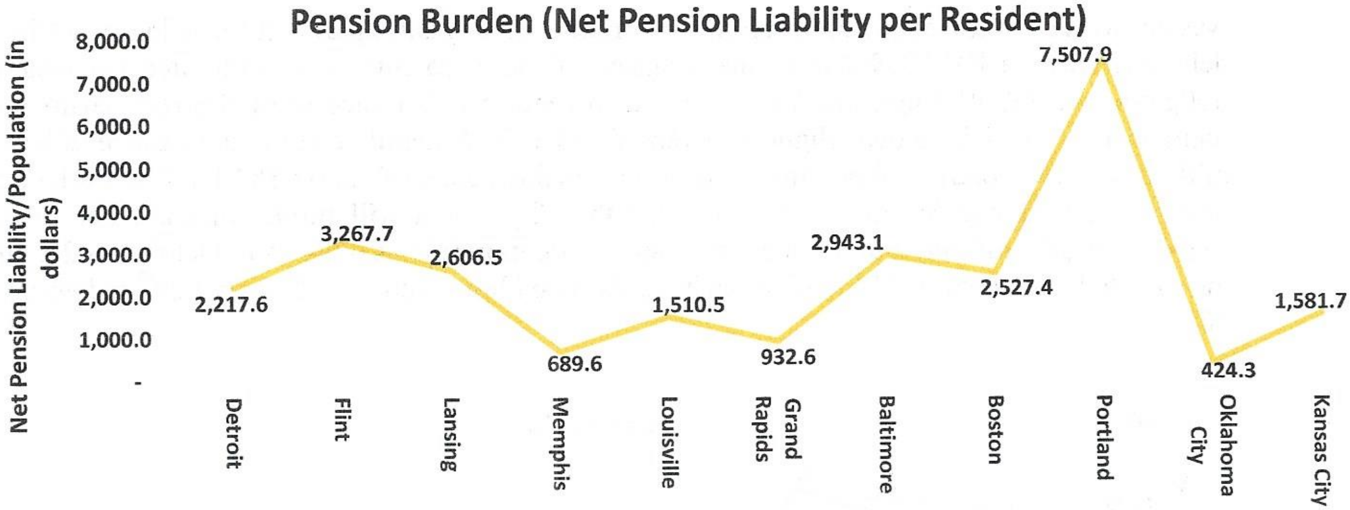


Pension Burden

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 $1.486[8] billion Net Pension Liability on City's Governmental Activities' Statement of Net Position on June 30, 2020. Detroit's pension burden is not as high as the other cities that are struggling financially such as Flint, Lansing, Baltimore and Portland in FY 2020 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.

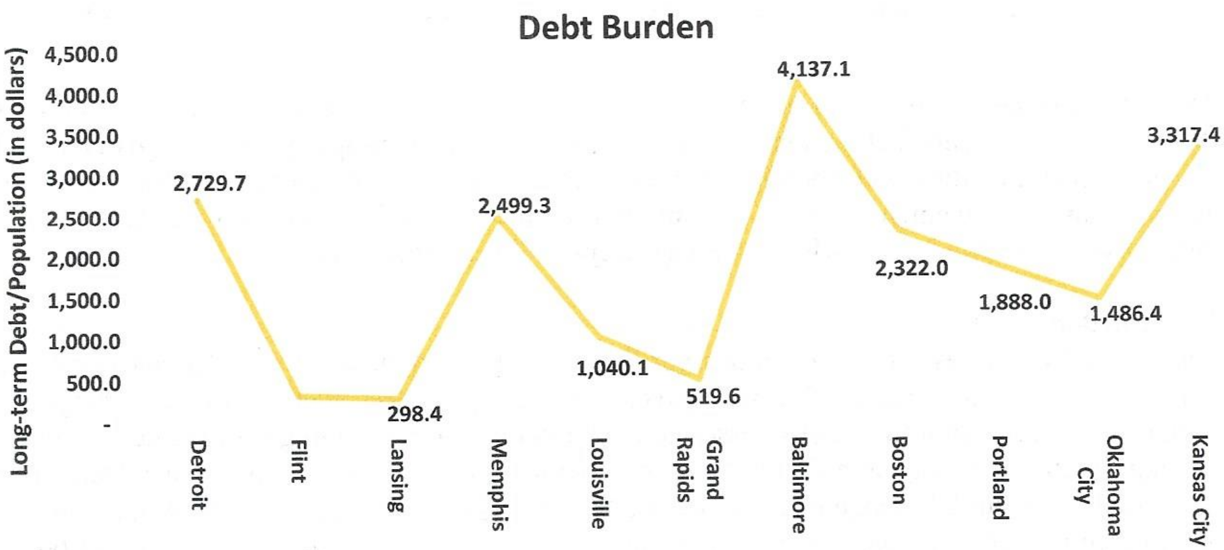
[8] Page 20 of the FY 2020 CAFR



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.

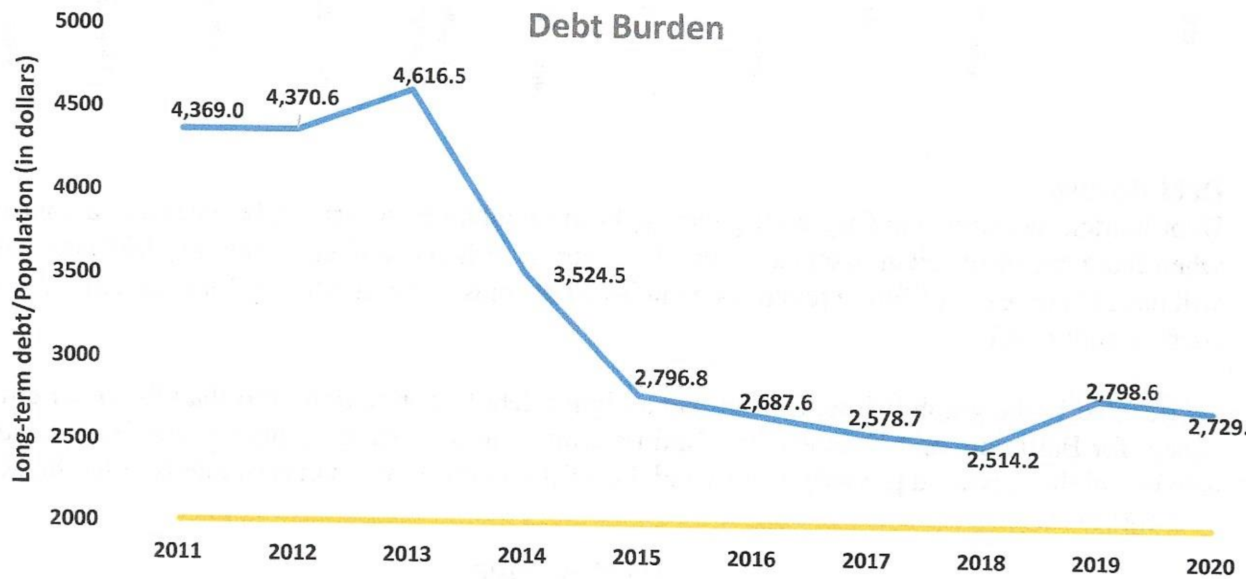
As detailed in the graph below, Detroit had a higher debt to population ratio than the other cities except for Baltimore and Kansas City. Baltimore and Kansas City have higher debt burdens, but also had higher assessed property values and the ability to raise more tax revenues to fund the debt as it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



The following graph details Detroit's debt burden over the past ten years. Detroit's debt burden decreased significantly in FY 2014 mainly because of the elimination of $766 million of retiree health benefits (OPEB) liabilities[9]. In FY 2015 the debt burden decreased due to the elimination of debt, mainly POCs[10], through the Bankruptcy's Plan of Adjustment. The FY 2016 reduction

[9] Page 125 of the FY 2014 CAFR
[10] Page 75 of FY 2015 CAFR

was due to the retirement of debt including $30 million of the bankruptcy exit financing. The City's debt increased in FY 2019 due to the issuance of the $135 million of unlimited tax general obligation (UTGO)[11] bonds and $51 million of revenue bonds issued to fund Street repairs and maintenance. The City's debt slightly decreased in FY 2020 mainly due to the issuance of $38.5 million revenue bonds to fund street repairs and maintenance offset by $82.1 million principal repayment. It should be noted, however, that the City's debt will further increase due to the issuance of $80 million in unlimited tax general obligation (UTGO) bonds in October 2020, and the soon to be issuance of $175 million in Neighborhood Improvement UTGO bonds[12] in February 2021.



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 UTGO 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 City's fiscal health.

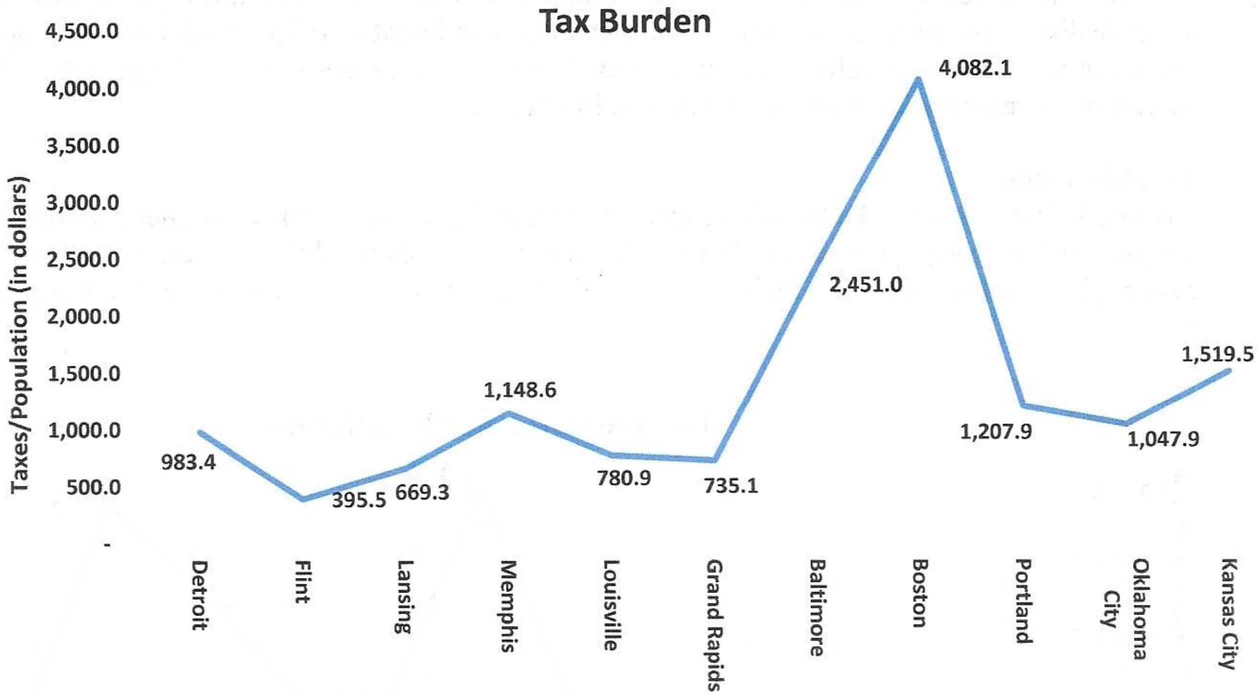
Tax Burden

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

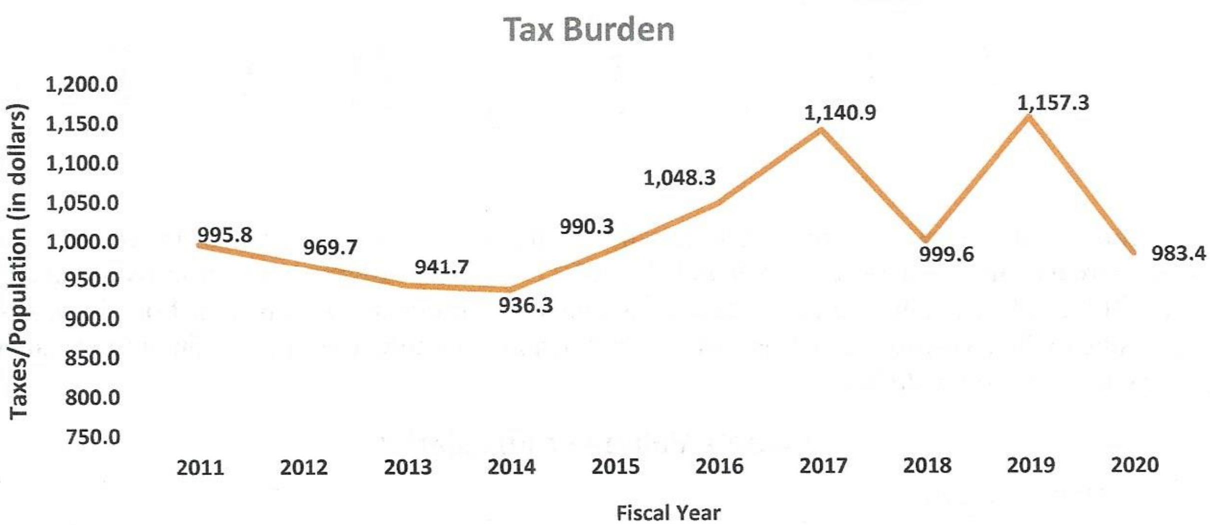
[11] Unlimited tax general oblgation (UTGO) bonds are paid from property tax revenue based on the property tax debt millage. Limited tax general obligation (LTGO) bonds are paid from general fund revenues.

[12] On July 21, 2020, the City Council authorized the issuance of $250 million of Neighborhood Improvement Bonds, and it was approved by the City's electors on November 3, 2020. As a result of these approvals, the City expects to issue approximately a $175 million portion of the authorized Neighborhood Improvement Bonds in 2021 (page 128 of 2020 CAFR).

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 ten years.

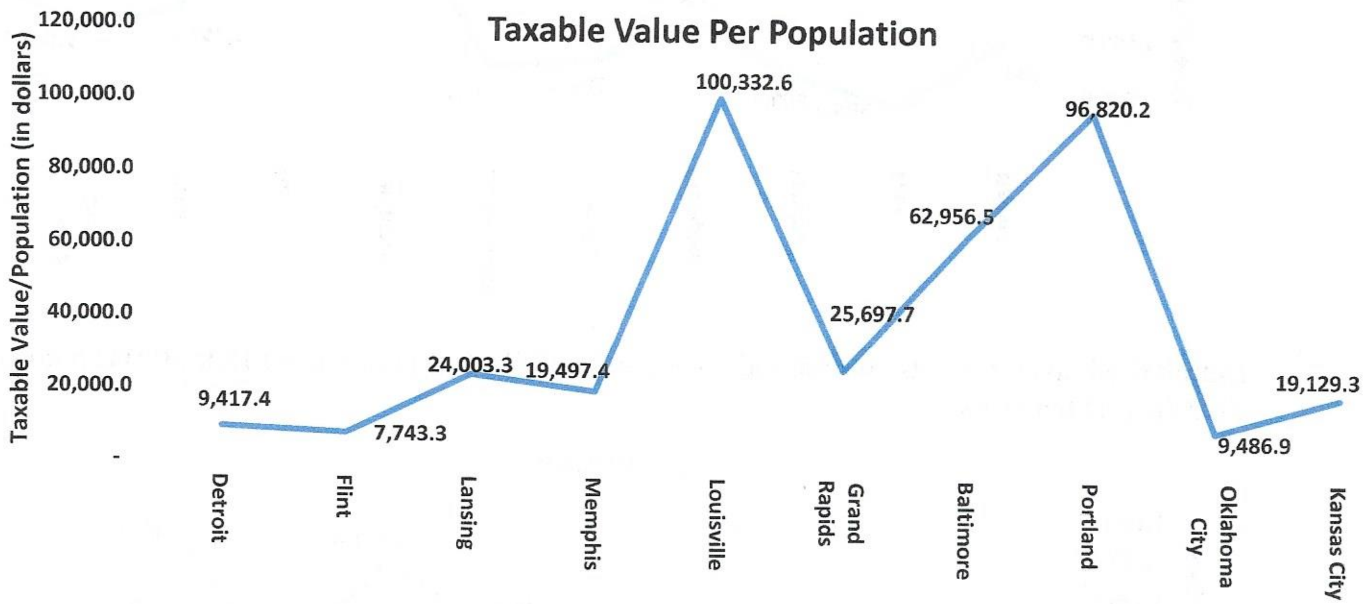


The Tax Burden increased in fiscal years 2016, 2017, and 2019 mainly because property, income and wagering taxes were much higher than the prior years and the City's population continued to decline per the Census Bureau estimate. Detroit's property tax revenue collected decreased in FY 2018 as collections of property taxes were down due to reductions in tax assessments and UTGO debt service. Detroit's tax burden decreased in FY 2020 due to decreases in income and casino wagering tax this was mainly due to the economic impact of the COVID-19 Pandemic.

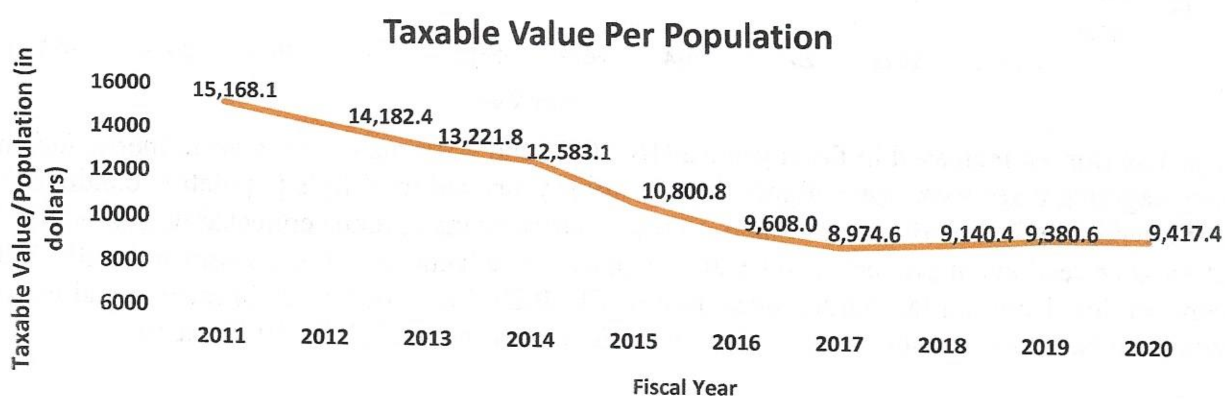
Detroit's tax burden declined from 2010 to 2014 due to reduced tax revenue collections, primarily property and wagering taxes. Also, assessed property values have fallen in the City contributing to the decline in property tax revenues. The Headlee amendment of 1978, which restricts property tax revenues 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.



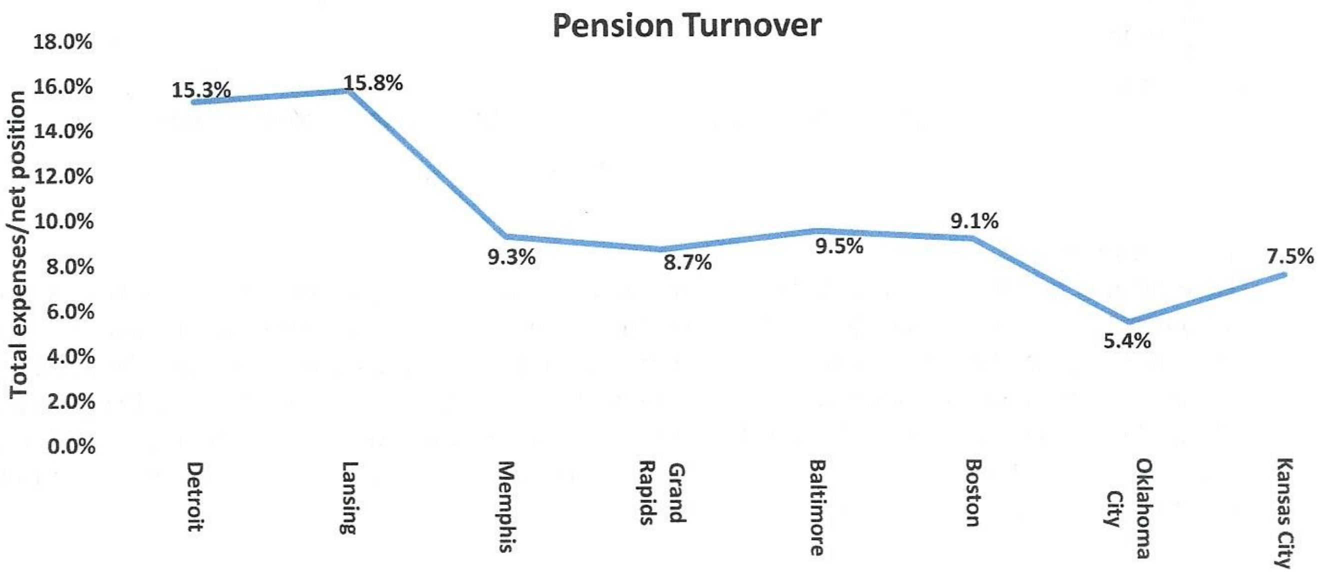
The graph below shows Detroit's taxable value trend over the past ten years. Detroit's taxable value increased in FY 2018, FY 2019 and FY 2020 due to developments and improvements. The City still has a low taxable value because of the poverty, foreclosures, and reductions in assessed values due to the 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 generate tax revenues sufficient to provide satisfactory services and maintain infrastructure for its residents.

Pension Turnover

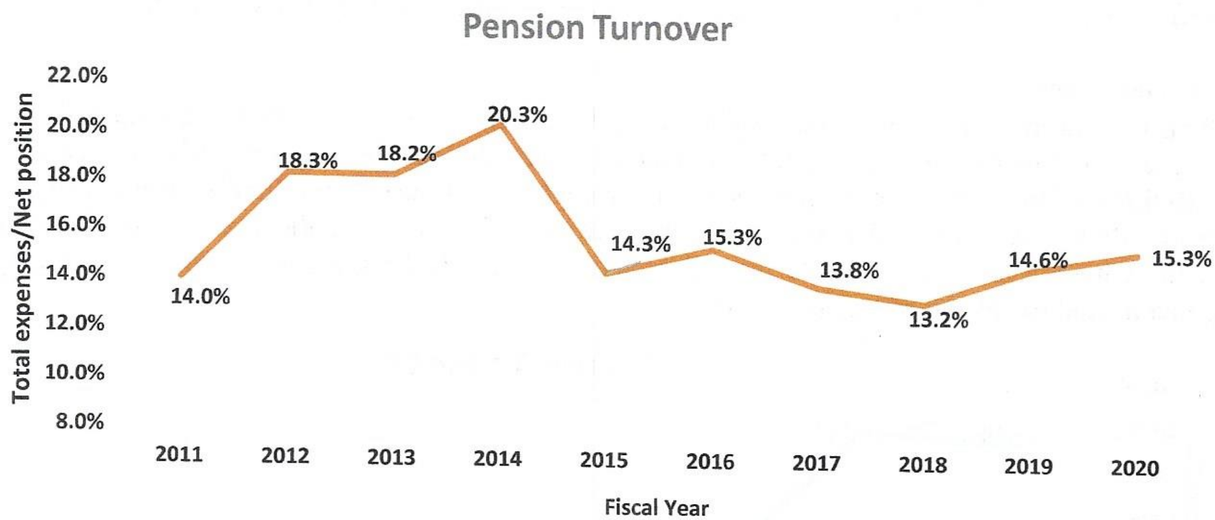
Pension Turnover measures the City's General Retirement System (GRS – Civilian Retirees Legacy System Component II) total annual expenses divided by the net position (assets less liabilities) of the Fund. It measures the turnover/depletion of the pension fund's assets. The graph below shows Detroit's GRS assets are turning over much quicker than the most of 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.



The City's legacy general retirement system (GRS) had a net position of $1,607,801,564 on June 30, 2020 which was a reduction of $203,487,542 from the prior fiscal year. In addition, the annual payment/deductions was $245,691,485 and if this level of payout remain the same, then the assets of the system would be fully depleted in 6.5 years. Flint, Louisville and Portland general retirement pensions were not comparable and we did not include them in the analysis[13].

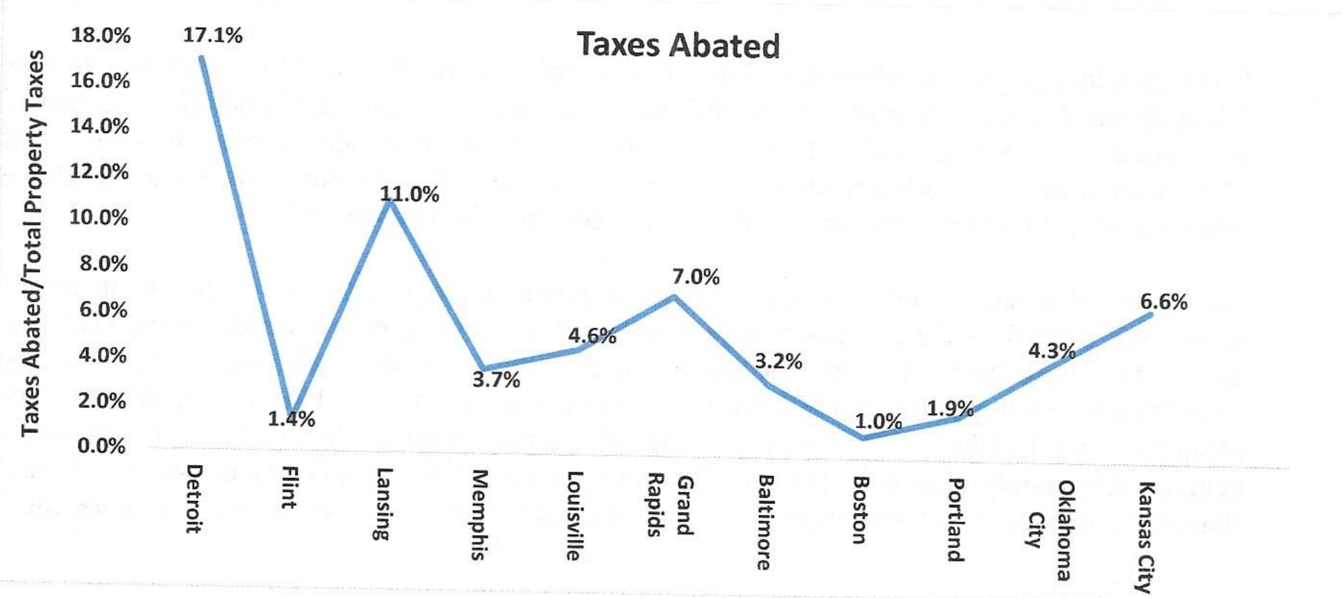
The graph below shows Detroit's pension turnover rate over the past ten years. The rate increased from 2012 to 2014, as the City had a larger number of retirees and benefits and expenses paid out due to the bankruptcy. The rate decreased in FY 2015 due the reduction of benefits and contributions made per the "Grand Bargain" in accordance with the Plan of Adjustment. The bankruptcy resulted in the: (1) freezing of the GRS legacy 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.

[13] Flint, Louisville and Portland's 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.



Taxes Abated

Taxes abated measures the City's property tax revenues foregone, as a percentage of property tax revenues[14], 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 City's economic wellbeing. Tax Abatements were reported for the first time for FY 2017, as required by GASB Statement No. 77, "Tax Abatement Disclosures"[15]. The graph below details that Detroit had the largest amount of property taxes abated of the cities we compared.



In FY 2020, Detroit had $39.1 million of tax abatements or 17.1% of the property tax revenues and abatements combined. Detroit had $20.6 million of tax abatements per the 2019 CAFR or 10.2% of the property tax revenues and abatements combined. The increase in the amount and

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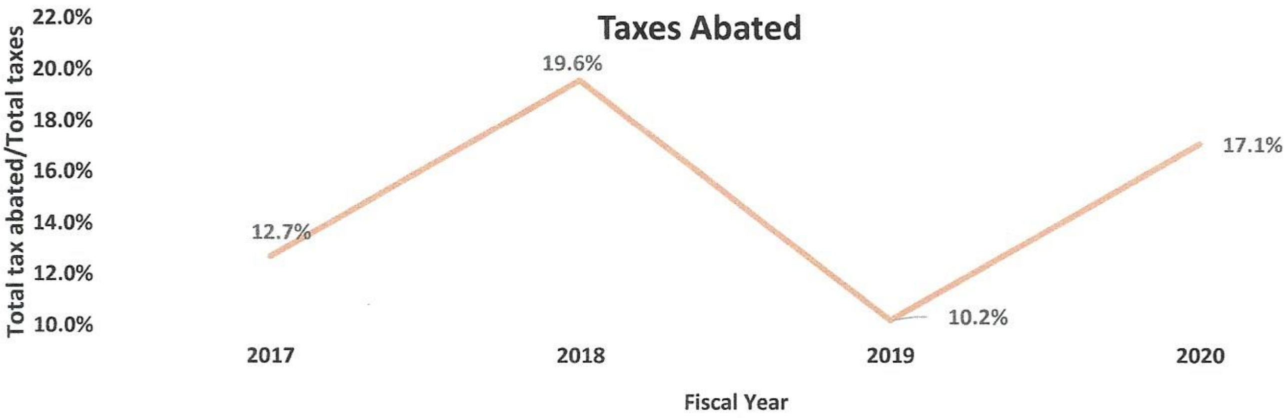
[14] Property tax revenues plus tax abatements

[15] Pages 125-127 of the 2020 CAFR, Note 14

percentage of tax abatements in FY 2020 was mainly due to the omission of the personal property tax exemptions in FY 2019 which was added back in FY 2020. After our FY 2019 CAFR review, we requested OCFO to add the personal property tax exemptions back to the tax abatement disclosure and OCFO agreed.

All other cities reported much less tax abatement rates than Detroit. The closest city to Detroit was Lansing which reported 11% or $5.2 million of tax abatements for FY 2020 (out of its $46.8 million total of property taxes and tax abatements). Baltimore reported $29.4 million in tax abatements in FY 2020 which was the second largest (behind Detroit) amount of tax abatements of the cities that, but it also had combined $911.7 million of property taxes and abatements which resulted in a 3.2% tax abatement rate which was much lower than Detroit's 17.1%. The City of Detroit needs to carefully manage abatements to ensure that the benefits are greater than the loss of property tax revenue.

The graph below shows Detroit's taxes abated as percent of total property tax and abatements for fiscal years 2017 to 2020.



<u>Conclusion</u>

LPD thanks Plante Moran representatives for meeting with us to discuss our concerns regarding the tax abatement disclosure before the CAFR was issued.

LPD encourages the Budget, Finance and Audit committee to continue its due diligence in reviewing the benchmarking report as it provides important information on how the City is doing financially compared to other cities.

Please let us know if we can be of any more assistance.

cc: Jay Rising, Acting CFO
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Steven Watson, Deputy CFO/Budget Director
Eric Higgs, Deputy CFO/Controller
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