EXHIBIT F

STATE OF MICHIGAN
DEPARTMENT OF TREASURY

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: December 14, 2012

TO: Rick Snyder, Governor

FROM: Andy Dillon, State Treasurer

SUBJECT: Preliminary Review of the City of Detroit

I. Background

On December 11, 2012, the Department of Treasury commenced a preliminary review of the finances of the City of Detroit to determine whether or not a serious financial problem existed. Section 12(1) of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, requires that a preliminary review be conducted if one or more of the conditions enumerated therein occurs.[1] The preliminary review of the City of Detroit resulted from the conditions enumerated in subdivision (j) and (k) of Section 12(1) having occurred within the City.[2]

As summarized below, based upon information received and considered as part of the preliminary review, I conclude that a serious financial problem does exist in the City of Detroit and recommend appointment of a financial review team. Appointment of a financial review team is a prerequisite step in the Act 72 process to the appointment of an emergency financial manager.

II. Preliminary Review Findings

The preliminary review found the following:

- The City has violated requirements of Section 17 of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, as amended, which provides that local officials monitor and

[1] The City presently is subject to a consent agreement in the form of the Financial Stability Agreement which was executed on April 4, 2012. The Financial Stability Agreement was executed pursuant to Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, and various other Acts. Subsequently, Act 4 was disapproved by voters at the November 2012 general election. The Attorney General's Office concluded in Opinion No. 7267 that, as a result of the disapproval of Act 4, Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, was revived. Various Michigan courts have concurred in this conclusion. Therefore, it is under Act 72 that this preliminary review was conducted.

[2] Subsection (j) provides that "[t]he local government has violated the requirements of sections 17 to 20 of the uniform budgeting and accounting act, 1968 PA 2, MCL 141.437 to 141.440, and the state treasurer has forwarded a report of this violation to the attorney general." Subsection (k) provides that "[t]he local government has failed to comply with the requirements of section 21 of the Glenn Steil state revenue sharing act of 1971, 1971 PA 140, MCL 141.921, for filing or instituting a deficit recovery plan."

promptly amend an adopted budget to the extent necessary to prevent deficit spending. For example in the General Fund for the year ending June 30, 2011, the insurance premium line item exceeded its budget by more than $6.7 million, the adjustment and undistributed costs line item exceeded its budget by more than $8.0 million, and the fire fighting operations line item exceeded its budget by more than $21.0 million. As a result of these, and other, line items, the General Fund had line items that exceeded its budget by more than $97 million.

- As has been shown above, City officials have violated requirements of Section 18 of Public Act 2 of 1968, as amended, which states that "[a]n administrative officer of the local unit shall not incur expenditures against an appropriation account in excess of the amount appropriated by the legislative body. The chief administrative officer, an administrative officer, or an employee of the local unit shall not apply or divert money of the local unit for purposes inconsistent with those specified in the appropriations of the legislative body." City officials have also violated requirements of Section 19 of Public Act 2 of 1968, as amended, which states that "[a] member of the legislative body, the chief administrative officer, an administrative officer, or an employee of a local unit shall not authorize or participate in the expenditure of funds except as authorized by a general appropriations act. An expenditure shall not be incurred except in pursuance of the authority and appropriations of the legislative body of the local unit."

- The City has also experienced cash flow problems throughout the 2010 and 2011 fiscal years some of which have been alleviated by the issuing or refinancing of debt. The City has projected possibly depleting its cash prior to its June 30, 2013 fiscal year end. However because of inherent problems within the reporting function of the City, the projections continue to change from month to month making it difficult to make informed decisions regarding its fiscal health. For example, a cash flow estimate in August projected a June 2013 cash deficit of $62 million while estimates for October and November projected deficits of $84 million and $122 million respectively. The City would not be experiencing significant cash flow challenges if City officials had complied with statutory requirements to monitor and amend adopted budgets as needed. In turn, such compliance requires the ability to produce timely and accurate financial information which City officials have not been able to produce.

- The City has incurred overall deficits in various funds including the General Fund. The General Fund's unrestricted deficit increased by almost $41 million from a June 30, 2010 amount of $155 million to a June 30, 2011 amount of $196 million and is projected to increase even further for 2012, which would not have happened if the City had complied with its budgets.

  City officials have not filed an adequate or approved deficit elimination plan with the Department of Treasury for the fiscal year ending June 30, 2011. On December 27, 2011, City officials filed an audit report that reflected a $196 million cumulative deficit in the General Fund, a $97 million cumulative deficit in the Transportation Fund, and a $17 million cumulative deficit in the Automobile Parking Fund.

  As can be seen in Table 1 on the following page, the City has experienced cumulative General Fund deficits that have exceeded $100 million dating back to 2005. These deficits have fluctuated between $155.4 million and $331.9 million. One of the primary methods the City has used to reduce the deficits has been to issue more debt. Total General Fund debt and other long-term liability proceeds for the years between 2005 and 2011 was over $600 million, temporarily reducing the deficits by an equal amount. Debt proceeds reduce the deficit in the year the debt is issued, but reduce fund balance over time as debt service payments increase.

Table 1
General Fund Deficits and Debt Proceeds

Year	Actual Deficit	Debt Proceeds	Approximate Cummulative Deficit Without Debt Proceeds*
2005	$(155,404,035)	$ 248,440,183	$ (403,844,218)
2006	(173,678,707)	34,892,659	(457,011,549)
2007	(155,575,800)		(438,908,642)
2008	(219,158,138)	75,210,007	(577,700,987)
2009	(331,925,012)		(690,467,861)
2010	(155,692,159)	251,663,225	(765,898,233)
2011	(196,577,910)		(806,783,984)

* Represents what the deficit would have been without the issuance of additional debt. The approximate amount would be reduced if subsequent debt service payments were added back in.

For the City on a whole (excluding component units), there was a 2011 unrestricted net assets deficit of almost $1.6 billion.[3]

[3] Net Assets are calculated on the government-wide financial statements that use the accrual basis of accounting and include such items as capital assets and long-term debt. The unrestricted amount measures the net assets that are appropriable for expenditure and are not legally segregated for a specific future use.