Detroit Public Schools

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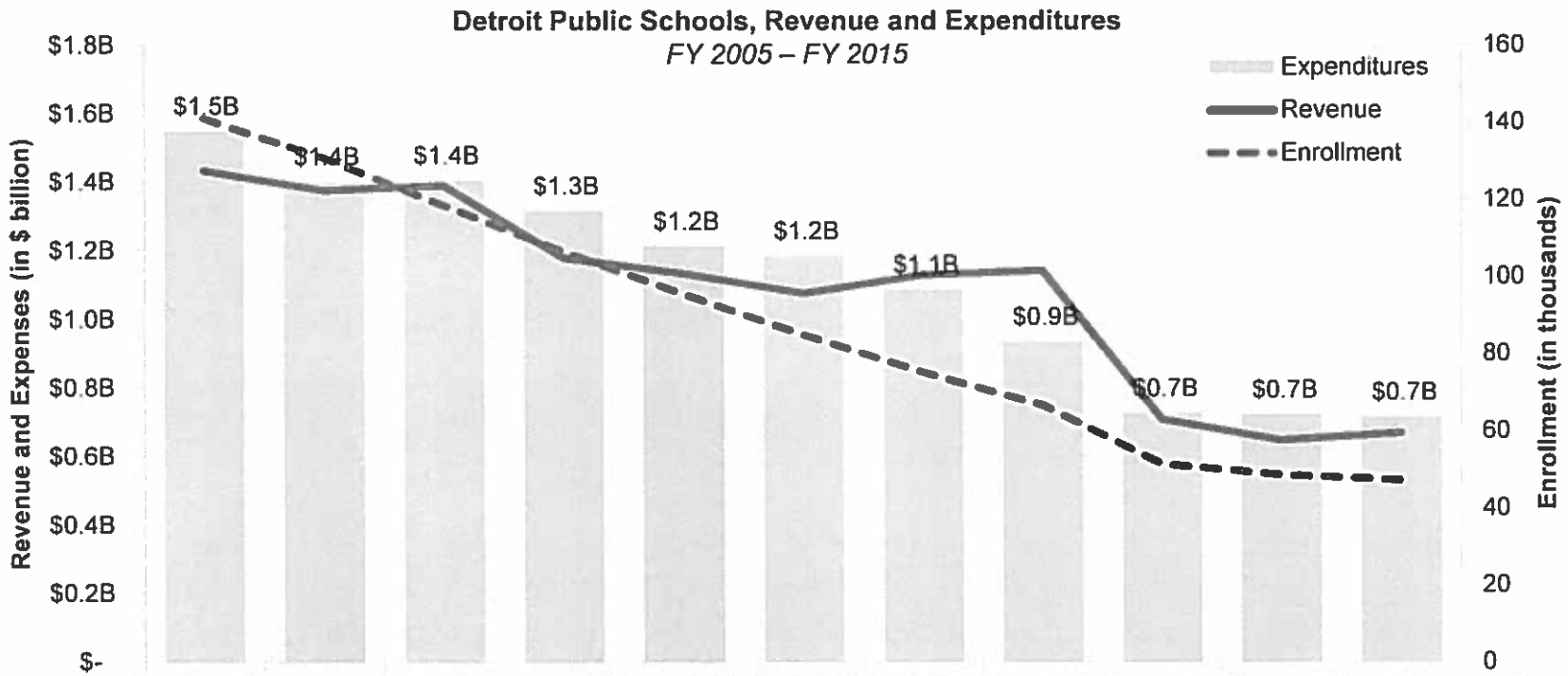
Summary

- Over the past decade, the Detroit Public School system (DPS) has reduced expenditures by over half and closed over 150 schools (62%), but has not been able to keep pace with the nearly 70% decline in students
- The decade long annual deficits has led to a large build up of debt
- In contrast to the city, most of DPS's debt is either owed directly to state, backed by the state, or is an obligation owed to the state teacher pension system
- DPS's current operating debt is approximately $515m, or $11,000 per pupil. Debt service is approximately $50m per year
- The transition to the new DPS will take another $200m for facility costs, working capital, and minimum educational investments
- Bankruptcy is a terrible option for the district. The bankruptcy process is always uncertain, but in the end, it will cost the state more than double the cost of the proposed legislation. At a minimum, we know bankruptcy will disrupt the district for 8 to 12 months and earn the lawyers, bankers, and consultants $75 to $100m
- In addition to long term solvency, the district faces a near term cash crisis. Barring legislative action, the district will run out of cash this spring or early summer
- The proposed legislation will fund DPS's legacy debt and give the district a chance. More will need to be done, but without some kind of Old Co/ New Co structure, the district will financially fail

DPS has closed more than 150 buildings and cut over $800M in expenses since 2005 but expenses continue to exceed revenue

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	% Change
Expenditures	$1.55B	$1.40B	$1.40B	$1.32B	$1.21B	$1.18B	$1.09B	$934M	$726M	$721M	$714M	-54%
Enrollment	141.1K	130.7K	118.4K	106.4K	95.5K	84.9K	75.2K	66.7K	51.3K	48.5K	47.2K	-67%
Schools*	255	232	225	198	172	146	146	130	100	96	96	-62%



	FY05	FY06	FY07	FY08	FY09	FY10	FY11†	FY12‡	FY13	FY14	FY15	Average
Annual surplus (deficit)	$ (115M)	$ (25M)	$ (15M)	$ (136M)	$ (79M)	$ (108M)	$ 43M	$ 208M	$ (18M)	$ (76M)	$ (46M)	$(33M)

* Includes elementary schools, middle schools, high schools, alternative education schools, special education schools, and career technical and vocational centers; includes creation of EAA resulted in transfer of 15 schools in FY13.

† Includes one-time grant revenue awarded under the American Recovery and Reinvestment Act (ARRA)
‡ Includes $245M revenue from new bond issuance, Deficit would have been $ (37M) without issuance
Source: Detroit Public Schools Comprehensive Annual Financial Reports

Approximately $515M of legacy obligations and $200M of start-up costs will remain with OldCo

- OldCo will continue to operate in its current form through 6/30/2016 ("FY16")
- Therefore, FY16 will be a transitional year until NewCo becomes effective 7/1/2016 ("FY17")
- The legacy *operating* liabilities of DPS as of June 30, 2016 are estimated to be **~$515M**
- In addition to $200M in startup/reinvestment liabilities OldCo is also responsible for $515M in legacy liabilities for a total of $715M, which is expected to be repaid by FY26

($ in millions)	**As of 6/30/16 (estimated)**
Series 2011/2012 bonds	$214
FY16 short-term note payments	$52
Deferred pension (through FY15)	$76
Deferred pension (FY16 estimate)	$81
Deferred AP (>90 days past due)	$47
FY16 cash shortfall (estimate)	$45
Total before start-up costs	**$515**
Start-up costs / reinvestment financing	$200
Total	**$715**

NewCo will need an estimated $200M for startup and transition related costs

($ in millions)	Estimate	Description/Examples of use
Facilities related costs	$75	Deferred maintenance, space consolidation, school rationalization, and school/building closure related costs
Transition & working capital	$50	Academic and instructional support, portfolio planning, professional transition costs (IT, legal, HR, financial), vendor continuity payments, timing lag for grant reimbursements
Minimum cash requirements	$25	Cash needed at inception for NewCo to operate based on timing of revenue receipts
Program retention/improvement	$25	Investment in key academic programs that have been neglected due to financial constraints and austerity measures
Other operating liabilities	$25	Expenditures related to other pending contingencies and claims that may need to be funded by NewCo
Total Startup Costs (estimated)	**$200**	

What are the implications of doing nothing?
State could become liable for a majority of DPS' costs and obligations

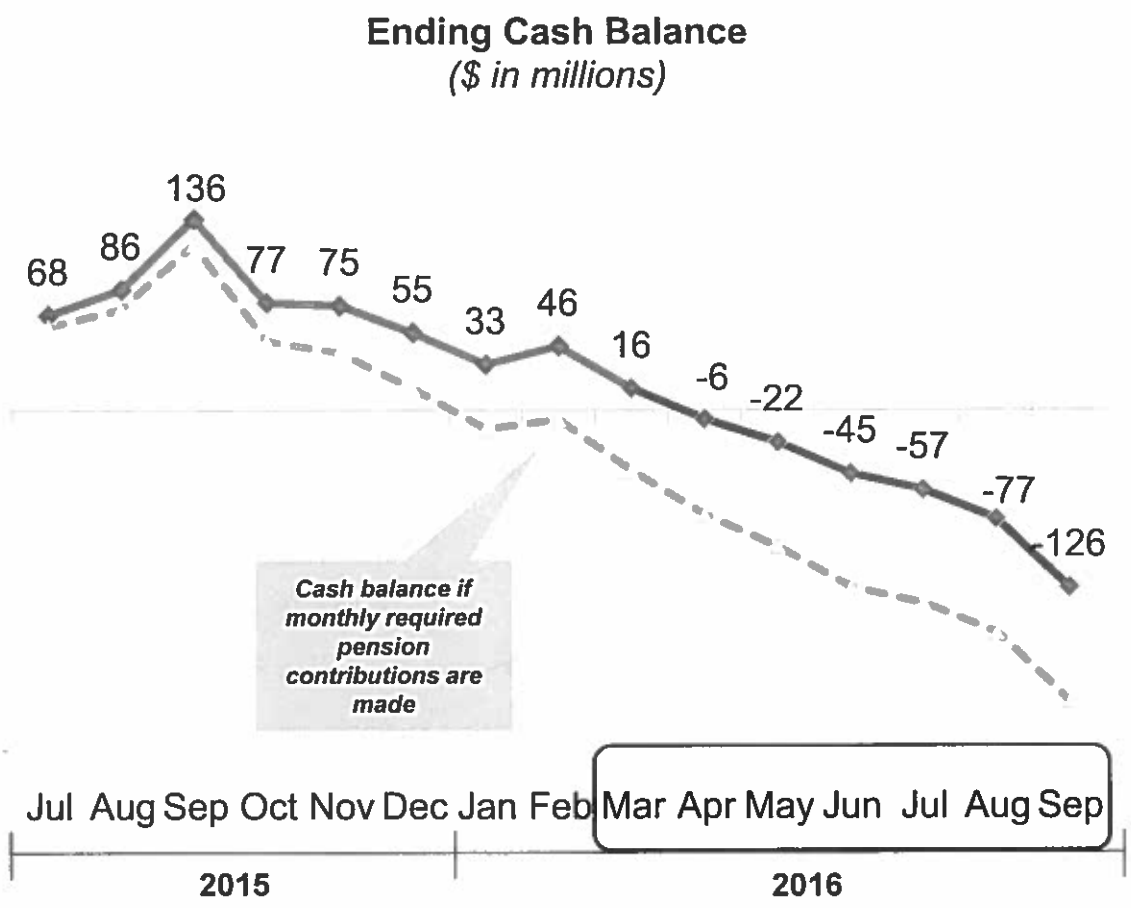
- The State is required to ensure education is provided to over 47,000 pupils currently enrolled in DPS.
- If DPS is unable to support current operating and legacy expenditures, it may need to consider formal insolvency proceedings, potentially requiring the State to finance the following obligations:

Risk*	Financial obligation	Type/Security
Direct	$196 million in School Loan Revolving Fund	Unlimited tax general obligation pledge
	$1.3 billion in net pension liability share in the Michigan Public Employee Retirement System	MPSERS
Potential Direct	$1.5 billion in long-term qualified bonds	Unlimited tax general obligation pledge
Indirect	$464 million in short-term not qualified bonds/notes, *Includes $121 million issued in September 2015*	State aid and the limited tax general obligation pledge of the District
	$50 million in outstanding past due accounts payables	Not secured

~$3.4 billion in outstanding liabilities – most of which are secured via a tax or state aid pledge. Unlike the City of Detroit, DPS would not benefit from a bankruptcy as it would predominantly shift liabilities onto other municipalities

*Risk assessment relates to impact to State; "Direct" denotes liabilities that immediately fall onto the State or statewide municipalities, "Potential direct" denotes liabilities with uncertainty what bankruptcy ruling would be, "Indirect" denotes liabilities which are indirectly associated with the State and where default would negatively affect other important or critical local and state-wide market participants that in turn could default.

DPS faces near term cash shortfalls



- DPS has taken recent action to address the mounting cash flow troubles, including more cost reductions, State Aid Note ("SAN") debt issuance ($120M in Sep'15), and deferrals
- Even so, DPS is expected to face a cash shortfall of ~$45M by June 2016
- We are exploring options to address the FY16 shortfall including the following:
  - Further deferrals
  - Personnel and benefits reductions (transformational savings)
  - Another refunding and/or SAN/TAN transaction
  - Distress funding from State (i.e cash flows presented do not include distressed district funds of $50M)

Overview – NewCo and OldCo

NewCo

- "NewCo" becomes **effective on July 1, 2016** ("FY17")
- **Operating assets and operations** of DPS will be transferred to NewCo;
- State aid (i.e. Foundation allowance) is **restored to replace loss of property tax revenue** to OldCo
- NewCo has access to **$200M in start-up/reinvestment** financing

OldCo

- FY16 is a transitional year for DPS, and will **require incremental funding** to cover the cash shortfall
- Majority of **operating debt and legacy obligations** remain with OldCo
- **Property tax operating revenue** (18 non-homestead mills and 6 mills on commercial personal property) remains with OldCo to service obligations
- In addition to $200M in startup/reinvestment liabilities OldCo is also responsible for $515M in legacy liabilities for a **total of $715M**, which is expected to be **repaid by FY26**

Detroit Public Schools
Legislative 'OldCo'/'NewCo' vs Chapter 9 Bankruptcy
($ in millions)

Legislative 'OldCo'/'NewCo'

Fiscal Year	Total State Cost
2017	$71.5
2018	$71.5
2019	$71.5
2020	$71.5
2021	$71.5
2022	$71.5
2023	$71.5
2024	$71.5
2025	$71.5
2026	$71.5
2027	$0.0
2028-2040	-
Total State Funding	**$715.0**

Annual Operating Enhancements under 'OldCo'/'NewCo'

- The $715.0 million total state funding includes:
  - Legacy Debt $515.0
  - Start-up Costs/Re-investment $200.0
- 18 mill Non-Homestead levy generates approximately $71.5 million annually
- Assumes Non-Homestead levy would flow to 'OldCo' until 2026 – legislatively determined timeframe or term

Chapter 9 Bankruptcy

Fiscal Year	Long-term School Bond Loan Debt*	Teacher Retirement System (MPSERS)**	Bankruptcy Costs & Fees	Total State Cost
2017	$200.0	-	-	-
2018	$125.0	$24.0	$100.0	$249.0
2019	$125.0	$24.0		$149.0
2020	$125.0	$24.0		$149.0
2021	$125.0	$24.0		$149.0
2022	$125.0	$24.0		$149.0
2023	$125.0	$24.0		$149.0
2024	$125.0	$24.0		$149.0
2025	$125.0	$24.0		$149.0
2026	$125.0	$24.0		$149.0
2027	$125.0	$24.0		$149.0
2028-2040	TBD	-		$0.0
Total State Funding	**$1,450.0**	**$240.0**	**$100.0**	**$1,790.0**

Annual Operating Enhancements after Bankruptcy

- Assumes the court would redirect 13 mills currently used for construction debt to support operations to cover the operating deficit and an investment program
- *School bond loan debt includes $125m in annual debt service ($1.5b debt outstanding) and $200m in existing state loans
- **MPSERS $240m is the estimate of DPS's unpaid pension payments through 2017
- Assumes DPS will fully pay both current and unfunded annual pension contribution post bankruptcy