SEE IT BELIEVE IT
DETROIT PUBLIC SCHOOLS

Detroit Public Schools: *Shaping the Future*

November 2015

Presented By Mr. Darnell Earley, ICMA-CM, MPA, Emergency Manager, Detroit Public Schools

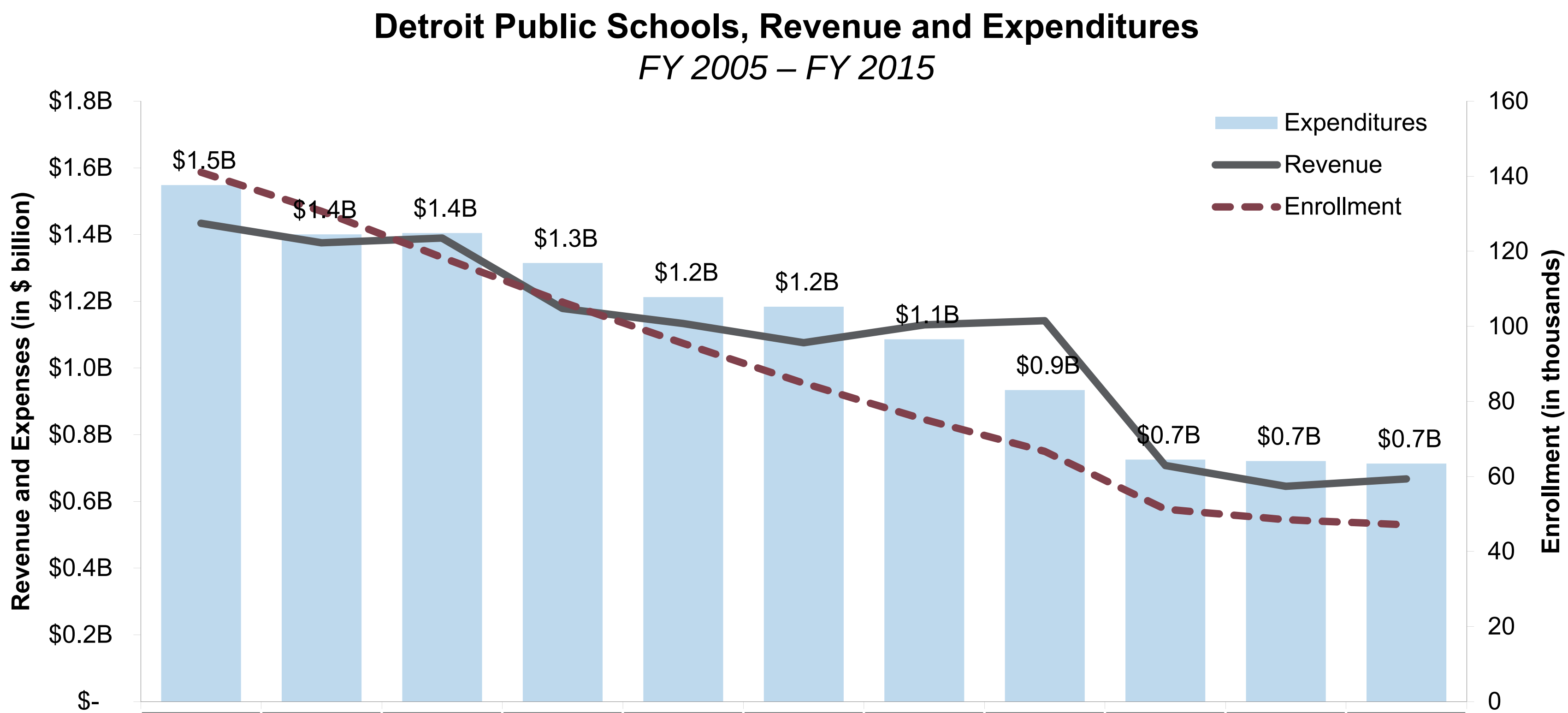
Marios Demetriou, Deputy Superintendent - Finance and Operations

Executive Summary

- The Detroit Public School System has undergone tremendous change over the past 10+ years
- Enrollment has declined over 65% since FY2005; in response the district has closed over 150 schools, reduced its workforce by over 10,000 positions , outsourced services and garnered various concessions to address mounting deficits
- While enrollment is beginning to show signs of stabilization, DPS continues to face operating losses in large part due to legacy operating debt obligations
- Without these debt obligations, DPS has a path to fiscal stability
- The initiatives currently underway and future initiatives will position DPS for success:
    - Complete reorganization of the central office which reduces 100 positions and overhead and pushes resources towards schools
    - Establishment of a network structure that will enable the district to operate more efficiently
    - Increased accountability to ensure the district's overall best interest
    - Comprehensive enrollment stabilization and retention program
- DPS needs legislative support in order to implement an orderly transition to fiscal stability allowing the district to focus on stabilizing enrollment and increase educational outcomes for Detroit's youth
- The time to act is now because Detroit Public Schools is running out of funds and the alternative is far worse for the State of Michigan, all Michigan school districts and for Detroit

Table of Content

DPS has cut over $800M in expenses since 2005 but expenses continue to exceed revenue



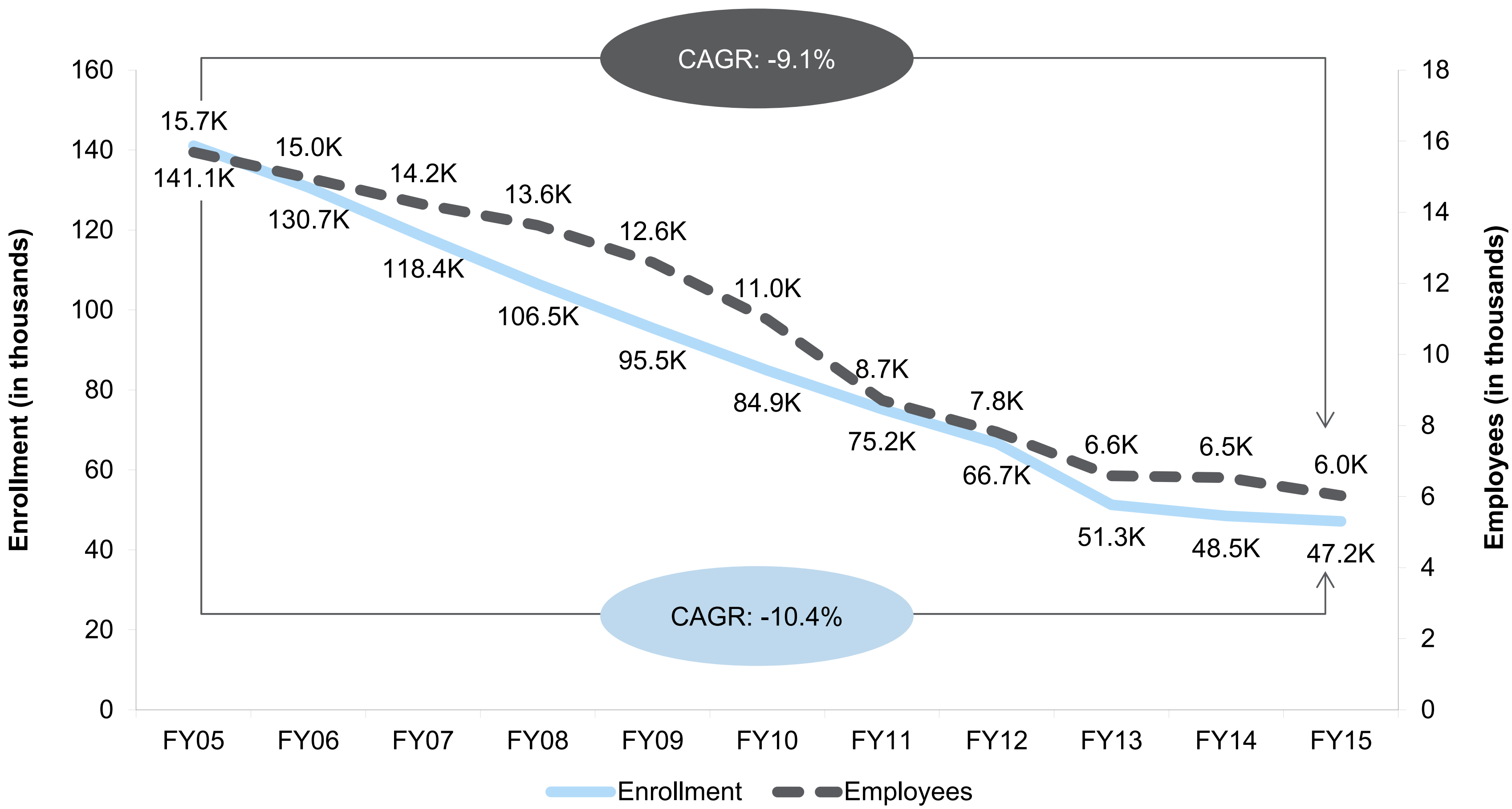
	FY05	FY06	FY07	FY08	FY09	FY10	FY11*	FY12†	FY13	FY14	FY15
Annual surplus (deficit)	$ (115M)	$ (25M)	$ (15M)	$ (136M)	$ (79M)	$ (108M)	$ 43M	$ 208M	$ (18M)	$ (76M)	$ (46M)

- Enrollment declined over 65% since FY05
- Over the same time DPS closed more than 150 schools and has continuously cut expenses but has been behind enrollment and revenue declines

* 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 bond issuance
Source: Detroit Public Schools Comprehensive Annual Financial Reports

DPS workforce has declined steadily since 2005 but has lagged the loss in enrollment

Detroit Public Schools, Enrollment and Employees
FY 2005 – FY 2015

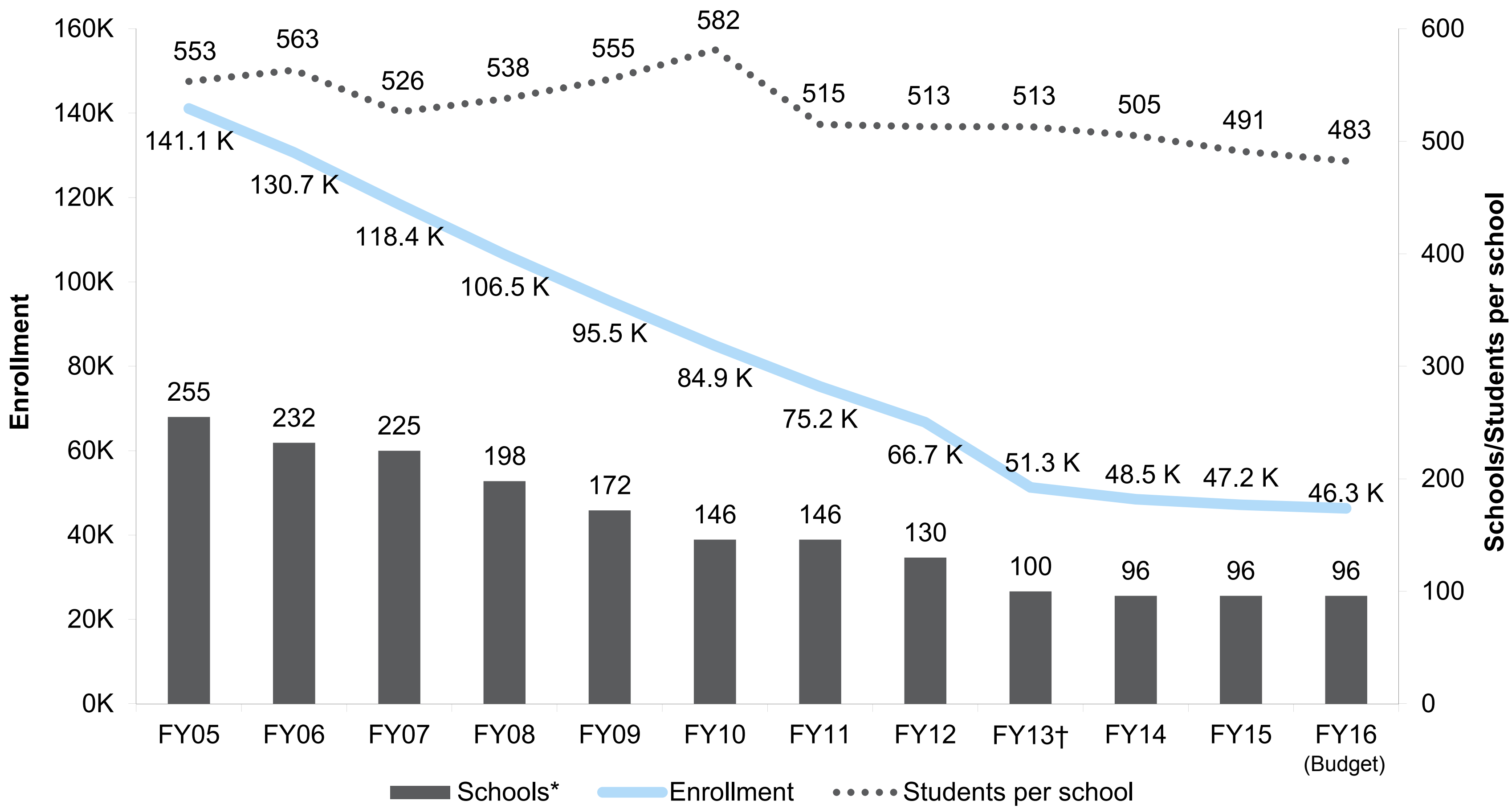


Note: CAGR stands for Compounded Annual Growth Rate
Source: Detroit Public Schools Comprehensive Annual Financial Reports

DPS has closed over 150 schools since 2005 in response to enrollment losses. School planning will continue to be important as enrollment stabilizes

Detroit Public Schools, School closures and School size

FY 2005 – FY 2016 Budget



† Creation of EAA resulted in transfer of 15 schools.
*Includes elementary schools, middle schools, high schools, alternative education schools, special education schools, and career technical and vocational centers.
Source: Detroit Public Schools Comprehensive Annual Financial Reports

DPS has undertaken a number of cost cutting measures but more transformation is necessary to align the district with current enrollment levels

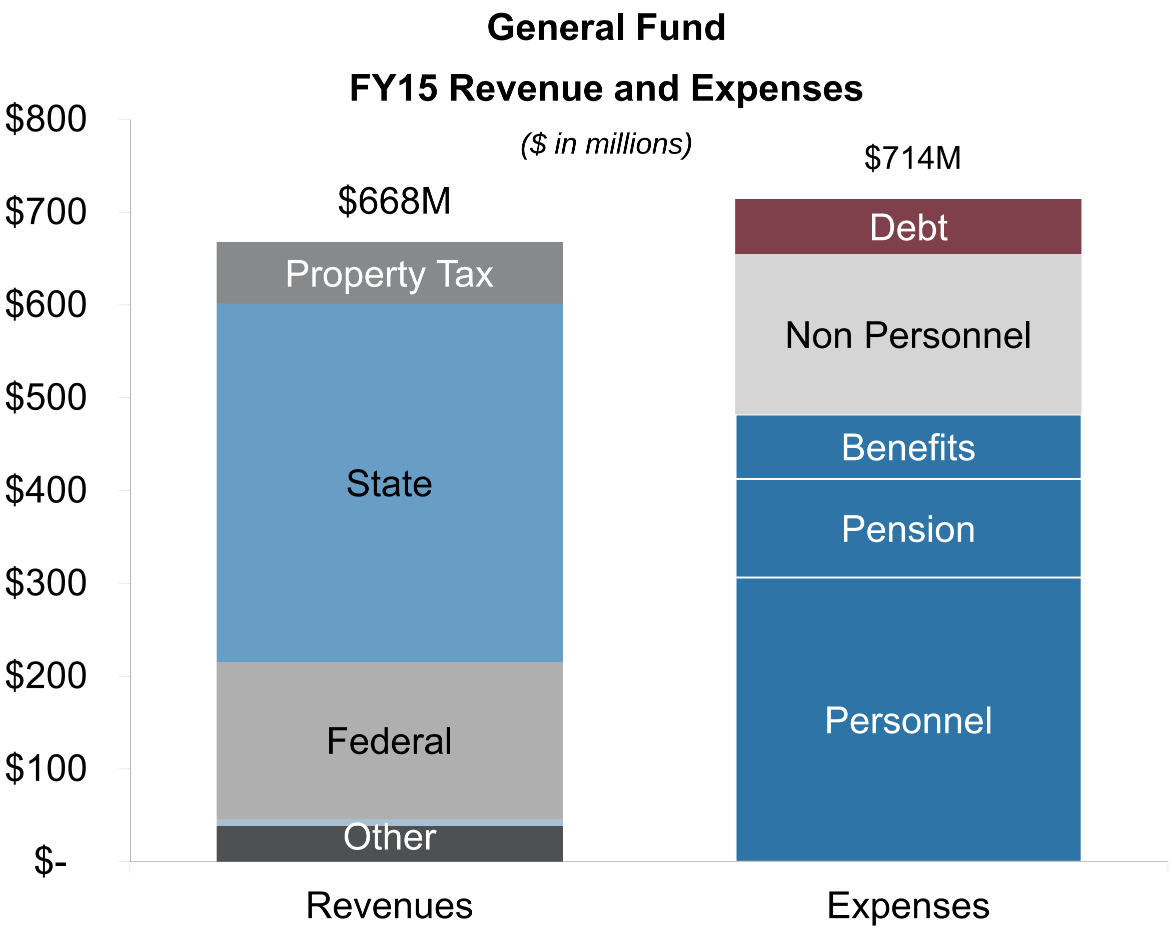
Actions Taken

- Wage concession of 10% and pay freezes dating back to FY 2000
- Sale of assets to generate revenue (>$15M in FY14 and FY15 alone)
- Reduction of nearly 10,000 positions since 2005 (62% decrease)
- Reduced number of schools by 159 since 2005 (62% decrease)
- Multiple modifications to healthcare benefits to reduce costs
- Implementation of two Employee Severance Plans to reduce payroll costs
- Continual effort to cancel, renegotiate and re-bid vendor contracts to reduce operating costs
- Enrollment stabilization campaign

DPS is transforming the way it operates beginning in FY16 with a smaller central office that includes new functions and a shift of resources to schools

Table of Content

DPS faces a structural imbalance due to legacy debt and high fixed cost structure



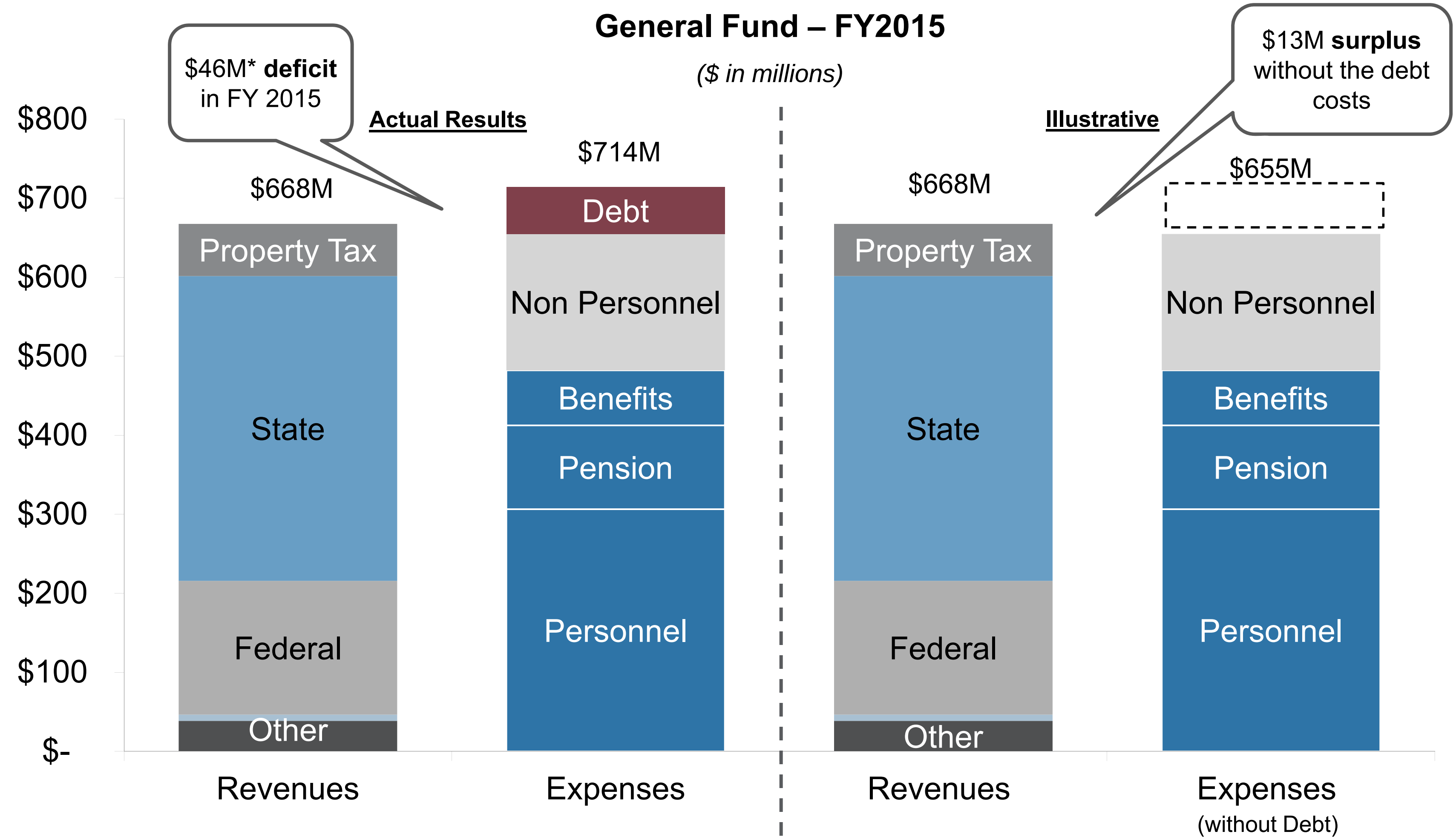
	Revenues	Expenses
Per Pupil	$14.2K	$15.2K

Drivers of Expenses

- High personnel cost due to costly benefits and state pension system
- High transportation costs
- Legacy debt payments (~$53M per year)
- DPS serves a higher proportion of high school students than other LEAs in Detroit that cost more to educate
- DPS serves a higher proportion of special education students than other schools in Detroit
- DPS serves a higher proportion of English Language Learners, homeless students, and other students that require additional support and services

Source: FY14 actuals

Without debt expenditures, DPS budget would have been balanced in FY2015



Per Pupil	$14.2K	$15.2K	$14.2K	$13.9K

Source: FY14 actuals

This actual figure was $22.3 million less than the projected figure in the FY15 adopted budget

What does DPS need?
Approximately $515M of legacy obligations and $200M of start-up costs

Legacy operating liabilities

($ ~515M)

+

Startup cost/ reinvestment financing

($ ~200M)

=

Total OldCo obligation

($ ~715M)

- Remaining operating debt (2011/2012 bonds)
- Short-term borrowing
- Deferred pension payments
- Deferred vendor payments
- Other

- Deferred maintenance
- Operational support during transition
- Investment in key academic programs
- Operating cash requirements
- Transition costs
- Other

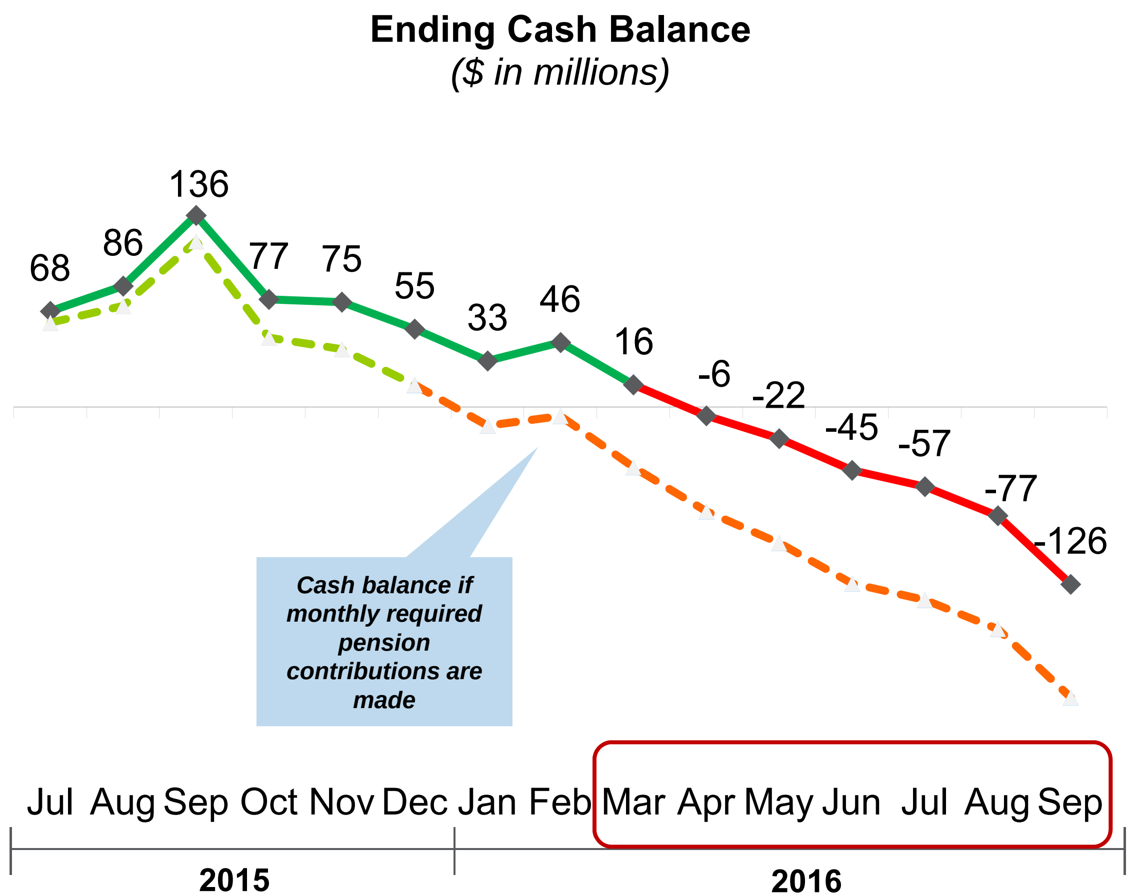
- OldCo will continue to operate in its current form through 6/30/2016 (“FY16”)
- Steady elimination of total OldCo obligations with dedicated funds from property tax receipts

To start with a clean slate at the beginning of FY17 DPS needs to retire its legacy obligations and start up funding

Outstanding operating liabilities as of 10/31/2015 ($ in millions)

$260M	2011/2012 Operating Bonds
83M	2015B SAN (State Aid Notes)
121M	2015E SAN (State Aid Notes)
103M	MPSERS
40M	Trade debt
607M	Subtotal
(106)M	Cash on hand (10/31/2015)
$501M	**Net debt (10/31/2015)**
~$515M	**Net debt projected as of 6/30/2016**

Why act now?
DPS faces near term cash shortfalls due to maturing debt and past due operating obligations

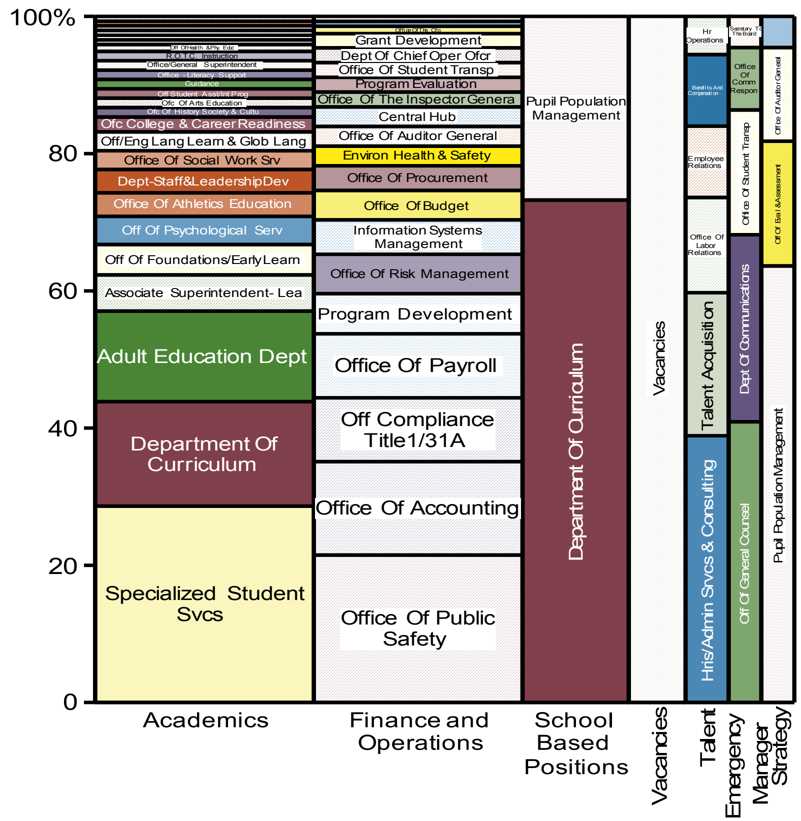


- DPS has taken recent action to address the mounting cash flow troubles, including more cost reductions, State Aid Note ("SAN") debt issuance ($120M in Sep'15), and deferrals
- Even so, DPS is expected to face a cash shortfall of ~$45M by June 2016
- We are exploring options to address the FY16 shortfall 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)

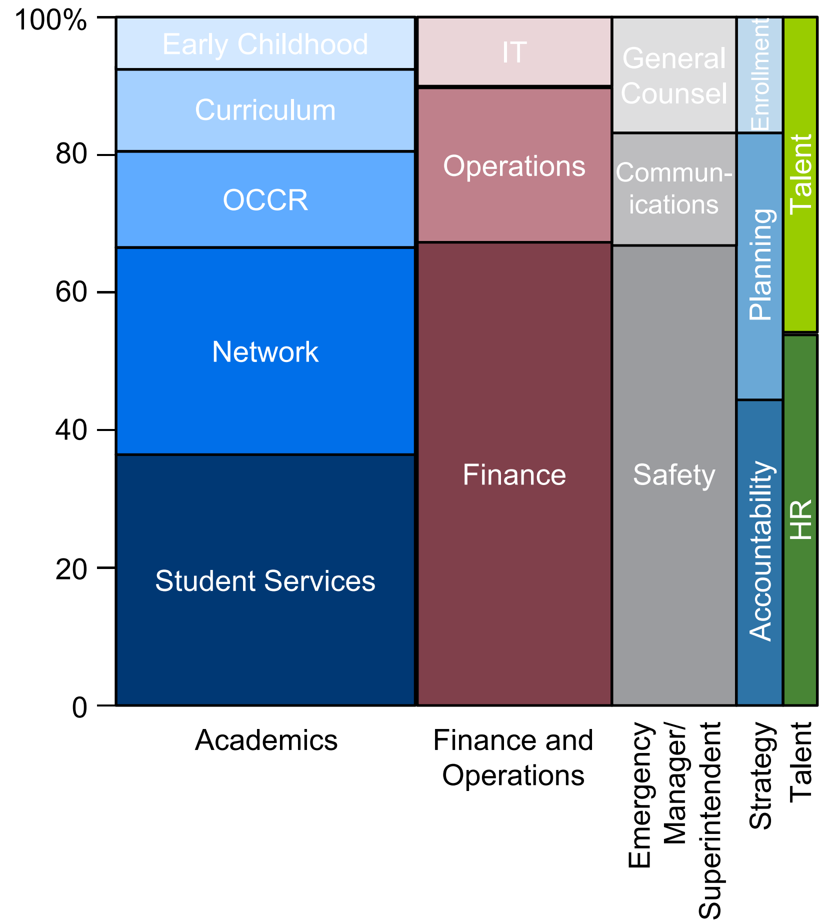
Table of Content

The Central Office will move from 60 departments to 16 offices within 5 divisions

DPS Central Office Budgeted Offices and Departments FY15



DPS Central Office Projected Offices and Departments FY16



Source: DPS Internal Data

Addressing the debt will allow for a shift in focus towards improving academic outcomes

- **Building Staff Capacity**
  - New Teacher Intensive Pre-Service Training
  - Ongoing/Differentiated Teacher Professional Development
  - School Leadership Institute (Building the Pipeline)
- **Data and Accountability**
  - Implement Data Cycles in Schools to focus on student academic progress data
  - Creating/enhancing Data Dashboards to communicate ongoing progress
  - Increased Performance Management
- **Network Supports**
  - Continuing to build out network systems to support school improvement, leadership coaching, and program effectiveness.
- **Curriculum/Program Enhancements**
  - Begin work to enhance the curriculum
  - Determining additional needs for curricular programs
  - Piloting special programs

The DPS transformation has begun, and the pending legislation will be an important step to ensure long-term sustainability

To date, DPS has taken a number of important steps to begin this transformation:

- **Central office reorganization and downsizing (~100 positions eliminated)**
  - **Creation of network structure to better support and empower schools**
  - **Focus on shifting resources to school level**
- **Procurement process overhaul and contract negotiations**
- **Benefits modifications resulting in cost savings**
- **Improved alignment of grants with district needs**

Legislative Action –

Transforming DPS Education

School Planning

- Address number and location of schools and capacity issues

Enrollment

- Stabilize enrollment
- Common enrollment system

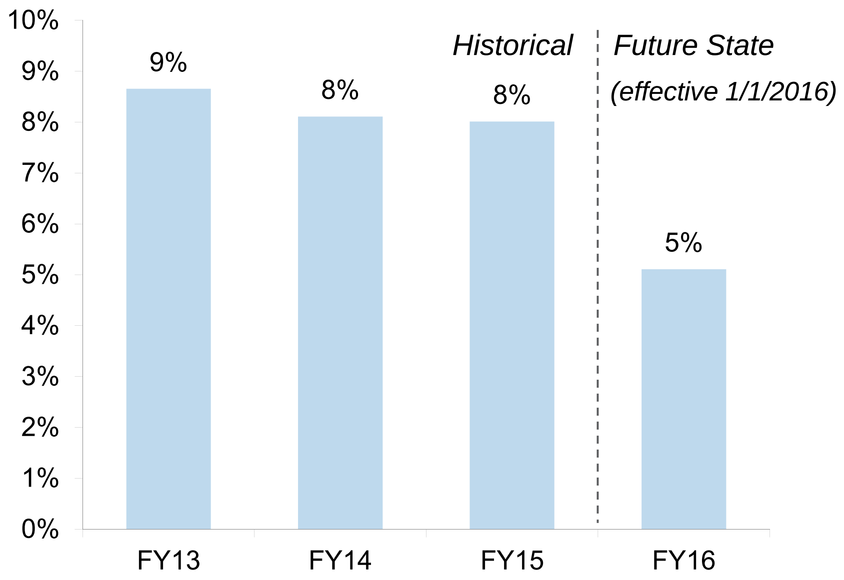
Financial Support

- Debt relief
- Establish full foundation allowance for NewCo

Examples of how DPS is realigning the district's focus on the schools

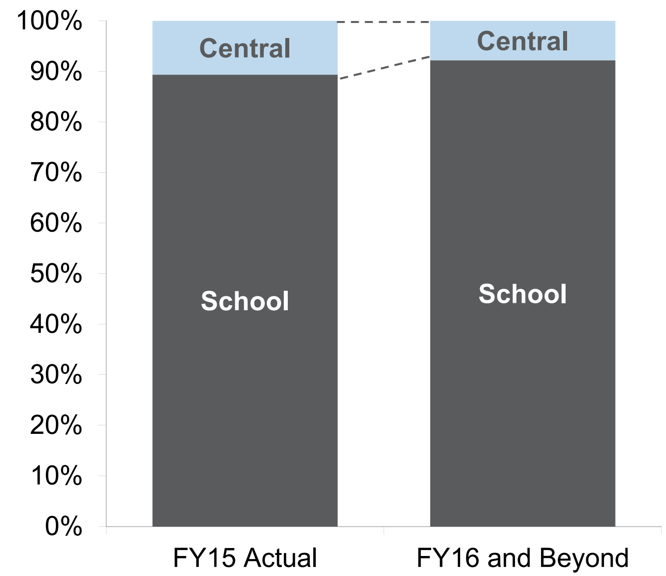
1

Percent of Central Office FTEs
FY13-FY16



2

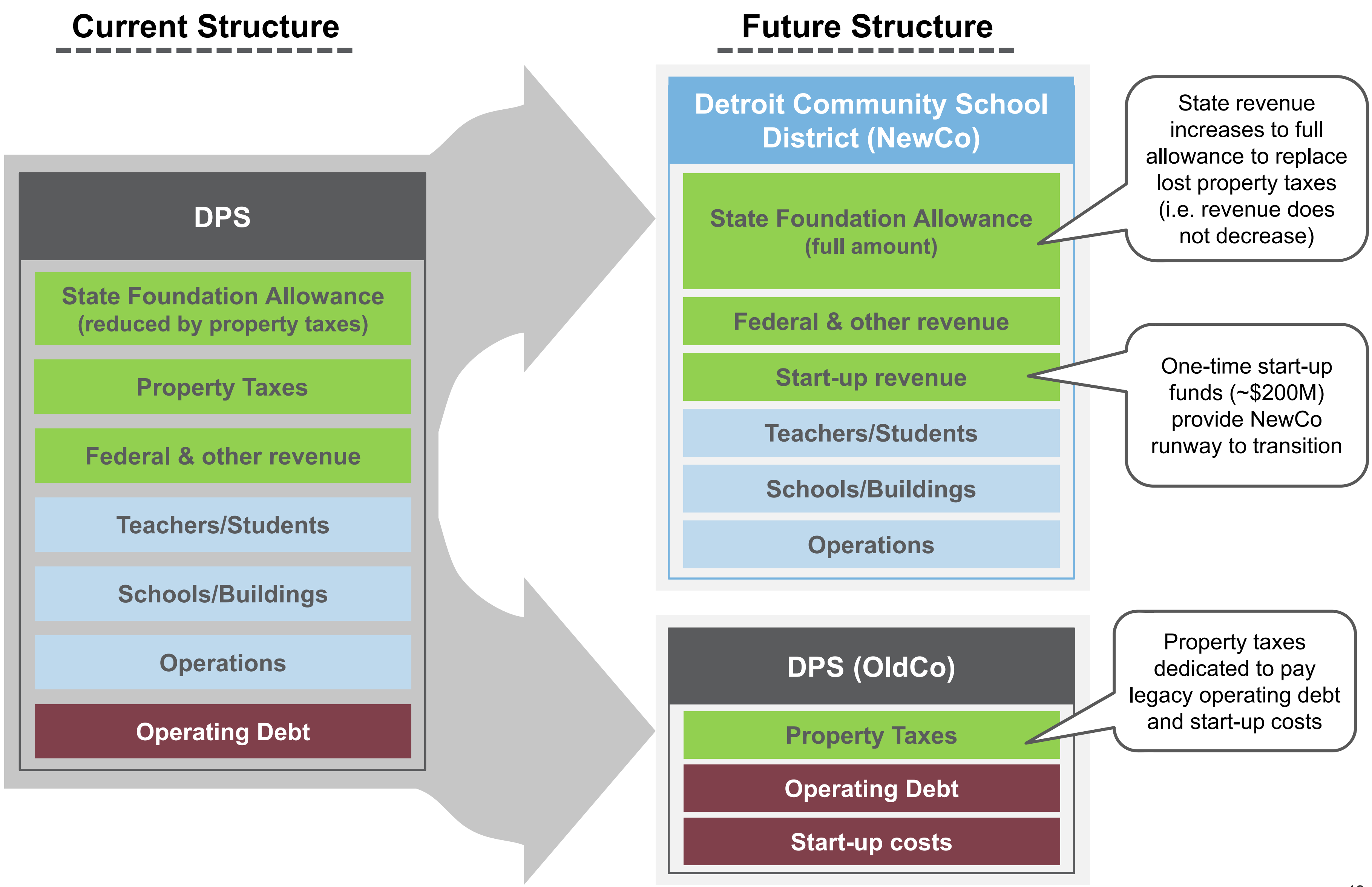
Comparison of Personnel expenses
FY15-FY16



- Central office operations and services are significantly downsized as resources are shifted closer to students
- Schools have access to a much larger pool of funds to be used and allocated at the school-level
- Achieving this shift will require support from MDE, as well as additional capacity at the school level

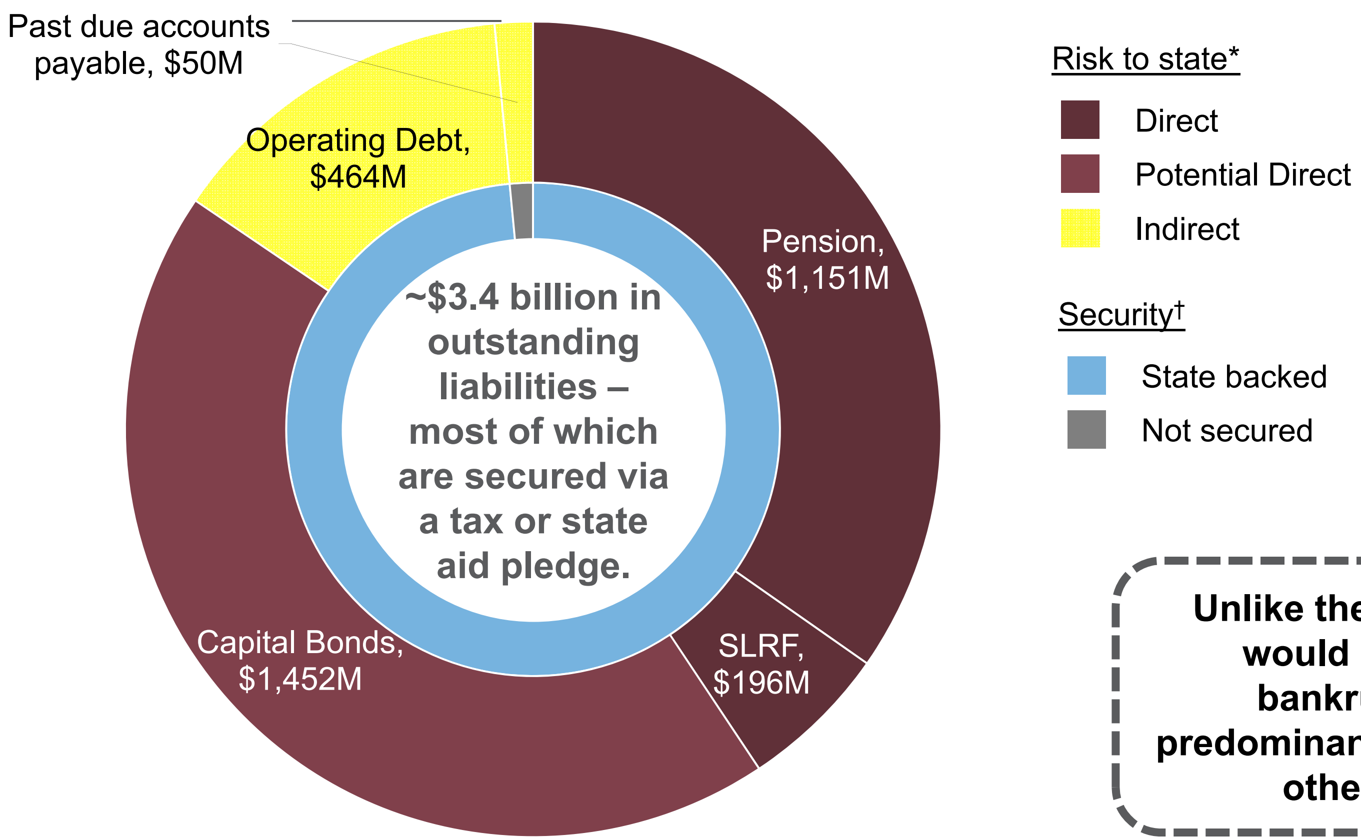
Source: 2014 CAFR and internal data

The proposed structure creates a new entity ("Detroit Community School District") with the same amount of revenue and no debt



What are the implications of doing nothing?
Tax payers 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 taxpayers to finance the following obligations:



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.
†State backing includes: Unlimited tax general obligation pledge, State aid and the limited tax general obligation pledge of the District, Michigan Public School Employee Retirement System

Key Takeaways

- Detroit Public Schools (DPS) has undergone tremendous change over the past 10+ years
- DPS has implemented a variety of best practice and cost saving measures and will continue to do so; removal of the debt will allow for a districtwide shift toward improved student achievement
- DPS is positioned to thrive in a debt free environment as evidenced by the 2014-15 audit which shows a $13M surplus if the debt is removed
- The time to act is now; Detroit Public Schools is rapidly running out of funds and the alternative is far worse for the State of Michigan (all Michigan school districts) and for Detroit