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TO: The Honorable City Council

FROM: David Whitaker, Director 
Legislative Policy Division Staff

DATE: February 11, 2016

RE: Information on the Current Financial Status of the Detroit Public Schools

Executive Summary

City Council has scheduled a Committee of the Whole meeting at 2 PM on Monday, February 15, 2016 to discuss the current financial status of the Detroit Public Schools (DPS). Mr. Marios Demetriou, Deputy Superintendent of Finance and Operations of the Detroit Public Schools and other DPS representatives are invited for the discussion.

To facilitate this discussion, the Legislative Policy Division (LPD) in this report provides the City Council information on the current financial status of DPS. We have reviewed the following to prepare this report:

- Various newspaper articles describing DPS's cash flow crisis, and proposed solutions to address this crisis (Attachment 1).
- DPS's Comprehensive Annual Financial Report (CAFR) for the year ended September 30, 2015 (Attachment 2).
- Citizens Research Council (CRC) of Michigan's report, dated January 2016, entitled "Detroit Public Schools' Legacy Costs and Indebtedness" (Attachment 3). The CRC report provides an excellent analysis of DPS's current financial challenges and the State of Michigan's role, and obligations for DPS finances. We have incorporated much of their analysis in this report.
- Senate Fiscal Agency's Bill Analysis of Senate Bill 710-introduced January 14, 2016 (Attachment 4), which is the proposed legislation to split DPS into two parts: (1) the "Old" DPS (Qualifying School District) which would pay off the operating (cash flow) debt of DPS with the existing operating millage (18 mills); and (2) the "New" DPS (Community District), which would function as the new Detroit Public Schools providing education to Detroit's

children through funding provided by a subsidy from the State School Aid Fund equivalent to the operating millage funds diverted to pay the old DPS operating debt.

At the end of this report are suggested questions for DPS to address. Council may wish to raise some of these questions during your discussion on Monday, February 15th to facilitate the meeting.

DPS's Cash Crisis

The number one concern is to determine why DPS may run out of cash in April 2016, as has been widely reported in the media. Based on our review of the newspaper articles per Attachment 1, LPD's limited understanding as to what is causing DPS to possibly run out of cash is as follows¹:

1. DPS's debt payments go from \$15 million a month in February 2015 and balloon to \$26 million a month in February 2016, an amount nearly equal to the school district's payroll and benefits.
2. The large increase in debt service payments is principally due to \$121 million DPS borrowed this school year for cash flow purposes and \$139.8 million for operating debts incurred in prior years. DPS borrowed the \$121 million through an advance on state aid in order to make payroll this school year. However, borrowing against future state aid is fairly common among school districts because state aid does not always come in during September.
3. Put in another way, DPS's debt payments are spiking in February 2016 because it is carrying an extra short term cash advance it couldn't pay off last school year-plus another \$3.8 million in interest and penalties. After the State Treasury Department let the district defer repayment of last year's loan, it added \$14.8 million in costs to the district's \$6.6 million monthly debt service payments in October 2015, thereby increasing debt service payments to \$21.4 million in October. Now the debt payment is \$26 million in February 2016.
4. The school district's payroll and health care benefits are projected to cost \$26.8 million in February 2016-meaning the debt payments will be 97 percent of payroll. General fund operating debt payments that exceed 10 percent of payroll is a red flag. Debt service payments were 59.4 percent of payroll in October 2015.
5. To avoid a default, DPS has made debt payments before honoring bills for vendors and employee pensions. DPS owes the state's school employee pension system \$114 million-a bill that's expected to top \$157 million by July 2016.

¹ Since LPD could not obtain financial information from DPS substantiating its cash flow crisis, we are sharing information from recent newspaper articles as the main source of information describing DPS's cash crisis. As a result, LPD expresses no opinion regarding the accuracy and validity of the financial information contained in these articles per Attachment 1. However, Mr. Marios Demetriou, Deputy Superintendent of Finance and Operations of DPS informed LPD that "the reports (newspaper and media reports) that DPS could run out of cash in April 2016 are correct. According to our cash flow estimates we will be running out of cash sometime in April. I do have internal documents that substantiate this but I do not share internal documents outside our organization. I will have a slide in my presentation to City Council on Monday that deals with this".

6. The district has another \$40 million in vendor bills that are due more than 90 days past due.
7. DPS also has \$16.6 million in debt related to a program in which teachers loaned a portion of their paychecks to the district to help with its cash flow needs, money DPS promised to return when teachers left the district. Departing teachers have been getting the money.

Proposed Solution to DPS's Cash Flow Crisis

According to newspaper articles per Attachment 1², Governor Snyder wants lawmakers to approve \$50 million as a supplemental appropriation for 2015-16 to operate DPS while his plan for changes in the district works its way through the Legislature.

DPS's Financial Challenges

Beyond its cash flow crisis, DPS has the following financial challenges based on LPD's review of DPS's 2015 CAFR (Attachment 2) and the January 2016 CRC report (Attachment 3):

- The DPS reported an unassigned General Fund deficit of \$219.1 million at June 30, 2015 (Attachment 2)³. This was \$46.8 million more than the \$172.3 million deficit at June 30, 2014⁴.
- On a positive note, DPS originally estimated the deficit at June 30, 2015 to be \$70 million, according to DPS's website. DPS credits the lower actual deficit due to restructuring efforts including reductions in non-classroom expenditures, modifications to the district's healthcare benefits, and the personnel actions taken in conjunction with the ongoing restructuring of central office operations. DPS's website also indicates that enrollment losses of 10-11 percent a year went down to just 2.7 percent loss for fiscal year 2014-15.
- The FY 2016 DPS budget projects that the General Fund will have a \$312 million operating deficit at June 30, 2016.
- DPS has over \$3.5 billion outstanding in combined operating and capital liabilities⁵. This includes \$1.3 billion in employee legacy (retiree pensions and health care) costs and \$560.5 million in cash flow borrowings and almost \$1.7 billion in multi-year bonds, notes and State loans⁶. DPS failed to pay all its required pension and retiree health care contributions for the year ending June 30, 2015. DPS had an unpaid retirement contribution including interest and late fees of \$80.9 million in FY 2015. It is estimated that the delinquency, along with additional interest and late fee charges will increase to \$165 million by the end of FY 2016.⁷

² LPD has not received any detailed information from the State. LPD has no weigh to predict the outcome of the Governor's proposed 2015-16 supplemental bill to address DPS's immediate cash crisis.

³ Attachment 2 – DPS FY 2015 CAFR, page 20

⁴ Ibid, page 74

⁵ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness" See Table 1 and page 2

⁶ Ibid, pages 1 and 2 and Table 1

⁷ Ibid, page 7

- The average outstanding school district debt in the State of Michigan was \$12,629 per pupil debt on December 31, 2014. DPS’s average outstanding debt per pupil was \$35,653, on June 30, 2015, nearly three times the State average.⁸

DPS’s Academic Challenge

Detroit Public Schools, the state’s largest district, continues to struggle academically as well as financially. It was recently reported that DPS ranked last in academic achievement (4th and 8th graders) among urban districts nationally on the National Assessment of Educational Progress. This was the fourth time in a row that DPS ranked at the bottom of all large city districts in the country.⁹ At the same time, the district has been grappling with chronic operating budget deficits, growing liabilities and indebtedness, and challenges to meet payroll.¹⁰

DPS’s Debt and Legacy Cost Challenges

DPS has been under emergency management for approximately six years. While under emergency management, DPS has suffered the following debt and legacy cost challenges:

1. The DPS’s poor financial health is terminal. DPS is insolvent with more debt and obligations than it has cash to pay. DPS’s growing “cancer” has been its borrowing for the last several years to generate cash flow to repay debt incurred in prior years and to meet current operating obligations. DPS continues to borrow in the current year to pay the debt due for last year’s borrowing which was done to pay debt due for other past borrowing. DPS is essentially bankrupt and has been for years. There is not enough funding to provide DPS’s current students with a satisfactory education.
2. The amount of debt and legacy costs that DPS is currently obligated for is like the lead in Flint’s water, with the equivalent adverse consequences to DPS’s student’s educational development and ability to compete in the workforce of the future. The likely social burden of this disaster will adversely impact future generations and hinder if not stop the comeback of the City of Detroit.
3. Too much of the limited financial resources available to DPS go to pay debt and legacy costs such as retiree pensions and health care and not enough is available to provide a satisfactory education that children in the more affluent school districts receive. Rather than penalizing DPS’s children for the financial mistakes of the past, the State leadership needs to put them on an equal footing with the other students in the State.

The CRC in its report, “Detroit Public Schools’ Legacy Costs and Indebtedness” (Attachment 2), observed “Paying the debt service on the long-term debt will compete for resources the district receives to fund education services for today’s students. For the current year, 40 percent of the

⁸ Attachment 3 - CRC Report “Detroit Public Schools’ Legacy Costs and Indebtedness”, page 8

⁹ U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, National Assessment of Educational Progress (NAEP), various years.

¹⁰ Attachment 3 - CRC Report “Detroit Public Schools’ Legacy Costs and Indebtedness”, page 12

district's per-pupil funding will have to go towards repaying past cash flow borrowings. No other district is saddled with this type of burden currently.”¹¹

The inability to generate sufficient tax revenues from Detroit's property also is a significant contributing factor to DPS's woes. Because the 13 mills (maximum rate allowed) DPS levies on City property owners to pay its general obligation debt is insufficient to generate sufficient revenue to pay its annual debt service it has had to borrow from the State to meet its obligations.¹² The Michigan Constitution requires the State to provide loans to districts to help with debt service on capital debt. As of December 1, 2015, DPS owes the State \$198.7 million (total principal and interest) for loans to provide sufficient funds to meet its general obligation debt payments. The lack of revenue and the borrowing and repayment of the debt further take financial resources from the classroom.¹³

The State of Michigan has been complicit over the years in “kicking” DPS's financial problems “down the road”. It has contributed to the unsustainable debt load by authorizing and securing the DPS debt. The State has a large responsibility for DPS obligations. Any DPS bankruptcy would end up costing the State significantly. Also, the repercussions for other troubled school districts would fall to the State.

Furthermore, a DPS bankruptcy would force action on the \$37.7 billion unfunded legacy costs (as of September 30, 2014) of the Michigan Public School Employee Retirement System (MPERS).¹⁴ These legacy costs are a huge burden for the State's public education system that the State will ultimately have to come to terms with, as the City of Detroit did with theirs. Can the State shed the \$11.2 million of unfunded retiree health benefits included in the \$37.7 billion total MPERS unfunded legacy costs like Detroit did with its \$5.7 billion in unfunded Other Post-Employment Benefits (OPEB) obligations? The question becomes should the State continue to fail to meet these challenges head-on and pass the costs onto DPS and the other school districts in the state with the resulting diminished funding for education and the adverse impact on the quality of education provided to all the State's students or deal with them and absorb the pain and costs to do so? The consequences of the State's action on these challenges could be devastating to the entire public education system in Michigan.

The CRC report noted, “The consequences of DPS failing to pay the obligations as they come due also differ. This is an important consideration as [State] policymakers develop a plan to deal with DPS finances, both in the near term and the long term. In some cases of nonpayment the financial responsibility could fall to the State of Michigan (all taxpayers). In other instances where DPS is unable to liquidate a debt, other school districts could be responsible for picking up the cost. For capital debts, there may not be any change in responsibility as Detroit taxpayers pledged to repay the liability with a dedicated local property tax. And for other obligations, it is unknown who would be liable for the district's nonpayment because either a similar default has never occurred or state law is silent on the matter.”¹⁵

¹¹ [Attachment 3](#) - CRC Report “Detroit Public Schools' Legacy Costs and Indebtedness”, page 12

¹² Debt mileages are usually not reduced by tax incentives.

¹³ [Attachment 3](#) - CRC Report “Detroit Public Schools' Legacy Costs and Indebtedness”, page 11

¹⁴ Ibid, page 6

¹⁵ [Attachment 3](#) - CRC Report “Detroit Public Schools' Legacy Costs and Indebtedness”, page 2

The Governor's Plan to Address DPS's Plight

The Governor on his website "The Plan for Detroit Public Schools" stated, "Detroit Public Schools enrollment has dropped by nearly 100,000 students in the past decade, which greatly contributes to the district accumulating more than \$500 million in operating debt. That figure, combined with borrowing for buildings, puts the district at risk of collapsing financially. Such a collapse would greatly affect all Michigan school districts as the state is constitutionally responsible to cover many debts and liabilities, a figure that could be billions of dollars."

The Governor presented a legislative package on October 19, 2015 that creates a debt-free school district that will cost the State up to \$715.0 million over 10 years. This is primarily due to the anticipated debt service for cash flow borrowing, which is estimated to total \$515.0 million by June 30, 2016. It also includes approximately \$200.0 million for start-up costs for capital improvements and additional debt in the first few years. Under this proposal the "Old" DPS would repay the debt using the existing 18-mill non-homestead property tax millage, which currently makes up the local portion of DPS's school operating funds. The "New" DPS would collect State Aid payments in an equivalent amount to fund its operations. Both the new and old DPS would be overseen by the City of Detroit Financial Review Commission¹⁶ until the debt is repaid in full.¹⁷

State Legislation

Currently Senate Bill 710 is being developed to enact this proposed legislation. The Senate Bill proposes to separate DPS into a qualifying district ("Old" DPS) and a community district ("New" DPS) effective July 1, 2016. The community district would have borrowing authority. The Qualifying district would retain its taxing authority while the community district would not levy any basic operating millage. The State would have to pay 100% of the basic operating millage for the community district's public school operations through the State School Aid Fund. The cost to the State would be roughly \$71.0 million per year until the qualifying district's debt was repaid (estimated at 10 years). The Senate Bill estimates the State cost at \$717.0 million, which is the \$515.0 million cash flow debt and \$202.0 million start-up costs and other uses. The School Aid Act would need to be amended to provide the community district with the foundation allowance equal to the \$1,687 per pupil retained by the qualifying district to pay off the debt.¹⁸

Updated Proposal to Fund the "New" DPS

According to newspaper articles per Attachment 1, Governor Snyder is now proposing as part of his proposed FY 2017 budget to set aside \$72 million a year from tobacco settlement money for ten years to fund the "New" DPS start up and operational cost. Apparently, it was too difficult to convince state legislatures to use state aid funding to address DPS's financial challenges since that proposal could have reduced per pupil allowance amounts in other school districts throughout the State.

¹⁶ Senate Bill 711, amends the Michigan Financial Review Commission Act, and gives the Detroit Financial Review Commission oversight over a community school district under Senate bill 710. Attachment 5-Senate Fiscal Agency Bill Analysis, Senate Bill 711.

¹⁷ Attachment 2-DPS FY 2015 CAFR, Footnote 15, pages 52-53

¹⁸ Attachment 4- Senate Fiscal Agency Bill Analysis, Senate Bill 710

Ongoing Concern Regarding DPS's Future

While the State's action and intent to improve DPS's finances and academics are commendable, we believe the current legislation proposed to eliminate the DPS cash flow debt, which is expected to be \$515.0 million by June 30, 2016, does not go far enough. DPS's financial problems may be a precursor for the entire State's public education system finances. The State's public education system with \$37.7 billion of unfunded legacy costs has been and will continue to drain much needed funds from the classroom and short-change all the State's students education in the future. Unless these legacy costs are dealt with, other State school districts will experience in the future the financial and education issues that Detroit has been dealing with in the last few years.

The CRC report concluded with the following:

“After years of state control of DPS, state policymakers are again being called to develop a new approach to deal with the district's problems. Whether this means a complete abandonment of the current emergency manager regime is unknown at this time. What is clear is the fact that a policy response must be a first-order priority of state officials. And while policymakers' actions may be motivated by the longevity and sheer size of DPS's financial and academic problems, a call to action must be prompted by the nearly 48,000 Detroit schoolchildren and the fact that they are not currently receiving the quality education they deserve and are entitled.

Dealing with the myriad challenges will require a comprehensive approach. A plan that solves the district's money problems without addressing what is taking place in the classroom will not set the district up for future success. Similarly, any financial plan that only deals with the district's near-term fiscal woes (cash flow for example) will not prove lasting and will not support student learning over the long haul if current financial problems are shifted to future students. Financial and academic reforms will have to be packaged with governance reforms and build upon the litany of management reforms implemented under emergency managers.”¹⁹

Detailed Analysis

Detroit Public Schools (DPS) is an urban public school district located in the City of Detroit. It is a fiscally independent district governed by the Emergency Manager that was appointed by the Governor.

DPS has 103 schools, consisting of 7 early childhood schools, 62 elementary schools, 3 middle schools, 18 high schools, 2 alternative education schools, 7 special education schools, and 4 career technical and vocational centers.²⁰

The detailed analysis below is mainly excerpted from the CRC report, dated January 2016, “Detroit Public Schools' Legacy Costs and Indebtedness”.

¹⁹ Attachment 3 - CRC Report “Detroit Public Schools' Legacy Costs and Indebtedness”, pages 12-13

²⁰ Attachment 2-DPS FY 15 CAFR, page 6

Legacy Costs

Much of DPS's liabilities are related to legacy costs and includes \$1.3 billion that represents DPS's estimated share of the unfunded actuarial accrued liabilities for retiree pension (\$872.7 million) and health care (\$443.8 million) costs as of June 30, 2015.²¹

DPS legacy costs are the "tip of the iceberg" for the State's public education system. The State's public education system has similar problems with legacy costs, as the City of Detroit had with its legacy costs prior to its bankruptcy. The Michigan Public School Employees Retirement System (MPSERS) pension unfunded liability grew from \$7.5 billion on September 30, 2004 to \$26.5 billion on September 30, 2014. In addition, the unfunded liability for the State's public school employee's retiree health benefit program was \$11.2 billion on September 30, 2014.²² These unfunded pension and retiree health benefit programs pose significant financial challenges for the State and its public education system.

The State attempted to address the legacy cost issue by making significant changes to MPSERS in 2012. A number of the reforms addressed the growth in the unfunded liabilities and the corresponding employer contribution rates. Additionally, the reforms established a cap on the combined (pension and retiree health) employer contribution rate for unfunded liabilities. Beginning in FY 2013, the cap is fixed at 20.96 percent of payroll by state law. Any amount above the capped employer contribution is provided by the state from an "off-the-top" allocation of School Aid Fund [various State revenues sources such as income and sales taxes fund the School Aid Fund] dollars, the state stabilization rate. The total employer contribution rate for all school districts participating in MPSERS in FY 2016 is 25.8 percent of payroll. The State of Michigan's share amounts to 10.5 percent of payroll. For every \$1 paid in wages by a school district, MPSERS receives 36.3 cents (25.8 from school districts and \$10.5 from the State).²³

The reduced employer UAAL payments combined with the increase in the total unfunded liability means the State of Michigan is picking up a larger share of the funding responsibility for school districts' legacy costs. The State's contribution, paid from the School Aid Fund, has increased from \$160 million (the equivalent of 1.6 percent of payroll) in FY 2013 to \$894 million (10.5 percent of payroll) in FY 2016. Because MPSERS is a multi-employer, cost-sharing plan and given the current mechanics of the employer rate cap, the ultimate responsibility for funding DPS's legacy costs falls directly to the State of Michigan and the portion of the UAAL paid through the state stabilization rate. Specifically, this portion of the pension liability is picked up by an annual appropriation from the School Aid Fund. If DPS is unable to contribute to MPSERS, funding DPS's share of the system's legacy costs becomes the responsibility of every other school district. This is because with an increase in the State share paid directly by the School Aid Fund, there are fewer School Aid Fund dollars to distribute among all districts, either through the per-pupil foundation allowance or categorical grants.²⁴

As required under new accounting standards (Governmental Accounting Standards Board – (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions), the State of

²¹ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", page 2 and Table 2

²² Ibid, page 6

²³ Ibid, Chart 1, page 4

²⁴ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", page 5

Michigan did an analysis to determine each participating employer's proportionate share of the \$22.4 billion MPSERS net pension liability. Under the new GASB standard, the proportion for each employer is to be consistent with the determination of pension plan contributions. Contributions are based on a district's reportable payroll. Because DPS has the largest workforce and payroll, the district is responsible for the largest share of the MPSERS net pension liability. According to the State's calculation, DPS's share of the liability is 3.96 percent or \$872.7 million.²⁵ This is reported in DPS's FY 15 CAFR.

MPSERS also has unfunded OPEB liabilities totaling \$11.2 billion as of September 30, 2014. GASB Statement No. 75 will require similar treatments of the OPEB liability as the pension liability under GASB 68. The new standard takes effect for fiscal years beginning after June 15, 2017. This means Michigan school districts will have to carry their proportionate share of the MPSERS OPEB liability on their FY 2018 financial statements. Using DPS' current proportionate share of the pension liability (3.96 percent), it is estimated that the district's share of the total OPEB liability is \$443.8 million. If the OPEB liability was required to be presented in the district's FY 2015 financial statements, DPS's total MSPERS liability (pension and retiree health) would be \$1.3 billion.²⁶

Termination Incentive Plan

In 2009, DPS Emergency Financial Manager Robert Bobb designed a plan to help ease the district's cash flow problems by reducing current employee paychecks and using the funds to cover other operational expenses. The program, called the Termination Incentive Plan (TIP), was included in the 2009-2012 collective bargaining agreement between the district and the Detroit Federation of Teachers. Under this program, the majority of district employees had \$250 deducted from each paycheck beginning in January 2010 and ending in December 2012. The deducted funds were deposited in a TIP account for each member to be made available upon their separation from the district. Upon separation, participating employees are entitled to a termination of service bonus equal to \$1,000 for each year of service up to 9 years (cap of \$9,000 per employee). The program effectively allowed DPS to receive a \$9,000 interest-free loan from each employee.²⁷

Roy Roberts, the district's emergency manager appointed in 2011 suspended the program in 2011 prior to its scheduled 2012 end date. Over the life of the plan, \$49 million was deducted from employee paychecks with the promise that these funds would be returned in the future. In effect, the TIP represented a postemployment benefit separate from the pension and retiree health benefits provided through MPSERS and entirely funded by the district (as opposed to the cost-sharing arrangement of MPSERS).

While the program was created to help the district with its cash flow for a couple of years, it also created another long-term liability. Based on the valuation report as of June 30, 2015, the TIP's unfunded liability is \$16.6 million. The district is required to pay off this liability over the next three fiscal years using current revenues. In FY 2015, the district contributed \$2.3 million towards the liability.²⁸

²⁵ Ibid, page 6

²⁶ Ibid, pages 6-7

²⁷ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", pages 7-8

²⁸ Ibid, page 8

Debt

Detroit Public Schools has borrowed money for a number of purposes, including to provide cash for operations, to finance its operating deficit, and to finance capital expenditures. Annually, the district issues short-term notes to help with its cash flow throughout the fiscal year. This borrowing requires repayment within a 13-month period from current- year resources. Additionally, the district has issued various forms of long-term debt, largely bonds payable over 10 to 30 years. “Limited tax” bonds are limited tax general obligation bonds repaid from the district’s general operating funds; “unlimited tax” general obligation bonds are backed by the full faith and credit of the district and are repaid from unlimited property tax levies subject to voter approval. As of August 31, 2015, DPS had \$1.7 billion in long-term debt outstanding. Of the total, \$1.5 billion is unlimited general obligation debt backed by a dedicated property tax and \$259 million is limited debt repaid from a pledge of the district’s state aid (primarily the per pupil foundation allowance).²⁹

Cash Flow Borrowing

DPS had \$463.0 million in debt obligations (bonds and notes) on June 30, 2015, issued to provide cash for its obligations and operations. The debt service on this debt comes from the DPS General Fund and reduces the amount of funding for education. The debt included: (1) \$259.2 million of notes payable issued in 2011 and 2012; (2) \$82.8 million of short-term notes payable issued in 2014 to refinance cash flow borrowing; and (3) \$121.0 million of bonds payable issued in 2015 for cash flow borrowing.

In August 2010, the district borrowed \$420 million to help with its cash flow during the 2010-11 school year. Faced with other fiscal pressures and an inability to bring spending within the limits of available resources, it became apparent during the year that the district would be unable to repay some of the notes within the year. In order to avoid a default, the state through (the emergency manager) authorized the district to issue \$231 million in 10- year notes to refinance a portion of the unpaid cash flow borrowing. This had the effect of converting short-term borrowing to a long-term liability, paid from future general operating revenues the district receives. The state’s Michigan Finance Authority issued the debt on behalf of DPS and required the district to pledge a portion of its state aid as repayment. This means that the debt service competes for resources that would otherwise go to general operations (classroom instruction, supplies, etc.). The notes carry an interest rate of 4.75 percent and will be fully repaid in 2021.³⁰

The 2011 debt was not the first time the district converted short-term borrowing to long-term debt. In 2005, the district was under the control of the mayoral-appointed school reform board. To avoid defaulting on its cash flow borrowing, the district converted \$210 million in cash flow borrowing to long-term debt in April 2005. To do this, the district issued special purpose bonds payable over 15 years. The plan required the debt service payments to begin in 2007 (\$16 million in 2007 and \$22 million each year after) and for the debt to be fully repaid by June 2020. This borrowing was part of the district’s multi-year deficit elimination plan approved by state officials earlier in 2005.³¹

²⁹ Ibid, page 8.

³⁰ [Attachment 3](#) - CRC Report “Detroit Public Schools’ Legacy Costs and Indebtedness”, page 10

³¹ Ibid, page 10

By the end of FY 2011, DPS still had \$141 million of the original \$210 million 2005 bonds outstanding; however, the district was now under the control of the state-appointed emergency manager. In May 2012, the emergency manager asked for approval from the Michigan Finance Authority to refinance the remainder of the original special purpose bonds to take advantage of lower interest rates. The Authority refinanced the debt but maintained the final maturity date of June 2020.³²

With the debt issued in 2011 and 2012 (originally in 2005), DPS was allowed to extend the repayment of its cash flow borrowings well beyond the years in which the original borrowed funds were used for school operations. At June 30, 2015, the district had a total of \$259 million outstanding between the two issues.³³

As noted, the 2011 and 2012 notes were issued by the Michigan Finance Authority, not DPS. While the debt does not represent a general obligation of DPS, the Michigan Finance Authority, or the State of Michigan, it is a limited obligation of the Authority payable from pledged DPS state aid payments. The 2011 long-term notes represent a first lien obligation, meaning that the district is required to allocate a sufficient amount of its state aid to cover the debt service before making any other expenditure. Similarly, the 2012 notes represent a second line obligation. For the 2015-16 school year, total debt service for these borrowings is \$53 million, which amounts to about \$1,100 per student. In the absence of the DPS state aid payments, it is not clear how the Michigan Authority would pay bondholders as the Authority does not have taxing authority.³⁴

For the 2014-15 school year, DPS issued \$107.8 million in cash flow notes in August 2014. In May 2015, district officials notified the state that repaying the full amount borrowed by August 2015 would create cash flow problems later in the year. To avoid a possible default and to head off a cash shortage in the last months of the year, the Michigan Finance Authority issued \$82.8 million in short-term notes to refinance a portion of the original borrowing. These proceeds, along with \$29.5 million in state aid set aside during the 2014-15 school year, were used to repay the original \$107.8 million notes. While this provided a financing mechanism for the original 2014-15 notes, it effectively pushed repayment of the borrowing into the 2015-16 school year.³⁵

The refinanced cash flow notes will have to be covered by the state aid payments the district receives during the 2015-16 year. Repayment was scheduled to begin in October 2015 and the notes completely repaid by June 2016. This will have the effect of reducing the amount of state aid funding available for current operations (similar to the debt service requirements of the 2011 and 2012 notes). The difference being that the 2014-15 refinanced cash flow notes will be repaid within a period of 12 months as opposed to over a period of 10 to 15 years.³⁶

For the 2015-16 school year, DPS will have to pay \$53 million to service the 2011 and 2012 notes and repay the \$82.8 million notes (\$87 million with interest) from the 2014-15 borrowing. In total, the district will pay \$140 million, nearly \$3,000 per pupil, to finance the costs of past cash flow

³² Ibid, page 10

³³ Ibid, page 10

³⁴ Ibid, page 10

³⁵ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", pages 11,12

³⁶ Ibid, page 12

borrowings (See Table 4). Additionally, there are interest costs associated with the 2015-16 cash flow borrowing that will have to be paid from current revenues in the 2015-16 school year.³⁷

On September 16, 2015, the Michigan Finance Authority issued \$121,200,000 in State Aid Revenue Notes, Series 2015E, School District of the City of Detroit, maturing on August 22, 2016 in the amount of \$121.2 million. The notes carry an interest rate of 5.75 percent. The proceeds from the sale of these notes will provide the District with funds to meet its cash flow requirements in fiscal year 2016. The District's State Aid revenue is pledged to repay this obligation, and amounts are set-aside from State Aid revenues due the School District sufficient to retire this obligation at maturity.³⁸

Converting cash flow borrowing to long-term debt is not an acceptable practice. It was done only one other time [in the State] to facilitate the merger of the Ypsilanti and Willow Run school districts and to assist the districts with deficit reduction.³⁹

General Obligation Debt

Of the total \$1.7 billion of DPS general obligation debt outstanding at June 30, 2015, \$1.5 billion is "unlimited" general obligation debt backed by a dedicated property tax and \$259 million is "limited" debt repaid from a pledge of the district's state aid (primarily the per-pupil foundation allowance). For the current year, DPS will pay \$191.3 million in principal and interest on its long-term debt.⁴⁰

Per the state Constitution, voters must approve the sale of unlimited general obligation debt. Unlike limited tax debt, unlimited debt does not compete with a district's general funds because it is repaid from the proceeds of a property tax levy that is set at a millage rate that is recalculated annually to generate sufficient funds to service the debt.⁴¹

Nearly every Michigan school district issues debt to fund capital improvements, major maintenance, and for other purposes. This debt is issued within limits established by the Michigan Constitution and state laws. The total amount of outstanding school district debt [in the State of Michigan] on December 31, 2014, was \$15.4 billion. Districts vary in their use of long-term debt as a financing tool, but on average, this equated to approximately \$12,629 per pupil in outstanding debt.⁴² As of June 30, 2015, DPS had \$1.7 billion in long-term debt outstanding. This equated to approximately \$35,653 per pupil in outstanding debt nearly three times the average for all State school districts.⁴³

Detroit Public School voters were last asked to approve unlimited general obligation debt in 2009. In November 2009, voters authorized the district to borrow up to \$500.5 million for various capital investments. The district issued the full amount of bonds under this authorization in 2009 and

³⁷ Ibid, page 12

³⁸ Attachment 2 - DPS FY 2015 CAFR, Footnote 19, Subsequent Event, page 55

³⁹ Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", pages 10-11

⁴⁰ Ibid, Table 3, pages 8-9

⁴¹ Ibid, page 11

⁴² Attachment 3 - CRC Report "Detroit Public Schools' Legacy Costs and Indebtedness", page 8

⁴³ Ibid, page 9

2010. As of June 30, 2015, the district had approximately \$1.5 billion in total unlimited general obligation debt outstanding.⁴⁴

All of the DPS district's general obligation debt is "qualified" by the State of Michigan through the School Bond Qualification and Loan Program. This program provides a state credit enhancement and loan mechanism for school district debt issues. Districts that receive qualification from the state receive a rating on the bonds equal to the state's credit rating, which will often result in a lower interest rate and cost, and the ability to borrow from the state an amount sufficient to enable the district to pay principal and interest requirements on its outstanding qualified bonds in the short-run if its property tax levy is insufficient to pay the full debt service (a minimum debt millage of seven mills must be levied before a district can borrow from the State).⁴⁵

To service its general obligation debt, DPS levies a debt millage of 13 mills, the maximum rate that a district is allowed to levy under the School Bond Qualification and Loan Program. The district has been levying its debt millage at the maximum rate since before 2009, when voters approved the \$500 million bond sale. The proceeds from the debt millage levy, along with loans from the State of Michigan, are used to make the annual principal and interest payments.⁴⁶

The Michigan Constitution requires the state to provide loans to districts to help with debt service on capital debt. The School Bond Qualification and Loan Program ensures that property-poor districts are able to access capital financing without being overburdened by debt repayment obligations. The capital liabilities, along with the state loans outstanding related to the debt, will remain with DPS.⁴⁷

While the annual debt service payments have been level in recent years (approximately \$139 million), the DPS district has been forced to regularly borrow funds from the state to make the required principal and interest payments. This is because the yield from the 13-mill debt levy has declined with the reduction in taxable value in the City of Detroit. In recent years, the district borrowed \$33.5 million (FY2013), \$44.9 million (FY2014), and \$28.4 million (FY2015). As of December 1, 2015, DPS owes the state \$198.7 million (total principal and interest) for loans to provide sufficient funds to meet its general obligation debt payments.⁴⁸

The City of Detroit charged its property owners 31.3415 mills for DPS including the 13 mills for debt service. An additional 6 mills for the State Education Tax (SET) was also charged to Detroit property owners for education. This contributes to the total 84.7979 mills Detroit property owners were charged by the City, DPS, Wayne County and Library for the 2014 tax year, which was among the highest property tax rates in the country.⁴⁹ These high property tax rates discourage homeownership and business investment in the City. The only way the City can encourage homeownership and development is to offer tax abatements that negates the amount of tax revenues the City collects to pay for debt, legacy costs and other services necessary for a City to

⁴⁴ Ibid, page 11

⁴⁵ Ibid, page 11

⁴⁶ Ibid, page 11

⁴⁷ Ibid, page 12

⁴⁸ Ibid, page 11

⁴⁹ City of Detroit FY 2015 Budget Redbook

succeed. The City needs to reduce the property tax millage rate to encourage home ownership and businesses development in the City.

Governor's Plan

On October 19, 2015, Governor Snyder presented a legislative package for Detroit Public Schools that is focused on a financially sound system and provide families with more quality educational options. He announced that creating a debt-free school district will cost the state up to \$715 million over 10 years. This is due to the operating debt expecting to increase to \$515 million by June 30, 2016 and the new district requiring \$200 million for related start-up costs for capital improvements and additional debt expected in the first few years. Under this proposal, the Old DPS would repay the debt using an existing 18-mill non-homestead property tax millage which expires in 2022, which currently makes up the local portion of the school operating funds. In addition, the proposal calls for the New DPS to collect all of the State Aid payments allocable to the district to fund its operations.⁵⁰

The proposed legislative package includes:

- Creating a new, traditional public school district – the Detroit Community School District which would educate the students (New DPS), with the current Detroit Public Schools existing to address the debt (Old DPS). The students, employees, contracts, employee benefits, and assets would move to the new district. The Governor's proposal includes DPS as well as the EAA and the charter schools. The new district would be governed by a seven-member board initially appointed by the Governor and the mayor of Detroit which would transition to an elected board in 2021.
- A Detroit Education Commission would be created, appointed by the governor and mayor, to engage with the community in hiring a Chief Education Officer. This Officer would hold the low-performing schools accountable and reward and increase the number of high-performing schools.
- The Chief Education Officer would operate a common enrollment system with common forms, enrollment periods and notification dates that will assist parents in identifying and evaluating their options in order to choose school's that is best for their children's needs.
- This restructuring plan calls for the New DPS and Old DPS to be overseen by a Financial Review Commission until the District's debt is repaid in full.

Senate Bill 710

Senate Bill 710, Senate Fiscal Agency, analysis dated February 5, 2016⁵¹, would provide for the transfer of a "qualifying school district" (Detroit Public Schools) to a proposed "community district" on July 1, 2016, and provide that the qualifying school district would retain a limited

⁵⁰ Attachment 2 - Note 15 DPS FY 2015 CAFR, pages 52-53

⁵¹ Attachment 4 – Senate Fiscal Agency Bill Analysis, Senate Bill 710

separate identity and its territory would continue as a separate taxing unit for the purpose of repaying outstanding debt until the debt was retired. The bill would include the following:

- Provide that the community district would be subject to the financial oversight of the financial review commission in place for the City of Detroit.
- Extend borrowing authority to the community district.
- Appropriate \$250,000 from the State of Michigan General Fund to the Department of Treasury for Fiscal Year 2015-16 for the purpose of providing financial support for the organization and administration of the community district during that fiscal year.
- Allow the district, with the approval of the State Treasurer, to issue “school financing stability bonds” for the purpose of eliminating an operating deficit or refunding or refinancing outstanding State aid anticipation notes issued through the Michigan Finance Authority; to pledge as security for repayment State school aid payment, school operating tax revenue, or other revenue; and to enter into an agreement with the Department of Treasury or the Michigan Finance Authority for direct payment of school aid to the Authority or a designated trustee.
- The financing of the DPS debt would be paid by allowing the “old” district (the “qualifying district”) to retain its identity as a taxing authority, while the “new” district (the “community district”) would not levy basic operating millage to finance its foundation allowance (requiring the State to pay 100% of the community district’s per-pupil funding), then the cost to the State of this proposal would be roughly \$71.0 million per year until the qualifying district’s debt was repaid (estimated at 10 years). The existing debt is estimated by the Department of Treasury to total \$515.0 million. The bill would allow for transitional operating costs not to exceed 3% of the taxable value of the qualifying school district (in this case, 3% of DPS’ taxable value is roughly \$202.0 million) to be included in school financing stability bonds, thereby adding the \$202.0 million to the \$515.0 million in existing debt, for a total of an estimated \$717.0 million, which would be the cost to the State if the proposed plan were enacted.
- DPS levies 18 operational mills, which brings in \$71.3 million yearly. This equates to \$1,687 per general education pupil, which is applied toward DPS’\$7,434 per-pupil foundation allowance, and the State makes up the difference of \$5,747 per general education pupil. (This is the same formula calculation for all districts: districts are required to levy mills for basic operations, and the State pays the difference between what is received in local revenue and the district’s foundation allowance, capped at the basic foundation allowance. Foundation allowances for charter schools are 100% State funded because charters do not levy mills).
- The School Aid Act would need to be amended to provide the new district with the Foundation allowance funding equal to the \$1,687 per pupil retained by the old district to pay off debt. This would trigger the fiscal impact on the State, estimated at \$71.0 million per year, which is equal to the diversion of the operating taxes to pay off debt – the \$515.0

million existing debt, plus the maximum \$202 million proposed under the bill for allowable transition costs.⁵²

Updated Proposal to Fund the “New” DPS

According to newspaper articles per Attachment 1, Governor Snyder is now proposing as part of his proposed FY 2017 budget to set aside \$72 million a year from tobacco settlement money for ten years to fund the “New” DPS start up and operational cost. Apparently, it was too difficult to convince state legislatures to use state aid funding to address DPS’s financial challenges since that proposal could have reduced per pupil allowance amounts in other school districts throughout the State.

The newspaper articles also indicate that Michigan’s tobacco settlement fund-established from a 1988 settlement of a multibillion-dollar lawsuit between 48 states and the U.S. tobacco industry-generates about \$193 million a year, of which \$75 million supports economic development efforts and \$17.5 million a year for 20 years is paying for the grand bargain that helped settle Detroit’s Chapter 9 bankruptcy by supporting City of Detroit pensioners and protecting the art collection of the Detroit Institute of Arts.

Questions for DPS

- 1. What is DPS’s short term solution to avoid running out of cash flow in April 2016 if the Governor is unsuccessful in getting a supplemental bill through for 2015-16 to address the district’s cash flow needs?**
- 2. Will the proposed Plan by the Governor and State Legislation (Senate Bill 710) be sufficient to remedy DPS’s financial problems?**
- 3. What are DPS’s biggest financial challenges?**
- 4. What will it take to make DPS financially solvent?**
- 5. Can DPS find other revenues, other than property taxes to fund education?**
- 6. How is DPS dealing with the large legacy costs for pensions and retiree health care? How will these obligations be funded?**
- 7. Has any consideration been given by DPS to cutting or eliminating retiree health care benefits?**
- 8. What is the DPS per-pupil spending after debt service and legacy costs are taken out?**

⁵² Attachment 4 – Senate Fiscal Agency Bill Analysis, Senate Bill 710

- 9. Has any benchmarking been done of other school districts per pupil spending for education? What does the Troy school district spend per-pupil? What does the Grosse Pointe school district spend per-pupil?**
- 10. What is the process for DPS to receive a larger per pupil allowance for the district?**
- 11. Will DPS be able to honor its obligations under the Termination Incentive Plan?**
- 12. Is bankruptcy an option for DPS? What positive benefits would DPS obtain from a bankruptcy?**
- 13. In Note 4. Of the DPS 2015 CAFR (page 36), Due from Other Governmental Units total \$94,988,283. Who are these from? Are any due from the City of Detroit? If so, how much is due from the City? Are these collectable?**
- 14. On page 18 of the DPS 2015 CAFR, the Accrued Salaries and benefits are \$124,319,172. Why is this balance so large? What is included in this total?**
- 15. On page 18 of the DPS 2015 CAFR, the Net Investment in capital assets is a negative \$126,652,164. Why is this balance negative?**
- 16. How much of the \$ 714,030,093 total expenditures of the DPS General Fund (page 22 of the 2015 CAFR) are legacy costs (pension and retiree health) and debt service costs?**

Attachment 1

Recent News Articles on DPS Cash Flow/Financial Crisis and Proposed State Contribution

DPS debt payments mount to unsustainable levels



Chad Livenood, Detroit News Lansing Bureau 12:14 p.m. EST January 4, 2016



(Photo: John T. Greilick / The Detroit News)

Lansing — The debt payments of Detroit Public Schools — already the highest of any school district in Michigan — are set to balloon in February to an amount nearly equal to the school district’s payroll and benefits as the city school system teeters on the edge of insolvency.

Detroit Public Schools has to begin making monthly \$26 million payments starting in less than a month to chip away at the \$121 million borrowed this school year for cash flow purposes and \$139.8 million for operating debts incurred in prior years. The city school system’s total debt payments are 74 percent higher from last school year.

The debt costs continue to mount while Gov. Rick Snyder and the Legislature remain at odds over how to rescue Michigan’s largest school district. A bankruptcy of the district could leave state taxpayers on the hook for at least \$1.5 billion in DPS debt.

The school district’s payroll and health care benefits are projected to cost \$26.8 million in February — meaning the debt payments will be 97 percent of payroll. General fund operating debt payments that exceed 10 percent of payroll are “a major warning flag,” municipal bond analyst Matt Fabian said.

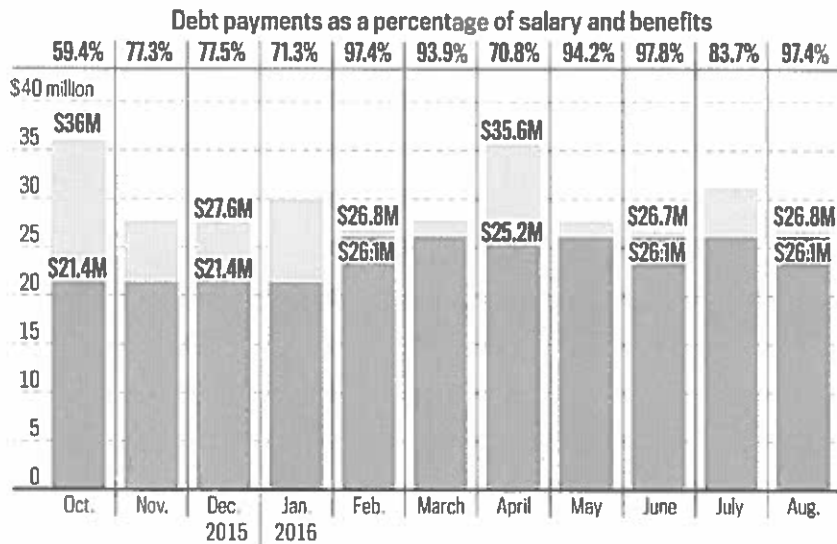
“That’s extremely high,” said Fabian, managing director of Municipal Market Advisors in Concord, Massachusetts, who also followed the city of Detroit’s bankruptcy case. “That’s no longer, really, a normal school district. The school district has turned into a debt-servicing entity. It’s making its own mission impossible.”

As a result, the Detroit district won’t have enough cash to pay any bills in four months.

Ballooning debt

Starting in February, monthly debt payments for Detroit Public Schools will begin rivaling what the district spends on employee salaries and benefits each month for the remainder of the school year.

KEY
 Payroll & benefits
 Debt payments



Sources: Detroit Public Schools; Michigan Finance Authority

The Detroit News

“We’re running out of money in April,” said Marios Demetriou, deputy superintendent of finance and operations at DPS. “We need help to fix the school district once and for all. Our kids deserve a good education and when you don’t have cash there are things that are lacking.”

Financial analysts say the skyrocketing debt payments owed to the state expose an unprecedented amount of money being diverted from classroom instruction to pay off past debts, even as the city school system eliminates 100 central office jobs this month.

The Detroit district’s payments on old debts — some dating back a decade or longer — amount to \$3,019 of the \$7,296 per student grant the district will receive from the state this school year, a Detroit News analysis of public records shows.

"That's \$3,000 that isn't available for each kid this year, and it pays for the education of kids 10 to 15 years ago," said Craig Thiel, senior research associate at the Citizens Research Council of Michigan. "They're as close as they've ever been to being insolvent, where you've got multiple bills that are owed to the state that have gone unpaid."

The operating loans are owed to a state revolving loan fund, which analysts say is the district's only available lender.

"For DPS, unfortunately, the only entity they can borrow money from right now is the state of Michigan," Thiel said. "If they were to go to Comerica Bank and try to get a line of credit, they'd probably laugh them out the door."

Why debt payments rising

At issue among state lawmakers is how to pay for the Detroit school system's \$515 million in past debts and unpaid vendor and pension bills and about \$200 million Snyder has requested for assistance in creating a new debt-free Detroit school district.

Legislators on both sides of the aisle have expressed support for aiding the Detroit district, but no legislation has been introduced after eight months of talks.

Detroit district officials and financial analysts said lawmakers have as little as two-and-a-half months to address the problem — since the 46,325-student district has lost 100,000 pupils in the past decade and may need to borrow more money this spring to keep its 103 school buildings open through June.

"This is a really serious problem," said Jeff Williams, CEO of Public Sector Consultants in Lansing. "There's such a cash flow crunch looming for DPS."

The district's debt payments are spiking in February because it is carrying an extra \$83 million short-term cash advance it couldn't pay off last school year — plus another \$3.8 million in interest penalties, records show. After the state Treasury Department let the district defer repayment of last year's loan, it added \$14.8 million in costs to the district's \$6.6 million monthly debt payments in October.

But to make payroll this year, the district borrowed another \$121 million through an advance on its state aid, which is common among school districts because they do not receive a payment from the state in September.

"The State Aid note borrowings were necessary in order for the district to be able to continue operating and educating its students," Treasury spokesman Terry Stanton said in an email.

Fabian, the bond analyst, said the Treasury Department's continued short-term loans have put the Detroit district "in an impossible position."

"How is there any expectation that they could pay that back?" Fabian said. "Just loaning DPS money that it can't possibly pay back doesn't fix the long-term problem."

Bills piling up

Financial analysts say the year-after-year borrowing shows the school district is on a fiscally unsustainable path.

"There's not a layperson on the street who would call that a sustainable business model," Williams said.

As a percentage of payroll, DPS debt payments on a monthly basis range from a low point of 59 percent in October to a projected 97 percent in February, June and August, a Detroit News analysis shows.

The Detroit school district's August budget plan calls for borrowing another \$80 million in June from the state for cash flow purposes before its fiscal year ends June 30, records show.

To avoid a default, the district has made the debt payments before honoring bills for vendors and [employee pensions](#) ([/story/news/education/2015/03/26/detroit-schools-finances-free-fall/70469838/](#)). DPS owes the state's school employee pension system \$114 million — a bill that's expected to [top \\$157 million by July](#) ([/story/news/politics/2015/10/27/detroit-school-debt-relief-legislature/74687854/](#)).

The district has another \$40 million in vendor bills that are more than 90 days past due, Demetriou said.

In March, Moody's Investors Service downgraded the school system's credit rating with a negative outlook given the mounting debts, low cash flow and "sustained financial stress."

In August, DPS projected it would be down to \$10 million in cash-on-hand by the end of May, in part because of this year's higher debt repayments.

"If you look at overall their cash low point is about \$10 million and if you compare that to a \$660 million overall general budget, that's very narrow," said Andrew Van Dyck Dobos, a public finance analyst at Moody's Investor Service. "It's very tight."

A tight window

The Detroit district is starting 2016 with 100 fewer positions in central administration, reductions that resulted in layoff notices last month, Demetriou said.

A Detroit News analysis last year found Detroit had among the state's highest per-pupil costs (</story/news/education/2015/03/26/detroit-schools-finances-free-fall/70469838/>) for administration in districts with more than 1,000 students.

"We have to find work-arounds in a lot different areas to make things work," Demetriou said.

Republicans and Democrats alike have resisted tapping the School Aid Fund for bailing out DPS because it would come at the expense of Michigan's other 600 school districts and 300 public charter schools.

House Minority Leader Tim Greimel, D-Auburn Hills, said the escalating debt costs for the Detroit district is "another good reason why the state needs to help resolve the fiscal distress of the Detroit Public Schools system."

"But again, the state needs to do so in a way that does not adversely affect the finances of other school districts," Greimel said.

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Report: DPS owes \$3.5B; out of cash in April?



Ann Zaniewski, Detroit Free Press Education Writer 10:20 a.m. EST January 15, 2016



(Photo: Detroit Free Press)

A new report says Detroit Public Schools' total debt tops \$3.5 billion, while district officials are warning that DPS is in danger of running out of cash this spring.

The report, released today by the Citizens Research Council of Michigan (http://crcmich.org/detroit_schools_legacy_costs_indebtedness/), offers the first detailed breakdown of employee legacy costs and sheds light on how the district's borrowing practices have added to the crisis, said Craig Thiel, senior research associate for the council. It urges state officials to take quick action.

"The sheer size of the debts suggests that the district isn't going to be able to get out of them on their own," Thiel said. "The takeaway is, something has got to be done. It can't be business as usual. Business as usual has always added to the problem."



DETROIT FREE PRESS

Can consent agreement help turn around Pontiac schools?

(<http://www.freep.com/story/news/local/michigan/oakland/2016/01/01/pontiac-school-district-consent-agreement/77741448/>)

The growing debt crisis comes as lawmakers in Lansing continue to grapple with how to address it.

The report says DPS has \$1.9 billion in operating liabilities, which are mostly employee legacy costs — such as unfunded pension benefits — and also include past cash flow borrowing. The district has another \$1.7 billion in debt related to bonds and state loans for capital improvements.

The numbers are based on the district's audited financial report for the 2014-15 school year, which was publicly released last month. Some debts have grown since the end of the last fiscal year, Thiel said.

Michelle Zdrodowski, spokeswoman for Detroit Public Schools, said the district projects it will run out of cash in April. Meanwhile, district officials continue to look for ways to save money.

Under employee legacy costs, the district's liabilities to the Michigan Public School Employees Retirement System include \$872.7 million in unfunded pension costs and \$443.8 million in unfunded retiree health costs, according to the report.

DPS is currently \$117 million behind on payments to the system, Kurt Weiss, spokesman for the state budget office, said Tuesday.

The district also has \$16.6 million in debt related to a program in which teachers loaned a portion of their paychecks to the district to help with its cash flow needs, money DPS promised to return when teachers left the district. Departing teachers have been getting the money.

"The liability they created when they created that program has been entirely unfunded," Thiel said.

The report also says DPS has repeatedly taken out short-term loans but then, through refinancing, converted them into long-term liabilities that became a financial burden. Most of that was done while the district was under governor-appointed emergency managers during the last six years, Thiel said.

"They have consistently made short-term liabilities into long-term liabilities, which has hampered the ability of the district to educate kids in the next year, and then the year after that," he said.

During the current school year, 40% of the district's per-pupil funding it receives from the state will have to go toward repaying past cash-flow borrowings, the report says.

Starting next month, the monthly payment DPS makes on all debt secured by state aid will spike to \$26.1 million. The district had deferred making payments for several months so it would have enough money to keep operating, said Terry Stanton, spokesman for the Michigan Department of Treasury. Deferrals eventually lead to higher payments, which for DPS began in October at just more than \$21 million a month.

The report says if DPS fails to pay its debts, the burden could fall on a combination of state taxpayers, Detroit taxpayers and other school districts. In some cases, as with the loans from the teachers to DPS, it's unclear what would happen.

Zdrowski said DPS continues to undergo a restructuring of its central office that began last year and is expected to save \$10 million. DPS has also modified employee health care benefits, she said, and is looking for ways to cut costs that won't impact classrooms.

Last spring, Gov. Rick Snyder proposed a plan that would split DPS into a "new" district that would educate children and an "old" district that would pay off the district's operating debt. The plan, which could cost the state up to \$715 million over 10 years, would add extra oversight to schools across the city, including charters.



DETROIT FREE PRESS

[Cass Tech closes for teacher sick-out, organizer says](#)

<http://www.freep.com/story/news/local/michigan/detroit/2016/01/05/cass-tech-closes-teacher-sick-out/78296240/>

But the proposed package of bills has stalled for months amid concerns from some lawmakers over governance and financing.

Sen. Geoff Hansen, R-Hart, said the proposal has been tweaked could be introduced in the Legislature as soon as next week.

Contact Ann Zaniewski: 313-222-6594 or azaniewski@freepress.com. Follow her on Twitter: [@AnnZaniewski](https://twitter.com/AnnZaniewski).

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Charters get free pass in DPS bills

The Detroit Free Press Editorial Board 10:52 p.m. EST January 14, 2016



(Photo: Getty Images)

The good news is that after months of foot-dragging, Michigan's Republican legislative leaders have finally accepted Gov. Rick Snyder's challenge to address a financial crisis that threatens to drive the state's largest school district into bankruptcy before the end of the current school year.

The bad news is that two bills introduced Thursday by Sen. Goeff Hansen, R-Hart, make no provision for what Snyder and Detroit Mayor Mike Duggan have identified as a critical element of any sustainable rescue plan: a Detroit Education Commission to enforce a single performance standard for traditional public schools as well as the taxpayer-funded charter schools that now serve more than half the district's K-12 population.



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[DPS legislation drawing fire from Detroit lawmakers](http://www.freep.com/story/news/politics/2016/01/14/dps-legislation-drawing-fire-detroit-lawmakers/78796254/)

[\(http://www.freep.com/story/news/politics/2016/01/14/dps-legislation-drawing-fire-detroit-lawmakers/78796254/\)](http://www.freep.com/story/news/politics/2016/01/14/dps-legislation-drawing-fire-detroit-lawmakers/78796254/)

The bills' implicit intention to hold DPS's feet to the fire while insulating charter operators from overdue accountability standards is just the latest example of educational policymakers subordinating students' interests to those of adults with commercial and ideological designs on public education in Detroit.

Metro Detroit legislators will not stand still for such an omission, nor should they.

That said, Hansen's bills would accomplish some urgent and useful objectives. These include enacting Snyder's proposal to split DPS into two entities -- one that would hold the current district's onerous debt until it's paid off, and a new Detroit Community School District that would assume responsibility for the education of the current district's 47,000 students.



DETROIT FREE PRESS

[Duggan says city to inspect all Detroit public schools](http://www.freep.com/story/news/local/michigan/detroit/2016/01/13/detroit-schools-closed-again/78728372/)

[\(http://www.freep.com/story/news/local/michigan/detroit/2016/01/13/detroit-schools-closed-again/78728372/\)](http://www.freep.com/story/news/local/michigan/detroit/2016/01/13/detroit-schools-closed-again/78728372/)

The legislation would also earmark \$250 million from the state's general fund to get the new district up and running, although it does not suggest where the money would come from.

Among the hazier provisions in Hansen's DPS proposal is one that would preserve state authority over the lowest-performing 5% of schools in the new district but keep them in the newly established community district.

The worst-performing schools would continue to answer to a state-appointed CEO; the rest would be overseen by an elected local school board after Jan. 1, 2017, assuming the Legislature acts in time to permit election of such a board next November. Unlike its predecessor, the new board would be under the oversight of the same financial review commission established to oversee the City of Detroit's finances after its emergence from municipal bankruptcy in 2014.

In the interim, the new school district would be run by a board composed of five members appointed by Snyder and four chosen by Duggan.

Still left to be addressed by future bills -- GOP legislative leaders anticipate six in addition to the two introduced Thursday -- is a realistic plan to pay off DPS's crushing debt, the majority of which was accumulated while the district was under state oversight. Snyder has proposed contributing \$700 million in state funds over the next 10 years to bail out the district, arguing that the state would face an even bigger liability if DPS is forced into

bankruptcy

Republican lawmakers have never warmed to Snyder's plan. Most recently they've cited the rolling teacher sick-outs staged by a group within the Detroit Federation of Teachers as justification for their skepticism and inaction.

The work stoppages, which have forced closures at more than 80% of the district's 97 schools in recent weeks, have obviously done nothing to engender the goodwill of outstate legislators. But they don't excuse Lansing's unconscionable stalling.

As the Skillman Foundation's Tonya Allen, a co-chair of the Coalition for the Future of Detroit Schoolchildren, noted in an interview with the Free Press this week, "None of us condone teacher absenteeism in the classroom, but the real issue is absenteeism in Lansing."

Hansen's flawed bills represent the first fitful indication that Lansing is at last turning its attention to the five-alarm fire at DPS. If the Legislature can muster the urgency it has brought to the task of abolishing straight-ticket voting and blocking campaign finance reform, Detroit's schoolchildren may yet get some relief in this lifetime.

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Snyder to seek \$72M in '17 budget for DPS rescue

Shawn D. Lewis, The Detroit News 5:50 p.m. EST February 9, 2016



(Photo: Todd McInturf / The Detroit News)

Gov. Rick Snyder will ask for \$72 million in his 2017 budget as part of a 10-year plan to pay down the debt of Detroit Public Schools and restructure the state's largest school district, which could run out of money this spring, according to a source familiar with the spending plan.

The money will come from the Tobacco Settlement Fund.

Additionally, the governor wants a \$50 million appropriation to keep the district running while lawmakers debate legislation to overhaul DPS, which has struggled for years with mounting debt and falling enrollment.

The debt relief funds will free up \$1,000 per student to go into the classrooms.

At this point, there is no indication that Snyder's request will include any funds to deal with an estimated \$50 million in building repairs. The district has been roiled by reports of health and safety problems in numerous schools, including water leaks, mold, rodent infestations and heating issues.

Snyder has previously proposed a \$715 million plan to rescue DPS and fund the startup of a new Detroit school district, with a gradual transition back to control by an elected school board. The state has run DPS since March 2009.

On the eve of the governor's budget address, the Senate Government Operations Committee conducted a hearing Tuesday on a two-bill package that includes some aspects of Snyder's proposal for rescuing and restructuring the financially troubled district.

Panel members heard from teachers union officials, DPS parents and others about the district's finances and health and safety problems in many of its buildings.

Craig Thiel of the Citizens Research Council discussed the district's \$3.5 billion in debt in a slide presentation. He said the debt is divided into two separate parts: operating and capital.

"The operating is taken from operation dollars in the per pupil fund and the capital is backed by a dedicated property tax," he said.

"This debt will not self-correct," Thiel said. "DPS can't address the lingering legacy debt and DPS students are not receiving the education they deserve."

Wanda Cook-Robinson, superintendent of Oakland Schools, said legislation shouldn't focus only on DPS.

"Let's take this opportunity to improve education in Michigan," she said. "Think about the consequences this plan will have on other districts. We need to know where the funding is coming from, and at what expense. I suggest you don't move forward until we know."

Sen. Goeff Hansen, R-Hart, who chaired the almost 2½ hours of testimony from 17 people, told those gathered that it was a "work in progress."

He said another committee hearing on the legislation is expected to convene next week.

Among those who addressed the committee were American Federation of Teachers president David Hecker and interim DFT president Ivy Bailey.

They presented slides of deteriorating building conditions including mold, rodent feces on a desk and roaches.

Sen. Morris Hood III, D-Detroit, was appalled.

"We should be ashamed of ourselves, to have to let any kid go to schools under those conditions," he said. "If there's a kid in Port Huron, Cadillac or any city, you wouldn't want your child to have to attend a school like that."

He continued, "Is what we're doing going far enough? Is what we're doing going to help kids 10, 15 years from now or are we doing a quick fix?"

About 30 parents of students in Detroit Public Schools took their concerns about conditions in the district to the city's streets — and to Lansing — on Tuesday.

Members of the Detroit Parent Network met at their headquarters on Lothrop before marching out of the building with picket signs and heading a few blocks away to rally in front of the state office building at Cadillac Place on West Grand. From there, they rode by bus to Lansing to participate in a hearing before the Michigan Senate Government Operations Committee about the district's future.

Parent Millicent Austin, 43, has a 5-year-old daughter who attends the Foreign Language Immersion and Cultural Studies school.

"I'm here to support the teachers, students and schools in the city of Detroit so legislators understand we are involved parents," said Austin. "And they need to know these things matter to us and we will do something about it."

But Austin said she is troubled by the bills, which include creating a nine-member interim school board, with five of the members appointed by Gov. Rick Snyder and four by Detroit Mayor Mike Duggan.

"We wouldn't be electing this board, and I don't think most of the legislators have children in this district," she said. "They don't have a dog in this fight so they don't really care."

Parent Patrina Riley, 43, of Detroit, was among several parents who addressed the committee. She has two grown children and a 9-year-old daughter who attends MacKenzie Elementary-Middle School.

"All the quality schools are downtown and we need the same kind of schools in our neighborhoods," she said.

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Snyder budget: Money for DPS fix could be heavy lift

Paul Egan, Kathleen Gray and Ann Zaniewski, Detroit Free Press Education Writer 7:28 p.m. EST February 10, 2016



(Photo: Ryan Garza, Detroit Free Press)

LANSING — Gov. Rick Snyder said he grappled with two pressing challenges — the Flint public health crisis and the financial meltdown of Detroit Public Schools — as he worked on the \$54.9-billion state budget he presented to lawmakers Wednesday.

Though Snyder described Flint as the biggest challenge he has faced, the governor's plan to save Detroit Public Schools by using \$720 million over 10 years to pay off its crippling debt could be the thornier of the two issues in terms of winning legislative support.

Resolving each crisis is critical to residents, especially children, in two economically challenged and majority black Michigan cities.

Another link is that the problems either developed or worsened while the city government or school district was under control of a state-appointed emergency manager. Flint is now in a transition back to self-government. Detroit Public Schools remains in state receivership.



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Highlights of the Gov. Rick Snyder's 2016-17 budget

[\(http://www.freep.com/story/news/politics/2016/02/10/highlights-gov-rick-snyders-2016-17-budget/80173018/\)](http://www.freep.com/story/news/politics/2016/02/10/highlights-gov-rick-snyders-2016-17-budget/80173018/)

Snyder spoke at the Capitol as demonstrators chanted outside the House Appropriations Committee room, voicing their anger over the lead contamination of Flint's drinking water.

Snyder's latest response to the Flint crisis — \$195.4 million in new funding requests for 2016 and 2017 that will bring the total amount of state funds Snyder has requested for the Flint water crisis to \$232 million — was reported in detail by the Free Press [on Tuesday and Wednesday](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/gov-propose-195m-flint-water-crisis/80065974/).

On the Detroit schools issue, Snyder announced in the spring he wants to split DPS into a "new" district that would educate children and an "old" district that would pay off the district's operating debt. But his initial idea of using the School Aid Fund — which supports all Michigan public schools — to pay off DPS debt had met fierce resistance.

On Wednesday, he detailed a new plan that would instead use Michigan's tobacco settlement fund — established from a 1988 settlement of a multibillion-dollar lawsuit between 46 states and the U.S. tobacco industry. The fund generates about \$193 million a year, of which \$75 million supports economic development efforts and \$17.5 million a year for 20 years is paying for the grand bargain that helped settle Detroit's Chapter 9 bankruptcy by supporting City of Detroit pensioners and protecting the art collection of the Detroit Institute of Arts.

Now, Snyder wants to tap the fund for \$72 million a year over 10 years to help DPS. He said the move, which would be subject to approval by not just this Legislature but future ones, would free up about \$1,100 per student for classroom spending that currently goes to pay debt.

"All of Michigan's children deserve a quality education that prepares them for future success," Snyder said in his budget message. "The financial stress currently facing the Detroit Public Schools must be resolved in order to ensure Detroit's schoolchildren have the same opportunities for success as other children in our state."

The governor said lawmakers need to move quickly because otherwise DPS creditors could take the district to court and create new complications.

The 10-year plan includes \$200 million in start-up and transition costs, including space consolidation, instructional support and investment in academic programs.

The governor wants lawmakers to approve \$50 million as a supplemental appropriation for 2015-16 to operate Detroit Public Schools while his plan for changes in the district is working its way through the Legislature, said Kurt Weiss, a spokesman for Budget Director John Roberts.

Concerns over the funding source continued Wednesday.

The chairman of the House Appropriations Committee, Rep. Al Pscholka, R-Stevensville, said he's not sure he wants to take the DPS money out of the tobacco settlement fund. While he wouldn't specify what alternative he is looking at, Pscholka said: "I think there's a way that we can get the DPS funding in place without using the school aid, tobacco settlement or other general fund revenues."

But Rep. David Knezek, D-Dearborn Heights, said he thinks using the tobacco fund is a great option.

"There was a time when the Legislature was talking about a \$50 per-pupil cut to every other school district in the state," Knezek said. "That was unacceptable to me. So this option allows us to find a sustainable funding source, a funding source that can pay down Detroit's debts, and a funding source that won't negatively impact the other school districts in our state. I think it's a win-win for everybody."

Members of the Detroit Public Schools board — left powerless under the state-appointed emergency managers that have run the district since 2009 — said the funding source doesn't matter.

"I don't care where they get the money," said Herman Davis, the school board president. "They just need to come up with money to replace what the state has squandered."

Rep. Brian Banks, D-Harper Woods, chairman of Detroit's Democratic House Caucus, said: "I think it's the same old spiel he's given regarding the debt, but it doesn't deal with academics or deplorable working conditions. He mentioned nothing about academics and improving test scores."

Snyder reminded lawmakers Wednesday that last year they were able to agree on a long-awaited road funding package that included a fuel tax increase.

"Now we must solve the Flint water crisis and



- [Flint mayor hopes to begin pipe replacement next month](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-mayor-details-plan-replace-lead-pipes/80049056/)
- [Water woes could sink Flint's property values even more](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/07/flint-property-values/79823532/)
- [A long friendship put spotlight on Flint water crisis](http://www.freep.com/story/news/columnists/rochelle-riley/2016/02/06/dr-muna-hanna-attisha-goes-doctor-global-hero/79772514/)
- [Dr. Mona Hanna-Attisha goes from doctor to global hero](http://www.freep.com/story/news/columnists/rochelle-riley/2016/02/06/long-friendship-put-spotlight-flint-water-crisis/79774098/)
- [Clinton, Sanders set for debate in Flint](http://www.freep.com/story/news/notices/2016/02/03/democratic-debate-flint-before-michigan-primary/79775040/)
- [House panel on Flint water: Failure at every level](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/03/live-congressional-panel-meet-flint-water-crisis/79743588/)
- [Schuette to DCA workers: Get your own lawyers in suit](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/01/31/dca-workers-need-find-own-lawyer-flint-law-suit/79698504/)
- [EPA: High lead levels in Flint exceed filters' rating](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/01/29/epa-high-lead-levels-flint-exceed-filters-ability/79540740/)
- [Amid denials, state workers in Flint got clean water](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/01/28/amid-denials-state-workers-flint-got-clean-water/79470650/)
- [Snyder e-mails: Aides figured Flint was others' problem](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/01/20/rick-snyder-releases-emails-related-flint-water-crisis/79057168/)
- [Snyder apologizes for Flint crisis in State of State address](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/01/19/snyder-address-flint-water-shut-off-tonight/78994522/)
- [All Flint's children must be treated as exposed to lead](http://www.freep.com/story/opinion/contributors/raw-data/2016/01/16/map-8657-flints-youngest-children-exposed-lead/78818888/)
- [In Flint, report that raised flags on lead went ignored](http://www.freep.com/story/opinion/columnists/nancy-kaffler/2016/01/11/flint-lead-water/78629628/)
- [Rochelle Riley: Snyder legacy will be Flint water crisis](http://www.freep.com/story/news/columnists/rochelle-riley/2016/01/09/snyder-legacy-flint-water-crisis/78510122/)
- [Time line: How Flint's water crisis unfolded](http://www.freep.com/pages/interactives/flint-water-crisis-timeline/)
- [Full coverage: Flint water crisis](http://www.freep.com/news/flint-water-crisis/)

address the challenges at Detroit Public Schools," said Snyder, who is hoping to draw on existing funds to address both issues and is not proposing tax hikes to raise the needed money.

But of the \$195.4 million announced for Flint, only about \$37 million is part of the 2017 budget Snyder presented Wednesday. Most will come in the form of supplemental appropriation requests for the 2016 fiscal year, said Weiss.

"Flint's needs are immediate and the supplemental provides the mechanism to get more aid for Flint this fiscal year," he said.

Snyder's budget message said that "clean drinking water is a necessity," and "Flint residents shouldn't have to rely on bottled water and water filters just to drink a glass of water or safely cook a meal."

The governor "is dedicated to ensuring the situation is dealt with quickly and thoroughly, so that Flint's water is safe for residents once again."

The \$195.4 million for Flint announced Wednesday is spread across several state agencies and "will be used to continue the work to provide Flint residents with immediate needs, like bottled water, water filters and replacement cartridges while also investing in longer term needs such as specialists and staff, including nurses and epidemiologists, support for health care access for Flint children, payment for testing and studies, and the ongoing treatment of children."

It includes \$30 million to subsidize bills for water that Flint residents can't drink, \$15 million for food and nutrition to combat lead exposure, and \$50 million to be placed in a reserve fund for future expenses that are yet to be determined. There's also \$25 million to replace lead water lines.

"Additional funds will be needed in the coming years to ensure Flint residents receive the care and services they need for a healthy future," the governor's budget statement said.

Flint Mayor Karen Weaver said Wednesday she appreciates the \$25 million earmarked for lead pipe removal, but said it falls short of the estimated \$55 million it will cost to remove all lead pipes in the city's water system.

"Job one for our city is to remove the lead pipes," Weaver said. "Until that happens, Flint cannot move forward. Our citizens will not have confidence and trust in the water that comes from their faucets."

Snyder said the cost of removing lead pipes can't be accurately estimated until officials know how many there are and where they are located. The state is about to sign an engineering contract to determine that, he said. Experts say that in some cases it is better to wait and allow phosphate additives to restore a protective coating to the interior surfaces of pipes before trying to remove them, he said.

A couple dozen protesters, many wearing "Flint Lives Matter" T-shirts, gathered outside the room where Snyder was giving his presentation. They shouted chants such as: "Fix the pipes!" "No water, no peace!" and "Not enough!" referring to the amount of money Snyder was proposing for Flint.

Asked about the demonstrators, Snyder said it was their democratic right and he only "had to speak up a little bit louder."

Senate Minority Leader Jim Ananich, D-Flint, said the governor's proposals for Flint "seem to match the areas we have been stressing" — health, education and infrastructure.

"Our challenge now is to make sure that the state delivers, and we don't take our foot off the gas," Ananich said in a news release.

Sen. Mike Kowall, R-White Lake, said the Senate has signed off on the chunk of money for Flint.

"We've looked at the numbers, and if this is what it's going to take to get good water for the people in Flint, then so be it," Kowall told the Free Press.

Lorenzo Avery Jr., 32, of Flint was one of the protesters who came from Flint to Lansing. He said he plans to return to the Capitol for as long as it takes to remove Snyder from office.

"I'm here to be a pain in his behind," Avery said. "We want him removed. Everyone who had something to do with it should be removed, too. We're in a Third World country. Until we get him out of here, we won't stop."

Beyond the two most immediate challenges, Snyder cited the cost of specialty drugs as an emerging issue. A drug that is hoped to be a cure for Hepatitis C patients is expected to cost the state's general fund \$91.5 million this year to treat about 7,000 patients, while a cystic fibrosis drug is expected to cost the state \$43.7 million to treat 320 children, he said. Expecting those types of costs to continue, Snyder said the budget sets aside \$30 million in a specialty drug reserve fund.

The governor cited the need for statewide infrastructure improvements as the fourth challenge. Snyder called for \$165 million to be set aside for statewide infrastructure needs in a newly created Michigan Infrastructure Fund, through a supplemental appropriation for the 2016 fiscal year.

Otherwise, the governor said budget priorities continue to be economic growth, education, public safety and fiscal responsibility. His address highlighted continued signs of improvement in the Michigan economy overall, with more than 440,000 new private-sector jobs since he took office in 2011, improving home prices and steady declines in the state unemployment rate.

"This plan provides a balanced approach to addressing our special challenges while continuing to pay off debt, save money for the future and make needed investments in critical areas," Snyder said.

For the first time since Snyder took office, the budget does not call for an increase to the Budget Stabilization Fund, better known as the Rainy Day Fund. Snyder said the balance in that fund stands at about \$611 million, up from \$2.2 million when he took office.

The total budget includes federal funds. The main state funds, the general fund and the School Aid Fund are estimated to have 2017 revenues of \$10.6 billion and \$12.8 billion respectively.

Brandon Dillon, chairman of the Michigan Democratic Party, said the budget "contains no serious commitment to replace the lead pipes poisoning children and families in Flint."

But House Speaker Kevin Cotter, R-Mt. Pleasant, said he views the budget positively because, despite the challenges Michigan faces, no significant cuts were required.

"What's put us here is very responsible budgeting practices in the last five years," Cotter said. "Thank God this didn't happen in 2011 or we would really be in a desperate situation."

For the broader K-12 budget, Snyder's proposal calls for \$150 million in extra funding for the school foundation allowance, which he said equates to \$60 to \$120 per pupil.

The budget calls for a 3.9% increase in constitutional revenue sharing with cities, villages and townships, bringing the total amount to \$781.5 million.

The budget also includes \$8.5 million for an academy to graduate 350 additional corrections officers for the state prison system, which is grappling with a large number of retirements.

The state prisons budget, which comes almost exclusively from the general fund, remains at \$2 billion, despite several cost-cutting initiatives, such as the privatization of prison food service.



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[Flint e-mails: CDC voiced concerns over Legionnaires' actions](#)

[\(http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-e-mails-state-city-appear-unable-share-info/80028820/\)](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-e-mails-state-city-appear-unable-share-info/80028820/)



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[Flint issues boil advisory after water main break](#)

[\(http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-residents-asked-boil-their-filtered-water/80086916/\)](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-residents-asked-boil-their-filtered-water/80086916/)



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[Flint mayor hopes to begin pipe replacement next month](#)

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[Bacteria fears left Flint water pipes unprotected](#)

[\(http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-corrosion-control-omitted-over-bacteria-concerns/80072284/\)](http://www.freep.com/story/news/local/michigan/flint-water-crisis/2016/02/09/flint-corrosion-control-omitted-over-bacteria-concerns/80072284/)

Contact Paul Egan: 517-372-8660 or pegan@freepress.com. Follow him on Twitter @paulegan4.

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Attachment 2
Detroit Public Schools
Comprehensive Annual Financial Report
For the Fiscal Year Ended June 30, 2015

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Year Ended
June 30, 2015

Financial
Statements

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INDEPENDENT AUDITORS' REPORT

November 2, 2015

Emergency Manager
Detroit Public Schools
Detroit, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of *Detroit Public Schools* (the "District"), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Independent Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Detroit Public Schools as of June 30, 2015, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Implementation of GASB Statement No. 68

As described in Note 18, the City implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, in the current year. Accordingly, beginning net position of governmental activities was restated. Our opinion is not modified with respect to this matter.

Funding Uncertainties

The District has suffered recurring operating deficits in the General Fund. Management's plans with regard to these matters are described in note 15.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, the schedules for the pension plan, the Schedule of Funding Progress and Schedule of Employer Contributions, and Budgetary Comparison Schedule for the general fund as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The combining fund financial statements, budgetary comparison schedule for the food service fund, and schedule of bond indebtedness listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining fund financial statements, budgetary comparison schedule for the food service fund, and schedule of bonded indebtedness are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued, under separate cover, our report dated November 2, 2015, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Our discussion and analysis of Detroit Public Schools' (the "District") financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2015. The intent of this management discussion and analysis is to look at the District's financial performance as a whole; it should be read in conjunction with the transmittal letter, financial statements and notes to the basic financial statements to enhance their understanding.

The District has prepared its annual financial report using a combination of both government-wide financial statements and fund financial statements. The basic financial statements contain three components:

1. Government-wide financial statements including the Statement of Net Position and the Statement of Activities which provide a broad, long-term overview of the District's finances, in a manner similar to a private sector business.
2. Fund financial statements including governmental funds, which focus on near-term inflows and outflows of available resources, as well as on balances of available resources available at the end of each fiscal year, and fiduciary funds, which account for the funds that the District holds in a fiduciary capacity for others. These statements include the Balance Sheets and the Statement of Revenues, Expenditures and Changes in Fund Balances.
3. Notes to the basic financial statements.

This report presents the financial highlights for the last year and contains required and other supplemental information.

About Detroit Public Schools

Detroit Public Schools is an urban public school district located in the City of Detroit. It is a fiscally independent district governed by the Emergency Manager that was appointed by the Governor.

The District has 103 schools, consisting of 7 early childhood schools, 62 elementary schools, 3 middle schools, 18 high schools, 2 alternative education schools, 7 special education schools, and 4 career technical and vocational centers.

Financial Highlights

Key financial highlights for 2015 are as follows:

Government-wide financial statements:

- The District implemented GASB Statement No. 68 in the current year. In addition to expanded disclosure requirements, the District is required to report its proportionate share of the MPERS net pension liability on the statement of net position. This change has resulted in a negative total net position of governmental activities of \$(1,664,735,120).
- Total net deficit increased from \$763.7 million in FY 2014 to \$1,664.7 million in FY 2015.
- Total revenues increased from \$810.9 million in FY 2014 to \$820.3 million in FY 2015.
- Total expenses decreased from \$888.0 million in FY 2014 to \$863.0 million in FY 2015.

Fund financial statements:

- The total fund balance deficit for all governmental funds increased from a deficit of \$(122.0) million in FY 2014 to a deficit of \$(175.9) million in FY 2015.
- The general fund deficit increased from \$(169.5) million in FY 2014 to \$(215.9) million in FY 2015.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

General Fund budgetary comparison schedules:

- Actual revenues were less than final budgeted revenues by \$42.6 million, primarily due to the reduction in the District's federal funding associated with current spending levels, reductions in Act 18 revenues received through Wayne RESA, and reductions in State Aid caused by enrollment decreases. In addition, proceeds from sales of capital assets were less than budget.
- Expenditures were less than final budgeted expenditures by \$65.3 million, primarily due to the reduction in federal funding and spending.
- The actual fund deficit of \$(215.9) million was less than the final budgeted deficit of \$(238.2) million by \$22.3 million.

Overview of the Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances in a manner similar to a private sector business. The statement of net position and the statement of activities provide information about the activities of the District as a whole, presenting both an aggregate view and a long-term view of the finances. These statements include all assets, deferred outflows of resources, liabilities and deferred inflows of resources using the accrual basis of accounting. This basis of accounting includes all of the current year's revenue and expenses regardless of when cash is received or paid.

The statement of net position presents information on all of the District's assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the net balance reported as net position. Increases or decreases in net position may serve as a useful indicator of whether the financial position is improving or deteriorating.

The statement of activities presents information showing the change in net position during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but not used vacation leave).

Both of the government-wide financial statements distinguish functions of the District that are principally supported by taxes and intergovernmental revenues (governmental activities).

Financial Analysis of the District as a Whole

All of the District's services are reported in the government-wide financial statements, including instruction, support services, community services, food services and athletics. Property taxes, state aid, and interest and investment earnings finance most of these activities. Additionally, all capital and debt financing activities are reported here.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Statement of Net Position. The statement of net position provides the perspective of the District as a whole. The following table provides a summary of the District's net position as of June 30, 2015 and 2014:

	Net Position		
	Governmental Activities		
	2015	2014	Percentage Change
Current and other assets	\$ 177,652,012	\$ 232,184,660	(23.49)%
Capital assets, net	1,379,453,373	1,455,873,724	(5.25)%
Total assets	1,557,105,385	1,688,058,384	(7.76)%
Deferred outflows	139,984,107	25,625,936	446.26 %
Other liabilities	1,244,387,375	354,913,083	250.62 %
Long-term liabilities	2,020,955,918	2,122,425,129	(4.78)%
Total liabilities	3,265,343,293	2,477,338,212	31.81 %
Deferred inflows	96,481,319	-	100.00 %
Net position:			
Net investment in capital assets	(126,652,164)	(101,890,474)	24.30 %
Restricted	23,546,812	26,280,121	(10.40)%
Unrestricted (deficit)	(1,561,629,768)	(688,043,539)	126.97 %
Total net position	\$ (1,664,735,120)	\$ (763,653,892)	118.00 %

The District's net deficit was \$1,664.7 million at June 30, 2015, as compared to a net deficit of \$763.7 million at June 30, 2014. The unrestricted net position deficit balance highlights a potential inability to meet future operational needs as well as working capital and cash flow requirements. The operating results of the General Fund have a significant impact on the change in unrestricted net position (deficit) from year to year.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Statement of Activities. The results of operations for the District as a whole are reported in the statement of activities which shows the change in net position for the fiscal years ended June 30, 2015 and 2014:

	Change in Net Position		
	Governmental Activities		
	2015	2014	Percentage Change
Program revenues:			
Charges for services	\$ 2,942,123	\$ 2,806,704	4.82 %
Operating grants	384,597,111	350,154,648	9.84 %
General revenues:			
Property taxes	156,450,484	177,706,934	(11.96)%
Unrestricted state aid	265,091,387	259,541,573	2.14 %
Interest and investment earnings	36,302	50,582	(28.23)%
Other	11,159,377	20,596,137	(45.82)%
Total revenues	820,276,784	810,856,578	1.16 %
Functions / program expenses:			
Instruction	374,874,427	381,901,033	(1.84)%
Support services	313,548,618	318,332,081	(1.50)%
Community services	3,258,057	4,179,408	(22.05)%
Food services	42,542,212	44,916,670	(5.29)%
Athletics	3,345,514	2,434,401	37.43 %
Interest on long-term debt	106,764,573	113,673,948	(6.08)%
Depreciation (unallocated)	18,679,335	22,536,086	(17.11)%
Total functions / program expenses	863,012,736	887,973,627	(2.81)%
Change in net position	(42,735,952)	(77,117,049)	(44.58)%
Net position:			
Beginning of year	(763,653,892)	(686,536,843)	11.23 %
Restatement for implementation of GASB 68	(858,345,276)	-	100.00 %
End of year	\$ (1,664,735,120)	\$ (763,653,892)	118.00 %

This decrease in net position was largely due to decreases in property tax revenues of \$21.2 million and other general revenues of \$9.4 million, as well as the continued burden of legacy costs including interest payments on long-term operating debt of \$17.3 million.

The cost of all governmental activities this year was \$863.0 million. Certain governmental activities were partially funded from those who benefited from the programs through charges for services of \$2.9 million or by the other governments and organizations that subsidized certain programs with grants and contributions of \$384.6 million. The remaining "public benefit" portion of the District's governmental activities was funded primarily by \$156.5 million in taxes and \$265.1 million in unrestricted federal funds and state aid. The District experienced a decrease in net position of \$42.7 million. As a result, the District reduced expenditures in instructional by \$6.7 million with a decrease of \$18.2 million in non-instructional areas.

As discussed above, the net cost shows the financial burden that was placed on the State and the District's taxpayers by each of these functions. Since property taxes for operations and unrestricted state aid constitute the vast majority of District operating revenue sources, the Emergency Manager, the Board of Education and administration must annually evaluate the needs of the District and balance those needs with available unrestricted resources. The overall financial position of the District continues to be challenged as enrollment declines.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Capital Asset and Debt Administration

Capital Assets. The District's investment in capital assets for its governmental activities as of June 30, 2015 amounts to \$1,379.5 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and building improvements, vehicles, furniture and equipment. This amount represents a net decrease (including additions, disposals, impairment and depreciation) of \$76.4 million.

Capital Assets (Net of Depreciation)			
	2015	2014	Percentage Change
Land	55,678,168	56,905,839	(2.16)%
Land improvements	102,443,164	106,689,413	(3.98)%
Buildings and building improvements	1,804,653,250	1,861,454,223	(3.05)%
Machinery and other equipment	207,722,273	207,808,739	(0.04)%
Buses and other vehicles	2,509,961	3,079,925	(18.51)%
Construction in progress	3,169,727	6,098,344	(48.02)%
	<u>2,176,176,543</u>	<u>2,242,036,483</u>	<u>(2.94)%</u>
Less accumulated depreciation	(796,723,170)	(786,162,759)	1.34 %
Total capital assets, net	<u>\$ 1,379,453,373</u>	<u>\$ 1,455,873,724</u>	<u>(5.25)%</u>

This year's additions of approximately \$8.3 million included building renovations, site improvements and equipment. The District issued \$290 million and \$210.5 million in fiscal year 2010 and 2011 respectively, as provided under Proposal S, that funded the majority of the additions. More detailed information about the District's capital assets is provided in Note 5 to the basic financial statements.

Long-Term Debt. As of June 30, 2015, the District had \$1.452 billion in bonds outstanding, plus \$74.1 million in unamortized bond premiums, for a total of \$1.526 billion. This represents a decrease of 5.13% from the previous year.

Outstanding Debt			
	2015	2014	Percentage Change
General obligation bonds	\$ 1,452,075,000	\$ 1,541,209,870	(5.78)%
Unamortized bond premium	74,129,609	67,568,056	9.71 %
Long-term notes payable	259,257,063	298,857,734	(13.25)%
Other long-term liabilities	235,494,246	214,789,469	9.64 %
Total long-term debt	<u>\$ 2,020,955,918</u>	<u>\$ 2,122,425,129</u>	<u>0.32 %</u>

The State limits the amount of general obligation debt that schools can issue to 15 percent of the assessed value of all taxable property within the District's boundaries. If the District issues "qualified debt," (i.e., debt backed by the State of Michigan), such obligations are not subject to this debt limit.

Other obligations include accrued vacation pay, sick leave, employee severance plan, workers' compensation and health insurance claims, and legal claims. More detailed information about the District's long-term liabilities is provided in Note 7 of the notes to the basic financial statements.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Financial Analysis of the District's Funds

The District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The District maintains separate funds for general operations, food services, debt service, and capital projects. The focus of the District's governmental funds is to provide information on near term inflows, outflows, and balances of available resources. Such information is useful in assessing the District's financing requirements. In particular, unassigned fund balance may serve as a useful measure of the District's net resources available for spending at the end of the year.

These funds are reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. These statements provide a detailed short-term view of the District's operations and the services it provides.

Because the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

As the District ended this year, the governmental funds reported a combined fund deficit for fiscal year 2015 of \$175.9 million, which is an increase in the fund deficit of \$54.0 million from fiscal year 2014. The primary reasons for the increase in the fund deficit are as follows:

- There was an increase in general fund revenue compared to last year of \$18.5 million. \$6.9 and \$32.8 million was due to the increase in federal and state funds, respectively.
- Total expenditures decreased by \$7.2 million, which reflects that the District is making the hard decisions of both reduction of staff and discretionary spending. Based on expenditures exceeding revenue by \$53.6 million, the District needs to continue making the difficult decisions in reducing staff and other expenditures in eliminating the deficit.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

General Fund

Based on our analysis of the information below, general fund revenue was higher than fiscal year 2014 due to increases in State and Federal sources. Expenditures also decreased from the previous year due to the District's cost saving effort.

	General Fund		
	Year Ended 2015	Year Ended 2014	Percentage Change
Revenues			
Local sources	105,322,614	126,426,524	(16.69)%
State sources	385,812,644	353,056,789	9.28 %
Federal sources	169,259,155	162,383,151	4.23 %
Total revenues	660,394,413	641,866,464	2.89 %
Expenditures			
Current:			
Instruction	335,669,369	346,100,939	(3.01)%
Support services	316,574,183	312,753,894	1.22 %
Community services	3,301,079	4,198,638	(21.38)%
Athletics	1,590,407	1,626,152	(2.20)%
Debt service:			
Principal retirement	39,600,671	37,767,192	4.85 %
Payment of interest	17,294,384	18,706,209	(7.55)%
Capital outlay	-	101,379	(100.00)%
Total expenditures	714,030,093	721,254,403	(1.00)%
Revenues under expenditures	(53,635,680)	(79,387,939)	(32.44)%
Other financing sources (uses)			
Transfers in	1,762,100	2,484,518	(29.08)%
Transfers out	-	(94,602)	(100.00)%
Proceeds from sale of capital assets	5,401,970	1,419,640	280.52 %
Total other financing sources	7,164,070	3,809,556	88.06 %
Net change in fund deficit	(46,471,610)	(75,578,383)	(38.51)%
Fund deficit:			
Beginning of year	(169,460,307)	(93,881,924)	80.50 %
End of year	(215,931,917)	(169,460,307)	27.42 %

Other Governmental Funds

Special Revenue

Food services. In fiscal year 2015, expenditures decreased by \$3.6 million with expenditures and other financing uses less than revenues and other financing sources by \$1.2 million, increasing the fund balance from \$5.0 million in fiscal year 2014 to \$6.1 million in fiscal year 2015.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Debt Retirement

Bond redemption. The bond redemption fund balance decreased from \$36.0 million in 2014 to \$31.8 million in 2015 primarily due to proceeds from the School Bond Loan Fund.

Judgment levy. The judgment levy fund deficit increased from \$541,457 in 2014 to \$1,279,367 in 2015 primarily due to decreases in property tax revenue and claims payments for past judgments.

Capital Projects

1986 School Building Site Improvement Bonds. The only activity in this fund was accrual of a small amount of interest.

Durant Bond. The primary activity in this fund was capital outlay expenditures of \$45,957, which exhausted the remaining fund balance from 2014.

1994 School Building Site Improvement Bonds Series V. The fund balance in Series V decreased from \$4.4 million in fiscal year 2014 to \$3.1 million in fiscal year 2015 due to capital outlay expenditures of \$1.3 million.

2009A, 2009B, 2010A, and 2010B Building Site Improvement Bonds Funds. On December 30, 2009, the District issued the 2009A and 2009B Building Site Improvement Bonds for a total of \$290.0 million. These bonds were authorized under Proposal S which was passed by the citizens of Detroit on November 3, 2009. Proposal S authorized the District to issue \$500.5 million in long-term bonds for the purpose of constructing eight (8) new schools and renovating ten (10) existing schools. In October 26, 2010, the District issued the remaining \$210.5 million authorized under Proposal S as the 2010A and 2010B Building Site Improvement Bonds. These Bonds are supported by the property tax revenues levied by the City of Detroit on behalf of the District. A total of 18 schools will be rebuilt or renovated under the Detroit Public School's School Construction Project. Eight schools will be replaced with new buildings, including three high schools. Ten schools will receive major renovations, four of which are scheduled to be completed by the end of the year. All schools will receive technology upgrades and improved security measures. Federal regulations stipulate that the project's bond funds be spent within three years.

The 2009A Building and Site Bond Funds were fully expended in prior years. For the year ended June 30, 2015, the 2009B and 2010B Building Site Improvement Bond Funds had expenditures of \$516,000 and \$1.7 million, respectively. Unspent bond proceeds at year end for these funds were \$1.1 million and \$(.8) million.

General Fund Budgetary Highlights

The District revises its budget over the course of the year, to manage unexpected changes in revenues and expenditures. State law requires that the budget be amended to ensure that expenditures do not exceed appropriations and available revenues and fund balance. The final amendment to the budget was approved in June 2015. A schedule showing the District's original and final budget amounts compared with actual revenues and expenditures is provided in the Required Supplemental Information section of these financial statements. Significant budget variances were as follows:

- The actual revenues of \$660.3 million are \$45.0 million less than the final budgeted revenue of \$705.4, due to a reduction in federal funding and spending.
- The actual support services expenditures of \$319.2 million are \$25.9 million less than the final budget of \$345.0 million. The decrease is primarily due to reduced federal fund spending in the instructional staff support area and reduced expenditures in central support services.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

Economic Factors and Next Year's Budget and Rates

On March 3, 2015, the Emergency Manager announced the District's implementation of the 10-Point Management Plan designed to guide the District toward financial stability and educational competitiveness, and ensure that it can achieve long-term sustainability. The goal of this management plan is to provide a strategy for determining and evaluating relevant and specific criteria for assessing and implementing operational and academic change within the organization. The plan identifies 10 critical points and objectives for each that will need to be met based upon the District Cabinet's review of data and other information related to the day-to-day work performed by the staff. Implemented with fidelity, this 10-Point Management Plan will make the District a more efficient and effective node on Detroit's education network, and will position the organization for both sustainability and a return to local control.

The following are the 10 critical areas of focus (five academic and five operational) covered by the plan:

- Academic Competitiveness
- Governance
- Staff Development
- Cash Flow Stability
- Higher Education/Collaboration
- Organizational Development
- Special Education
- Transportation
- Customer Service
- Comprehensive Funding Strategy

Fiscal year 2016 will be a transitional year, in which targeted cost reductions will be made in areas that do not impact the quality of education delivery. In addition to a review of all contracts, policies and procedures, the District is focusing on key areas during the restructuring process: central office administration, special education, curriculum and instruction, grants, and staffing models, as well as non-core programs.

While some aspects of this important work are more long-term, there are a number of immediate next steps that the District will be acting upon which include convening a summit of education service providers, which will consider the Coalition's recommendations (due March 31, 2015), with the goal of achieving the following:

- A moratorium on creating new schools before autumn 2015.
- Establish a working group to identify shared facility opportunities and potential closure of substandard facilities across the District.
- Establish a special education task force to address location of classes, enrollment rules, long-term strategy, and funding formulas.
- Evaluating existing schools and programs in order to determine potential closures, consolidations, or relocations prior to start of 2016-17 school year and in the future. This will be done in conjunction with our existing, comprehensive strategic planning process.
- Consideration of options regarding the potential for restructuring the District's obligation.

Ultimately, the end result is improving the quality of education provided to the children of Detroit.

Due to the critical nature of the District's efforts to stabilize and increase student enrollment, prior to the beginning of the school, the District conducted open houses to encourage the community to enroll their students and provided information on their particular school's curriculum. Other activities included walks, fairs, park events and calling campaigns at local schools. Based on the ongoing campaign, the fiscal year 2016 enrollment projections assume an enrollment decrease in line with the last two years of approximately 2%. Student membership projection for funding purposes is 46,331 (42,384 for general and 3,947 for special education students), with a per foundation allowance of \$7,434 per student.

DETROIT PUBLIC SCHOOLS

Management's Discussion and Analysis

The District's fiscal year 2016 budget did not include any school closures. District studies revealed that it lost an average of thirty percent (30%) of the students when a school was closed. The District is currently reviewing options for reducing its excess student capacity without suffering high pupil losses resulting from school closures.

For fiscal year 2016, the District continued to require all central office units to participate in a modified Zero Base Budgeting process. Because of the District's declining fiscal health, each central unit was required to present strategies to reduce expenditures by 20-40% in non-personnel costs.

State funding continues to represent the most significant sources of revenue for the District. The most significant component of the District's State funding is the per pupil Foundation Allowance. The blended formula for fiscal year 2016 has changed. The formula is 90% of the October count and 10% of the prior February count. Based on the District incurring a deficit in FY 2010, the District is required to provide the Michigan Department of Education (MDE) a Deficit Elimination Plan (DEP). This plan represents the District's assessment and recommendation concerning the available resources in compliance with the Michigan Uniform Budgeting and Accounting Act. The District's Deficit Elimination Plan was initially approved by the Superintendent of Public Instruction on August 4, 2010. The most recent revision of the DEP was approved on August 19, 2014, which included an extension through June 30, 2019 when the deficit should be eliminated. This plan includes budget reduction and revenue enhancement strategies to address the deficit. Reductions to the general fund include:

- Staff reductions in alignment with declining enrollment
- Reducing revenue thru pupil retention initiatives
- Reductions in general fund discretionary spending
- Employee concessions/benefit restructuring
- School closures

On September 3, 2015, the District received a letter from the Department of Treasury on the Enhanced Deficit Elimination Plan requirements which took in consideration the Financial and Operating plans plus supplemental information that the District provided including budget amendments and the adopted 2016 fiscal year budget. The State accepted the Financial Operating Plan to meet the state requirements pursuant to MCL 380.1220(5) of an enhanced deficit elimination plan.

Contacting the District's Financial Management Team

This financial report is designed to provide the District's citizens, taxpayers, parents, students, investors and creditors with a general overview of the District's finances and to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact Detroit Public Schools, Division of Finance, 3011 West Grand Blvd., Detroit, Michigan 48202.

Or visit our website at www.detroitk12.org for a complete copy of this report and other financial information.



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DETROIT PUBLIC SCHOOLS

BASIC FINANCIAL STATEMENTS

DETROIT PUBLIC SCHOOLS

Statement of Net Position

June 30, 2015

	Governmental Activities
Assets	
Cash and cash equivalents (Note 3)	\$ 44,696,885
Receivables:	
Due from other governmental units (Note 4)	98,600,051
Land contract (Note 4)	2,836,353
Taxes	18,082,585
Other (Note 4)	6,386,199
Prepays	2,275,464
Restricted assets: (Note 8)	
Cash and cash equivalents (Note 3)	4,774,475
Capital assets not being depreciated (Note 5)	58,847,895
Capital assets being depreciated, net (Note 5)	<u>1,320,605,478</u>
Total assets	<u>1,557,105,385</u>
Deferred outflows	
Deferred charge on refunding	16,758,605
Deferred pension amounts	<u>123,225,502</u>
Total deferred outflows of resources	<u>139,984,107</u>
Liabilities	
Accounts payable	78,839,496
Accrued salaries and benefits	124,319,172
Due to other governmental units	20,336,366
Notes payable	82,800,000
Interest payable	15,703,401
Other	16,792,357
Unearned revenue - unexpended restricted funds	21,436,602
Long-term liabilities (Note 7 & 11):	
Due within one year	117,502,385
Due in more than one year	1,903,453,533
Net other postemployment benefit obligation (Note 13)	11,423,985
Net pension liability	<u>872,735,996</u>
Total liabilities	<u>3,265,343,293</u>
Deferred inflows of resources	
Deferred pension amounts	<u>96,481,319</u>
Net position	
Net investment in capital assets (Note 10)	(126,652,164)
Restricted for debt service	16,497,983
Restricted for state and other programs	925,808
Restricted for food service	6,123,021
Unrestricted (deficit)	<u>(1,561,629,768)</u>
Total net position	<u>\$ (1,664,735,120)</u>

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Statement of Activities

For the Year Ended June 30, 2015

Functions / Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	
Governmental activities				
Instruction	\$ 374,874,427	\$ 69,891	\$ 203,373,959	\$ (171,430,577)
Support services	313,548,618	2,025,918	115,203,801	(196,318,899)
Community services	3,258,057	-	3,001,771	(256,286)
Food service	42,542,212	846,314	44,757,764	3,061,866
Athletics	3,345,514	-	-	(3,345,514)
Interest on long-term debt	106,764,573	-	18,259,816	(88,504,757)
Depreciation (unallocated portion)	18,679,335	-	-	(18,679,335)
Total governmental activities	<u>\$ 863,012,736</u>	<u>\$ 2,942,123</u>	<u>\$ 384,597,111</u>	<u>(475,473,502)</u>
General revenues				
Taxes:				
Property taxes, levied for general purposes				65,981,648
Property taxes, levied for debt services				90,468,836
State aid not restricted to specific purposes				265,091,387
Interest and investment earnings				36,302
Other				11,159,377
Total general revenues				<u>432,737,550</u>
Change in net position				<u>(42,735,952)</u>
Net position, beginning of year, as restated				<u>(1,621,999,168)</u>
Net position, end of year				<u><u>\$ (1,664,735,120)</u></u>

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Balance Sheet

Governmental Funds
June 30, 2015

	General Fund	Bond Redemption	Nonmajor Governmental Funds	Total Governmental Funds
Assets				
Cash and cash equivalents	\$ 44,696,265	\$ -	\$ 620	\$ 44,696,885
Receivables (Note 4):				
Due from other governmental units	94,988,283	-	3,611,768	98,600,051
Taxes	8,318,139	9,325,452	438,994	18,082,585
Land contract	2,836,353	-	-	2,836,353
Other	6,369,109	-	17,090	6,386,199
Due from other funds (Note 6)	-	25,613,908	5,660,213	31,274,121
Prepays	2,252,428	-	23,036	2,275,464
Restricted assets: (Note 8)				
Cash and cash equivalents (Note 3)	17,617	56,583	4,700,275	4,774,475
Total assets	\$ 159,478,194	\$ 34,995,943	\$ 14,451,996	\$ 208,926,133
Liabilities				
Accounts payable	\$ 74,137,639	\$ 2,325	\$ 4,699,532	\$ 78,839,496
Accrued salaries and benefits	124,319,172	-	-	124,319,172
Compensated absences (Note 7)	277,562	-	-	277,562
Unearned revenue - unexpended restricted funds	21,436,602	-	-	21,436,602
Due to other governmental units	17,001,314	3,198,644	136,408	20,336,366
Due to other funds (Note 6)	30,184,596	-	1,089,525	31,274,121
Notes payable	82,800,000	-	-	82,800,000
Interest payable	406,410	-	-	406,410
Other	16,472,983	-	319,374	16,792,357
Total liabilities	367,036,278	3,200,969	6,244,839	376,482,086
Deferred inflows of resources				
Unavailable revenue - long-term receivables	8,373,833	-	-	8,373,833
Fund balances (deficits) (Note 9)				
Nonspendable	2,252,428	-	23,036	2,275,464
Restricted	925,808	31,794,974	9,509,358	42,230,140
Unassigned	(219,110,153)	-	(1,325,237)	(220,435,390)
Total fund balances (deficits)	(215,931,917)	31,794,974	8,207,157	(175,929,786)
Total liabilities, deferred inflows of resources and fund balances (deficits)	\$ 159,478,194	\$ 34,995,943	\$ 14,451,996	\$ 208,926,133

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Reconciliation

Fund Balances (Deficits) of Governmental Funds
to Net Position (Deficit) of Governmental Activities
June 30, 2015

Fund balances (deficits) - total governmental funds	\$ (175,929,786)
Amounts reported for governmental activities in the statement of net position are different because:	
Capital assets used in governmental activities are not financial resources and are not reported as assets in the funds	1,379,453,373
Other long-term assets are not available to pay current period expenditures and are therefore deferred in the governmental funds	8,373,833
Differences between actuarially determined net other postemployment benefit costs and actual contributions reported in governmental funds are accumulated and reported as net other postemployment obligations	(11,423,985)
Long-term liabilities are not due and payable in the current period and are not reported in the governmental funds:	
Compensated absences and employee severance plan	(17,760,998)
Workers' compensation and health insurance	(18,167,069)
Bonds and notes payable	(1,785,461,672)
Deferred charge on refunding	16,758,605
School bond loan payable	(195,871,743)
Legal and other	(3,416,874)
Accrued interest payable is not included as a liability in governmental funds	(15,296,991)
Certain pension-related amounts, such as the net pension liability and deferred amounts are not due and payable in the current period or do not represent current financial resources and therefore are not reported in the funds.	
Net pension liability	(872,735,996)
Deferred outflows related to the net pension liability	123,225,502
Deferred inflows related to the net pension liability	(96,481,319)
Net position of governmental activities	<u>\$ (1,664,735,120)</u>

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Statement of Revenues, Expenditures and Changes in Fund Balances (Deficits)

Governmental Funds

For the Year Ended June 30, 2015

	General Fund	Bond Redemption	Nonmajor Governmental Funds	Total Governmental Funds
Revenues				
Local sources	\$ 105,322,614	\$ 88,508,342	\$ 2,878,701	\$ 196,709,657
State sources	385,812,644	33,129,520	1,653,364	420,595,528
Federal sources	169,259,155	13,352,426	43,044,669	225,656,250
Total revenues	660,394,413	134,990,288	47,576,734	842,961,435
Expenditures				
Current:				
Instruction	335,669,369	-	-	335,669,369
Support services	316,574,183	-	-	316,574,183
Community services	3,301,079	-	-	3,301,079
Food service	-	-	42,667,931	42,667,931
Athletics	1,590,407	-	-	1,590,407
Debt service:				
Principal retirement	39,600,671	71,779,870	-	111,380,541
Payment of interest	17,294,384	95,787,560	-	113,081,944
Issuance costs	-	1,243,540	-	1,243,540
Capital outlay	-	-	3,677,462	3,677,462
Other	-	62,355	2,707,724	2,770,079
Total expenditures	714,030,093	168,873,325	49,053,117	931,956,535
Revenues under expenditures	(53,635,680)	(33,883,037)	(1,476,383)	(88,995,100)
Other financing sources (uses)				
Transfers in	1,762,100	-	-	1,762,100
Transfers out	-	-	(1,762,100)	(1,762,100)
Issuance of long-term debt-School Bond Loan Fund	-	28,384,590	-	28,384,590
Issuance of long-term debt	-	192,580,000	-	192,580,000
Premiums on issuance of long-term debt	-	23,843,976	-	23,843,976
Payment to bond escrow agent	-	(215,180,436)	-	(215,180,436)
Proceeds from sale of capital assets	5,401,970	-	-	5,401,970
Total other financing sources (uses)	7,164,070	29,628,130	(1,762,100)	35,030,100
Net change in fund balances	(46,471,610)	(4,254,907)	(3,238,483)	(53,965,000)
Fund balances (deficits), beginning of year	(169,460,307)	36,049,881	11,445,640	(121,964,786)
Fund balances (deficits), end of year	\$ (215,931,917)	\$ 31,794,974	\$ 8,207,157	\$ (175,929,786)

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Reconciliation

Net Changes in Fund Balances (Deficits) of Governmental Funds
to Change in Net Position of Governmental Activities
For the Year Ended June 30, 2015

Net change in fund balances (deficits) - total governmental funds \$ (53,965,000)

Amounts reported for *governmental activities* in the statement of activities are different because:

Governmental funds report capital outlays not financed by capital leases as expenditures.

In the statement of activities, these costs are allocated over their estimated useful lives as depreciation. Impairment expenses in the statement of activities would have been expended in prior years in the governmental funds. Governmental funds report proceeds from sale of capital assets as increases to financial resources. In the statement of activities, the difference between proceeds and net book value is a gain or loss.

Depreciation expense	(53,434,467)
Capital outlay	8,349,749
Change in long-term land contracts receivable for sale of capital assets	(142,649)
Proceeds from sale of capital assets	(5,259,321)
Loss on sale of capital assets	(26,076,311)

Bond proceeds provide current financial resources to governmental funds in the period issued, but issuing bonds increases long-term liabilities in the statement of net position. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net position.

Issuance of long-term debt-refunding bonds	(192,580,000)
Premium received on issuance of long-term debt	(23,843,976)
Payments to escrow for advance refunding of bonds	215,180,436
Issuance of long-term debt-School Bond Loan Fund	(28,384,590)
Principal payment on long-term liabilities	111,380,541

The receipt of long-term receivables represent revenue in the fund financial statements, but are reported as a reduction of receivables in the statement of activities, conversely new long-term receivables are considered unavailable and not recognized in the fund, but are considered earned and reported as revenue in the statement of activities

Collections on long-term assets not considered to be available in the governmental funds	(28,222,131)
Increases in long-term assets not considered to be available in the governmental funds	5,537,480

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds.

Change in the net pension liability and related deferred amounts	12,353,463
Change in accrued interest on long-term debt	4,453,610
Amortization of deferred amount of refunding bonds	(1,589,642)
Amortization of bond premiums	4,759,298
Change in the accrual for compensated absences and employee severance plan	6,524,383
Change in the accrual for other postemployment benefit costs	(4,829,809)
Change in the accrual for legal obligations	1,796,941
Change in the accrual for worker's compensation and health insurance losses	5,256,043

Change in net position of governmental activities \$ (42,735,952)

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Statement of Fiduciary Net Position

Fiduciary Funds

June 30, 2015

	Agency Fund	Private-purpose Trust Fund
	Student Activities	Scholarships
Assets		
Cash and cash equivalents (Note 3)	\$ 1,356,801	\$ 610,223
Other	40	1,500
Total assets	<u>\$ 1,356,841</u>	611,723
Liabilities		
Due to student groups and other	<u>\$ 1,356,841</u>	<u>8,142</u>
Net position		
Restricted for scholarships		<u>\$ 603,581</u>

The accompanying notes are an integral part of these basic financial statements.

DETROIT PUBLIC SCHOOLS

Statement of Changes in Fiduciary Net Position

Fiduciary Funds

For the Year Ended June 30, 2015

	Private-purpose Trust Fund
	Scholarships
Additions	
Private donations	\$ 108,024
Interest	219
Total additions	<u>108,243</u>
Deductions	
Scholarships/Professional development and other purchased services	<u>85,857</u>
Change in net position	22,386
Net position, beginning of year	<u>581,195</u>
Net position, end of year	<u><u>\$ 603,581</u></u>

The accompanying notes are an integral part of these basic financial statements.



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DETROIT PUBLIC SCHOOLS

NOTES TO FINANCIAL STATEMENTS

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Detroit Public Schools (the "District") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the District.

Reporting Entity

The School District is a statutory public body created by the State of Michigan and functions under the provision of Act 451. The School District holds all power of a school board under Act 451 as well as those additional powers and limitations of a school board for a first class school district. Detroit Public Schools is the only first class school district in Michigan with an 11 Member Board.

On May 16, 2011, Governor Rick Snyder appointed Roy S. Roberts to serve as EM for the District, pursuant to Act 4 for an initial term to expire on May 16, 2012. On March 7, 2012, Mr. Roberts was reappointment by Governor Snyder for an additional one-year term. Subsequently, the validity of Act 4 was challenged in a public referendum process that resulted in suspending Act 4 and reinstating Act 72 in early August 2012, pending the outcome of the referendum election in November 2012. At the start of the suspension period, the Governor appointed Mr. Roberts as Emergency Financial Manager for the District pursuant to the reinstated Act 72. The statewide election on November 6, 2012 invalidated Act 4, with Act 72 continuing in effect until March 28, 2013. On that date, the new Act 436 became effective and Mr. Roberts was appointed Emergency Manager for the District under Act 436. He served as such until July 15, 2013. On July 15, 2013, the Governor appointed Jack Martin to serve as the District's Emergency Manager.

Effective January 13, 2015, the Governor appointed Darnell Earley to serve as the District's new Emergency Manager. Mr. Earley serves at the pleasure of the Governor and the Governor has the authority to remove the EM with or without cause at any time. The EM may also be removed by a 2/3 vote of the local governmental unit's governing body if the emergency manager has served at least 18 months after appointment by the Governor or by impeachment and conviction by the State Legislature.

Act 436 grants an emergency manager powers and authority similar to those previously granted to an emergency financial manager under Act 72, while providing additional powers to an EM to operate all aspects of the school district or other local governmental unit for which he or she has been appointed. Under Act 436, a school district emergency manager does not have the unilateral power to initiate a Chapter 9 bankruptcy filing on behalf of the school district, and needs the Governor's written approval for such filing.

In addition, the EM powers include, but are not limited to, the authority to:

Amend, revise, approve, or disapprove the budget of the local government, and limit the total amount appropriated or expended; receive and disburse on behalf of the local government all federal, state, and local funds earmarked for the local government. These funds may include, but are not limited to, funds for specific programs and the retirement of debt; require and approve or disapprove, or amend or revise a plan for paying all outstanding obligations of the local government; make, approve, or disapprove any appropriation, contract, expenditure, or loan; the creation of any new position, or the filling of any vacancy in a position by any appointing authority; act as sole agent of the local government in collective bargaining with employees or representatives and approve any contract or agreement; employ or contract for, at the expense of the local government and with the approval of the state financial authority, auditors and other technical personnel considered necessary to implement this act; remove, replace, appoint, or confirm the appointments to any office, board, commission, authority, or other entity which is within or is a component unit of the local government.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational and financial relationships that determine which of the governmental organizations are a part of the School District's reporting entity, and which organizations are legally separate, component units of the School District. Based on the application of the criteria, the School District does not contain any component units.

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from the accompanying statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. All of the School District's government-wide activities are considered governmental activities. The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenue includes (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and (2) grants and contributions that are restricted to meeting the operational or capital requirement of a particular function. Taxes, intergovernmental payments, and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide financial statements. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants, categorical aid, and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenue include (1) charges to customers or applicants for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes and unrestricted State Aid.

Fund financial statements. Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period, or one year for expenditure-driven grants. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments (such as self-insurance, contingencies), are recorded only when payment is due.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Property taxes, unrestricted State Aid, intergovernmental grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when cash is received by the District.

The District receives shared revenues from the Wayne County Regional Education Services Agency (Wayne RESA) which are used to partially fund its center based Special Education Program. The District records recipient revenue from such nonexchange transactions when all eligibility requirements have been met and in the same period the provider expenditures are recorded by Wayne RESA. Amounts initially received by the District are subject to adjustment in future periods, and may decrease. Management does not believe that the amount of future adjustments is reasonably estimable.

Fiduciary fund statements are also reported using the accrual basis of accounting. The District maintains a Student Activities Fund to record funds received and expended for student activities. It also maintains a private purpose trust fund, the Scholarship Fund, to record private donations and scholarships awarded from these donations. The private purpose trust fund uses the economic resources measurement focus.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, and then unrestricted resources as they are needed.

The District reports the following major governmental funds:

The *general fund* is the District's primary operating fund. It accounts for all financial resources of the District, except those accounted for or reported in another fund. The District maintains separate subfunds within the general fund for federal activities, adult education and special education.

The *bond redemption fund* is a debt service fund used to record principal and interest payments related to bonds issued by the District.

In addition, the District reports the following fund types:

Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The District's special revenue fund is the food service fund. Any operating deficit generated by this fund is the responsibility of the general fund.

Debt service funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. The District's nonmajor debt service fund is the judgment levy fund.

Capital projects funds are used to record bond proceeds or other revenue and the disbursement specifically designated for acquiring new school sites, buildings, equipment, and for remodeling. The fund operates until the purpose for which it was created is accomplished. The District's nonmajor capital projects funds include the 1986 School Building Site Improvement Bonds; the 1994 School Building Site Improvement Bonds Series V; the 2009B and 2010B Building Site Improvement Bonds; and the Durant Bond funds.

Agency funds are custodial in nature and do not present results of operations or have a measurement focus. The District presents and maintains an agency fund to record the transactions of student groups for school and school-related purposes. The funds are segregated and held in trust for the students.

The *private-purpose trust fund* is used to account for resources legally held in trust, including contributions received by the District to be awarded in the form of scholarships.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Equity

Deposits and investments. Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Receivables and payables. In general, outstanding balances between funds are reported as “due to/from other funds.” All trade and property tax receivables are shown net of an allowance for uncollectible amounts. Property taxes are assessed as of December 31st and the related property taxes become a lien on December 1st of the following year. These taxes are billed on July 1st for approximately 50% of the taxes and on December 1st for the remainder of the property taxes. Taxes are considered delinquent on March 1st of the following year. At this time, penalties and interest are assessed and the total obligation is added to the county tax rolls.

Prepays. Prepaid expenditures of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as other assets in both the district-wide and fund financial statements. Reported prepaid items are equally offset by nonspendable fund balance which indicates that they do not constitute “available spendable resources” even though they are a component of current assets.

Capital assets. Capital assets, which include land, buildings, equipment, and vehicles, are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the District as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of five years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Costs of normal repair and maintenance that do not add to the value or materially extend asset life are not capitalized. The District does not have infrastructure-type assets.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives (in years):

Building and building improvement	20-50
Buses and other vehicles	5-10
Furniture and other equipment	5-20

Deferred outflows of resources. In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense/expenditure) until then. The District reports deferred outflow for the loss on bond refundings. This amount represents the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt. The District also reports deferred outflows of resources related to the net pension liability. A portion of these costs represent contributions to the plan subsequent to the plan measurement date. More detailed information on pension-related deferred outflows of resources can be found in Note 12.

Compensated absences. The liability for compensated absences reported in the government-wide statements consists of unpaid, accumulated vacation and sick leave balances. A liability for these amounts is reported in governmental funds as it comes due for payment. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

Long-term obligations. In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net position.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Bond premiums and discounts costs are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses.

Deferred inflows of resources. In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The governmental funds report unavailable revenues, which arises only under a modified accrual basis of accounting, from long-term receivables. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available. The District also reports deferred inflows related to its pension plan. More detailed information on pension related deferred inflows of resources is presented in Note 12.

Fund equity. Governmental funds report nonspendable fund balance for amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. Restricted fund balance is reported when externally imposed constraints are placed on the use of the resources by grantors, contributors, or laws or regulations of other governments. Committed fund balance is reported for amounts that can be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision making authority, the Emergency Manager. An Executive Order of the Emergency Manager is required to establish, modify or rescind a fund balance commitment. The District reports assigned fund balance for amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed. Unassigned fund balance is the residual classification for the General Fund.

Pensions. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the plan fiduciary net position have been determined on the same basis as they are reported by the plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

When the District incurs an expenditure for purposes for which various fund balance classifications can be used, it is the District's policy to use restricted fund balance first, then committed fund balance, assigned fund balance, and finally unassigned fund balance.

2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Capital projects fund compliance. The capital projects funds include capital project activities funded with bonds issued after May 1, 1994. For current year activity of the 1994 Building Site Improvement Bonds Series V, 2009 Series A Building Site Improvement Bonds Fund, 2009 Series B Building Site Improvement Bonds Fund, and the 2010 Series A and B Building Site Improvement Bonds Funds, the District has complied with the applicable provisions of §1351a of the State of Michigan's School Code.

Deficit equity. For the year ended June 30, 2015, the District had a deficit unassigned fund balances in the General Fund, Judgment Levy nonmajor debt service fund, and Durant Bond nonmajor capital projects fund of \$219,110,153, \$1,279,367, and \$45,870, respectively, which is a violation of State law. This condition is further discussed in note 15.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Excess of expenditures over appropriations. For the year ended June 30, 2015, expenditures exceeded appropriations at the legal level of budgetary control as follows:

	Budget	Actual	Variance
General Fund			
General administration	\$ 6,462,078	\$ 7,583,101	\$ 1,121,023
School administration	33,091,117	35,378,176	2,287,059
Business office	10,824,368	16,031,649	5,207,281
Transportation	29,169,431	32,840,089	3,670,658
Other support service	166,539	433,088	266,549
Athletics	953,390	1,590,407	637,017
Debt service	56,001,079	56,895,055	893,976

3. DEPOSITS AND INVESTMENTS

A reconciliation of cash and investments as shown on the Statement of Net Position and Statement of Fiduciary Net Position is as follows:

Statement of Net Position		
Cash and cash equivalents		\$ 44,696,885
Restricted cash and cash equivalents		4,774,475
Statement of Fiduciary Net Position		
Student activities - cash and cash equivalents		1,356,801
Scholarships - cash and cash equivalents		<u>610,223</u>
Total		<u>\$ 51,438,384</u>
Deposits and investments		
Bank deposits (checking and savings accounts)		\$ 2,813,324
Investments:		
Money market accounts		<u>48,625,060</u>
Total		<u>\$ 51,438,384</u>

Michigan law authorizes the District to deposit and invest in:

Bonds, bills, or notes of the United States; obligations, the principal and interest of which are fully guaranteed by the United States; or obligations of the State. In a primary or fourth class district, the bonds, bills, or notes shall be payable at the option of the holder upon not more than 90 days notice or, if not so payable, shall have maturity dates not more than 5 years after the purchase dates.

Certificates of deposit insured by a State or national bank, savings accounts of a state or federal savings and loan association, or certificates of deposit or share certificates of a state or federal credit union organized and authorized to operate in this State. In addition, the District is allowed to invest funds in certificate of deposits with financial institutions that participate in the Certificate of Deposit Account Registry Service (CDARS) Program.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Commercial paper rated prime at the time of purchase and maturing not more than 270 days after the date of purchase.

Securities issued or guaranteed by agencies or instrumentalities of the United States government or federal agency obligation repurchase agreements, and bankers' acceptance issued by a bank that is a member of the federal deposit insurance corporation.

Mutual funds composed entirely of investment vehicles that are legal for direct investment by a district.

Investment pools, as authorized by the surplus funds investment pool act, composed entirely of instruments that are legal for direct investment by a district.

The District's investment policy allows for the following types of investments:

Bonds, bills or notes of the United States; obligations, the principal and interest of which are fully guaranteed by the United States; or obligations of the State.

Certificates of deposit insured by a State or national bank, organized and authorized to operate in this State or certificates of deposits issued by a State or Federal savings and loan association, organized and authorized to operate in this State.

Commercial paper rated prime at the time of purchase and maturing not more than 270 days after the date of purchase.

Surplus funds investment pool under P.A. 1982, No. 367.

The District has designated three banks and one credit union for the deposit of its funds.

The investment policy adopted by the District has authorized investments as listed in the State statutory authority as listed above.

The District's cash and investments are subject to several types of risks, which are explained in more detail below:

Custodial Credit Risk - Deposits. Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District's investment policy requires that financial institutions be evaluated and only those with an acceptable risk level are used for the District's deposits for custodial credit risk. At year end, the District's deposit bank balance of \$4,119,911 had \$3,312,567 of bank deposits (checking and savings accounts) that were uninsured and uncollateralized. The District believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the District evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk - Investments. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District's policy for custodial credit risk states that custodial credit risk will be minimized by limiting investments to the types of securities allowed by State law, and by pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with which the District will do business using the criteria established in the investment policy. At year end, the District did not hold any investments that were subject to custodial credit risk.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Interest Rate Risk. Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The District's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. The District's policy minimizes interest rate risk by requiring the structuring of the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the District's cash requirements. At year end, the District did not hold any investments with maturity dates.

Credit Risk. State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The District's investment policy does not further limit its investment choices. At year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	Maturities	Rating	Rating Organization
JP Morgan US Treasury Plus Money Market Fund Institutional Class	\$ 48,199,108	N/A	AAAm/Aaa-mf	S&P/Moody's
MILAF+ Cash Management Class	5,225	N/A	AAAm/NR	S&P/Moody's
MILAF+ Max Class	420,727	N/A	AAAm/NR	S&P/Moody's
Total investments	\$ 48,625,060			

Concentration of Credit Risk. The District places no limit on the amount the District may invest in any one issuer. The District's policy minimizes concentration of credit risk by requiring diversification of the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized. All investments held at year end are reported in the schedule above.

Foreign Currency Risk. Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of a change in foreign currency exchange rates. State law and the District's policy prohibit investment in foreign currency.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

4. RECEIVABLES

Receivables as of year end for the District's individual major funds and the nonmajor funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	General Fund	Bond Redemption	Nonmajor Governmental Funds	Total Governmental Activities
Receivables:				
Due from other governmental units	\$ 94,988,283	\$ -	\$ 3,611,768	\$ 98,600,051
Land contract	2,836,353	-	-	2,836,353
Taxes	8,318,139	9,325,452	438,994	18,082,585
Other	6,369,109	-	17,090	6,386,199
	<u>\$ 112,511,884</u>	<u>\$ 9,325,452</u>	<u>\$ 4,067,852</u>	<u>\$ 125,905,188</u>

Of the receivables listed above, \$2,480,030 of the land contract receivable is not expected to be collected within one year.

5. CAPITAL ASSETS

Capital asset activity of the District's governmental activities is as follows:

	Beginning Balance	Transfers	Additions	Disposals and Adjustments	Ending Balance
Capital assets, not being depreciated:					
Land	\$ 56,905,839	\$ -	\$ -	\$ (1,227,671)	\$ 55,678,168
Construction in progress	6,098,344	(2,938,782)	4,246,914	(4,236,749)	3,169,727
	<u>63,004,183</u>	<u>(2,938,782)</u>	<u>4,246,914</u>	<u>(5,464,420)</u>	<u>58,847,895</u>
Capital assets, being depreciated:					
Buildings and building improvements	1,861,454,223	1,009,330	3,719,407	(61,529,710)	1,804,653,250
Land improvements	106,689,413	1,322,354	72,033	(5,640,636)	102,443,164
Vehicles	3,079,925	-	40,912	(610,876)	2,509,961
Machinery and other equipment	207,808,739	607,098	270,482	(964,046)	207,722,273
	<u>2,179,032,300</u>	<u>2,938,782</u>	<u>4,102,834</u>	<u>(68,745,268)</u>	<u>2,117,328,648</u>
Less accumulated depreciation for:					
Buildings and building improvements	558,225,297	-	43,644,075	(38,513,954)	563,355,418
Land improvements	54,590,210	-	4,820,482	(3,146,579)	56,264,113
Vehicles	2,539,525	-	145,909	(610,877)	2,074,557
Machinery and other equipment	170,807,727	-	4,824,001	(602,646)	175,029,082
	<u>786,162,759</u>	<u>-</u>	<u>53,434,467</u>	<u>(42,874,056)</u>	<u>796,723,170</u>
Total capital assets being depreciated, net	<u>1,392,869,541</u>	<u>2,938,782</u>	<u>(49,331,633)</u>	<u>(25,871,212)</u>	<u>1,320,605,478</u>
Total capital assets, net	<u>\$ 1,455,873,724</u>	<u>\$ -</u>	<u>\$ (45,084,719)</u>	<u>\$ (31,335,632)</u>	<u>\$ 1,379,453,373</u>

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Depreciation expense was charged to activities of the District as follows:

Function	Depreciation Expense
Instruction	\$ 28,842,723
Support services	3,473,225
Community service	29,391
Food service	879,669
Athletics	1,530,124
Unallocated	18,679,335
	<u>\$ 53,434,467</u>

Depreciation expense was unallocated where the District considers its assets to impact multiple activities and allocation is not practical.

Asset impairment

In accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, impaired capital assets that will no longer be used are reported at the lower of carrying value or fair value. The fair values of District buildings identified for closure were estimated, and the book values were adjusted if the fair value was lower than the net book value. Assets with a carrying value of approximately \$13 million are considered to be idle at year end.

Construction commitments

The District has active construction projects at year end. At year end, the District's commitments with contractors are as follows in the listed bond issues:

Bond issue	Spent to Date	Remaining Commitment
2003B Series V	\$ 416,452,951	\$ 767,176
2010B	49,945,350	737
	<u>\$ 466,398,301</u>	<u>\$ 767,913</u>

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

6. INTERFUND RECEIVABLES AND PAYABLES AND TRANSFERS

The composition of interfund balances is as follows:

Fund Due From	Fund Due To		
	Bond Redemption	Nonmajor Governmental Funds	Total
General Fund	\$ 24,849,555	\$ 5,335,041	\$ 30,184,596
Nonmajor governmental funds	764,353	325,172	1,089,525
	<u>\$ 25,613,908</u>	<u>\$ 5,660,213</u>	<u>\$ 31,274,121</u>

Interfund receivables and payables occur in the course of ordinary operations and reflect short-term transactions between funds.

At fiscal year end, interfund transfers consisted of a \$1,762,100 transfer from the nonmajor food service fund to the general fund for administrative costs.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

7. LONG-TERM DEBT

The District issues bonds to provide for the acquisition and construction of major capital facilities and the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the District. The District has issued notes payable to refinance short-term State Aid Anticipation notes into long-term payables. Other long-term obligations include compensated absences, termination benefits, claims and judgments, and certain risk liabilities. In prior years, the General Fund has typically been used to liquidate nonbonded debt related long-term liabilities. The current portion of compensated absences reported in the General Fund, \$277,562 relates to the unpaid balance for terminated employees as of June 30, 2015, which is expected to be paid using current available resources.

Long term obligation activity is summarized as follows:

Description	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Bonds payable					
School building & site improvement:					
Series 1998C	\$ 51,965,000	\$ -	\$ (3,610,000)	\$ 48,355,000	\$ 3,800,000
Series 2001A	183,695,000	-	-	183,695,000	-
Series 2002A	35,785,000	-	-	35,785,000	-
Series 2005A	470,735,000	-	(243,935,000)	226,800,000	-
Series 2009A	79,967,400	-	(5,047,400)	74,920,000	5,595,000
Series 2009B	192,800,000	-	(1,400,000)	191,400,000	5,250,000
Series 2010A	145,665,000	-	(1,575,000)	144,090,000	7,755,000
Series 2010B	49,630,000	-	-	49,630,000	-
Series 2012A	312,595,000	-	(7,775,000)	304,820,000	8,490,000
Series 2015A	-	192,580,000	-	192,580,000	22,605,000
Series 1998 (Durant)	18,372,470	-	(18,372,470)	-	-
Total school building & site improvement	1,541,209,870	192,580,000	(281,714,870)	1,452,075,000	53,495,000
Unamortized bond premium	67,568,056	23,843,976	(17,282,423)	74,129,609	9,260,258
Total bonds payable	1,608,777,926	216,423,976	(298,997,293)	1,526,204,609	62,755,258
Notes payable					
Series 2011	188,352,734	-	(23,310,671)	165,042,063	24,415,928
Series 2012	110,505,000	-	(16,290,000)	94,215,000	17,105,000
Total notes payable	298,857,734	-	(39,600,671)	259,257,063	41,520,928
Total installment debt	1,907,635,660	216,423,976	(338,597,964)	1,785,461,672	104,276,186
Other liabilities					
Compensated absences payable	2,622,609	583,684	(42,728)	3,163,565	583,684
Employee severance plan	21,809,183	8,451,743	(15,385,931)	14,874,995	8,451,743
Workers' compensation and health insurance claims	23,423,112	44,926,076	(50,182,119)	18,167,069	773,898
Legal and other	5,213,815	3,416,874	(5,213,815)	3,416,874	3,416,874
School Loan Revolving Fund	161,720,750	34,150,993	-	195,871,743	-
Total other liabilities	214,789,469	91,529,370	(70,824,593)	235,494,246	13,226,199
Total long-term obligations	\$ 2,122,425,129	\$ 307,953,346	\$ (409,422,557)	\$ 2,020,955,918	\$ 117,502,385

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The effective issue dates, year of maturity, serial interest rate, and original amount of issue for the bonds outstanding at June 30, 2015 is as follows:

Description	Effective Date of Issue	Year of Maturity	Serial Interest Rates of Debt	Amount of Original Issue
Bonds payable				
Series 1998C	11/01/1998	2025	3.50% - 5.25%	\$ 84,855,000
Series 2001A	10/30/2001	2031	3.00% - 6.00%	438,365,000
Series 2002A	10/29/2002	2032	3.00% - 6.00%	388,995,000
Series 2005A	08/17/2005	2032	5.00% - 5.25%	500,000,000
Series 2009A*	12/30/2009	2025	3.19%	90,000,000
Series 2009B	12/30/2009	2039	5.06%	200,000,000
Series 2010A*	10/06/2010	2029	6.65%	160,910,000
Series 2010B	10/06/2010	2040	6.85%	49,630,000
Series 2012A	03/13/2012	2033	3.00% - 5.00%	337,735,000
Series 2015A	02/11/2015	2025	3.00% - 5.00%	192,580,000

* - Annual payments are paid to a trustee that holds the proceeds in trust for payment of the full amount of the bonds at maturity. The bonds are considered to be defeased at the time payments are made to the trustee.

Annual debt service requirements to maturity for long-term debt are as follows:

Year Ended June 30,	School Building and Site Improvement Bonds			Notes Payable		
	Principal	Interest	Total	Principal	Interest	Total
2016	\$ 53,495,000	\$ 84,801,816	\$ 138,296,816	\$ 41,520,928	\$ 11,481,166	\$ 53,002,094
2017	56,535,000	81,964,226	138,499,226	43,537,684	9,471,291	53,008,975
2018	58,995,000	79,772,394	138,767,394	45,653,774	7,355,298	53,009,072
2019	61,525,000	77,538,335	139,063,335	47,864,278	5,141,291	53,005,569
2020	64,285,000	75,080,275	139,365,275	49,886,482	3,117,218	53,003,700
2021-2025	369,675,000	333,275,988	702,950,988	30,793,917	1,462,711	32,256,628
2026-2030	460,780,000	219,078,969	679,858,969	-	-	-
2031-2035	229,715,000	69,700,806	299,415,806	-	-	-
2036-2040	97,070,000	19,064,222	116,134,222	-	-	-
	<u>\$ 1,452,075,000</u>	<u>\$ 1,040,277,031</u>	<u>\$ 2,492,352,031</u>	<u>\$ 259,257,063</u>	<u>\$ 38,028,975</u>	<u>\$ 297,286,038</u>

Notes Payable

The effective issue dates, year of maturity, serial interest rate, and original amount of issue for the notes outstanding at June 30, 2015 is as follows:

Description	Effective Date of Issue	Year of Maturity	Serial Interest Rates of Debt	Amount of Original Issue
Notes payable				
Series 2011	10/13/2011	2021	4.75%	\$ 244,910,407
Series 2012	05/17/2012	2020	1.260% - 5.018%	141,095,000

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

On October 13, 2011, the District issued long-term notes to refinance \$231 million of short-term state aid anticipation notes. On May 17, 2012, the District entered into an amended and restated multi-year repayment agreement with the Michigan Finance Authority to redeem bonds issued in 2005. Those bonds were originally issued in April 2005 to refinance \$210 million in short-term state aid anticipation notes.

School Loan Revolving Fund

The school loan revolving fund payable represents notes payable to the State of Michigan for loans made to the District, as authorized by the 1963 State of Michigan Constitution, for the purpose of paying principal and interest on general obligation bonds of the District issued for capital expenditures. Interest rates are to be annually determined by the State Administrative Board. The interest rate charged to the District for the year was 3.4% through June 30, 2015. Repayment is required when the millage rate necessary to cover the annual bonded debt service requirements falls below 7.0 mills. As of June 30, 2015, the District did not have a current balance due as a result of this requirement. The District is required to levy mills and repay the State any excess of the amount levied over the bonded debt service requirement. Due to the variability of the factors that affect the timing of repayment, including the future amount of state-equalized value of property in the District, no provision for repayment has been included in the above amortization schedule. Changes in principal and interest were as follows:

	Principal	Interest	Total
Beginning balance	\$ 152,916,577	\$ 8,804,173	\$ 161,720,750
Additions	28,384,590	5,766,403	34,150,993
Ending balance	<u>\$ 181,301,167</u>	<u>\$ 14,570,576</u>	<u>\$ 195,871,743</u>

Advance refundings

On March 12, 2015, the District issued \$192,580,000 School Building and Site Improvement Refunding Bonds with an interest rate of 3.00%-5.00% to refund \$209,935,000 of outstanding 2005A Series Bonds with an average coupon rate of 5.00%. This refunding resulted in a savings of \$27,336,925 and an economic gain of \$24,890,098. The net proceeds of the 2015 bonds were used to purchase direct United States Treasury securities. These securities were deposited in an irrevocable escrow fund to be used to pay, when due, the principal, and interest on the refunded bonds. The refunded 2005A Series were called for redemption on May 1, 2015, and were paid from the escrow fund.

Compensated absences

On August 19, 2011 the District's Emergency Manager signed an Amended Order Relating to Wage, Compensation and Benefits Structure For District Employees ("Amended Order"). Wage and compensation restructuring provisions of the Amended Order became effective July 29, 2011. The Amended Order, among other wage and compensation restructuring provisions, suspended payment by the District of any sick days remaining unused at the time of an employee's resignation or retirement.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

During Fiscal Year 2013, union contracts were negotiated suspending payment of unused sick leave days throughout the duration of the agreements. This suspension is applicable to all Detroit Public Schools unions with the exception of the Detroit Federation of Teachers. As part of the union contract, these benefits were negotiated at a reduced rate each year with a maximum of 200 days paid to retirees. The District has agreed to provide restoration and payment of unused sick days at retirement for employees who retire effectively July 1 and August 1 and whose irrevocable separation-from-service form is submitted no later than May 1 of each year until 2016. It is the District's intent to periodically review this and other provisions in the Amended Order to determine if any should be modified.

Termination Benefits - Employee Severance Plans

The Employee Severance Plan ("ESP") was available to actively working employees with Detroit Public Schools ("the District") represented by the Detroit Federation of Teachers ("DFT") excluding hourly and substitutes, who, (1) had ten or more years of service with the District as of June 30, 2013; or (2) were earning a minimum of \$60,000 and had a minimum of 5 years of service with the District as of June 30, 2013. The Plan was also available to employees represented by AFSCME, Local 345, OSAS, OSAS Related, DAEOE, DAEOE Related, Police Officers Association of Michigan (POAM), POAM Related, Police Officers Labor Council, NISP, Paraprofessionals and non represented employees including Principals, Assistant Principals, and Executive staff who had ten or more years of service with the District as of June 30, 2013. However, the Plan was not available to any District employee who notified the District in writing on or before May 1, 2013 that he/she would be resigning or retiring from DPS for the 2012-2013 school year, was a substitute, temporary or contracted employee, was laid off or terminated, or who had previously retired and returned to the District. A similar plan was also made available to employees represented by DFT meeting the same requirements as of June 30, 2014 and 2015.

The District is paying a severance incentive payment to an eligible employee who participates in the Plan, provided that the employee has fulfilled his/her contractual obligations through his/her exit date. Eligible employees electing the Plan were required to select a separation of service date of June 30, 2013, or a separation date of June 30, 2014 or July 31, 2014 (for qualified DFT members assigned to summer school or extended year programs) for the plan offered in 2014. The District reserves the right to change the separation date of a participant to an alternate date based on operational needs as determined solely by the District; however, the alternate date shall not be later than June 30, 2015 or July 31, 2015. If the District exercises this right, the alternate date selected by the District became the separation of service date of the Employee. An employee retained through an alternate date selected by the District receives the same Plan benefit dollar amount he/she would have received had the District not changed the exit date, but the Plan benefit payments started not later than four months following his/her actual exit date. Failure to fulfill contractual obligations through the employee's exit date will result in forfeiture of the Plan benefits. Death or disability is not considered a lack of fulfillment of contractual obligations, and does not preclude the Employee from receiving Plan benefits.

Following separation from service with the District the employee is free to accept full or part-time employment with another employer, or perform substitute services, or other employment with the District at the District's sole discretion.

For the 2013 plan, employees who elected to participate in the ESP will receive a severance incentive payment in an amount equal to sixty-five percent (65%) of his/her 2012-2013 post-concession base annual salary. Employees elected to participate in the Plan from May 13, 2013 through June 28, 2013. In fiscal year 2013, the Plan had 184 participants. For the plan offered in 2014, employees who elect to participate in the ESP will receive a severance incentive payment in an amount equal to sixty percent (60%) of his/her 2013-2014 base annual salary, plus applicable sick leave pay and Termination Incentive Pay ("TIP").

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Participants receive payment of the total Plan benefit over a period of five years, divided into 60 equal monthly payments paid to an annuity contract or custodial account that is designed to meet the tax-qualification requirements of Internal Revenue Code Section 403(b).

8. RESTRICTED ASSETS

The unspent bond proceeds and related interest of the capital projects funds are required to be set aside for construction. The unspent program income earned by the food service fund is required to be set aside for food services. The unspent receipts for adult education is required to be set aside for adult education. In addition, the unspent property taxes levied in the debt service fund are required to be set aside for future bond principal and interest payments. These amounts have been classified as restricted assets.

The balances of the restricted asset accounts are as follows:

	Governmental Activities
Unspent bond proceeds and related interest	\$ 4,053,653
Unspent property taxes levied for debt service	56,966
Unspent food services fund proceeds	646,239
Unspent adult education funds	<u>17,617</u>
	<u>\$ 4,774,475</u>

9. FUND BALANCES (DEFICITS)

	General Fund	Bond Redemption	Nonmajor Governmental Funds	Total
Fund balances				
Nonspendable:				
Prepays	\$ 2,252,428	\$ -	\$ 23,036	\$ 2,275,464
Restricted for:				
State and other programs	925,808	-	-	925,808
Food service	-	-	6,123,021	6,123,021
Debt service	-	31,794,974	-	31,794,974
Capital projects	-	-	3,386,337	3,386,337
Total restricted	<u>925,808</u>	<u>31,794,974</u>	<u>9,509,358</u>	<u>42,230,140</u>
Unassigned (deficits)	<u>(219,110,153)</u>	<u>-</u>	<u>(1,325,237)</u>	<u>(220,435,390)</u>
Total fund balances (deficits)	<u>\$ (215,931,917)</u>	<u>\$ 31,794,974</u>	<u>\$ 8,207,157</u>	<u>\$(175,929,786)</u>

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

10. NET INVESTMENT IN CAPITAL ASSETS

As of June 30, 2015, net investment in capital assets was comprised of the following:

Capital assets:	
Capital assets not being depreciated	\$ 58,847,895
Capital assets being depreciated, net	1,320,605,478
	<u>1,379,453,373</u>
Related debt:	
Bonds payable	1,526,204,609
Deferred charge on refunding	(16,758,605)
Unspent bond proceeds	(3,340,467)
	<u>1,506,105,537</u>
 Net investment in capital assets	 <u><u>\$(126,652,164)</u></u>

11. RISK MANAGEMENT

The District is self-insured for workers' compensation, certain health benefits and other claims, litigation, and assessments. Accruals for claims, litigation, and assessments are recorded in the government-wide financial statements. These accruals are recorded in the fund financial statements, within the governmental funds, when the amounts are due and payable at year-end. There were no significant reductions in coverage from the prior year.

Health insurance and workers' compensation claims that are probable of loss and estimable in amount are included in the government-wide financial statements. The amount of claims liability is based on analyses performed by outside consultants and includes an estimate of incurred claims that have not yet been reported.

A reconciliation of the District's self-insured claims liability at June 30, 2015 is as follows:

Claims liability, June 30, 2013	\$ 28,044,656
Claims incurred during fiscal year 2014, including changes in estimate	59,807,309
Payments on claims	<u>(64,428,853)</u>
Claims liability, June 30, 2014	23,423,112
Claims incurred during fiscal year 2015, including changes in estimate	44,926,076
Payments on claims	<u>(50,182,119)</u>
 Claims liability, June 30, 2015	 <u><u>\$ 18,167,069</u></u>

The liability for workers' compensation claims includes an estimate of loss and allocated loss adjustment (ALAE). The estimate of loss is based on historical loss runs for the workers' compensation program through June 30, 2015. ALAE represents the cost of legal fees, expert testimony, medical examination, etc, that are associated with the defense and settlement of particular claims. Unallocated loss adjustment expenses are not included in the estimate.

Various legal actions, proceedings, and claims are pending or may be asserted in the future against the District, including those arising out of personal injuries and civil actions. Some of the foregoing matters involve compensatory and/or punitive damage claims.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Litigation is subject to many uncertainties, the ultimate outcome of which is not predictable; however, the District's management believes the resulting liabilities from outstanding legal actions, proceedings, and claims will not have a material adverse effect upon the District's financial position or results of operations. At June 30, 2015, the District has recorded an estimated liability of approximately \$3.4 million for pending litigation as a long-term obligation.

12. RETIREMENT PLAN

General Information about the Pension Plan

Plan Description. The District contributes to the Michigan Public School Employees Retirement System ("MPERS"), a cost-sharing multiple-employer pension plan administered by the State of Michigan Department of Management and Budget, Office of Retirement Services with oversight from a 12-member board. Benefit provisions are established and may be amended by state statute. The Office of Retirement Services issues a publicly available financial report that includes financial statements and required supplementary information for MPERS. That report can be obtained by writing to Michigan Public School Employees Retirement System, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan, 48909 or by calling (517) 322-5103.

Participants are enrolled in one of multiple plans based on date of hire and certain voluntary elections. A summary of the pension plans offered by MPERS is as follows:

Plan Name	Plan Type	Plan Status
Member Investment Plan (MIP)	Defined Benefit	Closed
Basic	Defined Benefit	Closed
Pension Plus	Hybrid	Open
Defined Contribution	Defined Contribution	Open

The Member Investment Plan (MIP) includes additional subgroups based on hire date. The MIP Fixed plan includes members hired prior to January 1, 1990. The MIP Graded plan includes members first hired from January 1, 1990 through June 30, 2008. The MIP Plus plan includes members first hired from July 1, 2008 through June 30, 2010. Members who initially enrolled in the MIP plan and made a voluntary election to contribute a higher rate are participants in the MIP 7% plan.

Members hired between July 1, 2010 and September 3, 2012 were enrolled in the *Pension Plus* plan. Members hired on or after September 4, 2012 are automatically enrolled in this plan unless an election is made to participate in the defined contribution plan. The plan includes a pension component as well as a savings component. Member contributions to the savings component are match at a rate of 50% by the employer (up to a maximum of 1%) and invested in a 401(k) plan.

Effective February 1, 2013, members that initially enrolled in MIP were provided the option to convert to a defined contribution plan (Basic 4%). In these instances, any service credit accumulated under the defined benefit plan before February 1, 2013 is retained. For service performed after this date, the converted plan member receives 4% employer contributions to a personal 401(k) account.

A member first enrolling in MPERS on or after September 4, 2012 may elect to enroll in the *defined contribution* plan. Employer and employee contribution rates and vesting requirements are consistent with the defined contribution component of the Pension Plus plan as described above.

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Benefits Provided. MPERS provides retirement, death, disability and postemployment benefits to eligible participants. Retirement benefits are calculated as a percentage of the employee's final average compensation times the employee's years of service. All participants qualify for a benefit multiplier of 1.5% for the first 30 years of service. Certain benefit groups receive a reduced rate of 1.25% for service above 30 years. Disability benefits are calculated the same as regular service retirement. Participants are eligible to receive full retirement benefits upon reaching the age and years of service requirements below. Most plans offer additional options for early retirement if certain stipulations have been met. Voluntary contributions vest immediately.

Plan	Eligibility Based on Years of Service	Vesting
Member Investment Plan (MIP)	Age 46 with 30 years or age 60 with 10 years	10 years
Basic	Age 55 with 30 years or Age 60 with 10 years	10 years
Pension Plus	Age 60 with 10 years	4 years
Defined Contribution	Age 46 with 30 years or age 60 with 10 years	4 years

Contributions. Employer contributions to the plans are based on a percentage of covered payroll that has been actuarially determined as an amount that, when combined with employee contributions, is expected to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Member contributions are determined based on date of hire and the plan selected. In addition, the District is invoiced monthly an amount that approximates 7.63% of covered payroll for "MPERS UAAL Stabilization." This additional contribution is offset by monthly State aid payments equal to the amounts actually billed by the Office of Retirement Services. For the plan year ended September 30, 2015, an additional 1.13% MPERS liability prepayment was invoiced as a one-time cost. Employer contribution requirements for pension, inclusive of the MPERS UAAL Stabilization and one-time prepayment rates, range from 27.52% to 31.83% of covered payroll. Plan member contributions range from 0.0% to 7.0% of covered payroll.

The District's contribution to MPERS under all pension plans for the year ended June 30, 2015, inclusive of the MPERS UAAL Stabilization and one-time prepayment, was \$98,482,599.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2015, the District reported a liability of \$872,735,996 for its proportionate share of the net pension liability. The net pension liability was measured as of September 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation rolled forward from September 30, 2013. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating school districts, actuarially determined. At September 30, 2014, the District's proportion (as calculated by MPERS) was 3.96221%.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

For the year ended June 30, 2015, the District recognized pension expense of \$70,752,360. At June 30, 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources	Net Deferred Outflows (Inflows) of Resources
Changes in assumptions	\$ 32,202,091	\$ -	\$ 32,202,091
Changes in proportion and differences between District contributions and proportionate share of contributions	224,197	-	224,197
Net difference between projected and actual earnings on pension plan investments	-	96,481,319	(96,481,319)
	<u>32,426,288</u>	<u>96,481,319</u>	<u>(64,055,031)</u>
District contributions subsequent to the measurement date	90,799,214	-	90,799,214
Total	<u>\$ 123,225,502</u>	<u>\$ 96,481,319</u>	<u>\$ 26,744,183</u>

The amount of deferred outflows of resources related to District contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as pension-related deferred outflows of resources and deferred inflows of resources will be recognized in pension expense as follows:

Year Ended June 30,	Amount
2016	\$ (15,688,500)
2017	(15,688,500)
2018	(15,688,500)
2019	<u>(16,989,531)</u>
Total	<u>\$ (64,055,031)</u>

Actuarial Assumptions. The total pension liability in the September 30, 2013 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Wage inflation	3.5%
Salary increases	3.5% to 12.3%, including wage inflation at 3.5%
Investment rate of return	8.0% (7.0% for the Pension Plus plan)
Cost of living adjustments	3.0% annual, non-compounded for MIP members
Healthcare cost trend rate	8.5% year 1 graded to 3.5% year 12

The mortality table used in this valuation was the RP-2000 Male and Female Combined Healthy Life Mortality Tables, adjusted for mortality improvements to 2025 using projection scale BB. For retirees, 100% of the table rates were used. For active members, 80% of the table rates were used for males and 70% of the table rates were used for females.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Assumption changes as a result of an experience study for the periods 2007 through 2012 have been adopted by the System for use in the annual pension valuations beginning with the September 30, 2014 valuation.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimates of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return	Expected Money-Weighted Rate of Return
Domestic equity pools	28.00%	4.80%	1.34%
Alternative investment pools	18.00%	8.50%	1.53%
International equity	16.00%	6.10%	0.98%
Fixed income pools	10.50%	1.50%	0.16%
Real estate and infrastructure pools	10.00%	5.30%	0.53%
Absolute return pools	15.50%	6.30%	0.98%
Short-term investment pools	2.00%	-0.20%	-0.02%
	100.00%		5.50%
Inflation			2.50%
Investment rate of return			8.00%

Discount Rate. The discount rate used to measure the total pension liability was 8.0%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that District contributions will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate. The following presents the net pension liability of the District, calculated using the discount rate of 8.0%, as well as what the District’s net pension liability would be if it were calculated using a discount rate that is 1% lower (7.0%) or 1% higher (9.0%) than the current rate:

	1% Decrease (7.0%)	Current Discount Rate (8.0%)	1% Increase (9.00%)
District's proportionate share of the net pensic liability	\$1,150,626,415	\$ 872,735,996	\$ 638,609,215

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Pension Plan Fiduciary Net Position. Detailed information about the pension plan's fiduciary net position is available in the separately issued MPERS financial statements available on the State of Michigan Office of Retirement Services website at www.michigan.gov/orsschools.

Payable to the Pension Plan. At June 30, 2015, the District reported a payable of \$76,164,997 for the outstanding amount of pension contributions to the Plan required for the year ended June 30, 2015. This amount included approximately seven months of contractually required contributions which the District has not yet remitted to the Plan due to cash flow difficulties.

Other Postemployment Benefits

Retirees enrolled in MPERS before September 4, 2012 have the option of participating in the *Premium Subsidy* plan, a defined benefit postemployment healthcare plan, which is funded by employers on a cash disbursement basis. The State of Michigan has contracted to provide the comprehensive group medical, hearing, dental and vision coverage for retirees and beneficiaries. All health care benefits are on a self-funded basis. A significant portion of the premium is paid by MPERS with the balance deducted from the monthly pension. Employer contributions range from 2.20% to 2.71% of covered payroll. Plan participants contribute 3% of covered payroll to the Retiree Healthcare Fund. At retirement, these individuals receive a subsidy for healthcare premiums that covers up to 80% of cost.

Plan members enrolled on or after September 4, 2012 participate in the *Personal Healthcare Fund*. This defined contribution other postemployment benefits plan includes a required 2% employee contribution into a personal tax-deferred account, which is matched by an additional 2% employer contribution. Employees are fully vested in these contributions which can be used, along with earnings thereon, to pay for postemployment healthcare expenses. Plan members working prior to September 4, 2012 were given the option to convert from the Premium Subsidy plan to the Personal Healthcare Fund option. Effective February 1, 2014, these members are no longer required to make the 3% employee contribution. Amounts paid into the Retiree Healthcare Fund between September 4, 2012 and February 1, 2014 were credited to each individual's Personal Healthcare Fund account. Any contributions made prior to September 4, 2012 are pending a Supreme Court resolution.

The District's contributions to MPERS for other postemployment benefits amounted to \$9,905,566 for the year ended June 30, 2015.

13. POSTEMPLOYMENT BENEFITS - TERMINATION INCENTIVE PLAN (TIP)

Plan Description. The Detroit Federation of Teachers (DFT), Local 231 union contract from July 1, 2009 through June 30, 2012 includes a professional compensation clause: Termination Incentive Plan. This Plan started on January 12, 2010 and was expected to expire in fiscal year 2012. On August 19, 2011, the District's Emergency Manager signed an amended order relating to wages, compensation, and benefits structure for District employees. This amended order suspended the Termination Incentive Plan. The plan applies to all salaried members of DFT except assistant attendance officers, accompanists and members who work less than .5 FTEs. \$250 was deducted each pay except during the summer. Plan-to-date, these deductions amounted to \$49 million. If an employee retires or resigns after this agreement, the employee is entitled to \$1,000 for each year of service up to nine years with a cap of \$9,000. No payment will exceed the amount contributed. Payments are subject to pension calculations and reportable to the Office of Retirement at the time the employee receives the funds from the District.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

Funding Policy. The contribution requirements of Plan members and the District are established and may be amended by the District's Emergency Manager. The District is required to contribute the annual required contribution of the employer (ARC) at an actuarially determined rate as required by the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded liability (or funding excess) over a period not to exceed 30 years.

Annual OPEB Cost and Net OPEB Obligation. The District's annual other postemployment benefit (OPEB) cost was \$7,113,089. The required contribution was determined as part of the June 30, 2015 actuarial valuation, using the unprojected unit credit actuarial cost method. Significant actuarial assumptions include a 2.5% investment rate of return (net of administrative expenses). The District's unfunded actuarial accrued liability is being amortized using the level dollar method on a closed basis. The remaining amortization period at June 30, 2015 is 3 years.

The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the District's net OPEB obligation:

Annual required contribution	\$ 9,228,694
Interest on net OPEB obligation	164,854
Adjustment to annual required contribution	<u>(2,280,459)</u>
Net OPEB cost (expense)	7,113,089
Contributions made	<u>(2,283,280)</u>
Increase in net OPEB obligation	4,829,809
Net OPEB obligation, beginning of year	<u>6,594,176</u>
Net OPEB obligation, end of year	<u><u>\$ 11,423,985</u></u>

Three-Year Trend Information			
Year Ended	Net OPEB Cost	Percentage of Net OPEB Cost Contributed	Net OPEB Obligation
06/30/2013	\$ 7,292,832	82.2%	\$ 3,108,825
06/30/2014	6,917,077	49.6%	6,594,176
06/30/2015	7,113,089	32.1%	11,423,985

Funded Status. As of June 30, 2015, the most recent actuarial valuation date, the actuarial accrued liability for benefits was \$16,617,931, all of which was unfunded.

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and Plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

14. STATE AID ANTICIPATION NOTES

The proceeds from the sale of these notes provide the District with funds to meet its cash flow requirements for the current fiscal year. The District's State Aid revenue is pledged to repay this obligation, and amounts are set-aside from State Aid revenues due the District sufficient to retire this obligation at maturity.

Note	Date of Issuance	Maturity Date	Interest Rate	Beginning Balance	Additions	Retirements	Ending Balance
2013C	08/27/13	08/20/14	4.375%	\$ 92,000,000	\$ -	\$ (92,000,000)	\$ -
2014E	08/29/14	08/20/15	2.850%	-	107,800,000	(107,800,000)	-
2015B	05/19/15	06/01/16	4.750%	-	82,800,000	-	82,800,000
				<u>\$ 92,000,000</u>	<u>\$ 190,600,000</u>	<u>\$ (199,800,000)</u>	<u>\$ 82,800,000</u>

On May 19, 2015, the District issued \$82,800,000 to refinance \$78,550,000 of the 2014E State Aid Anticipation notes. These proceeds of these notes, along with set aside payments of \$29,250,000, were used to purchase direct United States Treasury securities. These securities were deposited in an irrevocable escrow fund to be used to pay, when due, the principal, and interest on the refinanced notes. As a result, the refinanced notes are considered to be defeased and the liability for notes notes has been removed from the financial statements.

15. FUNDING UNCERTAINTIES

The District receives over 55 percent of its funding for regular operations from the State of Michigan through its "foundation allowance" and other school district funding. The foundation allowance for the current fiscal year was determined by the State and paid on the basis of the number of students attending the District on count day in October 2014 and in February 2015. The District has experienced declines in enrollment which resulted in reductions in State and Federal revenues. These declines in revenue have challenged the District to reduce operating expenditures including facilities, staffing, health care, pension and other costs.

As required by State law, a public school district that incurs a deficit must submit a deficit elimination plan to the Michigan Department of Education (MDE) for review and approval. The District's latest plan was approved by the State Superintendent of Public Instruction in August 2014.

The Deficit Elimination Plan addresses the deficit through development of plans for reductions in general fund spending, and enhancement of revenues including:

- Central administration reorganization and restructuring
- Implementation of new ERP system to enhance operational efficiencies
- Staff reductions to align staffing with pupil enrollment
- Reductions in general fund discretionary spending
- School closures
- Union concessions
- Increasing revenue through pupil gain and retention initiatives
- Employees Severance Plan
- Sale of surplus real estate and other property
- Employees benefits restructuring

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

The District was also required to provide to the Department of Treasury an Enhanced Deficit Elimination Plan which was accepted by the State Treasurer's office on September 3, 2015. This year's deficit is less than budget amendment five which projected a deficit of \$238 million. The actual deficit for fiscal year 2015 is \$216 million. There still remains a significant deficit which must be dealt with in Fiscal year 2016 and beyond. Therefore in order to reorganize the District, Detroit Public Schools is undertaking a major transformation and reorganizing the Central Office and streamlining support to direct more resources to the schools which will provide them with more authority at the school level.

The continuing decline in enrollment for fiscal year 2015 provided the District with challenges maintaining a balanced budget throughout the year. To mitigate the District's traditional enrollment decline, it has developed a comprehensive pupil retention and gain program that was implemented in FY 2014 and continued through fiscal year 2015. The loss of enrollment in the Fall 2015 suggests that the measures are beginning to show results.

The District's ability to stabilize its financial condition has a direct correlation to its ability to increase pupil enrollment, stabilize and enhance its revenues, and complete a comprehensive restructuring of its operations.

With the implementation of innovative revenue producing initiatives and the reduction or elimination of many expenditures, the District is committed to the elimination of the legacy deficit and right-sizing Detroit Public Schools so that it provides a quality education to the children of Detroit.

The fiscal year 2016 budget reflects a \$50 million shortfall in cash in the early spring which requires support from the State. Without this support, it is very difficult for the District to continue operations. After 2016, the District will continue to require assistance from the State. Therefore, the District must reform from the current structure.

In order to reform the District, various initiatives have taken place.

In December 2014, a diverse cross-section of leaders representing Detroit's education, civic, philanthropic, business, religious, and community sectors led by the Skillman Foundation formed a Coalition for the Future of Detroit Schoolchildren (the "Coalition"). The Coalition's work focused on the City's charter schools, the District and the Education Achievement Authority ("EAA"), a school district created in 2011 to operate the State's lowest achieving schools, and how the City's fragmented school systems impact student outcomes and efficiency in operations. On March 30, 2015, the Coalition fulfilled its stated charge to create a list of suggested education changes and present them to public officials and lawmakers, including the Governor and the City's Mayor. The Coalition's recommendations included the creation of a Detroit city commission to implement and administer a unified system for transportation and other support services for all public and charter schools located in the City, the return of all EAA schools to the District and a proposed assumption of all District outstanding obligations supported by a pledge of the District's State Aid.

On October 19, 2015, Governor Snyder presented a legislative package for Detroit Public Schools that is focused on a financially sound system and provide families with more quality educational options. The Governor's recommendations were primarily based on the work of the Coalition. He announced that creating a debt-free school district will cost the state up to \$715 million over 10 years. This is due to the operating debt expecting to increase to \$515 million by June 30, 2016 and the new district requiring \$200 million for related start-up costs for capital improvements and additional debt expected in the first few years. Under this proposal, the Old DPS would repay the debt using an existing 18-mill non-homestead property tax millage which expires in 2022, which currently makes up the local portion of the school operating funds. In addition, the proposal calls for the New DPS to collect all of the State Aid payments allocable to the district to fund its operations.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

The proposed legislative package includes:

- Creating a new, traditional public school district - the Detroit Community School District which would educate the students (New DPS), with the current Detroit Public Schools existing to address the debt (Old DPS). The students, employees, contracts, employee benefits, and assets would move to the new district. The Governor's proposal includes DPS as well as the EAA and the charter schools. The new district would be governed by a seven-member board initially appointed by the Governor and the mayor of Detroit which would transition to an elected board in 2021.
- A Detroit Education Commission would be created, appointed by the governor and mayor, to engage with the community in hiring a Chief Education Officer. This Officer would hold the low-performing schools accountable and reward and increase the number of high-performing schools.
- The Chief Education Officer would operate a common enrollment system with common forms, enrollment periods and notification dates that will assist parents in identifying and evaluating their options in order to choose school's that is best for their children's needs.
- This restructuring plan calls for the New DPS and Old DPS to be overseen by a Financial Review Commission until the District's debt is repaid in full.

Since the announcement of the Governor's proposal, other legislative propositions have been suggested to restructure education in the city of Detroit. The outcome of any reform initiated by the Governor on the District, or any legislation proposed to restructure the District and its operations is still being reviewed. It is expected that legislation will be introduced in the very near future.

The District currently is in the midst of restructuring its support services by reducing 100 central office positions by January 1, 2016. In addition, it is taking other austerity measures such as offering even more cost effective health plans, continuing the prior 10% pay reductions, selling excess properties, and restructuring existing vendor contracts.

16. POLLUTION REMEDIATION ACTIVITIES

Under federal and state asbestos and lead abatement laws and guidelines, the District is required to perform asbestos and lead abatement in school facilities. The District's Office of Environmental Health and Safety hires consultants to evaluate the nature and extent of contamination and to design and conduct remediation plans to address these environmental issues. As required by law, 6-month surveillance and 3-year re-inspections are performed. There is no liability for pollution remediation costs recorded as of June 30, 2015.

17. JOINTLY GOVERNED ORGANIZATION

Education Achievement Authority

Creation and purpose. The Education Achievement Authority (EAA), a Michigan public body corporate and special authority was created effective June 24, 2012. The Michigan Legislature implemented Section 5 of Article III of the State Constitution of 1963 and Section 28 of Article VII of the State Constitution of 1963 by enacting the Urban Cooperation Act of 1967, 1967 (Ex Sese) PA7, MCL124.501 to 124.512 ("Act"). Under the act, a public agency may jointly exercise with any other public agency any power, privilege, or authority that the agencies share in common and that each might exercise separately. An agreement between one or more public agencies under the act may provide for a separate legal or administrative entity, which must be a public body corporate or politic, to administer or execute the agreement.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

It is the intent of Eastern Michigan University (University) and the District, at the request of the Governor of the State of Michigan, to utilize existing constitutional and statutory law to establish a mechanism for providing improved public educational services. The University and the District intend to achieve their goal by creating a separate legal entity named the Education Achievement Authority (Authority). Effective June 24, 2012, the District entered into an "Interlocal Agreement" with the Board of Regents of Eastern Michigan University.

The District agreed that the Authority would administer or execute the joint powers, duties, functions, responsibilities, and authority possessed by the District and the University as necessary to provide innovative, flexible, transparent, safe, efficient, and effective public educational services.

Authority Governance. The governing body of the District appoints 2 residents of the State as members of the Authority Board. The governing body of the University appoints 2 residents of the State as members of the Authority Board. The Governor of the State appoints 7 residents of the State as members of the Authority Board. The Governor designates an Authority Board member to serve as Chairperson of the Authority Board.

The Executive Committee of the Authority consists of 5 members of the Authority Board and exercises the powers of the Authority unless otherwise provided in the Agreement.

At the time of the formation of the Authority, the Emergency Manager of the District serviced on the Board of the Authority, as well as the Chairman of the Executive Committee.

Authority Operations. The Authority began organizing during FY 2012-2013 and began actual operation of schools effective July 1, 2013. To facilitate the Authority's operations, the District and Authority staff engaged in certain transition activities and tasks. These activities and tasks resulted in the Authority and the District entering into several agreements effective July 1, 2013:

1. *Master Service Agreement* - This agreement covers any services that the District may provide to the Authority and the related compensation the District is to receive for those services. Subsequent to June 30, 2013 and continuing through the current fiscal year, the District agreed to provide the following services to the Authority at cost:
 - Network operations services
 - Security services
 - Pupil food services
 - High school athletic services
 - Assistance with Medicaid billing
 - Joint grant management

The cost reimbursement for these services is approximately \$500,000 for fiscal year ended June 30, 2015.

2. *Various Lease, Asset Transfers and Pre-K Agreements* - Effective July 1, 2013, the District leased 15 of its schools to the Authority. The initial terms of the leases are for a three (3) year period. The base rent for each of the 15 schools is \$1.00 per year. In addition, the Authority agreed to pay the District no later than August 24, 2014, the sum equal to the number of Detroit Resident Students attending school at the premises multiplied by \$910. Similar payments are to continue, under the leases, until all the District operating debt resulting from deficit financing, outstanding as of June 30, 2013 and each June 30th, thereafter has been retired. The District also agreed to provide limited pre-kindergarten services in certain leased schools.

DETROIT PUBLIC SCHOOLS

Notes to Financial Statements

The Authority is responsible for all costs of operating the various schools. The District will reimburse the Authority for costs required to mitigate facility code violations up to a maximum of twenty percent of the annual rental payments. Generally, all fixtures, equipment and furnishings paid for by the District, remain the property of the District.

Outstanding receivables from the EAA as of June 30, 2015 were approximately \$5.5 million.

18. RESTATEMENTS

The District adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, in the current year. As a result of this change, beginning net position of governmental activities was decreased by \$858,345,276.

19. SUBSEQUENT EVENT

State Aid Revenue Notes

On September 16, 2015, the Michigan Finance Authority issued \$121,200,000 in State Aid Revenue Notes, Series 2015E, School District of the City of Detroit, maturing on August 22, 2016 in the amount of \$121.2 million. The notes carry an interest rate of 5.75 percent. The proceeds from the sale of these notes will provide the District with funds to meet its cash flow requirements in fiscal year 2016. The District's State Aid revenue is pledged to repay this obligation, and amounts are set-aside from State Aid revenues due the School District sufficient to retire this obligation at maturity.





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DETROIT PUBLIC SCHOOLS

REQUIRED SUPPLEMENTARY INFORMATION

DETROIT PUBLIC SCHOOLS

Required Supplementary Information MPERS Cost-Sharing Multiple-Employer Plan

Schedule of the District's Proportionate Share of the Net Pension Liability

	Year Ended June 30, 2015
District's proportion of the net pension liability	3.96221%
District's proportionate share of the net pension liability	\$ 872,735,996
District's covered-employee payroll	330,958,130
District's proportionate share of the net pension liability as a percentage of its covered-employee payroll	263.70%
Plan fiduciary net position as a percentage of the total pension liability	66.20%

The amounts presented for each fiscal year were determined as of September 30 of the preceding year.

Note: GASB 68 was implemented in fiscal year 2015. This schedule is being built prospectively. Ultimately, 10 years of data will be presented.

DETROIT PUBLIC SCHOOLS

Required Supplementary Information MPERS Cost-Sharing Multiple-Employer Plan

Schedule of District Contributions

	Year Ended June 30, 2015
Contractually required contributions	\$ 98,482,599
Contributions in relation to the contractually required contribution	<u>(98,482,599)</u>
Contribution deficiency (excess)	<u>\$ -</u>
District's covered-employee payroll	\$ 314,790,059
Contributions as a percentage of covered-employee payroll	31.29%

Note: GASB 68 was implemented in fiscal year 2015. This schedule is being built prospectively. Ultimately, 10 years of data will be presented.

DETROIT PUBLIC SCHOOLS

Required Supplementary Information For the Year Ended June 30, 2015

Schedule of Funding Progress Other Postemployment Benefits Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a / b)
06/30/2011	\$ -	\$ 32,180,704	\$ 32,180,704	0.0%
06/30/2013	-	25,627,103	25,627,103	0.0%
06/30/2015	-	16,617,931	16,617,931	0.0%

Schedule of Employer Contributions Other Postemployment Benefits Plan

Year Ended June 30,	Annual Required Contributions	Percentage Contributed
2011	\$ 8,074,988	90.7%
2012	10,261,492	87.9%
2013	7,632,963	78.5%
2014	7,655,578	44.8%
2015	9,228,694	24.7%

DETROIT PUBLIC SCHOOLS

Required Supplementary Information

Budgetary Comparison Schedule - General Fund
For the Year Ended June 30, 2015

	Original Budget	Final Budget	Actual	Variance With Final Budget
Revenues				
Local sources				
Special education millage	\$ 42,689,166	\$ 41,011,077	\$ 30,085,680	\$ (10,925,397)
Other	108,662,496	89,006,608	75,236,934	(13,769,674)
Total local sources	151,351,662	130,017,685	105,322,614	(24,695,071)
State sources	361,548,947	384,986,851	385,812,644	825,793
Federal sources	156,156,530	187,969,665	169,259,155	(18,710,510)
Total revenues	669,057,139	702,974,201	660,394,413	(42,579,788)
Expenditures				
Instruction	319,109,387	371,584,480	335,669,369	(35,915,111)
Support services				
Pupil services	60,122,328	67,463,416	52,375,223	(15,088,193)
Instructional staff support	58,548,474	78,792,830	62,830,196	(15,962,634)
General administration	6,830,748	6,462,078	7,583,101	1,121,023
School administration	35,279,744	33,091,117	35,378,176	2,287,059
Business office	9,324,934	10,824,368	16,031,649	5,207,281
Operations & maintenance	78,049,928	88,903,080	79,307,554	(9,595,526)
Transportation	26,910,502	29,169,431	32,840,089	3,670,658
Central support service	26,474,558	30,195,677	29,780,386	(415,291)
Other support service	104,795	166,539	433,088	266,549
Total support services	301,646,011	345,068,536	316,559,462	(28,509,074)
Community services	3,709,231	5,294,392	3,301,079	(1,993,313)
Food service	13,037	-	-	-
Athletics	863,300	953,390	1,590,407	637,017
Facilities acquisitions and improvement	-	455,346	14,721	(440,625)
Debt service	56,509,586	56,001,079	56,895,055	893,976
Total expenditures	681,850,552	779,357,223	714,030,093	(65,327,130)
Revenues under expenditures	(12,793,413)	(76,383,022)	(53,635,680)	22,747,342
Other financing sources (uses)				
Transfers in	2,400,000	2,400,000	1,762,100	(637,900)
Proceeds from sale of capital assets	11,700,000	5,204,321	5,401,970	197,649
Total other financing sources (uses)	14,100,000	7,604,321	7,164,070	(440,251)
Net change in fund balances	1,306,587	(68,778,701)	(46,471,610)	\$ 22,307,091
Fund balances (deficit), beginning of year	(169,460,307)	(169,460,307)	(169,460,307)	
Fund balances (deficit), end of year	\$ (168,153,720)	\$ (238,239,008)	\$ (215,931,917)	

See notes to required supplementary information.

DETROIT PUBLIC SCHOOLS

Notes to Required Supplementary Information

1. BUDGETS AND BUDGETARY ACCOUNTING

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States and State law for the general fund and all special revenue funds. All annual appropriations lapse at fiscal year end.

The budget document presents information by fund and function. The legal level of budgetary control adopted by the governing body (i.e., the level at which expenditures may not legally exceed appropriations) is at the functional level. State law requires the District to have its budget in place by July 1. Expenditures in excess of amounts budgeted are a violation of Michigan law. State law permits districts to amend their budgets during the year. During the year, the budget was amended in a legally permissible manner.

Encumbrance accounting is employed in governmental funds. Encumbrances (e.g., purchase orders, contracts) outstanding at year end do not constitute expenditures or liabilities because the goods or services have not been received as of year end; the commitments will be reappropriated and honored during the subsequent year as appropriate.

2. BUDGETARY ACCOUNTING BASIS DIFFERENCES

The budget has been presented in accordance with accounting principles generally accepted in the United States of America.



OTHER SUPPLEMENTAL INFORMATION

DETROIT PUBLIC SCHOOLS

Combining Balance Sheet Nonmajor Governmental Funds June 30, 2015

	Special Revenue Fund	Debt Service Fund		
	Food Service	Judgment Levy	1986 School Building Site Improvement Bonds	1994 School Building Site Improvement Bonds Series V
Assets				
Cash and cash equivalents	\$ 429	\$ -	\$ -	\$ -
Receivables:				
Due from other governmental units	3,611,768	-	-	-
Taxes	-	438,994	-	-
Other	17,090	-	-	-
Due from other funds	5,335,041	-	-	-
Prepays	23,036	-	-	-
Restricted assets:				
Cash and cash equivalents	646,239	383	28	3,628,552
Total assets	\$ 9,633,603	\$ 439,377	\$ 28	\$ 3,628,552
Liabilities				
Accounts payable	\$ 3,168,172	\$ 985,627	\$ -	\$ 545,521
Due to other governmental units	-	136,408	-	-
Due to other funds	-	596,709	-	21,682
Other liabilities	319,374	-	-	-
Total liabilities	3,487,546	1,718,744	-	567,203
Fund balances (deficit)				
Nonspendable	23,036	-	-	-
Restricted	6,123,021	-	28	3,061,349
Unassigned	-	(1,279,367)	-	-
Total fund balances (deficit)	6,146,057	(1,279,367)	28	3,061,349
Total liabilities and fund balances (deficit)	\$ 9,633,603	\$ 439,377	\$ 28	\$ 3,628,552

Capital Projects Funds

2009B Building Site Improvement Bonds Fund	2010B Building Site Improvement Bonds Fund	Durant Bond	Total
\$ -	\$ -	\$ 191	\$ 620
-	-	-	3,611,768
-	-	-	438,994
-	-	-	17,090
325,172	-	-	5,660,213
-	-	-	23,036
-	425,073	-	4,700,275
<u>\$ 325,172</u>	<u>\$ 425,073</u>	<u>\$ 191</u>	<u>\$ 14,451,996</u>
\$ 212	\$ -	\$ -	\$ 4,699,532
-	-	-	136,408
-	425,073	46,061	1,089,525
-	-	-	319,374
<u>212</u>	<u>425,073</u>	<u>46,061</u>	<u>6,244,839</u>
-	-	-	23,036
324,960	-	-	9,509,358
-	-	(45,870)	(1,325,237)
<u>324,960</u>	<u>-</u>	<u>(45,870)</u>	<u>8,207,157</u>
<u>\$ 325,172</u>	<u>\$ 425,073</u>	<u>\$ 191</u>	<u>\$ 14,451,996</u>

DETROIT PUBLIC SCHOOLS

Combining Statement of Revenues, Expenditures and Changes in Fund Balances

Nonmajor Governmental Funds
For the Year Ended June 30, 2015

	Special Revenue Fund	Debt Service Fund		
	Food Service	Judgment Levy	1986 School Building Site Improvement Bonds	1994 School Building Site Improvement Bonds Series V
Revenues				
Local sources	\$ 906,280	\$ 1,969,814	\$ 20	\$ 2,094
State sources	1,653,364	-	-	-
Federal sources	43,044,669	-	-	-
Total revenues	45,604,313	1,969,814	20	2,094
Expenditures				
Current:				
Food service	42,667,931	-	-	-
Capital outlay	-	-	48,245	1,332,728
Other	-	2,707,724	-	-
Total expenditures	42,667,931	2,707,724	48,245	1,332,728
Revenues over (under) expenditures	2,936,382	(737,910)	(48,225)	(1,330,634)
Other financing uses				
Transfers out	(1,762,100)	-	-	-
Net change in fund balances	1,174,282	(737,910)	(48,225)	(1,330,634)
Fund balances, beginning of year	4,971,775	(541,457)	48,253	4,391,983
Fund balances (deficit), end of year	\$ 6,146,057	\$ (1,279,367)	\$ 28	\$ 3,061,349



Capital Projects Funds

2009B Building Site Improvement Bonds Fund	2010B Building Site Improvement Bonds Fund	Durant Bond	Total
\$ 197	\$ 209	\$ 87	\$ 2,878,701
-	-	-	1,653,364
-	-	-	43,044,669
<u>197</u>	<u>209</u>	<u>87</u>	<u>47,576,734</u>
-	-	-	42,667,931
1,301,643	948,889	45,957	3,677,462
-	-	-	2,707,724
<u>1,301,643</u>	<u>948,889</u>	<u>45,957</u>	<u>49,053,117</u>
(1,301,446)	(948,680)	(45,870)	(1,476,383)
-	-	-	(1,762,100)
<u>(1,301,446)</u>	<u>(948,680)</u>	<u>(45,870)</u>	<u>(3,238,483)</u>
<u>1,626,406</u>	<u>948,680</u>	<u>-</u>	<u>11,445,640</u>
<u>\$ 324,960</u>	<u>\$ -</u>	<u>\$ (45,870)</u>	<u>\$ 8,207,157</u>

DETROIT PUBLIC SCHOOLS

Statement of Changes in Assets and Liabilities

Agency Fund

For the Year Ended June 30, 2015

	Balance June 30, 2014	Additions	Deletions	Balance June 30, 2015
Assets				
Cash	\$ 1,317,151	\$ 3,396,123	\$ 3,356,473	\$ 1,356,801
Other	40	-	-	40
Total assets	<u>\$ 1,317,191</u>	<u>\$ 3,396,123</u>	<u>\$ 3,356,473</u>	<u>\$ 1,356,841</u>
Liabilities				
Due to student groups and other	<u>\$ 1,317,191</u>	<u>\$ 3,396,123</u>	<u>\$ 3,356,473</u>	<u>\$ 1,356,841</u>

DETROIT PUBLIC SCHOOLS

Budgetary Comparison Schedule

Food Service Fund

For the Year Ended June 30, 2015

	Original Budget	Final Budget	Actual	Variance With Final Budget
Revenues				
Local sources				
Other	\$ 1,629,350	\$ 1,639,351	\$ 906,045	\$ (733,306)
Earnings on investments	9,500	9,500	235	(9,265)
State sources	1,016,641	1,084,989	1,653,364	568,375
Federal sources	44,484,145	44,581,262	43,044,669	(1,536,593)
Total revenues	47,139,636	47,315,102	45,604,313	(1,710,789)
Expenditures				
Food service:				
Salaries	11,711,767	9,943,754	9,412,948	(530,806)
Benefits	5,680,964	4,809,078	4,116,866	(692,212)
Purchased services	2,179,886	2,458,336	1,066,366	(1,391,970)
Supplies	24,486,358	25,028,520	24,424,489	(604,031)
Other	190,000	194,155	1,848,597	1,654,442
Capital outlay	490,661	2,481,259	1,798,665	(682,594)
Total expenditures	44,739,636	44,915,102	42,667,931	(2,247,171)
Revenues over expenditures	2,400,000	2,400,000	2,936,382	536,382
Other financing uses				
Transfers out	(2,400,000)	(2,400,000)	(1,762,100)	637,900
Net change in fund balances	-	-	1,174,282	\$ 1,174,282
Fund balances, beginning of year	4,971,775	4,971,775	4,971,775	
Fund balances, end of year	\$ 4,971,775	\$ 4,971,775	\$ 6,146,057	

DETROIT PUBLIC SCHOOLS

Schedule of Bonded Indebtedness

For the Year Ended June 30, 2015

Description	Maturity Date	Interest Rate (Percent)	Maturing per Period	Bonds Outstanding July 1, 2014	Issued	Retired	Bonds Outstanding June 30, 2015	Current Portion
Series 1998C								
Amount of Issue - \$84,855,000								
Due May 1:								
	2015	5.250	\$ 3,610,000	\$ 3,610,000	\$ -	\$ (3,610,000)	\$ -	\$ 3,800,000
	2016	5.250	3,800,000	3,800,000	-	-	3,800,000	-
	2017	5.250	4,000,000	4,000,000	-	-	4,000,000	-
	2025	5.250	40,555,000	40,555,000	-	-	40,555,000	-
Total Series 1998C issue				51,965,000	-	(3,610,000)	48,355,000	3,800,000

The Bonds were issued for the purposes of (i) defraying the cost of advance refunding a portion of the District's School Building and Site Bonds (Unlimited Tax General Obligation), Series 1992, dated July 1, 1992, in the original principal amount of \$33,000,000 and its School Building and Site Improvement Bonds (Unlimited Tax General Obligation), Series 1996A, dated March 1, 1996, in the original principal amount of \$89,000,000 and (ii) paying costs of issuance of the Bonds.

Series 2001A

Amount of Issue - \$438,365,000

Due May 1:

	2022	6.000	14,320,000	14,320,000	-	-	14,320,000	-
	2023	6.000	15,180,000	15,180,000	-	-	15,180,000	-
	2024	6.000	16,095,000	16,095,000	-	-	16,095,000	-
	2025	6.000	17,055,000	17,055,000	-	-	17,055,000	-
	2026	6.000	24,420,000	24,420,000	-	-	24,420,000	-
	2027	6.000	25,885,000	25,885,000	-	-	25,885,000	-
	2028	6.000	27,430,000	27,430,000	-	-	27,430,000	-
	2029	6.000	43,310,000	43,310,000	-	-	43,310,000	-

Total Series 2001A issue

183,695,000 - - 183,695,000 -

The Bonds were issued for the purpose of defraying the cost of acquiring, construction, and reconstructing certain permanent improvements to existing school facilities and sites, acquiring new sites, constructing new school buildings, and acquiring certain equipment, including school buses and technology, and paying costs of issuance of the Bonds.

Series 2002A

Amount of Issue - \$388,995,000

Due May 1:

	2019	6.000	11,240,000	11,240,000	-	-	11,240,000	-
	2020	6.000	11,915,000	11,915,000	-	-	11,915,000	-
	2021	6.000	12,630,000	12,630,000	-	-	12,630,000	-

Total Series 2002A issue

35,785,000 - - 35,785,000 -

The Bonds were issued for the purpose of defraying the cost of acquiring, construction, and reconstructing certain permanent improvements to existing school facilities and sites, acquiring new sites, constructing new school buildings, and acquiring certain equipment, including school buses and technology, and paying costs of issuance of the Bonds.

DETROIT PUBLIC SCHOOLS

Schedule of Bonded Indebtedness

For the Year Ended June 30, 2015

Description	Maturity Date	Interest Rate (Percent)	Maturing per Period	Bonds Outstanding July 1, 2014	Issued	Retired	Bonds Outstanding June 30, 2015	Current Portion
Series 2005A								
Amount of issue - \$500,000,000								
Due May 1:								
2015	5.000	\$	34,000,000	\$ 34,000,000	\$	-(34,000,000)	\$	\$
2016	5.000		24,670,000	24,670,000	-	(24,670,000)	-	-
2017	5.000		30,480,000	30,480,000	-	(30,480,000)	-	-
2018	5.000		30,850,000	30,850,000	-	(30,850,000)	-	-
2019	5.000		21,150,000	21,150,000	-	(21,150,000)	-	-
2020	5.000		22,215,000	22,215,000	-	(22,215,000)	-	-
2021	5.000		23,325,000	23,325,000	-	(23,325,000)	-	-
2022	5.000		13,275,000	13,275,000	-	(13,275,000)	-	-
2023	5.000		13,945,000	13,945,000	-	(13,945,000)	-	-
2024	5.000		14,625,000	14,645,000	-	(14,645,000)	-	-
2025	5.000		15,380,000	15,380,000	-	(15,380,000)	-	-
2026	5.250		16,145,000	16,145,000	-	-	16,145,000	-
2027	5.250		16,990,000	16,990,000	-	-	16,990,000	-
2028	5.250		17,890,000	17,890,000	-	-	17,890,000	-
2029	5.250		18,825,000	18,825,000	-	-	18,825,000	-
2030	5.250		65,715,000	65,715,000	-	-	65,715,000	-
2031	5.250		69,165,000	69,165,000	-	-	69,165,000	-
2032	5.250		22,070,000	22,070,000	-	-	22,070,000	-
Total Series 2005A				470,735,000	-	(243,935,000)	226,800,000	-

The Bonds were issued for the purpose of refunding the District bonds for achieving debt service savings.

Series 1998 (Durant)

Amount of issue - \$59,304,433

Due May 15:								
2015	4.760		18,372,470	18,372,470	-	(18,372,470)	-	-
Total Series 1998 (Durant)				18,372,470	-	(18,372,470)	-	-

Series 2009A

Amount of issue - \$90,000,000

Due May 1:								
2015	3.190		5,047,400	5,047,400	-	(5,047,400)	-	5,595,000
2016	3.190		5,595,000	5,595,000	-	-	5,595,000	-
2017	3.190		6,325,000	6,325,000	-	-	6,325,000	-
2018	3.190		7,055,000	7,055,000	-	-	7,055,000	-
2019	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2020	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2021	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2022	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2023	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2024	3.190		7,700,000	7,700,000	-	-	7,700,000	-
2025	3.190		9,745,000	9,745,000	-	-	9,745,000	-
Total Series 2009A issue				79,967,400	-	(5,047,400)	74,920,000	5,595,000

The Bonds were issued for the School Construction and Modernization Program, (Proposal S), including construction, and renovating certain school facilities and sites, acquiring new sites, constructing new school buildings, and paying costs of issuance of the Bonds. There are annual sinking fund deposits made by the District to an escrow account held by the trustee until debt is paid.

DETROIT PUBLIC SCHOOLS

Schedule of Bonded Indebtedness
For the Year Ended June 30, 2015

Description	Maturity Date	Interest Rate (Percent)	Maturing per Period	Bonds Outstanding July 1, 2014	Issued	Retired	Bonds Outstanding June 30, 2015	Current Portion		
Series 2009B										
Amount of issue - \$200,000,000										
Due May 1:										
2015	5.060	\$	1,400,000	\$	1,400,000	\$	-	\$	5,250,000	
2016	5.060		5,250,000		5,250,000		5,250,000		-	
2017	5.060		1,600,000		1,600,000		1,600,000		-	
2018	5.060		1,700,000		1,700,000		1,700,000		-	
2019	5.060		1,800,000		1,800,000		1,800,000		-	
2020	5.060		1,900,000		1,900,000		1,900,000		-	
2021	5.060		2,300,000		2,300,000		2,300,000		-	
2022	5.060		2,400,000		2,400,000		2,400,000		-	
2023	5.060		2,500,000		2,500,000		2,500,000		-	
2024	5.060		2,600,000		2,600,000		2,600,000		-	
2025	5.060		2,700,000		2,700,000		2,700,000		-	
2026	5.060		3,150,000		3,150,000		3,150,000		-	
2027	5.060		6,275,000		6,275,000		6,275,000		-	
2028	5.060		6,525,000		6,525,000		6,525,000		-	
2029	5.060		6,625,000		6,625,000		6,625,000		-	
2030	5.060		6,925,000		6,925,000		6,925,000		-	
2031	5.060		6,925,000		6,925,000		6,925,000		-	
2032	5.060		8,925,000		8,925,000		8,925,000		-	
2033	5.060		9,550,000		9,550,000		9,550,000		-	
2034	5.060		18,625,000		18,625,000		18,625,000		-	
2035	5.060		18,625,000		18,625,000		18,625,000		-	
2036	5.060		18,625,000		18,625,000		18,625,000		-	
2037	5.060		18,625,000		18,625,000		18,625,000		-	
2038	5.060		18,625,000		18,625,000		18,625,000		-	
2039	5.060		18,625,000		18,625,000		18,625,000		-	
Total Series 2009B issue					192,800,000		(1,400,000)		191,400,000	5,250,000

The Bonds were Issued for the School Construction and Modernization Program, (Proposal S), including construction, and renovating certain school facilities and sites, acquiring new sites, constructing new school buildings, and paying costs of Issuance of the Bonds.

DETROIT PUBLIC SCHOOLS

Schedule of Bonded Indebtedness

For the Year Ended June 30, 2015

Description	Maturity Date	Interest Rate (Percent)	Maturing per Period	Bonds Outstanding July 1, 2014	Issued	Retired	Bonds Outstanding June 30, 2015	Current Portion
Series 2010A								
Amount of issue - \$160,910,000								
Due May 1:								
2015	6.645	\$ 1,575,000	\$ 1,575,000	\$ -	\$ (1,575,000)	\$ -	\$ 7,755,000	\$ -
2016	6.645	7,755,000	7,755,000	-	-	-	7,755,000	-
2017	6.645	6,910,000	6,910,000	-	-	-	6,910,000	-
2018	6.645	7,895,000	7,895,000	-	-	-	7,895,000	-
2019	6.645	7,620,000	7,620,000	-	-	-	7,620,000	-
2020	6.645	7,985,000	7,985,000	-	-	-	7,985,000	-
2021	6.645	8,095,000	8,095,000	-	-	-	8,095,000	-
2022	6.645	8,525,000	8,525,000	-	-	-	8,525,000	-
2023	6.645	8,960,000	8,960,000	-	-	-	8,960,000	-
2024	6.645	9,415,000	9,415,000	-	-	-	9,415,000	-
2025	6.645	9,885,000	9,885,000	-	-	-	9,885,000	-
2026	6.645	16,850,000	16,850,000	-	-	-	16,850,000	-
2027	6.645	14,265,000	14,265,000	-	-	-	14,265,000	-
2028	6.645	14,650,000	14,650,000	-	-	-	14,650,000	-
2029	6.645	15,280,000	15,280,000	-	-	-	15,280,000	-
Total Series 2010A Issue				145,665,000	-	(1,575,000)	144,090,000	7,755,000

The Bonds were issued for the School Construction and Modernization Program, (Proposal S), including construction, and renovating certain school facilities and sites, acquiring new sites, constructing new school buildings, and paying costs of issuance of the Bonds. There are annual sinking fund deposits made by the District to an escrow account held by the trustee until debt is paid.

Series 2010B

Amount of issue - \$49,630,000

Due May 1:								
2030	6.845	1,200,000	4,510,000	-	-	-	4,510,000	-
2031	6.845	6,000,000	4,510,000	-	-	-	4,510,000	-
2032	6.845	1,400,000	4,510,000	-	-	-	4,510,000	-
2033	6.845	5,250,000	4,510,000	-	-	-	4,510,000	-
2034	6.845	1,600,000	4,510,000	-	-	-	4,510,000	-
2035	6.845	1,700,000	4,510,000	-	-	-	4,510,000	-
2036	6.845	1,800,000	4,510,000	-	-	-	4,510,000	-
2037	6.845	1,900,000	4,515,000	-	-	-	4,515,000	-
2038	6.845	2,300,000	4,515,000	-	-	-	4,515,000	-
2039	6.845	2,400,000	4,515,000	-	-	-	4,515,000	-
2040	6.845	2,500,000	4,515,000	-	-	-	4,515,000	-
Total Series 2010B Issue				49,630,000	-	-	49,630,000	-

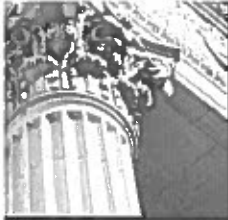
The Bonds were issued for the School Construction and Modernization Program, (Proposal S), including construction, and renovating certain school facilities and sites, acquiring new sites, constructing new school buildings, and paying costs of issuance of the Bonds.

DETROIT PUBLIC SCHOOLS

Schedule of Bonded Indebtedness For the Year Ended June 30, 2015

Description	Maturity Date	Interest Rate (Percent)	Maturing per Period	Bonds Outstanding July 1, 2014	Issued	Retired	Bonds Outstanding June 30, 2015	Current Portion
Series 2012A								
Amount of Issue - \$337,735,000								
Due May 1:								
2015	5.000	\$ 7,775,000	\$ 7,775,000	\$ 7,775,000	\$ -	\$ (7,775,000)	\$ -	\$ 8,490,000
2016	5.000	8,490,000	8,490,000	8,490,000	-	-	8,490,000	-
2017	5.000	8,595,000	8,595,000	8,595,000	-	-	8,595,000	-
2018	5.000	8,725,000	8,725,000	8,725,000	-	-	8,725,000	-
2019	5.000	9,100,000	9,100,000	9,100,000	-	-	9,100,000	-
2020	5.000	9,500,000	9,500,000	9,500,000	-	-	9,500,000	-
2021	5.000	9,910,000	9,910,000	9,910,000	-	-	9,910,000	-
2022	5.000	20,505,000	20,505,000	20,505,000	-	-	20,505,000	-
2023	5.000	21,465,000	21,465,000	21,465,000	-	-	21,465,000	-
2024	5.000	22,480,000	22,480,000	22,480,000	-	-	22,480,000	-
2025	5.000	23,655,000	23,655,000	23,655,000	-	-	23,655,000	-
2026	5.000	24,905,000	24,905,000	24,905,000	-	-	24,905,000	-
2027	5.000	26,145,000	26,145,000	26,145,000	-	-	26,145,000	-
2028	5.000	27,450,000	27,450,000	27,450,000	-	-	27,450,000	-
2029	5.000	14,520,000	14,520,000	14,520,000	-	-	14,520,000	-
2030	5.000	16,095,000	16,095,000	16,095,000	-	-	16,095,000	-
2031	5.000	16,900,000	16,900,000	16,900,000	-	-	16,900,000	-
2032	5.000	17,745,000	17,745,000	17,745,000	-	-	17,745,000	-
2033	5.000	18,635,000	18,635,000	18,635,000	-	-	18,635,000	-
Total Series 2012A issue				<u>312,595,000</u>	<u>-</u>	<u>(7,775,000)</u>	<u>304,820,000</u>	<u>8,490,000</u>
The Bonds were issued for the purpose of refunding the District bonds for achieving debt service savings.								
Series 2015A								
Amount of Issue - \$192,580,000								
Due May 1:								
2016	0.000	22,605,000	-	22,605,000	-	-	22,605,000	22,605,000
2017	3.000	29,105,000	-	29,105,000	-	-	29,105,000	-
2018	5.000	29,410,000	-	29,410,000	-	-	29,410,000	-
2019	5.000	19,635,000	-	19,635,000	-	-	19,635,000	-
2020	5.000	20,625,000	-	20,625,000	-	-	20,625,000	-
2021	5.000	21,655,000	-	21,655,000	-	-	21,655,000	-
2022	5.000	11,520,000	-	11,520,000	-	-	11,520,000	-
2023	5.000	12,105,000	-	12,105,000	-	-	12,105,000	-
2024	5.000	12,645,000	-	12,645,000	-	-	12,645,000	-
2025	5.000	13,275,000	-	13,275,000	-	-	13,275,000	-
Total Series 2015A issue				<u>-</u>	<u>192,580,000</u>	<u>-</u>	<u>192,580,000</u>	<u>22,605,000</u>
Total Bonded Indebtedness				<u>\$ 1,541,209,870</u>	<u>\$ 192,580,000</u>	<u>\$ (281,714,870)</u>	<u>\$ 1,452,075,000</u>	<u>\$ 53,495,000</u>

Attachment 3
Citizens Research Council of Michigan
Detroit Public Schools' Legacy Costs and Indebtedness
Dated January 2016



CRC MEMORANDUM



No. 1138

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DETROIT PUBLIC SCHOOLS' LEGACY COSTS AND INDEBTEDNESS

Introduction

The Detroit Public Schools (DPS) recently submitted its audited financial statement for fiscal year 2014-15 (FY2015) to the State of Michigan.¹ Because of recent changes to accounting and financial reporting standards, the report provides a much richer picture of the district's overall financial condition than previous reports. In addition to the liabilities associated with various debt instruments that routinely appear in financial statements, the most recent report includes, for the first time, an accounting of the legacy costs for unfunded pension benefits owed to current and former employees. As debate continues about crafting a financial plan to reduce the district's operating deficit and provide educational services to nearly 48,000 students, a key fiscal consideration concerns the district's liability for future payments.

¹ Public school districts operate on a fiscal year that runs from July 1 to June 30. The State of Michigan's fiscal year runs from October 1 to September 30.

As reported in **Table 1**, DPS has over \$3.5 billion outstanding in combined operating and capital liabilities. This includes nearly \$1.9 billion in employee legacy costs and cash flow borrowings and almost \$1.7 billion in multi-year bonds/notes and state loans.

The amounts in **Table 1** represent only the principal outstanding for many of the liabilities; however, liquidating these liabilities over the time schedules assumed when the debts were incurred will include interest and other costs. This adds to the district's total future payments. For example, retiring the nearly \$1.5 billion in general obligation bonds as currently structured will require \$1.0 billion in interest payments over the next 25 years. Payment on the total debt incurred for capital improvements will be spread out over decades and financed by a dedicated property tax. Other annual debt service obligations (under "Operating" in **Table 1**) will be financed from the district's general operating revenue. Financing

DPS Governance

In late 2008, State Superintendent of Public Instruction Michael Flanagan, acting under Public Act 72 of 1990, declared that a financial emergency existed in the Detroit Public School district and recommended to Governor Jennifer Granholm the appointment of an emergency financial manager. In early 2009, the Governor appointed the district's first emergency manager, Robert Bobb. Since that time, and through various iterations of the state's emergency manager law, the district has been under the control of a series of state-appointed emergency managers. Emergency managers assume all of the powers and responsibilities of a school district's elected board and appointed superintendent.

Under state law, state intervention in local school district affairs is premised on financial reasons. However, in addition to addressing a district's financial problems, emergency managers are tasked with improving the academic performance of students. In Detroit's case, a financial crisis prompted state intervention, but the district's academic performance has been consistently at, or near, the worst in the country among big city districts.^a

^a Robert Bobb (2009 to 2011), Roy Roberts (2011 to 2013), Jack Martin (2013 to 2015), and Darnell Earley (2015 to present).



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these liabilities with operational funds competes with other expenditures, including paying teachers, maintaining buildings, and buying supplies.

Furthermore, the amounts above only reflect a small portion of the district's reported accumulated operating deficit; the \$81 million payable to the retirement system. For FY2015, the General Fund finished with a deficit of \$215.9 million, up from a deficit of \$169.5 million for FY2014. This amount is carried forward into the FY2016 budget and equates to roughly 28 percent of planned General Fund expenditures. Instead of paying down the accumulated deficit, the FY2016 spending plan will add to it. The FY2016 budget projects that the General Fund will have a \$312 million operating deficit at June 30, 2016.

Each liability listed differs in material ways (e.g., its original purpose, how it is accounted for in financial statements, how repayment is structured and financed, etc.). Similarly, the consequences of failing to pay the obligations as they come due also differ. This is an important consideration as policymakers develop a plan to deal with DPS finances, both in the near term and the long term. In some cases of nonpayment, the financing responsibility could fall to the State of Michigan (all taxpayers). In other instances where DPS is unable to liquidate a debt, other school districts could be responsible for picking up the cost. For capital debts, there may not be any change in responsibility as Detroit taxpayers pledged to repay the liability with a dedicated local property tax. And for other obligations, it is unknown who would be liable for the district's nonpayment because either a similar default has never occurred or state law is silent on the matter.

Table 1
Detroit Public Schools Legacy Costs and Other Liabilities, 2015
(Dollars in millions)

Operating Liabilities	Amount
MPSERS – Pension Unfunded Actuarially Accrued Liability (UAAL)	\$872.7
MPSERS – Retiree health Unfunded Actuarially Accrued Liability	443.8
Delinquent MPSERS payment (principal and interest)	80.9
Termination Incentive Plan – UAAL	16.6
Refinanced 2005 and 2011 cash flow borrowings	259.2
Refinanced 2014 cash flow borrowing	82.8
2015 cash flow borrowing	<u>121.0</u>
<i>Subtotal – operating liabilities</i>	<i>\$1,877.0</i>
Capital Liabilities	
“Qualified” general obligation bonds	1,452.1
School Loan Revolving Fund loan (principal and interest)	<u>198.7</u>
<i>Subtotal – capital liabilities</i>	<i>\$1,650.8</i>
Total	\$3,527.8

Source: Comprehensive annual financial reports of Detroit Public Schools from multiple years, comprehensive annual financial reports of the Michigan Public School Employees Retirement System, official prospectuses for various borrowings by Detroit Public Schools, and State of Michigan sources. Information is reported for the most recent fiscal year (FY2015) when available.

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Future Employee Costs

In 2014, the Detroit Public School district was the fifth largest employer in Detroit with just over 6,500 employees. As recently as 2005, DPS was the largest employer in the City with 18,600 employees. The shrinking workforce is a direct byproduct of the student enrollment losses, outsourcing, and program cutbacks over the last decade. The district enrolled approximately 141,400 students during the 2004-05 school, nearly three times the number it enrolled during 2014-15.²

The costs associated with current and retired employees are a part of the district's ongoing financial challenge. **Table 2** shows general fund expenditures associated with active and retired employees in FY2014.

As is the case for all Michigan school districts, the vast majority of spending is concentrated in personnel expenses; public education is a people-intensive endeavor. For DPS, this spending equated to over two-thirds of its total operating budget in FY2014. While the majority of personnel expenses are associated with active employees (salaries and insurance benefits), DPS must allocate current resources to pay for retirement benefits promised to current and former employees. In FY2014, the

district spent \$84.2 million (nearly 12 percent of the total operating budget) on retirement benefits. This includes contributions to defined benefit and defined contribution retirement plans for current employees as well as paying for legacy costs associated with unfunded pension and retiree health benefits.³

Retirement Benefits

Unlike the City of Detroit, which operates its own retirement systems for city government employees (the City operates two systems – General Retirement and Police and Fire), DPS participates in the Michigan Public School Employees Retirement System (MPSERS), a multi-employer, cost-sharing plan run by the State of Michigan. The system provides retirement benefits for covered employees of traditional public school districts and community colleges, as well as certain public school academies (charter schools), state universities, and public libraries. The system provides both a financial pension benefit, as well as health, dental, and vision insurance benefits for eligible retirees, generically called other postemployment benefits (OPEB).

As a multi-employer, cost-sharing plan, the assets and the obligations of all participating employers

Table 2
Detroit Public Schools Personnel Expenditures, FY2014
(Dollars in millions)

	General Fund Expenditures	Percent of Total
Salaries and Wages	\$321.8	44.6%
Active Employee Insurance Benefits	44.0	6.1
FICA/Retirement/Unemployment/Workers Comp.	123.2	17.1
Other	<u>\$2.4</u>	<u>0.3</u>
Total Personnel Expenditures	\$491.3	68.1%
Total General Fund Expenditures	\$729.3	100.0%

Source: Center for Educational Performance and Information, MI School Data

²The transfer of 15 DPS schools to the Education Achievement Authority (EAA) in the 2012-13 school year contributed to the student enrollment decline and the reduction in DPS staff. The EAA enrolled approximately 8,700 students in 2012-13, almost all of whom were former DPS students.

³This does not include the MPSERS rate stabilization payment ("state share") received from the Michigan Department of Education, which totaled approximately \$20.7 million in FY2014. See discussion on page 4.

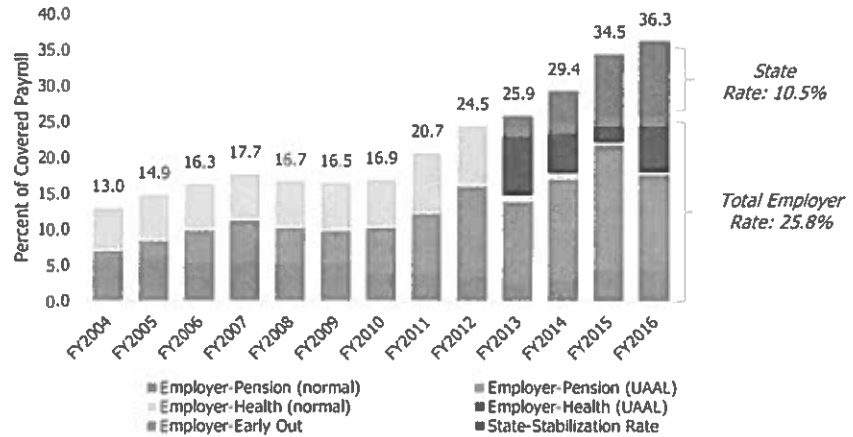
are pooled together rather than maintaining separate accounts for each employer. This means that the cost of providing these benefits is shared by employers that participate in the system.⁴ Plan assets are used to pay the pensions of the retirees of any participating employer. Employer contributions to meet estimated retirement costs are determined annually by the state’s Office of Retirement Services on the basis of an annual actuarial valuation of the retirement system’s assets and accrued liabilities. The estimated cost is then charged to employers as a percentage of payroll for employees covered under the system.

The annual employer contribution rate charged to individual school districts is comprised of three component categories: 1) pension normal costs (the cost of future retirement benefits attributable to the current year of service); 2) retiree health normal costs (the cost of future health care benefits attributable to the current year of service); and 3) unfunded actuarially accrued liabilities (UAAL) for both the pension and retiree health benefits. This last component is commonly referred to as employee “legacy costs” and results when the previous amounts collected to cover the normal costs are not sufficient to cover the actuarially-determined value of benefits in the future. When the assumptions used in setting the annual contribution rate are not met, unfunded liabilities result for the system. Since employee contributions are fixed in statute, these unfunded liabilities must be covered through additional employer contributions (i.e., larger percentage charged against payroll).

Chart 1 presents the employer contribution rate for all employers participating in MPSERS, by major

⁴In addition to employer contributions to the system, employees are required to contribute based on their date of hire and the benefit program selected. These contribution rates range from 3 percent to 7 percent and are set in state law (The Public School Employees Retirement Act of 1979, Public Act 300 of 1980).

**Chart 1
MPSERS Employer Contribution Rates, FY2004 to FY2016**



Source: Office of Retirement Services

component, from FY2004 to FY2016 (current year). The total employer contribution rate in FY2016 is 25.8 percent of payroll. In addition to the various employer rates, the State of Michigan is responsible for funding some of the UAAL contribution annually. For FY2016, the state share amounts to 10.5 percent of payroll and results in a total (state and employer) rate of 36.3 percent of payroll. Stated differently, for every \$1 paid in wages by a school district, MPSERS receives 36 cents.

Two trends stand out in **Chart 1**. First, the total contribution rate over the last 13 years has nearly tripled. Second, the driver of this growth is clearly the pension legacy costs (UAAL) component (gray portion of bar). Whereas these contributions amounted to less than 1 percent of payroll in FY2004, the contribution for pension legacy costs in FY2016 is 13.2 percent of payroll. Over the same period, the contribution rate for the system’s pension normal cost fell from 6.26 percent of payroll in FY2004 to 4.39 percent today. This decline was largely the result of system reforms requiring larger employee contributions.

A second noteworthy development, was that beginning in FY2013, the State of Michigan started prefunding the retiree health benefit. Previously, the cost of these benefits were paid on a cash basis with current employer contributions financing the costs of

health care services consumed by current retirees. With the switch to prefunding, two employer contribution rates are required, similar to treatment of the pension benefit; 1) normal cost (less than 0.5 percent of covered payroll in FY2016), and 2) UAAL (6.4 percent of covered payroll). These rates are reflected by the light orange and dark blue portions of the bar in **Chart 1**, respectively.

DPS's Funding of Legacy Costs

As a result of the 2012 MPSERS reforms, school districts' exposure to retirement funding is capped as a fixed percentage of their covered payroll. Controlling the employer contribution rate variable means that the actual amount a district pays each year towards unfunded liabilities is a function of its payroll. In DPS's case, its payroll has been declining rapidly for the past decade with workforce reductions caused primarily by student enrollment declines, but also by program eliminations and privatization of services. DPS's payroll dropped from \$803 million in FY2005 to \$340 million in FY2014, a 58 percent decrease.

Since the employer rate cap has been in place, the district's total annual UAAL payment has declined from \$95 million in FY2012 to \$71 million in FY2014. It is likely that its UAAL payment shrank again in FY2015 as a result of further staffing reductions caused by a 3.8 percent decline in student enrollment between FY2014 and FY2015.

Detroit is not the only school district with declining payroll; other school districts have experienced the same trend in response to declining student enrollments, program cuts, and privatization over the past 10 years. However, the total covered payroll of all traditional school districts (excluding DPS) declined by 12 percent between FY2005 and FY2014, far less than DPS's 58 percent drop over the same period. Since the employer UAAL rate cap has been in effect, the total payroll for non-DPS districts has declined by 1.7 percent. With the contribution rate fixed as a percentage of payroll, districts with shrinking payrolls have been able to reduce their annual UAAL payment in nominal terms.

At the same time that some districts' UAAL payments have declined, the total unfunded liability for the

pension system has increased. In recent years, the pension liability rose from \$24.2 billion in FY2012 to \$26.5 billion in FY2014. The reduced employer UAAL payments combined with the increase in the total liability means that the State of Michigan is picking up a larger share of the funding responsibility for school districts' legacy costs. The state's contribution, paid from the School Aid Fund, has increased from \$160 million (the equivalent of 1.6 percent of payroll) in FY2013 to \$894 million (10.5 percent of payroll) in FY2016.

Because MPSERS is a multi-employer, cost-sharing plan and given the current mechanics of the employer rate cap, the ultimate responsibility for funding DPS's legacy costs falls directly to the State of Michigan and the portion of the UAAL paid through the state stabilization rate. Specifically, this portion of the pension liability is picked up by an annual appropriation from the School Aid Fund. In a practical sense, if DPS is unable to contribute to MPSERS, funding DPS's share of the system's legacy costs becomes the responsibility of every other school district. This is because with an increase in the state share paid directly by the School Aid Fund, there are fewer School Aid Fund dollars to distribute among all districts, either through the per-pupil foundation allowance or categorical grants.

Accounting for DPS's Share of Legacy Costs

Historically, accounting and reporting the legacy costs of school districts has not been very transparent or accessible to the layperson. While the State of Michigan has reported MPSERS unfunded liabilities for pension and retiree health benefits in the system's annual financial report for a number of years, this information was relegated to the notes and supplementary information sections of the report. The State of Michigan reported this information, despite the fact that it does not have any employees covered by MPSERS. Further, the reported information was aggregated for *all* participating districts combined. Individual employers were not required to present actuarial information about pensions, including any liability, in their own financial statements.

Recent changes in government accounting standards (GASB Statement No. 68) require that actuarial

Financing MPSERS Legacy Costs

Growth in the UAAL components (pension and retiree health) is generally the result of lower-than-anticipated investment returns for system assets.^b The actuarial assumptions used by the system are based on an expected eight percent annual rate of return. Failing to meet this assumption in a number of years means that the system's pension unfunded liabilities have increased substantially since the early 2000s, rising from \$7.5 billion on September 30, 2004, to \$26.5 billion on September 30, 2014.^c In effect, employer contributions have had to increase to "catch up" for previous years' underfunding. This growth is mirrored in the employer contribution rates discussed above.

To address these rising costs and to add some predictability to retirement funding for all participating employers (school districts), the state made significant changes to MPSERS in 2012. A number of the reforms addressed the growth in the unfunded liabilities and the corresponding employer contribution rates. Of particular note, the legislation eliminated the retiree health guaranteed benefit for new employees and required prefunding of the benefit beginning in FY2013, as noted. This ended the practice of financing the benefit on a cash basis.^d This had the effect of creating two employer rates for the retiree health benefit – normal cost and UAAL.

Additionally, the reforms established a cap on the combined (pension and retiree health) employer contribution rate for unfunded liabilities. Beginning in FY2013, the cap is fixed at 20.96 percent of payroll (the combined rate charged for pension UAAL and retiree health in FY2012) in state law. Any amount above the capped employer contribution is provided by the state from an "off-the-top" allocation of School Aid Fund dollars, the state stabilization rate in **Chart 1** (light blue portion of bar).

^b See www.crcmich.org/funding_public_education_drivers_policy_options-2013/

^c Additionally, as of September 30, 2014, the UAAL for the retiree health benefit program was \$11.2 billion, bringing the system's total unfunded liability to \$37.7 billion.

^d In addition to the switch to prefunding, the legislation redirected an existing 3 percent employee contribution towards prefunding the retiree health benefit and guaranteed each employee's prefunding contribution. Previously, this employee contribution was used to finance the annual costs of the retiree health benefit.

information, including legacy costs associated with pension plans, must be presented in the financial statements for *all employers* participating in the retirement system (see box discussion below). For MPSERS and Michigan school districts, this means that individual districts, for the first time, will carry pension long-term liabilities on their books. The new standards took effect for larger governments in the 2015 fiscal year.

As required under the new accounting standard, the State of Michigan did an analysis to determine each participating employer's proportionate share of the \$22.4 billion MPSERS net pension liability.⁵ Under the new GASB standard, the proportion for each employer is to be consistent with the determination

⁵ The new GASB statement required pension plans to determine the total net pension liability as of September 30, 2014 and then allocate this liability among participating employers. MPSERS net pension liability was based on the actuarial valuation as of September 30, 2013. The State of Michigan, Office of Retirement Systems then used each employer's proportionate share of reportable compensation to allocate the liability.

of pension plan contributions. Contributions are based on a district's reportable payroll. Because DPS has the largest workforce and payroll, the district is responsible for the largest share of the MPSERS net pension liability. According to the state's calculation, DPS's share of the liability is 3.96 percent, or \$872.7 million. This is reflected on the district's FY2015 financial statements.

MPSERS also has unfunded OPEB liabilities totaling \$11.2 billion as of September 30, 2014. Under current accounting standards, these liabilities are not required to be allocated to individual employers and contained in the financial statements of these entities. However, GASB Statement No. 75 dealing with OPEB will require similar treatment as the pension liability under Statement No. 68. The new standard takes effect for fiscal years beginning after June 15, 2017. This means that Michigan school districts will have to carry their proportionate share of the MPSERS OPEB liability on their FY2018 financial statements.

MPSERS Delinquency

Detroit Public Schools racked up an unpaid retirement bill of \$80.9 million in FY2015.^e Instead of paying its monthly retirement bill, the district used its state aid to meet other obligations during the year. In October, the district resumed paying a portion of the required monthly payment, but it has not budgeted the funds to repay even a portion of its MPSERS delinquency. In fact, the delinquency is projected to more than double by the end of FY2016. If this debt goes unpaid, the retirement system will have fewer resources to pay benefits to pensioners or to invest. While Detroit's delinquency represents a very small percentage of the total assets held by MPSERS, if unpaid, it will have to be factored into future actuarial calculations and could affect contribution rates.

For approximately seven months during FY2015, DPS failed to pay its monthly MPSERS bill. This included both the employer contributions as well as the funds provided to the district to cover the state's share of the UAAL payment (state stabilization rate). At one point, the district was not remitting the employee contributions, but this stopped during the year and these funds have been sent to the retirement system. The decision to withhold payment to the retirement system was based on the district's cash flow problems during the year.

State law requires school districts to remit their retirement contributions monthly to the Office of Retirement System (ORS). If a district fails to do so, the law allows ORS to request the State Superintendent of Public Instruction and the State Treasurer to intercept a district's state aid to satisfy its retirement obligations. After months of nonpayment and to avoid the potential loss of state aid, in August, the DPS Emergency Manager entered into an agreement with the ORS to begin paying a portion of its monthly retirement bill. Specifically, the district committed to timely remit all employee contributions and all pass-through amounts provided by the state. Additionally, the agreement requires the district to pay a portion of its employer contribution (\$750,000 per month). The district resumed making retirement contributions in October 2015. As long as the district complies with the agreement, the ORS has indicated that it would not initiate a state aid intercept.

As noted, the agreement between DPS and ORS does not address the \$80.9 MPSERS delinquency that existed at the end of FY2015. In fact, by agreeing to pay only a portion of the employer contribution (\$750,000 per month) beginning in October 2015, the delinquency will increase going forward. It is estimated that the delinquency, along with additional interest and late fee charges, will increase to \$165 million by the end of FY2016.

For perspective, participating employer contributions to MPSERS for pension and retiree health totaled \$2.6 billion in FY2014 and the system had assets with a market valuation of \$46.6 billion as of September 30, 2014. And while the nonpayment is not currently factored in, should the \$165 million DPS delinquency remain unpaid, it would have to be incorporated into the actuarial valuation at some point. It is unlikely that the nonpayment would have a material effect on future contribution rates. However, the district's failure to pay its retirement bill clearly sets a bad precedent for all other districts in the state, including those facing financial difficulties.^f

^e This includes interest and late fees on the unpaid balance as of June 30, 2015, according to the State of Michigan, Office of Retirement Services.

^f As of June 30, 2015, five other school districts had outstanding MPSERS balances with ORS: Flint (\$10.9 million), Pontiac (\$3.7 million), Hazel Park (\$2.3 million), Muskegon Heights (\$1.9 million), and Highland Park (\$720,000), according to the Office of Retirement Services.

Using DPS's current proportionate share of the pension liability (3.96 percent), it is estimated that the district's share of the total OPEB liability is \$443.8 million. If the OPEB liability was required to be presented in the district's FY2015 financial statements, DPS's total MPSERS liability (pension and retiree health) would be \$1.3 billion.

Termination Incentive Plan

In 2009, then DPS Emergency Financial Manager Robert Bobb designed a plan to help ease the district's cash flow problems by reducing current employee paychecks and using the funds to cover other operational expenses. The program, called the Termination Incentive Plan (TIP), was included in the 2009-2012 collective bargaining agreement between the district and the Detroit Federation of

Teachers. Under this program, the majority of district employees had \$250 deducted from each paycheck beginning in January 2010 and ending in December 2012. The deducted funds were deposited in a TIP account for each member to be made available upon their separation from the district. Upon separation, participating employees are entitled to a termination of service bonus equal to \$1,000 for each year of service up to 9 years (cap of \$9,000 per employee). The program effectively allowed DPS to receive a \$9,000 interest-free loan from each employee.

Roy Roberts, the district's emergency manager appointed in 2011 suspended the program in 2011 prior to its scheduled 2012 end date. Over the life of the plan, \$49 million was deducted from employee

paychecks with the promise that these funds would be returned in the future. In effect, the TIP represented a postemployment benefit separate from the pension and retiree health benefits provided through MPSERS and entirely funded by the district (as opposed to the cost-sharing arrangement of MPSERS).

While the program was created to help the district with its cash flow for a couple of years, it also created another long-term liability. Based on the valuation report as of June 30, 2015, the TIP's unfunded liability is \$16.6 million. The district is required to pay off this liability over the next three fiscal years using current revenues. In FY2015, the district contributed \$2.3 million towards the liability.

Bonded Debt

Nearly every Michigan school district issues debt to fund capital improvements, major maintenance, and for other purposes. This debt is issued within limits established by the Michigan Constitution and state laws. The total amount of outstanding school district debt on December 31, 2014, was \$15.4 billion. Districts vary in their use of long-term debt as a financing tool, but on average, this equated to approximately \$12,629 per pupil in outstanding debt.⁶ Bonded debt is secured by dedicated revenues from local property tax levies and is retired over a number of years (20 to 30 years). Long-term general obligation debt backed by property tax revenue must be approved by local voters. For the year ending December 31, 2015, school districts paid a total of \$1.5 billion in debt service (principal and interest) on debt issued with the State of Michigan's backing through the School Bond Loan and Qualification Program.

Detroit Public School's Long-term Debt

Detroit Public Schools has borrowed money for a number of purposes, including to provide cash for operations, to finance its operating deficit, and to finance capital expenditures. Annually, the district

issues short-term notes to help with its cash flow throughout the fiscal year. This borrowing requires repayment within a 13-month period from current-year resources (see box below). Additionally, the district has issued various forms of long-term debt, largely bonds payable over 10 to 30 years. "Limited tax" bonds are limited tax general obligation bonds repaid from the district's general operating funds; "unlimited tax" general obligation bonds are backed by the full faith and credit of the district and are repaid from unlimited property tax levies subject to voter approval. As of August 31, 2015, DPS had \$1.7 billion in long-term debt outstanding (see **Table 3**).

Of the total, \$1.5 billion is "unlimited" general obligation debt backed by a dedicated property tax and \$259 million is "limited" debt repaid from a pledge of the district's state aid (primarily the per-pupil foundation allowance). For the current year, DPS will pay \$191.3 million in principal and interest on its long-term debt (see **Table 4**). Of this total, \$53 million will go towards meeting the annual debt service on general obligation limited tax notes issued in 2005 (refinanced in 2012) and 2011 to help with the district's cash flow problems. In these years, the district was able to convert short-term cash flow borrowing into long-term debt.

⁶ Michigan Department of Treasury, Bureau of State and Authority Finance, School Bond Qualification and Loan Program, 2014 Annual Report, www.michigan.gov/documents/treasury/SBQLPAnnualReport_456025_7.pdf.

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Table 3
Detroit Public Schools Bonded Indebtedness (as of June 30, 2015)
(Dollars in millions)

Date Issued	Series	Type	Maturity	Outstanding
11/1/98	Refunding, Series 1998C	Unlimited	5/1/25	\$48.3
10/1/01	Building & Site, Series 2001A	Unlimited	5/1/29	183.7
10/31/02	Building & Site, Series 2002A	Unlimited	5/1/21	35.8
8/17/05	Refunding, Series 2005A	Unlimited	5/1/32	226.8
12/30/09	Building & Site, Series 2009A	Unlimited	5/1/25	74.9
12/30/09	Building & Site, Series 2010B	Unlimited	5/1/39	191.4
10/28/10	Building & Site, Series 2010A	Unlimited	5/1/29	144.1
10/28/10	Building & Site, Series 2010B	Unlimited	5/1/40	49.6
10/13/11	Amended and Restated Series 2011A Notes	Limited	6/1/21	165.0
3/27/12	Building & Site Refunding, Series 2012A	Unlimited	5/1/33	304.8
5/17/12	2012 Multi-Year Repayment Obligation (originally issued in 2005)	Limited	6/1/20	94.2
3/12/15	Refunding, Series 2015	Unlimited	5/1/25	192.6
				\$1,711.3

Source: Municipal Advisory Council of Michigan

Table 4
Detroit Public Schools Annual Debt Service on Long-term Debt
(Dollars in millions)

Year Ending June 30	Unlimited Obligation			Limited Obligation		
	Principal	Interest	Total	Principal	Interest	Total
2016*	\$53.5	\$84.8	\$138.3	\$124.1	\$15.5	\$139.6
2017	56.5	82.0	138.5	43.5	9.5	53.0
2018	59.0	79.8	138.8	45.7	7.4	53.0
2019	61.5	77.5	139.1	47.9	5.1	53.0
2020	64.3	75.1	139.4	30.8	1.5	32.3
2021-2025	369.7	333.3	703.0			
2026-2030	460.8	219.1	679.9			
2031-2035	229.7	69.7	299.4			
2036-2040	97.1	19.1	116.1			
	\$1,452.1	\$1,040.3	\$2,492.4	\$292.0	\$39.0	\$330.9

* Includes repayment of \$82.8 million 2014-15 cash flow notes by June 2016.

Source: DPS, 2014-15 Financial Report

CRC MEMORANDUM

Converting Short-Term Borrowing to Long-Term Debt.⁷ Because of the differences between the timing of receipts and outlays each month, school districts sometimes need to borrow money to ensure they have sufficient funds on-hand when bills come due. To raise the funds, school districts issue short-term notes to manage their cash flow needs throughout the school year. Districts generally engage in cash flow borrowing early in the fiscal year (July 1) and are required to set aside some of their state aid revenue to retire the notes at maturity. Generally, districts repay the full amount borrowed, plus interest, by August of the following calendar year.

In August 2010, the district borrowed \$420 million to help with its cash flow during the 2010-11 school year. Faced with other fiscal pressures and an inability to bring spending within the limits of available resources, it became apparent during the year that the district would be unable to repay some of the notes within the year. In order to avoid a default, the state through (the emergency manager) authorized the district to issue \$231 million in 10-year notes to refinance a portion of the unpaid cash flow borrowing. This had the effect of converting short-term borrowing to a long-term liability, paid from future general operating revenues the district receives.

The state's Michigan Finance Authority issued the debt on behalf of DPS and required the district to pledge a portion of its state aid as repayment. This means that the debt service competes for resources that would otherwise go to general operations (classroom instruction, supplies, etc.). The notes carry an interest rate of 4.75 percent and will be fully repaid in 2021 (see **Table 3**).

The 2011 debt was not the first time the district converted short-term borrowing to long-term debt. In 2005, the district was under the control of the mayoral-appointed school reform board. To avoid defaulting on its cash flow borrowing, the district converted \$210 million in cash flow borrowing to long-term debt in April 2005. To do this, the district

issued special purpose bonds payable over 15 years. The plan required the debt service payments to begin in 2007 (\$16 million in 2007 and \$22 million each year after) and for the debt to be fully repaid by June 2020. This borrowing was part of the district's multi-year deficit elimination plan approved by state officials earlier in 2005.

By the end of FY2011, DPS still had \$141 million of the original \$210 million 2005 bonds outstanding; however, the district was now under the control of the state-appointed emergency manager. In May 2012, the emergency manager asked for approval from the Michigan Finance Authority to refinance the remainder of the original special purpose bonds to take advantage of lower interest rates. The Authority refinanced the debt but maintained the final maturity date of June 2020.

With the debt issued in 2011 and 2012 (originally in 2005), DPS was allowed to extend the repayment of its cash flow borrowings well beyond the years in which the original borrowed funds were used for school operations. At June 30, 2015, the district had a total of \$259 million outstanding between the two issues.

As noted, the 2011 and 2012 notes were issued by the Michigan Finance Authority, not DPS. While the debt does not represent a general obligation of DPS, the Michigan Finance Authority, or the State of Michigan, it is a limited obligation of the Authority payable from pledged DPS state aid payments. The 2011 long-term notes represent a first lien obligation, meaning that the district is required to allocate a sufficient amount of its state aid to cover the debt service before making any other expenditure. Similarly, the 2012 notes represent a second line obligation. For the 2015-16 school year, total debt service for these borrowings is \$53 million, which amounts to about \$1,100 per student. In the absence of the DPS state aid payments, it is not clear how the Michigan Authority would pay bondholders as the Authority does not have taxing authority.

Converting cash flow borrowing to long-term debt is not a common practice. In fact, it was done only one other time. To facilitate the merger of the Ypsilanti and Willow Run school districts and to assist the districts with deficit reduction, the Michigan

⁷ In a previous report, CRC examined the history of DPS's actions to convert its cash flow borrowing to long term bonded debt. See www.crcmich.org/PUBLICAT/2010s/2015/state_assumption_DPS_debts-2015.pdf.

CRC MEMORANDUM

Finance Authority issued \$19 million of long-term notes in August 2013 to refinance the two districts' outstanding 2012-13 cash flow borrowings (due August 2013). The notes will be retired by 2026 and the annual debt service covered by a portion of the state aid the new, consolidated school district (Ypsilanti Community Schools) receives.

Unlimited General Obligation Debt. Per the state Constitution, voters must approve the sale of unlimited general obligation debt. Unlike limited tax debt, unlimited debt does not compete with a district's general funds because it is repaid from the proceeds of a property tax levy that is set at a millage rate that is recalculated annually to generate sufficient funds to service the debt.

Detroit Public School voters were last asked to approve unlimited general obligation debt in 2009. In November 2009, voters authorized the district to borrow up to \$500.5 million for various capital investments.⁸ The district issued the full amount of bonds under this authorization in 2009 and 2010. As of June 30, 2015, the district had approximately \$1.5 billion in total unlimited general obligation debt outstanding (see **Table 3**).

All of the district's general obligation debt is "qualified" by the State of Michigan through the School Bond Qualification and Loan Program. This program provides a state credit enhancement and loan mechanism for school district debt issues. Districts that receive qualification from the state

receive a rating on the bonds equal to the state's credit rating, which will often result in a lower interest rate and cost, and the ability to borrow from the state an amount sufficient to enable the district to pay principal and interest requirements on its outstanding qualified bonds in the short-run if its property tax levy is insufficient to pay the full debt service (a minimum debt millage of seven mills must be levied before a district can borrow from the State).

To service its general obligation debt, DPS levies a debt millage of 13 mills, the maximum rate that a district is allowed to levy under the School Bond Qualification and Loan Program.⁹ The district has been levying its debt millage at the maximum rate since before 2009, when voters approved the \$500 million bond sale. The proceeds from the debt millage levy, along with loans from the State of Michigan, are used to make the annual principal and interest payments. While the annual debt service payments have been level in recent years (approximately \$139 million), the district has been forced to regularly borrow funds from the state to make the required principal and interest payments. This is because the yield from the 13-mill debt levy has declined with the reduction in taxable value in the City of Detroit. In recent years, the district borrowed \$33.5 million (FY2013), \$44.9 million (FY2014), and \$28.4 million (FY2015). As of December 1, 2015, DPS owes the state \$198.7 million (total principal and interest) for loans to provide sufficient funds to meet its general obligation debt payments.

Other Liabilities

The district is carrying other liabilities on its financial books, including nearly \$83 million of restated 2014-15 cash flow notes and amounts owed to various vendors for providing services and goods. Additionally, the district issued \$122 million in cash flow notes in September to provide the funds needed to make payroll and meet other obligations as they come due during the 2015-16 school year. Many of these other liabilities are due within the year and will compete with classroom instruction and ancillary services for the resources the district receives.

⁸ See www.crcmich.org/PUBLICAT/2000s/2009/memo1095.pdf.

Refinanced 2014-15 Cash Flow Borrowing

For the 2014-15 school year, DPS issued \$107.8 million in cash flow notes in August 2014. In May 2015, district officials notified the state that repaying the full amount borrowed by August 2015 would create cash flow problems later in the year. To avoid a possible default and to head off a cash shortage in the last months of the year, the Michigan Finance Authority issued \$82.8 million in short-term notes to refinance a portion of the original borrowing. These

⁹ Technically, the City of Detroit levies the millage on behalf of the school district.

proceeds, along with \$29.5 million in state aid set aside during the 2014-15 school year, were used to repay the original \$107.8 million notes. While this provided a financing mechanism for the original 2014-15 notes, it effectively pushed repayment of the borrowing into the 2015-16 school year.

The refinanced cash flow notes will have to be covered by the state aid payments the district receives during the 2015-16 year.¹⁰ Repayment was scheduled to begin in October 2015 and the notes completely repaid by June 2016. This will have the effect of reducing the amount of state aid funding available for current operations (similar to the debt service requirements of the 2011 and 2012 notes).

The difference being that the 2014-15 refinanced cash flow notes will be repaid within a period of 12 months as opposed to over a period of 10 to 15 years.

For the 2015-16 school year, DPS will have to pay \$53 million to service the 2011 and 2012 notes and repay the \$82.8 million notes (\$87 million with interest) from the 2014-15 borrowing. In total, the district will pay \$140 million, nearly \$3,000 per pupil, to finance the costs of past cash flow borrowings (See **Table 4**).¹¹ Additionally, there are interest costs associated with the 2015-16 cash flow borrowing that will have to be paid from current revenues in the 2015-16 school year.

Conclusion

Detroit Public Schools has \$3.5 billion in outstanding debt. Nearly half of this amount, \$1.7 billion, is capital liabilities payable with a dedicated millage. The Michigan Constitution requires the state to provide loans to districts to help with debt service on capital debt. The School Bond Qualification and Loan Program ensures that property-poor districts are able to access capital financing without being overburdened by debt repayment obligations. The capital liabilities, along with the state loans outstanding related to the debt, will remain with DPS.

The balance of DPS's liabilities are related to legacy costs and repaying short-term borrowings converted to long-term debt by state-appointed emergency managers. This includes \$1.3 billion that represents DPS's estimated share of the unfunded actuarial accrued liabilities for retiree pension and health care costs; \$97.5 million of legacy costs unique to DPS; and \$463 million of long-term debt being repaid from operating funds. Paying the debt service on the long-term debt will compete for resources the district receives to fund education services for today's students. For the current year, 40 percent of the district's per-pupil funding will have to go towards repaying past cash flow borrowings. No other district is saddled with this type of burden currently.

Efforts to address the debts unique to DPS would put the district on par with other school districts in the state. Depending on how such an effort is structured will determine whether putting DPS on par with other school districts comes at the expense of funding available to all other districts statewide.

It is clear that something must be done. Despite being under the control of a state-appointed emergency manager since 2009, Detroit Public Schools, the state's largest district, is failing academically and financially. It was recently reported that DPS ranked last in academic achievement (4th and 8th graders) among urban districts nationally on the National Assessment of Educational Progress. This was the fourth time in a row that DPS ranked at the bottom of all large city districts in the country.¹² At the same time, the district has been grappling with chronic operating budget deficits, growing liabilities and indebtedness, and challenges to meet payroll.

After years of state control of DPS, state policymakers are again being called to develop a new approach to deal with the district's problems. Whether this means a complete abandonment of the current

¹⁰ The district also issued \$121 million in 2015-16 cash flow notes in September 2015 to provide funds needed to pay bills as they come due during the year. Repayment of these notes will be made by August 2015.

¹¹ See www.crcmich.org/paying-for-former-students-education-with-todays-dollars/

¹² U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, National Assessment of Educational Progress (NAEP), various years.

Attachment 4
Senate Bill 710
Senate Fiscal Agency Bill Analysis



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS



Telephone: (517) 373-5383
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Senate Bill 710 (as introduced 1-14-16)
Sponsor: Senator Goeff Hansen
Committee: Government Operations

Date Completed: 2-5-16

CONTENT

The bill would amend the Revised School Code to provide for the transfer of a "qualifying school district" (Detroit Public Schools) to a proposed "community district" on July 1, 2016, and provide that the qualifying school district would retain a limited separate identity and its territory would continue as a separate taxing unit for the purpose of repaying outstanding debt until the debt was retired. The bill would do the following:

- Provide for the board of the qualifying school district to be dissolved upon the election of the board of the community district.
- Require the school board of the community district to consist of nine school electors of the district.
- Require the initial board of the community district to be appointed by the Governor and the chief administrative officer (the mayor of Detroit), and require board members to be elected in the November regular election of even-numbered years.
- Provide that the community district could not levy a school operating tax during a tax year if another school district were authorized to levy a school operating tax within the geographic boundaries of the community district during the tax year.
- Provide that the terms and conditions of a collective bargaining agreement applicable to employees of the qualifying district on the transfer date would be the terms and conditions applicable to employees of the community district.
- Provide that the community district would be subject to the financial oversight of the financial review commission in place for the City of Detroit.
- Provide that the appointment of a superintendent for the community district would be subject to the approval of the financial review commission.
- Authorize the community district board to appoint an advisory board.
- Extend borrowing authority to the community district.

The bill would appropriate \$250,000 from the General Fund to the Department of Treasury for fiscal year 2015-16 for the purpose of providing financial support for the organization and administration of the community district during that fiscal year.

The bill also would do the following:

- Allow the board of a school district, rather than a school district that operates grades K-12, to be an authorizing body for a public school academy (PSA).
- Revise the conditions under which an authorizing body must be notified and take action when a site is among the 5% lowest-performing schools in the State.

- **Expand provisions under which a school district is not required to employ a superintendent.**
- **Require a constituent district to transfer regional enhancement property tax revenue to another school district or public entity that operated a public school for the constituent district.**
- **Allow a district to provide public education services through an agreement, contract, or other cooperative arrangement with another public entity, including another school district or an intermediate school district.**
- **Allow the governing body of a year-round school to designate a date after May 31 and before the first Monday in September as the end of the school year for that school.**

In addition, the bill would allow a district, with the approval of the State Treasurer, to issue "school financing stability bonds" for the purpose of eliminating an operating deficit or refunding or refinancing outstanding State aid anticipation notes issued through the Michigan Finance Authority; to pledge as security for repayment State school aid payment, school operating tax revenue, or other revenue; and to enter into an agreement with the Department of Treasury or the Michigan Finance Authority for direct payment of school aid to the Authority or a designated trustee.

The bill also would repeal Part 5A of the Code, which provides for the appointment of a school reform board to govern Detroit Public Schools, and other sections of the Code related to a vote on the question of reapportioning the district.

Transfer of Qualifying School District

The bill would define "qualifying school district" as a school district that was previously organized and operated as a first class school district governed by Part 6 of the Code that has a pupil membership of less than 100,000 enrolled on its most recent pupil membership count day, including a school district that was previously organized and operated as a first class school district before the bill's effective date. (Detroit Public Schools meets the criteria of the definition.)

Beginning on the bill's effective date, if a school district were or became a qualifying school district, the district would lose its organization and be dissolved as provided in the bill. In that event, except as otherwise provided, all records, funds, and property of the district would be transferred on the transfer date to a community district created with the same geographic boundaries as the qualifying school district. A school building or other real property owned by and located in the qualifying school district would become part of and owned by the community district.

("Transfer date" would mean the first July 1 after the date a school district becomes a qualifying school district. For a school district that became a qualifying school district on the bill's effective date, the transfer date would be July 1, 2016.)

If the qualifying school district had outstanding debt on the transfer date, it would retain a limited separate identity as a school district and its territory would continue as a separate taxing unit only for the limited purposes of repayment of the debt until it was retired and compliance with the Michigan Financial Review Commission Act.

Until the elected members of the community district were elected and took office, the board of the qualifying school district would continue for the limited purpose of performing the functions and satisfying the responsibilities of the board and officers of the qualifying district relating to the repayment of debt and the dissolution of the district. These functions and responsibilities would include at least all of the following:

- Certifying and levying taxes for satisfaction of the debt in the name of the qualifying school district.
- Conducting school district elections.
- Doing all other things relative to the repayment of the outstanding debt, including levying or renewing a school operating tax or refunding or refinancing debt at a lower rate.
- Doing all other things relative to the dissolution of the district.

All of the following would apply on the transfer date:

- The community district would acquire, succeed to, and assume the exclusive right, responsibility, and authority to own, occupy, operate, control, use, lease, and convey the facilities of the qualifying school district existing on the transfer date.
- The community district would acquire, succeed to, and assume all rights, title, and interests in and to the fixtures, equipment, materials, furnishings, and other personal property owned and used by the qualifying school district as of the transfer date.
- Except as otherwise provided, the community district would acquire, succeed to, and assume all of the rights of the qualifying school district relating to it under any ordinances, agreements, or other instruments and under law.
- The community district would have the right and authority to own, occupy, operate, control, use, lease, and convey the transferred facilities, subject to any liens on the real property and restrictions on its use.
- Except for debt or other obligations retained by the qualifying district, the community district would have the qualifying district's right, title, and interest in, and all of the qualifying district's responsibilities and authority arising under, leases, concessions, and other contracts for facilities.
- All records and files, software, and software licenses required for financial management, personnel management, accounting and inventory systems, or general administration of the qualifying district would be transferred to the community district.

The community district also would acquire, succeed to, and assume all of the rights, duties, and obligations under a collective bargaining agreement applicable to the qualifying district on the transfer date. The terms and conditions of that agreement applicable to employees of the qualifying district on that date would be the terms and conditions applicable to the employees of the community district, and the community district would be the successor employer for employees of the qualifying district on the transfer date.

A transfer to a community district would not impair a contract with a party in privity with the qualifying school district.

Upon the transfer to a community district, the qualifying school district would be relieved from all operational jurisdiction over the district and facilities, and from all further costs and responsibilities arising from or associated with operating a public school or providing public education services, except as otherwise required under obligations retained by the qualifying district, including debt.

The qualifying school district would be required to do all of the following:

- Refrain from any action that would impair the community district's exercise of powers granted to it under the bill, or that would impair the efficient operation and management of the community district.
- Take all action reasonably necessary to cure any defects in title to property transferred to the community district.
- Upon creation of the community district and before the transfer date, conduct operations of the qualifying school district in the ordinary and usual course of business.

- Comply with the terms and conditions of any loan agreement between the qualifying school district and the Local Financial Emergency Assistance Loan Board, including any terms and conditions providing for the payment of transitional operating costs.
- Notify the State Treasurer upon the repayment of all outstanding operating obligations of the qualifying school district.
- Notify the State Treasurer upon the repayment of all outstanding debt of the qualifying school district.

As permitted under Federal law, on the transfer date, the Superintendent of Public Instruction would have to allocate to the community district all applicable grants under specified sections of the U.S. Code, and other Federal funds that otherwise would be made available for grants to or Federal funding for the public school, or make other adjustments in the allocation of Federal funds to implement the transfer of functions and responsibilities for the public school.

Dissolution of Qualifying School District & Board

When the members of the initial elected school board of the community district were elected and assumed their duties, the school board of the qualifying school district would be dissolved and the functions and responsibilities of the district would have to be exercised by the community district on behalf of the qualifying school district until it was fully dissolved.

If the State Treasurer were notified that all outstanding operating obligations of the qualifying school district had been repaid, the Treasurer would have to verify whether all of its outstanding obligations had been repaid. The Treasurer also could determine that the outstanding operating obligations had been satisfied without notice. If he or she determined that all outstanding operating obligations had been repaid, the State Treasurer would have to certify the repayment in a written notice to the community district.

If the State Treasurer were notified that all outstanding debt of the qualifying school district had been repaid, he or she would have to verify that repayment. If the Treasurer determined that all of the outstanding debt of the qualifying district had been repaid, he or she would have to certify the repayment to the community district.

Upon certification by the State Treasurer that all outstanding debt had been repaid, the qualifying school district would be fully dissolved and any remaining assets would be transferred to the community district.

The bill would define "operating obligations" as debt of a school district incurred for purposes of financing the operation of a school district or public schools operated by a school district, including financial stability bonds and an emergency loan under the Emergency Municipal Loan Act, and transitional operating costs. Operating obligation would not include debt incurred for the purpose of constructing, renovating, maintaining, or otherwise improving school facilities.

"Transitional operating cost" would mean a cost of operating public schools incurred by the community district as a result of the transfer of functions and responsibilities from the qualifying school district to the community district, as agreed to in writing, including academic and instructional support, professional transition costs, payments to vendors, cash flow needs, insurance, academic program expenditures, deferred maintenance, space consolidation, and facilities rationalization.

"Debt" would mean that term as defined in the Revised Municipal Finance Act and all of the following:

- Obligations of the qualifying school district under an energy installment purchase contract.
- Obligations of the qualifying school district under a capital lease.

- Any unpaid amounts payable by the qualifying school district to the Michigan Public School Employees' Retirement Board.
- The repayment of any loan or obligations under any loan agreement between the qualifying school district and the Local Financial Emergency Assistance Loan Board, including any terms and conditions providing for the payment of transitional operating costs not to exceed 3% of the taxable value of the district.
- The repayment of school financing stability bonds.
- Any other monetary obligations of the qualifying school district.

(The Revised Municipal Finance Act defines "debt" as all borrowed money, loans, and other indebtedness, including principal and interest, evidenced by bonds, obligations, refunding obligations, notes, contracts, securities, refunding securities, municipal securities, or certificates of indebtedness that are lawfully issued or assumed, in whole or in part, by a municipality, or will be evidenced by a judgment or decree against the municipality.)

Community District

Creation. Effective 30 days after a school district became a qualifying school district, a community district would be created for the same geographic area of that qualifying school district to provide public education services for residents of that geographic area and to otherwise exercise the powers of a community district for that geographic area beginning on the transfer date.

The community district would be governed by Part 5B of the Code, which the bill would enact, the provisions of Article 2 of the Code that were not inconsistent with Part 5B, and Articles 3 and 4. (Article 2 addresses such topics as school elections, the powers and duties of school boards, bonds and notes, school taxes, condemnation, professional development, and compulsory school attendance. Article 3 pertains to special education programs and services. Article 4 pertains to violations.)

The community district would be a political subdivision and public body corporate separate and distinct from the State and other school districts in the State.

A school district governed by Part 5B would be under the jurisdiction of the school board of the community district.

Except as otherwise provided in Part 5B, the community district would have to be organized and conducted in the same manner as a general powers school district. Except as otherwise provided by law, a community district would have all of the powers of a general powers school district and all additional powers granted by law to the community district or its school board.

The bill would include a community district in the Code's definition of "public school".

Financial Review Commission. If a financial review commission were in place for the community district, the appointment of a superintendent for the district would be subject to the commission's approval. Before the superintendent's appointment was final, the school board would have to submit the proposed appointment to the commission for its approval. If the commission did not approve the appointment within 45 days after it was submitted, the appointment would be denied.

In addition, if a financial review commission were in place for the community district, the district could not alter the terms and conditions of an employment contract with the superintendent of the district, alter the benefits provided to the superintendent, or terminate the superintendent's employment unless the commission approved that action.

School Board. The school board for the community district would have to consist of nine school electors of the district. The initial board would have to include four members appointed by the chief administrative officer and five members appointed by the Governor. Members would have to be appointed within 30 days after the district was created. If the chief administrative officer failed to appoint a member within that 30-day period, the Governor would have to appoint that member. All appointed members would have to be residents of the district. (The definition of "chief administrative officer" would include the mayor of a city if it had the largest population of any city, village, or township located within the geographic area of the community district, i.e., the mayor of Detroit.)

The chief administrative officer would have to designate an appointed member of the board to serve as its initial chairperson. If the chief administrative officer failed to do so within 30 days after the district was created, the Governor would have to make the designation. After the initial chairperson was designated, the board members would have to designate its chairperson.

A member of the school board for the qualifying school district could not also serve as a member of the school board of the community district. A member of the board of the community school district could not also serve as a member of the board of the qualifying district.

A member of the community district school board appointed to an initial term would have to continue to serve until a replacement member was elected and took office. Members elected to the board would have to be elected at the November regular election in even-numbered years, with nominations occurring at the August primary election of those years.

Of the school board members initially elected, three would have to be elected for a term of six years, three for a term of four years, and three for a term of two years. After the initial elected terms, members of the board would have to be elected to six-year terms. The terms of elected board members would begin on January 1.

If the geographic boundaries of the community district included a single city and members of its governing body were elected from nine or fewer electoral districts, a member of the community district board would have to be elected from each of the electoral districts. If the city had fewer than nine electoral districts for members of its governing body, a member of the school board residing in each electoral district would have to be elected from each electoral district and the remaining members would have to be elected on a districtwide basis.

Superintendent: Annual Evaluation. Within 90 days after the community district was created, its school board would have to appoint a superintendent for the district (subject to approval of a financial review commission, if applicable). The superintendent would have to be selected based upon his or her demonstrated ability, record of competence, experience in increasing academic achievement, experience with education reform and redesign, and expertise in the turnaround of academically underperforming urban schools.

On an annual basis, the school board would have to evaluate the performance of the superintendent.

Also on an annual basis, the board would have to evaluate and issue a report on the performance of the community district, based on the following factors:

- The proportion of pupils enrolled in the district who achieved scores at least equivalent to proficient on State assessments.
- The proportion of pupils enrolled in the district who achieved at least a school year's worth of academic growth in a school year.

-- The proportion of graduates from or pupils enrolled in the district who were enrolled in some form of postsecondary education.

Levy of School Operating Tax. If another school district were authorized to levy a school operating tax within the geographic boundaries of the community district during a tax year, the community district could not levy a school operating tax during that tax year.

Lowest-Achieving Schools. If a public school operated by the community district were on the list of the public schools in the State that the Department of Education had determined to be among the lowest-achieving 5% of all public schools in the State, the State School Reform/Redesign Officer (SRRO) would have to ensure that the school was not closed as a result of an intervention model for at least two years after the transfer date.

Financial Oversight. If the geographic area of the community district included a qualified city as defined under the Michigan Financial Review Commission Act, the district would be subject to financial oversight by the financial review commission for that city to the extent provided under that Act. (A "qualified city" is a city with a population of more than 600,000 that is subject to a plan for adjustment of its debts approved by the United States Bankruptcy Court, i.e., Detroit.)

Advisory Board. The board of the community district could appoint an advisory board to assess academics and operations and make recommendations on the use of facilities, enrollment, building capacity, transportation, student proficiency and growth, graduation rates and trends, special education, wrap-around services, and other matters requested by the district board. The advisory board could include representatives of authorizing bodies for public school academies operating within the district, community groups, and other interested parties with relevant experience.

If an advisory board were appointed, it would have to meet at least annually, regularly report on its activities to the school board, and prepare and submit to the board and superintendent an annual written report of its assessment and recommendations. The community district would have to give a copy of the report to the SRRO and to the standing committees of the Legislature with responsibility for education legislation.

Public Library. Part 5B would not repeal or affect a general law or local law governing the management and control of a public library established in the community district under Part 5B or a first class school district under Part 6. Any powers and duties of a qualifying school district relating to the management and control of a public library would be transferred to the community district on the transfer date.

Borrowing. Subject to certain restrictions, Section 1225 of the Code allows a school board or intermediate school board to borrow money and issue notes of the district in order to secure funds for school operations or to pay previous loans obtained for that purpose.

A school board or intermediate board may make more than one borrowing under Section 1225 during a school year. With the approval of the State Treasurer, a school board or intermediate board also may obtain a line of credit to secure funds for school operations or to pay previous loans for that purpose. Under the bill, these provisions also would apply to the school board of the community district.

Section 1351a allows a school district to borrow money and issue bonds of the district to defray the costs of purchasing, remodeling, or equipping school building and other facilities, furnishing school buildings, acquiring, developing, or improving sites for school buildings, and purchasing and equipping school buses. A school district may not borrow money and issue notes under Section 1351a for certain costs related to software and media. Under the bill, these provisions also would apply to the community district.

Hiring Teachers. The school board of the community district could employ or contract for, or both, qualified teachers and other qualified instructional personnel at a public school that formerly operated as an achievement school, as defined in the State School Aid Act, as necessary to carry out the purposes of the district. (An achievement school is a school operated by the Education Achievement Authority, which is a system that operates a number of lowest-achieving schools in Detroit.)

General Powers School District

The Code requires each school district to be organized and conducted as a general powers school district regardless of previous classification. This does not apply to a school district of the first class. The bill would make another exception for a community district.

A general powers school district has all of the rights, powers, and duties expressly stated in the Code; may exercise a power implied or incident to a power expressly stated in the Code; and, except as otherwise provided by law, may exercise a power incidental or appropriate to the performance of a function related to operation of the school district in the interests of public elementary and secondary education in the district. The bill would refer to a function related to operation of a public school and the provision of public education services.

The powers of a general powers school district include educating pupils. The bill specifies that a school district could do either or both of the following:

- Educate pupils by directly operating one or more public schools on its own.
- Cause public education services to be provided for pupils of the district through an agreement, contract, or other cooperative arrangement with another public entity, including another school district or an intermediate school district (ISD).

A general powers school district also may hire, contract for, schedule, supervise, or terminate employees, independent contractors, and others. Under the bill, these would include another school district or an ISD.

In addition, a general powers school district may enter into agreements or cooperative arrangements with other entities, or join organizations as part of performing the functions of the district. Under the bill, a general powers school district could enter into agreements, contracts, or other cooperative arrangements with other entities, including another school district or ISD, or join organizations.

Public School Academies

The Code allows certain entities to act as an authorizing body to issue a contract to organize and operate one or more public school academies. These entities include the board of a school district that operates grades K to 12. Also, the definition of "authorizing body" includes the board of a school district that operates grades K to 12. In both of these provisions, the bill would refer, instead, to the board of a school district. (The bill would make the same changes with respect to the authorizing body of a school of excellence.)

The Code requires an application for a contract to organize and operate a PSA to contain specified information and documents, including a copy of the educational goals of the PSA, the curricula to be offered, and the methods of pupil assessment to be used. To the extent applicable, the progress of pupils must be assessed using at least a Michigan Education Assessment Program (MEAP) test. The bill, instead, would require pupil progress to be assessed using both the mathematics and reading portions of the Michigan Student Test of Educational Progress (M-STEP). (The bill would make the same change with respect to an urban high school academy and a school of excellence.)

Currently, if a PSA site that has been operating for at least four years is determined to be among the lowest-achieving 5% of all public schools in the State, is in year two of restructuring sanctions under the No Child Left Behind Act, and is not currently undergoing reconstitution, the State School Reform/Redesign Officer must notify the PSA's authorizing body (which then must amend or revoke the PSA's contract). Under the bill, this would be required if a PSA site that had been operating for at least four years were determined to be among the lowest-achieving 5% of all public schools in the State for three of the preceding five school years, and were not undergoing reconstitution. (The bill would make the same change with respect to an urban high school academy and a school of excellence.)

Superintendent

Currently, in a constituent district not employing a superintendent, the ISD superintendent must recommend all teachers to the school board; suspend a teacher for cause until the school board of the constituent district employing the teacher consider the suspension; supervise and direct the work of the teachers; and classify and control the promotion of pupils.

Under the bill, these requirements would not apply to a constituent district if both of the following applied:

- The constituent district was not required to employ a superintendent as an employee of the district as provided in Section 1229.
- All of the public schools within the constituent district had been transferred to one or more other school districts or public entities.

Section 1229 provides that a school district, instead of directly employing a superintendent of schools, may contract with its ISD for the intermediate superintendent to serve as the superintendent of schools or to provide another person to do so. Under the bill, a school district also could contract with another person, including the superintendent of another school district, to serve as superintendent of schools for the district. If a school district did not operate a public school directly on its own, it would not be required to employ a superintendent.

Regional Enhancement Property Tax

The Code allows an ISD to levy a regional enhancement property tax of up to three mills if approved by the intermediate school electors. After receiving revenue from the tax, the ISD is required to calculate and pay each of its constituent districts an amount based on each district's proportionate pupil membership of the ISD.

Under the bill, if a constituent district had entered into an agreement with another school district or public entity to perform the functions and responsibilities of the constituent district for operating a public school, the pupils in membership in that public school would have to be counted in membership in the constituent district, and the constituent district would have to transfer the revenue payable to it to the school district or public entity performing the functions and responsibilities of the constituent district for operating the public school.

Revenue from a regional enhancement property tax could not be allocated or paid to a constituent district that did not operate a public school directly but retained a limited separate identity for certain purposes (including the repayment of outstanding debt by a qualifying school district).

Operation of School; Transfer of Functions

The Code requires each intermediate superintendent annually to compile a list of constituent districts that did not operate a school within the district during the preceding two or more

years. The superintendent must notify each district on the list to comply with certain requirements, which include either 1) attaching itself totally or partly to one or more operating school districts, or 2) reopening and operating its own school. Under the bill, a district would have to take one of those actions or transfer the functions and responsibilities of the constituent district relating to operating public schools to one or more other public entities authorized to operate public schools, including another school district or an ISD.

A constituent district would have to be considered to have operated a school within the district if it did either or both of the following:

- Directly operated one or more schools on its own.
- Caused public education services to be provided within the school district to residents of the district through an agreement, contract, or other cooperative arrangement with another public entity, including another school district or an ISD.

Kindergarten Enrollment

Under Section 1147 of the Code, beginning with the 2015-2016 school year, a child who resides in a school district may enroll in kindergarten if he or she is at least five years old on September 1 of the school year of enrollment. Under the bill, the child could enroll in kindergarten in a public school operated by the school district, or, for a community district or a school district that did not directly operate schools on its own, in another public school located within the geographic boundaries of the school district.

If a child residing in a district (or a nonresident child who is eligible to be counted in a district's membership under provisions of the State School Aid Act) is not five years old on that enrollment eligibility date but will be five by December 1 of a school year, his or her parent or legal guardian may enroll the child in kindergarten for that school year. Under the bill, the child could be enrolled in a public school operated by the school district, or, for a community district or a school district that did not directly operate schools on its own, in another public school located within the geographic boundaries of the school district.

The bill specifies that Section 1147 would not do either of the following: require a school district to operate a public school directly on its own; or require a school district or PSA that did not otherwise provide kindergarten to do so.

The bill also specifies that Section 1147 would not apply to a school district that did not operate a public school directly but retained a limited separate identity for certain purposes (including the payment of outstanding debt by a qualifying school district).

Designation of School Year End

Under the bill, the governing body for a public school that operated a year-round program or operated as a year-round school could designate a date after May 31 and before the first Monday in September as the end of the school year for the public school. A date adopted by the governing body would be the end of the school year for that school for purposes of the Code and other laws of the State.

School Financing Stability Bonds

The bill would amend Section 1356 to allow a school district that had an operating or projected operating deficit or that had outstanding State aid anticipation notes issued under Section 1225 through the Michigan Finance Authority (MFA), with the approval of the State Treasurer, to borrow and issue notes or bonds for the purpose of eliminating the deficit or refunding or refinancing the notes. The notes or bonds issued under Section 1356 would be known as "school financing stability bonds".

Before a school district issued these notes or bonds, the board of the district would have to provide by resolution for the submission to the Department of Treasury of the following certified and substantiated information:

- An operating deficit existed or would exist in the district or the district had outstanding State aid anticipation notes issued under Section 1225 through the MFA.
- If the district had a deficit, during or before the fiscal year in which the application was made, the district had made every available effort to offset the deficit.
- The district had a plan approved by the State Treasurer that outlined actions to be taken to balance future expenditures with anticipated revenue and to repay any bonds or notes issued under Section 1356.

The State Treasurer could recognize a deficit elimination plan or an enhanced deficit elimination plan authorized under the School Aid Act as satisfying the requirement for an approved plan.

Using normal school accounting practices, the Department of Treasury would have to determine the existence and amount of an operating or projected operating deficit, and the amount necessary to refund or refinance any school aid anticipation notes issued under Section 1225 through the MFA. The amount of a note or bond could not exceed the amount determined by the Department.

The school district could pledge as security for the repayment of principal and interest on the notes or bonds money from State school aid payments paid or payable to the district, revenue from taxes levied by the district for school operating purposes, and other tax revenue or money of the district legally available as security.

A school district could enter into an agreement with the Department of Treasury or the Michigan Finance Authority, or both, providing for the direct payment on behalf of the district to the MFA or a designated trustee of State school aid pledged for the repayment of principal and interest on notes and bonds issued under Section 1356 in the same manner as an agreement under Section 17a(4) of the School Aid Act. (That section applies to an arrangement made by a district for which an emergency manager is in place or that has an approved deficit elimination plan.)

Notes or bonds issued under Section 1356 would be valid and binding general obligation bonds of the school district. If a school district did not receive State school aid, the validity of a note or bond issued under Section 1356 would not be affected.

The proceeds of the sale of the notes or bonds, after the payment of the costs of issuance and interest, would have to be used solely for the purpose of paying necessary operating expenses of the school district.

The board of a school district that borrowed under Section 1356 would have to submit its budget for review and approval to the Department of Treasury. The Department would have to take necessary steps to assure that the district's expenditures did not exceed revenue on an annual basis and that the district maintained a balanced budget.

MCL 380.3 et al.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

State: If, as has been discussed publicly, the financing of the Detroit Public Schools (DPS) debt would be paid by allowing the "old" district (the "qualifying district") to retain its identity as a taxing authority, while the "new" district (the "community district") would not levy basic operating millage to finance its foundation allowance (requiring the State to pay 100% of the

community district's per-pupil funding), then the cost to the State of this proposal would be roughly \$71.0 million per year until the qualifying district's debt was repaid (estimated at 10 years). The existing debt is estimated by the Department of Treasury to total \$515.0 million. The bill would allow for transitional operating costs not to exceed 3% of the taxable value of the qualifying school district (in this case, 3% of DPS' taxable value is roughly \$202.0 million) to be included in school financing stability bonds, thereby adding the \$202.0 million to the \$515.0 million in existing debt, for a total of an estimated \$717.0 million, which would be the cost to the State if the proposed plan were enacted.

However, the debt financing proposal described above would be only partially covered by Senate Bill 710; in fact, amendments to the State School Aid Act (SAA) also would be required to first provide the "new" district with a foundation allowance and then provide that the State would pay 100% funding of that foundation allowance. Currently, the SAA requires local districts to levy operational mills in partial support of the cost of a district's foundation allowance. In the current year, DPS levies 18 operational mills, bringing in \$71.3 million yearly. This equates to \$1,687 per general education pupil, which is applied toward DPS' \$7,434 per-pupil foundation allowance, and the State makes up the difference of \$5,747 per general education pupil. (This is the same formula calculation for all districts: local districts are required to levy mills for basic operations, and the State pays the difference between what is received in local revenue and the district's foundation allowance, capped at the basic foundation allowance. Foundation allowances for charter schools are 100% State funded because charters do not levy mills.)

If Senate Bill 710 were enacted as is, and no amendments were made to the SAA, the "new" district, since it would not be allowed to levy operating mills as long as the "old" district levied those mills, and since there would be nothing providing for a foundation allowance, would not receive any State aid, or, once provided with a foundation allowance, would have a hole in its foundation allowance funding equal to the \$1,687 per pupil retained by the "old" district to pay off debt. However, if the SAA also were amended to fill that hole with State funding, that would trigger the fiscal impact on the State, estimated at \$71.0 million per year, which is equal to the diversion of the operating taxes to pay off debt. Again, this has been estimated by the Department of Treasury to total \$515.0 million in existing debt, plus the maximum \$202.0 million proposed under the bill for allowable transition costs.

There are other provisions of the bill that could or would have fiscal impacts on the State. First, and most straightforward, the bill would appropriate \$250,000 from the General Fund to the Department of Treasury, which would be a cost increase to the State. Second, as mentioned above, the bill would allow for transitional operating costs not to exceed 3% of the taxable value of the qualifying school district (or roughly \$202.0 million) to be included in school financing stability bonds, and ultimately considered part of the qualifying district's debt. Third, the bill would allow the community district to employ or contract for qualified teachers and other instructional personnel at a public school that formerly operated as an achievement school in the Education Achievement Authority (EAA), and if the qualifying district moved more schools into the EAA before the transition, or if multiple schools were combined with an existing EAA school, this could lead to additional payroll not covered by the retirement system, resulting in higher stranded retirement costs, which would be paid for by the School Aid Fund. Fourth, and along the same lines as the third point, the bill would allow school districts to "cause education to be provided" for pupils through an agreement with another public entity, and if those other public entities were not part of the retirement system, it is possible that higher stranded costs could occur, again paid by the School Aid Fund.

Local (DPS): As mentioned above, without amendments to the School Aid Act that would provide the community district with a foundation allowance and allow for that foundation allowance to be fully funded by the State, the bill would leave the "new" district with either reduced or no foundation allowance funding. However, the bill would provide up to an estimated \$202.0 million in "transitional operating cost" revenue to pay for the cost of

operating schools incurred by a community district as a result of the transfer of functions and responsibilities from a qualifying district. Another local fiscal impact would be the costs to provide an annual evaluation and report on academic performance (if not already done by DPS). The bill also would allow for the community district to borrow money and issue bonds for capital improvements.

Local (All Districts): It is anticipated that the bill would have fiscal impacts on all districts, not just DPS, as follows: the bill would allow districts with outstanding State aid anticipation notes to borrow and issue bonds for refunding and refinancing. These changes could allow deficit districts to refinance any existing debt, or issue debt to pay off a deficit and, depending on interest rates available at the time of the borrowings or refinancings, could lead to district savings.

One other change in the bill related to regional enhancement millage revenue also could have an impact on all affected districts. The bill would require a district that was a constituent of an intermediate district levying a regional enhancement millage, and that entered into an agreement with another district or public entity to operate a public school of the constituent district, to transfer all enhancement millage revenue due to the constituent district to the district or public entity operating a public school of the constituent district. As the bill is written, this transfer of millage revenue would be in its entirety, regardless of the number of schools actually operated by an entity other than the constituent district and regardless of the number of proportion of pupils educated by that other entity.

Fiscal Analyst: Kathryn Summers

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.

Attachment 5
Senate Bill 711
Senate Fiscal Agency Bill Analysis



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS



Telephone: (517) 373-5383
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Senate Bill 711 (as introduced 1-14-16)
Sponsor: Senator Goeff Hansen
Committee: Government Operations

Date Completed: 2-8-16

CONTENT

The bill would amend the Michigan Financial Review Commission Act extend it to a "qualified school district" (Detroit Public Schools); provide for the Financial Review Commission for Detroit also to be the Financial Review Commission for the school district; give the Commission generally the same oversight for the district as it has for the city; and provide that the district could not appoint a superintendent without the Commission's approval.

The Act creates a Financial Review Commission for a "qualified city", which is a city with a population of more than 600,000 that is subject to a plan of adjustment of its debts approved and entered by a U.S. bankruptcy court under Chapter 9 of Title 11 of the United States Code (i.e., Detroit).

Under the bill, a Financial Review Commission also would be created for a "qualified school district", which would be a community school district organized under Part 5B of the Revised School Code, to which the functions of a qualifying school district had been transferred. (Senate Bill 710 would add Part 5B to the Code and otherwise amend the Code to provide for the transfer of a qualifying school district (Detroit Public Schools) to a proposed "community district", which would have the same geographic boundaries as the qualifying district. The qualifying district would retain a separate legal identity and its territory would continue as a separate taxing unit until the district's outstanding debts were repaid.)

Senate Bill 711 provides that, if a community school district became a qualified school district under the Act and the district were located within the geographic boundaries of a qualified city for which a Financial Review Commission was operating under the Act, beginning on the transfer date, the Commission for the city also would be the Financial Review Commission for the school district, and no separate or additional commission would be created for the district. (That is, the Financial Review Commission operating for Detroit would be the Financial Review Commission for the school district. Under Senate Bill 710, the "transfer date" would be July 1, 2016.)

The Commission must consist of nine members specified in the Act, including the mayor or chief executive officer of the qualified city, or his or her designee, as well as the president or chairperson of the city's governing body, or his or her designee. Under the bill, in addition to those individuals, the Commission would have to include the superintendent of the qualified school district and the chairperson of its school board. The superintendent and school board chairperson would not have a vote on matters relating to the city. The mayor or chief executive officer of the city and the president or chairperson of its governing body, or their designees, would not have a vote on matters relating to the school district.

The Act requires the Commission to provide oversight for the city. The bill also would require the Commission to provide oversight for the qualified school district beginning on the date that the school district became a qualified school district.

The Commission must ensure that the city is complying with the Act, the Revised Municipal Finance Act, the Uniform Budgeting and Accounting Act, and specified sections of the Publicly Funded Health Insurance Contribution Act and the Home Rule City Act. The bill would require the Commission also to ensure that the qualified school district was in compliance with those laws, as applicable, and the following:

- The Revised School Code.
- Article 1 (State Aid to Public Schools, Early Childhood, and Adult Education) of the State School Aid Act.
- The Public School Employees Retirement Act.

The Financial Review Commission Act requires the Commission to establish and maintain programs and requirements for the responsible fiscal management of the qualified city. Among other things, the programs and requirements must include the streamlining of the provision of services and review of the compensation and benefits of employees. The bill would extend these provisions to the qualified school district.

Currently, all applicable contracts are subject to review and approval by the Commission, but they must first be approved by the governing body and mayor of the city. The bill would require applicable contracts to be first approved by the governing body and the mayor or chief executive officer of the city or the qualified school district. ("Applicable contract" means a contract for goods or services that either exceeds \$750,000, or a higher amount determined by the Commission, or is for a term exceeding two years. "Applicable contract" also includes multiple contracts for less than \$750,000, or a higher amount determined by the Commission, with one entity that, in the aggregate, exceed \$750,000 or the higher amount within a 12-month period.)

Under the Act, the qualified city, when required by the Commission, must present written reports regarding its financial stability and must permit the Commission to audit or inspect financial statements, actuarial reports, revenue estimates, and all other documents, data, or findings that the Commission considers necessary to carry out its purpose. The bill would extend this requirement to the qualified school district.

The bill also would include references to the qualified school district, its governing body, or its chief financial officer in provisions that do the following:

- Require the Commission, on June 1 and December 1 of each year in which it has oversight over the city, to file a written report with the Governor.
- Require the Commission to approve all collective bargaining agreements to which the city is a party after approval of its governing body and mayor.
- Require the mayor, governing body, and chief financial officer of the city, at least 45 days before the beginning of each fiscal quarter, to certify to the Commission the amount of debt service due on bonds, leases, or other debt.

(Also, where current provisions refer to the city's mayor, the bill would add "or chief executive officer".)

In addition, the bill would include references to the qualified school district, its governing body, or its chief financial officer in provisions that authorize the Commission to do the following:

- Review, modify, and approve proposed and amended operational budgets of the city.

- Require the city's chief financial officer to give the Commission information it requests related to the city's finances, and require the city to remove the chief financial officer and appoint a successor if he or she fails to comply.
- Review and approve requests by the city to issue debt under the Revised Municipal Finance Act or any other law governing the issuance of bonds or notes.
- Review the appointment of the city's chief financial officer.
- Review the city's compliance with a deficit elimination plan.
- Require the development and implementation of financial best practices for the city.
- Require the pursuit of financial or managerial training to ensure the proper discharge of duties for the city.
- Require the city and its employees or agents to timely produce all information and documents, and provide access to all information on assets, services, records, and other materials or documents the Commission determines are necessary to carry out its responsibilities.
- Require officers or employees of the city to attend Commission meetings.

In addition, the bill would authorize the Commission to approve the appointment of the school district's superintendent. The appointment would be denied if it were not approved within 45 days after written submission by the district. The district could not alter the terms and conditions of an employment contract with or the benefits of its superintendent or terminate its superintendent without the Commission's approval. The superintendent and the chairperson of the school board would not have a vote on approval.

The Act requires the Commission to waive requirements concerning its oversight if various conditions are met. These include certification by the Commission that the city has adopted and adhered to deficit-free budgets for three consecutive years; demonstration by the city that it has sufficient ability to borrow in the municipal securities market; and certification by the Commission that the city is in substantial compliance with the Act. The city also must have established employee retirement plans that meet certain criteria. Under the bill, the Commission also would have to waive oversight requirements for the school district if generally the same conditions were met. Instead of the employment plans required of the city, the school district would be required to have fully satisfied all of its obligations to the system created under the Public School Employees Retirement Act and under any other school improvement plan or measure applicable under Section 1280c the Revised School Code. (That section applies to the 5% lowest-achieving schools in the State.)

The Act also requires the Commission to rescind its waiver of oversight if certain circumstances occur or there is a substantial likelihood that they will imminently occur. This applies, for example, if the city fails to pay the principal of or interest on any municipal securities when due or payable; the city incurs a budget deficit in a fiscal year equal to or more than 5% of the total expenditures in that year; the city issues municipal securities without the Commission's authorization or in violation of the Revised Municipal Finance Act; or the city's chief financial officer has resigned or been terminated and a successor has not been appointed within 180 days. The bill also would require the Commission to rescind its waiver of oversight for the school district under generally the same circumstances, and if the district were not in compliance with a school improvement plan or measure applicable under Section 1280c of the Revised School Code.

The Act requires the Commission to dissolve itself if it has waived its oversight requirements each year for the immediately preceding 10 consecutive fiscal years, and the plan for adjustment has expired. Under the bill, however, the Commission could not dissolve itself until the State Treasurer certified the payment in full of all outstanding debt of the qualified school district.

FISCAL IMPACT

State: If the Department of Treasury's Financial Review Commission required additional staff, services, contracts, or supplies in order to review a qualified school district (which would be the proposed community district in Detroit), in addition to the City of Detroit, then there would be increased State costs. Under current law, a Financial Review Commission already exists for review of the City of Detroit, and under the bill, the Commission's role would be expanded to review the finances of the "new" Detroit school system. The Department of Treasury has estimated that the additional cost to the Financial Review Commission for oversight of the "new" system would be \$1.0 million, which would be used primarily to support outside assistance and expertise to assist with necessary review and analysis on both the financial and academic sides of the district, as well as the transition itself from the "old" to the "new" system.

Local: The Financial Review Commission would be required to review and approve applicable contracts and collective bargaining agreements (CBAs) of the qualified school district (other than those approved by an emergency manager), and the school district would not be able to execute CBAs until approved by the Commission. It appears that the contracts in place on the transfer date (July 1, 2016) would remain in place, but new contracts and CBAs would be subject to approval by the Commission. Therefore, there could be some fiscal impact on the district if the Commission's approvals or disapprovals of contracts and CBAs caused the district to change its financial planning compared to what it would have done in the absence of Commission oversight.

Similarly, the bill would allow the Commission to revise a revenue estimate prepared in connection with a budget of the qualified district if the Commission determined that the revenue estimate was not based on reasonable assumptions, which could lead to adjustments in the district's budget. Also, the bill would allow the Commission to review, modify, and approve proposed and amended operational budgets of the qualified district, and the proposed budget would not take effect unless approved by the Commission. Therefore, again, there could be some fiscal impact on the district if the oversight of the Commission caused it to use a different set of revenue and expenditures than it would in the absence of the oversight.

Fiscal Analyst: Kathryn Summers