



MICHIGAN DEPARTMENT OF
TALENT AND ECONOMIC
DEVELOPMENT

FINANCIAL AUDIT REPORT

OF THE MICHIGAN STRATEGIC FUND



FISCAL YEAR ENDING
SEPTEMBER 30, 2016

(A DISCRETELY PRESENTED COMPONENT UNIT OF THE STATE OF MICHIGAN)

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with requirements material to the financial statements. This financial audit of the Michigan Strategic Fund (MSF) was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Auditor's Report Issued

The Auditor General's Office issued unmodified opinions on the MSF's basic financial statements.

Internal Control over Financial Reporting and on Compliance and Other Matters

In accordance with *Government Auditing Standards*, the Auditor General's Office will also issue a report on consideration of the MSF's internal control over financial reporting and on tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

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Office of the Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

Independent Auditor's Report on the Financial Statements
and Other Reporting Required by *Government Auditing Standards*

Mr. Steven Arwood
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Arwood:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2016 and the related notes to the financial statements, which collectively comprise the Fund'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.

Auditor's 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 auditor's 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.



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Doug A. Ringler, CPA, CIA
Auditor General

Mr. Steven Arwood
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Opinions

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Michigan Strategic Fund as of September 30, 2016 and the respective changes in financial position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1 to the financial statements, the financial statements present only the Michigan Strategic Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2016, the changes in its financial position, or, where applicable, its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 2 to the financial statements, beginning fund balance was restated for the reasons disclosed in the note. As also discussed in Note 2, the Michigan Strategic Fund adopted Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*, for the fiscal year ended September 30, 2016. Our opinion is not modified with respect to these matters.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the required supplementary information 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the Fund'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 Fund's internal control over financial reporting and compliance.

Sincerely,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler
Auditor General
January 18, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Michigan Strategic Fund (MSF) management has prepared this discussion and analysis of the financial performance of the MSF for the period October 1, 2015, through September 30, 2016. The MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan. The MSF's management is responsible for the basic financial statements, required supplementary information and this discussion.

Using the Financial Report

This financial report is prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accounting standards require a statement of net position; a statement of activities; a fund balance sheet; and a statement of revenues, expenditures, and changes in fund balance. The financial statements are interrelated and represent the financial status of the MSF.

This financial report includes the independent auditor's report, management's discussion and analysis, the basic financial statements and required supplementary information.

Major Changes

Pursuant to Executive Order No. 2014-12, beginning in fiscal year 2016, all accounting and reporting related to the Workforce Development Agency (WDA) were transferred from the MSF to the Department of Talent and Economic Development (TED). Fiscal year 2016 beginning net assets have been restated to reflect this transfer; it is discussed further in the notes to the financial statements.

Pursuant to Executive Order No. 2015-10, beginning in fiscal year 2016 all accounting and reporting related to the Michigan Energy Office (MEO) were transferred from the MSF to the Department of Licensing and Regulatory Affairs (LARA). Fiscal year 2016 beginning net assets have been restated to reflect this transfer; it is discussed further in the notes to the financial statements.

During fiscal year 2016, the MSF implemented GASB Statement No. 72, *Fair Value Measurement and Application*, which provides guidance for determining fair value measurement for reporting purposes, applying fair value to certain investments, and preparing disclosures related to all fair value measurements. Also, as a result of implementing this statement, assets previously reported as investments were reclassified to a new asset classification, economic development equity programs. The implementation of these requirements is further discussed in the notes to the financial statements.

The 2016 appropriation for the MSF included \$7.3 million to support debt service for the Facility for Rare Isotope Beams project. In addition, the following appropriations were reduced in 2016 compared to 2015: Business Attraction and Community Revitalization by \$13.8 million, Film Incentives by \$17.4 million, special grants for identified industries or recipients by \$6.5 million, and Skilled Trades Training Program (STTP) by \$10.0 million. The STTP appropriation was transferred to the Michigan Talent Investment Agency (TIA) in 2016.

Analysis of Financial Activities

The assets and deferred outflows of resources of the MSF exceeded its liabilities and deferred inflows of resources by \$498.9 million at September 30, 2016, and by \$508.2 million at September 30, 2015. Total net position decreased by \$9.2 million during fiscal year 2016.

Condensed Financial Information Statement of Net Position As of September 30

	<u>2016</u>	<u>2015</u>
Cash and equity in common cash	\$ 397,982,626	\$ 461,820,669
Amounts due from federal government	7,879,959	39,113,959
Other current assets	60,561,169	49,548,770
Total current assets	\$ 466,423,754	\$ 550,483,398
Noncurrent assets	677,540,644	488,664,111
Total assets	\$ 1,143,964,398	\$ 1,039,147,509
Deferred outflows of resources	\$ 754,912	\$ 3,930,493
Total assets and deferred outflows of resources	\$ 1,144,719,310	\$ 1,043,078,002
Current liabilities	\$ 105,019,405	\$ 118,544,369
Long-term liabilities	540,291,884	413,457,337
Total liabilities	\$ 645,311,290	\$ 532,001,706
Deferred inflows of resources	\$ 472,068	\$ 2,912,986
Total liabilities and deferred inflows of resources	\$ 645,783,358	\$ 534,914,692
Net position:		
Restricted	\$ 664,298,678	\$ 661,281,115
Unrestricted	(165,362,725)	(153,117,805)
Total net position	\$ 498,935,953	\$ 508,163,310

Cash and equity in common cash decreased by \$63.8 million largely as the result of \$35.3 million of film incentives being spent and \$34.8 million of previously issued bond funds being spent.

Amounts due from federal government primarily consist of receivables for federal pass-through for the Community Development Block Grants (CDBGs) to subrecipients in fiscal year 2016. This line item decreased by a net amount of \$31.2 million during fiscal year 2016 mainly due to the transfer of WDA and MEO programs from the MSF.

Other current assets primarily consist of loans receivable, capital lease receivable, the tribal gaming revenue receivables and participation loans. This line item increased by a net amount of \$11.0 million during fiscal year 2016 mainly due to an increase in capital lease receivable to account for the interest revenue due on the leases. Prior to fiscal year 2016, the financial activity related to the interest revenue on the leases wasn't recorded in the MSF's financial

statements. In fiscal year 2016, prior period adjustments were completed, which are further explained in the notes to the financial statements. Significant changes are also noted in the noncurrent assets, current liabilities and long-term liabilities analyses due to this.

Noncurrent assets include the Capital Access Program, capital lease receivable, loans receivable, economic development equity programs (EDEPs), collateral deposits and participation loans. The net increase in noncurrent assets during fiscal year 2016 was \$188.9 million. Capital lease receivables increased by \$135.0 million to account for the interest revenue due on the leases. EDEPs, which were recorded as investments in fiscal year 2015, increased by \$31.8 million largely due to the issuance of new equities, conversion of loans to equities and decrease in loss provision. Noncurrent collateral funding increased by \$15.5 million largely due to an increase in Michigan Business Growth Fund and Michigan Supplier Diversification Fund programs. The total amount of EDEPs and loans receivable (net of loss provisions) included in the current and noncurrent assets categories is \$233.5 million.

Current liabilities primarily consist of accounts payable and other liabilities, amounts due to component units, bond and interest payables related to the limited obligation revenue bonds and unearned capital lease interest revenue. This line item decreased by a net amount of \$13.5 million during fiscal year 2016. The decrease of \$39.1 million in accounts payable and other liabilities is mainly due to the transfer of the WDA program from the MSF and a decrease in CDBG program payables. These decreases are partially offset by increases of \$8.3 million to account for the unearned capital lease interest revenue and \$16.9 million in amounts due to component units due to an increase in tribal gaming revenue due to MEDC. An explanation on the tribal gaming revenue due to MEDC is included within the analysis of the statement of revenues, expenses and changes in net position.

Long-term liabilities primarily consist of bonds payables, the reserves for the Capital Access Program, unearned capital lease interest revenue and the net pension liability. This line item increased by a net amount of \$126.8 million during fiscal year 2016 primarily due to an increase of \$145.5 million to account for the unearned capital lease interest revenue. This increase was partially offset by a \$17.0 million decrease in bonds payable.

Deferred outflows/inflows of resources are related to pensions, which are discussed further in Note 7.

Restricted net position represents resources that are subject to external restrictions, constitutional provisions or enabling legislation limiting how they can be used. Total restricted net position increased by \$3 million during fiscal year 2016.

Unrestricted net position represents resources that are not included in restricted net position. Total unrestricted net position decreased by \$12.2 million primarily related to a decrease of \$18.9 million in Film Incentive Program encumbrances that are funded by the General Fund and a decrease of \$9.6 million in principal balances of the capital lease receivables for the various buildings owned by the MSF. These decreases were partially offset by an increase to unrestricted net position of \$15.8 million due to a decrease in bonds payables.

Condensed Financial Information
Statement of Activities
For the Fiscal Years Ended September 30

	<u>2016</u>	<u>2015</u>
Expenses		
Community Development Block Grants (CDBG)	\$ 32,505,457	\$ 34,594,027
Arts and Cultural Grants	9,778,702	9,818,671
Michigan Energy Office	0	2,530,171
Jobs for Michigan Investment Fund	111,458,193	141,627,120
Workforce Development Agency Fund	0	259,947,308
Film Incentives and other programs	87,721,151	49,154,798
Payments to the Michigan Economic Development Corporation (MEDC)	90,889,926	80,391,645
Other	26,472,097	29,116,605
Total program expenses	<u>\$ 358,825,526</u>	<u>\$ 607,180,344</u>
Program revenues		
Charges for services	\$ 1,619,862	\$ 2,218,901
Operating grants and contributions	32,104,263	283,200,576
Total program revenues	<u>\$ 33,724,125</u>	<u>\$ 285,419,476</u>
Net program expenses	<u>\$ 325,101,401</u>	<u>\$ 321,760,868</u>
General revenues		
Payments from the State of Michigan	\$ 250,286,704	\$ 291,755,821
Other	91,351,306	79,838,491
Total general revenues	<u>\$ 341,638,010</u>	<u>\$ 371,594,313</u>
Change in net position	\$ 16,536,609	\$ 49,833,445
Net position - Beginning (restated)	<u>\$ 482,399,344</u>	<u>\$ 458,329,865</u>
Net position - Ending	<u>\$ 498,935,953</u>	<u>\$ 508,163,310</u>

CDBG expenses decreased by \$2.1 million in fiscal year 2016 due to decreases in awards made to subrecipients. CDBG is a federal pass-through grant program and grant awards are spent over several years.

Jobs for Michigan Investment Fund expenses decreased by \$30.2 million mainly due to a decrease in spending in the Business Attraction and Community Revitalization programs.

Workforce Development Agency Fund and **Michigan Energy Office** were transferred from the MSF in fiscal year 2016 per Executive Orders 2014-12 and 2015-10.

Film Incentives and other programs expenses increased by \$38.6 million mainly due to increases of \$47.8 million in Film Incentive Program expenditures due to incentives being earned and of \$8.3 million in grant payments for the Community Colleges Skilled Trades Equipment Program. These increases are partially offset by a decrease of \$18.3 million in grant payments to Michigan State University for the Facility for Rare Isotope Beams Project.

Payments to MEDC primarily consist of the MSF state appropriations transferred to fund programs administered by MEDC, as well as tribal gaming and fee revenue. This line item increased by a net amount of \$10.5 million during fiscal year 2016. The tribal gaming and fee revenues transferred to MEDC increased by \$29.9 million. The State reached a partial settlement agreement with the Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians resolving a tribal compact dispute and allowing the resumption of gaming revenue-sharing payments from the Gun Lake Casino. In addition, the Nottawaseppi Huron Band of Pottawatomi Indians and the State agreed to a compact amendment to transfer tribal gaming revenues related to the Firekeeper's Casino from the MSF to MEDC. The MSF state appropriations transferred to MEDC decreased by \$19.4 million primarily due to decreases of General Fund appropriations of \$6.5 million for special grants for identified industries or recipients and \$10 million for STTP. The STTP's appropriation was transferred to TIA in 2016.

Other expenses primarily consist of payments to the General Fund, other interest and miscellaneous expenses. This line item decreased by \$2.6 million mainly due to the transfer of WDA from the MSF.

Operating grants and contributions primarily reflect the funds received from the federal government for CDBG in fiscal year 2016. This line item decreased by a net amount of \$251.1 million mainly due to the transfer of the WDA programs from the MSF.

Payments from the State of Michigan primarily consist of transfers of the MSF appropriations from the State General Fund of \$79.8 million and reimbursements of the MSF expenditures from the 21st Century Jobs Trust Fund of \$170.5 million. The revenue from the General Fund transfers decreased by \$50.2 million as a result of reduced authorization to the Film Incentive Program, STTP, special grants to targeted industries and recipients for economic development support and WDA programs. The STTP's and WDA's appropriations were transferred to TIA in 2016. The revenue from the 21st Century Jobs Trust Fund for grants, loans, investments and promotion programs increased by \$8.7 million as a result of increased program expenditures, as well as loans, EDEPs, collaterals and participation loans made using these funds.

Other general revenues primarily consist of tribal gaming revenue, interest income, returns on EDEPs and revenue related to capital lease agreements. This line item increased by a net amount of \$11.5 million during fiscal year 2016 due to an increase of \$18.8 million in tribal gaming revenue and \$10.0 million in miscellaneous revenue due to returns on EDEPs, return of Capital Access Program funds and grant repayments. These increases are offset by a decrease of \$16.8 million in the fair value of investments due to the implementation of GASB Statement No. 72. The MSF no longer has investments and the implementation of this statement is further discussed in the notes to the financial statements.

BASIC FINANCIAL STATEMENTS

MICHIGAN STRATEGIC FUND
Statement of Net Position
As of September 30, 2016

ASSETS

Current assets:	
Cash (Note 3)	\$ 85,535,200
Equity in common cash (Note 3)	268,806,480
SSBCI checking account (Note 3)	30,829,202
Collateral deposits (Note 4)	12,811,744
Participation loans	8,709,651
Amount due from federal government	7,879,959
Loans receivable (Note 5)	4,418,430
Capital lease receivable (Note 6)	18,645,563
Other current assets (Note 5)	28,787,525
Total current assets	<u>\$ 466,423,754</u>
Noncurrent assets:	
Capital Access Program (Notes 3, 4, and 10)	\$ 5,918,180
Collateral deposits (Note 4)	45,349,664
Participation loans	48,354,692
Capital lease receivable (Note 6)	347,238,672
Economic development equity programs	176,831,101
Loans receivable (Note 5)	52,281,652
Other noncurrent assets (Note 5)	1,566,684
Total noncurrent assets	<u>\$ 677,540,644</u>
Total assets	<u>\$ 1,143,964,398</u>

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows related to pensions	\$ 754,912
Total deferred outflows of resources	<u>\$ 754,912</u>
Total assets and deferred outflows of resources	<u>\$ 1,144,719,310</u>

LIABILITIES

Current liabilities:	
Accounts payable and other liabilities	\$ 44,599,149
Compensated absences (Note 10)	440,495
Amounts due to component units	28,575,384
Capital Access Program (Notes 4 and 10)	400,000
Amounts due to primary government	112,275
Interest payable	6,039,940
Bonds payable (Note 8)	15,595,000
Unearned revenue (Note 6)	9,257,161
Total current liabilities	<u>\$ 105,019,405</u>
Long-term liabilities:	
Bonds payable (Note 8)	\$ 364,055,608
Unearned revenue (Note 6)	145,566,332
Compensated absences (Note 10)	243,366
Capital Access Program (Notes 4 and 10)	5,518,180
Net pension liability (Note 10)	24,908,398
Total long-term liabilities	<u>\$ 540,291,884</u>
Total liabilities	<u>\$ 645,311,290</u>

DEFERRED INFLOWS OF RESOURCES

Deferred inflows related to pensions	\$ 472,068
Total deferred inflows of resources	<u>\$ 472,068</u>
Total liabilities and deferred inflows of resources	<u>\$ 645,783,358</u>

NET POSITION

Restricted for:	
Other purposes	\$ 664,298,678
Unrestricted	(165,362,725)
Total net position	<u>\$ 498,935,953</u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN STRATEGIC FUND
Statement of Activities
For the Fiscal Year Ended September 30, 2016

EXPENSES (Note 1)

Community Development Block Grants	\$ 32,505,457
Arts and Cultural Grants	9,778,702
Jobs for Michigan Investment Fund	111,458,193
Film Incentives and other programs	87,721,151
Payments to MEDC	90,889,926
Other Interest	16,320,646
Miscellaneous	<u>10,151,451</u>
Total program expenses	<u>\$ 358,825,526</u>

PROGRAM REVENUES (Note 1)

Charges for services

Program fees	\$ 1,619,862
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Operating grants and contributions

Federal revenues	31,679,062
Revenues from local units	<u>425,200</u>
Total program revenues	<u>\$ 33,724,125</u>

Net program expense	<u>\$ 325,101,401</u>
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GENERAL REVENUES (Note 1)

Payments from the State of Michigan

Payments from General Fund	\$ 79,812,345
Payments from 21st Century Jobs Trust Fund	170,474,359

Other

Interest earnings	13,673,048
Tribal gaming	58,657,047
Lease revenue	978,147
Miscellaneous	<u>18,043,064</u>
Total general revenues	<u>\$ 341,638,010</u>

Increase in net position	\$ 16,536,609
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Net position - Beginning Restated (Note 2)	<u>482,399,344</u>
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Net position - Ending	<u><u>\$ 498,935,953</u></u>
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The accompanying notes are an integral part of the financial statements.

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30, 2016

	Major Funds			Total
	General Operations Fund	Jobs for Michigan Investment Fund	Debt Service Fund	
ASSETS				
Current assets:				
Cash (Note 3)	\$ 64,230,357	\$ -	\$ 21,304,843	\$ 85,535,200
Equity in common cash (Note 3)	82,656,213	186,150,267	-	268,806,480
SSBCI checking account (Note 3)	30,829,202	-	-	30,829,202
Collateral deposits (Note 4)	9,015,156	3,796,588	-	12,811,744
Participation loans	1,132,941	7,576,711	-	8,709,651
Amounts due from federal government	7,879,959	-	-	7,879,959
Loans receivable (Note 5)	-	4,418,430	-	4,418,430
Capital lease receivables (Note 6)	-	-	18,645,563	18,645,563
Other current assets (Note 5)	26,860,712	1,926,813	-	28,787,525
Total current assets	<u>\$ 222,604,540</u>	<u>\$ 203,868,809</u>	<u>\$ 39,950,405</u>	<u>\$ 466,423,754</u>
Noncurrent assets:				
Capital Access Program (Notes 3, 4, and 10)	\$ 5,918,180	\$ -	\$ -	\$ 5,918,180
Collateral deposits (Note 4)	31,888,855	13,460,810	-	45,349,664
Participation loans	6,419,997	41,934,695	-	48,354,692
Capital lease receivables (Note 6)	-	-	347,238,672	347,238,672
Economic development equity programs	1,802,376	175,028,725	-	176,831,101
Loans receivable (Note 5)	-	52,281,652	-	52,281,652
Other noncurrent assets (Note 5)	-	1,566,684	-	1,566,684
Total noncurrent assets	<u>\$ 46,029,408</u>	<u>\$ 284,272,565</u>	<u>\$ 347,238,672</u>	<u>\$ 677,540,644</u>
Total assets	<u>\$ 268,633,948</u>	<u>\$ 488,141,373</u>	<u>\$ 387,189,077</u>	<u>\$ 1,143,964,398</u>
DEFERRED OUTFLOWS OF RESOURCES				
Total assets and deferred outflows of resources	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 7,836,587	\$ 36,762,561	\$ -	\$ 44,599,149
Amounts due to component units	9,238,712	868,074	-	10,106,786
Capital Access Program (Note 4 and 10)	400,000	-	-	400,000
Amounts due to primary government	112,275	-	-	112,275
Unearned revenue	361,224	-	801,189	1,162,412
Total current liabilities	<u>\$ 17,948,799</u>	<u>\$ 37,630,635</u>	<u>\$ 801,189</u>	<u>\$ 56,380,623</u>
Long-term liabilities:				
Capital Access Program (Notes 4 and 10)	\$ 5,518,180	\$ -	\$ -	\$ 5,518,180
Total long-term liabilities	<u>\$ 5,518,180</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,518,180</u>
Total liabilities	<u>\$ 23,466,979</u>	<u>\$ 37,630,635</u>	<u>\$ 801,189</u>	<u>\$ 61,898,803</u>
DEFERRED INFLOWS OF RESOURCES				
Capital lease interest (Note 6)	\$ -	\$ -	\$ 153,661,081	\$ 153,661,081
Unavailable revenue	18,468,598	10,949,576	-	29,418,174
Total deferred inflows of resources	<u>\$ 18,468,598</u>	<u>\$ 10,949,576</u>	<u>\$ 153,661,081</u>	<u>\$ 183,079,255</u>
FUND BALANCE (Note 11)				
Restricted fund balance	\$ 214,471,801	\$ 439,561,162	\$ 232,726,807	\$ 886,759,770
Committed fund balance	48,730	-	-	48,730
Assigned fund balance	10,009,195	-	-	10,009,195
Unassigned fund balance	2,168,645	-	-	2,168,645
Total fund balance	<u>\$ 226,698,371</u>	<u>\$ 439,561,162</u>	<u>\$ 232,726,807</u>	<u>\$ 898,986,340</u>
Total liabilities, deferred inflows of resources, and fund balance	<u>\$ 268,633,948</u>	<u>\$ 488,141,373</u>	<u>\$ 387,189,077</u>	<u>\$ 1,143,964,398</u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN STRATEGIC FUND
Reconciliation of the Governmental Fund Balance Sheet
to the Statement of Net Position
As of September 30, 2016

	2016
Total fund balance	\$ 898,986,340
Amounts reported for governmental activities in the statement of net position are different because:	
Deferred outflows related to pensions are not due and payable in the current period and therefore are not reported in the governmental fund statement.	754,912
Compensated absences and net pension obligations are not due and payable in the current period and therefore are not reported in the governmental fund statement.	(25,592,260)
Bonds payable and interest payable are not due and payable in the current period and therefore are not reported in the governmental fund statement.	
Bonds payable	(379,650,608)
Bond interest payable	(6,039,940)
Certain amounts due to component units are not due and payable in the current period and therefore are not reported in the governmental fund statement.	(18,468,598)
Unearned revenue related to capital lease interest is not reported on the governmental fund statements.	(153,661,081)
Deferred inflows of resources is not available for the current period and therefore is not recognized as revenue in the governmental fund statement. This includes:	
Capital lease interest	153,661,081
Tribal gaming revenue	18,468,598
Other revenues	1,368,510
Related to pensions	(472,068)
Loan interest revenue	9,581,066
Net position of governmental activities	\$ 498,935,953

MICHIGAN STRATEGIC FUND
Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance
For the Fiscal Year Ended September 30, 2016

	Major Funds			Total
	General Operations Fund	Jobs for Michigan Investment Fund	Debt Service Fund	
REVENUES (Note 1)				
<u>Charges for services</u>				
Program fees	\$ 1,619,862	\$ -	\$ -	\$ 1,619,862
<u>Operating grants and contributions</u>				
Federal Revenues	31,679,062	-	-	31,679,062
Revenues from local units	425,200	-	-	425,200
<u>Payments from the State of Michigan</u>				
Payments from General Fund	79,812,345	-	-	79,812,345
Payments from 21st Century Jobs Trust Fund	-	170,474,359	-	170,474,359
<u>Other</u>				
Tribal gaming	40,279,855	16,583,655	-	56,863,511
Interest earnings	1,614,038	2,798,112	8,533,350	12,945,499
Lease revenue	-	-	978,147	978,147
Miscellaneous	4,226,572	12,447,982	-	16,674,554
Total revenues	<u>\$ 159,656,935</u>	<u>\$ 202,304,108</u>	<u>\$ 9,511,497</u>	<u>\$ 371,472,540</u>
EXPENDITURES (Note 1)				
Community Development Block Grants	\$ 32,505,457	\$ -	\$ -	\$ 32,505,457
Arts and Cultural Grants	9,778,702	-	-	9,778,702
Jobs for Michigan Investment Fund	-	114,968,092	-	114,968,092
Film incentives and other programs	87,721,151	-	-	87,721,151
Payments to MEDC	76,946,389	-	-	76,946,389
Other interest	-	-	18,469,198	18,469,198
Debt service principal redemption	-	-	14,270,000	14,270,000
Miscellaneous	9,283,687	-	1,000	9,284,687
Total expenditures	<u>\$ 216,235,386</u>	<u>\$ 114,968,092</u>	<u>\$ 32,740,198</u>	<u>\$ 363,943,676</u>
Excess of revenues over/(under) expenditures	<u>\$ (56,578,451)</u>	<u>\$ 87,336,016</u>	<u>\$ (23,228,702)</u>	<u>\$ 7,528,863</u>
OTHER FINANCING SOURCES (USES)				
Transfer from General Operations Fund	\$ -	\$ -	\$ 11,900,000	\$ 11,900,000
Transfer to Debt Service Fund	(11,900,000)	-	-	(11,900,000)
Other financing sources (uses)	<u>\$ (11,900,000)</u>	<u>\$ -</u>	<u>\$ 11,900,000</u>	<u>\$ -</u>
Net change in fund balances	\$ (68,478,451)	\$ 87,336,016	\$ (11,328,702)	\$ 7,528,863
Fund balance - Beginning Restated (Note 2)	<u>295,176,822</u>	<u>352,225,146</u>	<u>244,055,509</u>	<u>891,457,477</u>
Fund balance - Ending	<u>\$ 226,698,371</u>	<u>\$ 439,561,162</u>	<u>\$ 232,726,807</u>	<u>\$ 898,986,340</u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN STRATEGIC FUND
**Reconciliation of the Governmental Fund Statement of Revenues, Expenditures,
and Changes in Fund Balance to the Statement of Activities**
For the Fiscal Year Ended September 30, 2016

	2016
Net change in fund balance	\$ 7,528,863
Amounts reported for governmental activities in the statement of activities are different because:	
Tribal Gaming revenues that are reported as resources in the fund statement but were earned in prior fiscal years are not reported in the statement of activities.	1,793,537
Certain interest earnings are delayed and not available and have been deferred at the governmental fund level but are recognized in the statement of activities.	727,549
Payments to MEDC that are not due and payable in the current period are not reported as expenditures in the governmental fund statement.	(13,943,537)
Other interest expense for bonds payable that was due and payable in the current period and was reported as an expenditure in the governmental fund statement.	2,148,553
Debt service principal redemption was due and payable in the current period and was reported as an expenditure in the governmental fund statement.	14,270,000
Correction of Prior Year Revenues were recorded in governmental fund statement but not recognized in statement of activities.	3,509,899
Miscellaneous revenues were not recorded in governmental fund statement for receivables recorded in statement of activities.	1,368,510
Compensated absences, supplemental pension payments and net pension obligations are not reported in the governmental fund statement because payments are not due and do not use current financial resources.	(866,764)
Change in net position of governmental activities	\$ 16,536,609

Notes to Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Strategic Fund (MSF) conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of more significant policies:

A. Reporting Entity

The MSF was created by Act 270, P.A. 1984, to help diversify the economy of the State of Michigan and to provide for economic development, primarily by assisting business enterprises in obtaining additional sources of financing. Under the provisions of this Act, the MSF succeeded to the rights, properties, obligations and duties of the Michigan Job Development Authority and the Michigan Economic Development Authority.

Executive Order No. 1999-1 further authorized the MSF to enter into an interlocal agreement with local public agencies. Under this authority, the MSF entered into an interlocal agreement and created the Michigan Economic Development Corporation (MEDC) as a new public entity in 1999 to help administer the programs transferred to the MSF. The interlocal agreement provided that any economic development programs transferred to the MSF could be transferred, along with the relevant personnel and funding, to MEDC.

Executive Order No. 2003-18, effective December 7, 2003, transferred the MSF as an autonomous agency from the Department of Management and Budget to the Department of Energy, Labor and Economic Growth (DELEG). Subsequently, Act 225, P.A. 2005, effective November 21, 2005, transferred the MSF as an autonomous agency from DELEG to the Department of Treasury.

The MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of the Department of Licensing and Regulatory Affairs and eight members who are appointed by the Governor with the advice and consent of the Senate.

The MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan because the primary government appoints a voting majority of the MSF Board of Directors and there is a financial burden/benefit relationship between the MSF and the State.

Executive Order No. 2011-4, effective April 24, 2011, transferred the Bureau of Workforce Transformation and energy programs from DELEG and the State Land Bank Fast Track Authority (SLBFTA) and the Michigan State Housing Development Authority (MSHDA) from the Department of Treasury to the MSF. However, all accounting and reporting responsibilities were transferred effective October 1, 2011, except for MSHDA, which is responsible for its own accounting and reporting responsibilities.

Executive Order No. 2013-8, effective July 16, 2013, transferred SLBFTA from the MSF to MSHDA. In accordance with governmental accounting and financial reporting standards, SLBFTA and MSHDA are not considered component units of the MSF and are reported as discretely presented component units of the State of Michigan in the fiscal year 2014 *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. Executive Order No. 2014-8, effective July 21, 2014, abolished the SLBFTA Board of Directors and Office of Executive Director and transferred all responsibilities and functions to the executive director of MSHDA. Therefore, beginning in fiscal year 2015, SLBFTA was reported as a component unit of MSHDA.

Executive Order No. 2014-12, effective March 2015, created the Department of Talent and Economic Development (DTED) and transferred the MSF from the Department of Treasury, MSHDA from the MSF, and SLBFTA from MSHDA to DTED. The executive order also created the Michigan Talent Investment Agency (MTIA) within DTED and transferred the Workforce Development Agency (WDA) from the MSF and the Unemployment Insurance Agency (UIA) from LARA to MTIA. However, all accounting and reporting responsibilities were transferred effective October 1, 2015, and beginning in fiscal year 2016, WDA was no longer included as part of the MSF.

Executive Order No. 2015-10, effective May 2015, transferred the Michigan Energy Office (MEO) from the MEDC and the MSF to LARA. However, all accounting and reporting responsibilities were transferred effective October 1, 2015, and beginning in fiscal year 2016, MEO was no longer included as part of the MSF.

B. Financial Statement Presentation

The MSF's financial statements include the entity-wide and governmental fund financial statements. The entity-wide financial statements include the statement of net position and the statement of activities and report on the MSF as a whole. The statement of net position presents the MSF's assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position. The difference between assets plus deferred outflows of resources and liabilities plus deferred inflows of resources represents the MSF's net position. The statement of activities demonstrates the degree to which direct expenses of a given function or segment are offset by program revenues. Program revenues include charges to users who directly benefit from the services, grants and contributions that are restricted to meeting the requirements of a function. Taxes and other items not meeting the definition of program revenues are reported as general revenues.

The MSF's governmental fund financial statements include the MSF's General Operations Fund, Jobs for Michigan Investment Fund (a special revenue fund), and Debt Service Fund. All of the MSF's funds are considered major funds. The MSF's three funds are accounted for in a separate set of self-balancing accounts that comprise its assets, deferred outflows of resources, liabilities, deferred inflows of resources, fund balances, revenues and expenditures. The General Operations Fund accounts for all of the activities of the MSF except those accounted for in the Jobs for Michigan Investment Fund and the Debt Service Fund. The Jobs for Michigan Investment Fund accounts for the equity funding, loan and grant activity provided for in Act 225, P.A. 2005. The Debt Service Fund accounts for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds issued. Additional disclosures describing the bonds accounted for in the Debt Service Fund are provided in Note 8.

The accompanying financial statements present only the MSF. Accordingly, they do not purport to, and do not present fairly the financial position, the changes in financial position, or, where applicable, cash flows of the State of Michigan or its component units in conformity with GAAP.

C. Measurement Focus and Basis of Accounting

The entity-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. The effect of interfund activity has been eliminated from the entity-wide financial statements.

The governmental fund financial statements are presented, using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period, generally within 60 days. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable. Transfers (interfund activity) represent flows of assets (such as cash) without equivalent flows of assets in return or a requirement for repayments. In addition, transfers are recorded when a fund receiving revenue provides it to the fund which expends the resources.

D. Financial Data

(1) MSF's General Operations Fund includes the following:

- (a) Revenues: Revenues include federal revenues for Community Development Block Grants (CDBGs) from the U.S. Department of Housing and Urban Development; State appropriations from the General Fund; tribal gaming; interest earnings; fees from private activity bond* (PAB) issuances; and fees from Michigan Economic Growth Authority (MEGA) and Brownfield program applications.
- (b) Expenditures: CDBG expenditures primarily consist of pass-through grants to local governmental units. Film Office expenditures consist of grants to film producers to promote film industry in Michigan. Arts and Cultural Grants expenditures consist of grants to local libraries, schools and art groups. Other program expenditures include grants for the Facility for Rare Isotope Beams Project and the Community Colleges Skilled Trades Equipment Program. Payments to MEDC include tribal gaming; fees from PABs, MEGA and Brownfield; and State appropriations for programs administered by MEDC. Expenditures in each of the programs also include administrative and other miscellaneous costs.
- (c) Other Financing Sources: Other financing sources consist of amount transferred to the Debt Service Fund to fund the payment of principal and interest for the Community Colleges Skilled Trades Equipment Program and the Facility for Rare Isotope Beams Project limited obligation revenue bonds.

- (2) MSF's Jobs for Michigan Investment Fund primarily includes the following:
 - (a) Revenues: Revenues include payments from the 21st Century Jobs Trust Fund, tribal gaming and interest and earnings from loans and economic development equity programs.
 - (b) Expenditures: Expenditures primarily consist of grants to private entities, universities and colleges and expenditures for travel promotion, business marketing, business incentive programs and administration.
- (3) MSF's Debt Service Fund primarily includes revenues from lease agreements and interest earned on the lease payments, bond proceeds and transfers of funds from the General Operations Fund, deposited in the bank for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds.

E. Fund Balance Classifications

- (1) Restricted fund balance includes amounts that are restricted when constraints placed on the use of the resources are either externally imposed by creditors, grantors, contributors or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The MSF's restricted fund balance consists of the entire fund balance in the Jobs for Michigan Investment Fund, fund balance for funds created through enabling legislation, the entire fund balance of the State Small Business Credit Initiative (SSBCI) program, the unspent cash reserves less amounts held for others and other liabilities for the various bond issuances and the entire fund balance in the Debt Service Fund at year-end (Note 11).
- (2) Committed fund balance includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the State Legislature through legislation passed into law. The MSF's committed fund balance consists of the fund balance for grant application fees authorized to be collected through the MSF's annual appropriations act.
- (3) Assigned fund balance includes amounts that are constrained by the MSF's intent to be used for specific purposes, but are neither restricted nor committed. The MSF's assigned fund balance consists of encumbrances funded by the MSF appropriations that were not previously restricted or committed.
- (4) Unassigned fund balance is the residual classification for the General Operations Fund and represents fund balance that has not been assigned to other funds and that has not been restricted, committed or assigned to specific purposes within the General Operations Fund.
- (5) The MSF's policy is that restricted amounts are spent first when an expenditure is incurred for purposes for which both restricted or unrestricted (committed, assigned and unassigned) resources are available. When expenditures are incurred for which only unrestricted resources are available, the intent is to use committed resources first, then assigned. Unassigned amounts are generally used only after the other resources have been used.

Note 2 Accounting Changes and Restatements

A. Accounting Changes

During fiscal year 2016, the MSF implemented the Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*. GASB Statement No. 72 provides guidance for determining fair value measurement for reporting purposes and applying fair value to certain investments and disclosures related to all fair value measurements. This statement also revised the definition of an investment as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. As a result of implementing this statement, assets previously reported as investments were reclassified to a new asset category, economic development equity programs, due to the primary purpose of these assets being economic development and not income or profit. Therefore, in these circumstances, the cost method is the appropriate measurement basis and the MSF restated its beginning fund balance in its Jobs for Michigan Investment Fund and beginning net position by (\$3,079,543).

B. Restatements

During fiscal year 2016, the MSF also restated its beginning fund balance and net position for the following:

- (1) Decreased beginning fund balance in its General Operations Fund and increased beginning fund balance in its Debt Service Fund by \$1,467,700 to account for a prior period adjustment.
- (2) Decreased beginning fund balance in its General Operations Fund and decreased beginning net position by \$24,181,055 due to the transfer of the Michigan Energy Office to LARA per Executive Order No. 2015-10.
- (3) Decreased beginning fund balance in its Workforce Development Agency Fund by \$700 and increased beginning net assets by \$1,546,663 due to the transfer of the Workforce Development Agency to TED per Executive Order 2014-12. As a result of the executive order, the MSF no longer has a Workforce Development Agency Fund.
- (4) Increased beginning fund balance in its Debt Service Fund by \$221,742,890 and decreased beginning net position on its statement of activities by \$50,031 to reflect a prior period adjustment to account for the outstanding principal balances of the capital lease receivables. Additional disclosures describing the capital lease receivables are provided in Note 6.

Note 3 Deposits

A. Deposits

Deposits held by the MSF at September 30, 2016, were as follows:

Equity in common cash	\$ 268,806,480
Deposits	116,364,401
Capital Access Program	5,918,180
Collateral deposits	58,161,409
Total deposits	<u>\$ 449,250,471</u>

B. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a bank failure, the MSF deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent, but not in the MSF's name.

Deposits included in the MSF's bank accounts (without recognition of outstanding checks or deposits in transit) were \$180,455,830 on September 30, 2016. The majority of these balances are from the various bank accounts within the Capital Access Program, Collateral Programs, the SSBCI checking account and various bond issuances. Of that amount, \$139,448,941 was uninsured and uncollateralized and \$32,374,022 was uninsured and collateralized with securities held by the pledging financial institution or collateralized with securities held by the pledging financial institution's trust department or agent, but not in the MSF's name; therefore, these amounts were exposed to custodial credit risk. The MSF has no policy for controlling custodial credit risk.

The MSF's deposits included in the State of Michigan's equity in common cash are managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, to be organized under federal or State law and to maintain an office in Michigan. The policy also restricts deposits in a maximum of 50% of each financial institution's net worth. As of September 30, 2016, 99.76% of the State's common cash was either covered by federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are described in the *SOMCAFR*.

Note 4 Nonexchange Financial Guarantees

The MSF extends nonexchange financial guarantees through its Capital Access Program (CAP), collateral deposit programs and the Loan Guarantee Program (LGP). The MSF Board of Directors has the legal authority to approve the program creation and guidelines and to delegate authority for the administration of the programs. The MSF has a contractual relationship with the issuing financial entities that are issuing the obligations under all programs.

Under CAP, the MSF contributes a minimum of 3% and a maximum of 7% of the total loan amount that is deposited into a special reserve fund to cover future losses that may occur on these loans. The length of time of the guarantees varies as it is only when the issuing entity stops offering this program and all loans are paid in full that any remaining funds in the reserve fund would be returned to the MSF. Due to the high risk nature of these loans, the MSF records a liability that is limited to the amount of deposits the MSF has made to the special reserve account. As of September 30, 2016, the total amount on deposit in the reserve fund was \$5,918,180.

Under the collateral deposit programs, the MSF generally guarantees up to 49.9% of the total loan amount, with a total dollar limit of \$5.0 million per project. The length of time of the guarantees is based on the length of each borrowing period as determined between the lender and the borrower. On a quarterly basis, the MSF reconciles its collateral deposit balances with the lenders and collects any monies that are contractually owed back to the MSF. Based on information obtained by the MSF from the lenders regarding the likelihood of default, the MSF did recognize a loss provision of \$114,905 for these deposits. The MSF has separate subordinated guarantee agreements with the borrowers for the majority of its collateral deposits, which provide the MSF with the right to recover its funds in the event of default. As of September 30, 2016, collateral deposits were \$58,161,409 which include outstanding guarantees of \$57,218,473.

Under the LGP, the MSF generally guarantees up to 80% of the total loan amount with a total program dollar limit of \$3,750,000. The length of time of the guarantees is based on the length of each borrowing period as determined between the lender and the borrower. The MSF has separate agreements with the financial institutions issuing the loans which provide the MSF payment obligations and arrangements for recovery payments. As of September 30, 2016, outstanding guarantees totaled \$3,364,171.

Note 5 Loans Receivable and Other Assets

Loans receivable totaled \$56,700,082 on September 30, 2016, for the Jobs for Michigan Investment Fund. These are high-risk loans issued for the purpose of diversifying Michigan's economy and helping to create jobs in competitive edge technologies. The loans were issued to organizations that research or commercialize (transition from research to market) products, processes or services in the competitive edge technologies. These loans may be converted to EDEPs at the MSF's option with the MSF Board of Directors' approval.

The loans are for varying lengths and interest rates. Interest and loan repayments may be initially delayed for several years to provide the borrower with an opportunity to substantially complete the project. The interest receivable of \$2,105,993 consisting of \$1,539,309 in current interest receivable and \$566,684 in noncurrent interest receivable reported under other current assets and other noncurrent assets. Also interest receivable was reported as revenue on the entity-wide financial statements but as deferred inflows of resources on the governmental fund balance sheet because the revenue was not available.

Included in the Business Attraction and Economic Gardening program are forgivable loans. Forgivable loan agreements contain language that allows a portion of the loan to be forgiven when certain milestones are met. At fiscal year-end, \$9.25 million had been disbursed for this program.

Loan Category	Loans Receivable
Business Attraction & Economic Gardening-forgivable	\$ 9,250,000
Less: forgivable portion	<u>(9,250,000)</u>
Total forgivable loans (net)	\$ -

Loans receivable held by the MSF as of September 30, 2016, consisted of the following:

Loan Category	Loans Receivable
Technology Tri-Corridor	\$ 4,816,349
Life Sciences Corridor	373,457
Choose Michigan Fund	2,318,290
Competitive Edge Technology:	
Advanced Automotive, Manufacturing and Materials Technology	3,655,079
Life Sciences Technology	5,259,997
Homeland Security and Defense Technology	4,117,504
Alternative Energy Technology	718,385
Capital Conduit Program	11,506,004
Business Attraction & Economic Gardening	24,283,806
Pure Michigan Venture Match Fund	<u>500,000</u>
Total	\$ 57,548,871
Less: Allowance for uncollectible loans	<u>(848,789)</u>
Total loans receivable (net)	<u>\$ 56,700,082</u>

Note 6 [Capital Lease Receivable](#)

As described in Note 8, the MSF issued limited obligation revenue bonds to acquire ownership in the Anderson House Office Building, the Cadillac Place Building, and a condominium unit in the Capital View Building. The MSF's capital lease agreements with the Michigan House of Representatives (Anderson House Office Building), the Department of Technology, Management and Budget (DTMB) (Cadillac Place building), and the Michigan Senate (Capital View Building) contained lease maturity dates of October 15, 2023, September 1, 2031, and October 15, 2047, respectively. At the end of the leases, the House of Representatives, DTMB and the Senate may purchase the buildings/condominium unit for nominal amounts. The lease payments are paid to a trustee and are being used to pay the interest and retire bonds issued to purchase the buildings/condominium unit. The lease payments are contingent upon annual appropriation by the State of Michigan, and neither the full faith and credit nor the taxing power of the State

are pledged to the payments coming due under the leases. The following table summarizes the components of the MSF's net lease receivable:

Capital Lease Receivable	
	As of September 30, 2016
Total lease payments to be received	\$365,884,234
Less: Unearned interest income*	<u>153,661,081</u>
Net investment in capital leases	<u><u>\$212,223,153</u></u>

* Unearned interest income related to the capital leases is reported as deferred inflows of resources in the Debt Service Fund on the Governmental Fund Balance Sheet and as current and long-term unearned revenue on the Statement of Net Position.

Lease payments to be received from the House of Representatives, DTMB and the Senate as of September 30, 2016:

Fiscal Year Ended September 30	Lease Receivable
2017	\$ 18,645,563
2018	22,518,863
2019	23,166,779
2020	23,600,768
2021	24,290,044
2022 – 2031	172,297,421
2032 - 2041	47,798,068
2042 - 2047	<u>33,566,729</u>
Total	<u><u>\$ 365,884,234</u></u>

Note 7 [Pension Plans and Other Employee Benefits](#)

Defined Benefit Plan

A. Plan Description

The Michigan State Employees Retirement System (System) is a single-employer, state-wide, defined benefit public employee retirement plan governed by the State of Michigan (State) and created under Public Act 240 of 1943, as amended. Section 2 of this act established the board's authority to promulgate or amend the provisions of the System. Executive Order 2015-13 signed by the Governor on October 27, 2015, established the State of Michigan Retirement Board. The executive order establishes the board authority to promulgate or amend the provisions of the System. The board consists of nine members:

- The Attorney General
- The State Treasurer
- The Legislative Auditor General
- The State Personnel Director
- One member or retirant of the State Employees' Retirement system appointed by the Governor
- One member of the Judges Retirement System appointed by the Governor
- One current or former officer or enlisted person in the Michigan Military Establishment who is a member or retirant under the Military Retirement Provisions appointed by the Governor
- One retirant member of the State Employee's Retirement System appointed by the Governor
- One member of the general public appointed by the Governor

The System's pension plan was established by the State to provide retirement, survivor and disability benefits to the State's government employees.

The Michigan State Employees' Retirement System is accounted for in a separate pension trust fund and also issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by visiting www.michigan.gov/ors or by calling the Customer Information Center at (517) 322-5103 or 1-800-381-5111.

B. Benefits Provided

(1) Introduction

Benefit provisions of the defined benefit pension plan are established by the State statute, which may be amended. Public Act 240 of 1943, State Employees' Retirement Act, as amended, establishes eligibility and benefit provisions for the defined benefit pension plan. Retirement benefits are determined by final average compensation and years of service. Members are eligible to receive a monthly benefit when they meet certain age and service requirements. The System also provides duty disability, non-duty disability and survivor benefits.

A member who has separated from employment may request a refund of his or her member contribution account. A refund may cancel a former member's rights to future benefits. However, former members who return to employment and who previously received a refund of their contributions may reinstate their service through repayment of the refund upon satisfaction of certain requirements.

Effective March 31, 1997, Public Act 487 of 1996 closed the plan to new entrants. All new employees become members of the defined contribution plan. The Public Act allows returning employees and members who left State employment on or before March 31, 1997, to elect the defined benefit plan instead of the defined contribution plan.

Public Act 185 of 2010, established a pension supplement. Members who retired under the retirement incentive of the legislation agreed to forfeit accumulated leave balances, excluding banked leave time; in exchange they receive a pension supplement for 60 months to their retirement allowance

payments equal to 1/60 of the amount forfeited from funds, beginning January 1, 2011.

(2) Pension Reform of 2012

On December 15, 2011, the Governor signed Public Act 264 of 2011 into law. The legislation granted members a choice regarding their future retirement plan. They had the following options:

- Option 1: DB Classified. Members voluntarily elected to remain in the DB plan for future service and contribute 4% of their annual compensation to the pension fund until they terminate state employment. The 4% contribution began on April 1, 2012.
- Option 2: DB 30. Members voluntarily elected to remain in the DB plan for future service and contribute 4% of pay until they reach 30 years of service. When they reach 30 years of service, they will switch to the State's DC plan. The 4% contribution began April 1, 2012, and continues until they switch to the DC plan or terminate employment, whichever comes first.
- Option 3: DB/DC Blend. Members voluntarily elected not to pay the 4% and therefore became participants in the DC plan for future service beginning April 1, 2012. As a DC plan participant they receive a 4% employer contribution to their 401(k) account and are eligible for an additional dollar-for-dollar employer match of up to 3% of pay to the plan.

Deferred members of the DB plan (with 10 or more years of service) who are reemployed by the State on or after January 1, 2012, become participants in the DC plan. Their pension calculation is determined by their final average compensation (FAC) and years of service as of March 31, 2012. They retain their eligibility for the retiree health insurance premium subsidy offered by the State.

Former nonvested members of the DB plan (with less than 10 years of service) who are reemployed by the State on or after January 1, 2012, and before January 1, 2014, become participants in the DC plan. When they have earned sufficient service credit for vesting (10 years) they would be eligible for a pension based on their FAC and years of service in the DB plan as of March 31, 2012. They retain their eligibility for the retiree health insurance premium subsidy offered by the State.

Former nonvested members (with less than 10 years of service) of the DB plan who are reemployed by the State on or after January 1, 2014, become members of the DC plan. Any service credit previously earned would count towards vesting for the DC plan. They will not be eligible for any pension or retiree health insurance coverage premium but will become a participant in the Personal Healthcare Fund where they will contribute up to 2% of their compensation to a 401(k) or 457 account, earning a matching 2% employer contribution. They will also receive a credit into a health reimbursement account (HRA) at termination if they terminate employment with at least 10 years of service. The credit will be \$2,000 for participants who are at least 60 years old or \$1,000 for participants who are less than 60 years old at termination.

(3) Regular Retirement

The retirement benefit is based on a member's years of credited service (employment) and FAC. The normal benefit equals 1.5% of a member's FAC multiplied by the years and partial year of credited service and is payable monthly over the member's lifetime.

Under PA 264 of 2011, FAC is initially determined as the annual average of the highest 3 years of compensation (including overtime paid before January 1, 2012, but excluding overtime paid after December 31, 2011). If the end date for the initial FAC calculation is between January 1, 2012, and January 1, 2015, then a prorated amount of post-2008 average overtime will be added to the initial FAC calculation. If the end date for the initial FAC calculation is January 1, 2015, or later, then an annual average of overtime - for the 6-year period ending on the FAC calculation date - will be added to that initial FAC calculation to get the final FAC number.

For members who switch to the DC plan for future service, the pension calculation (FAC times 1.5% times years of service) will be determined as of the point the member switches to the DC plan. If the FAC period includes the date of the switch to the DC plan, then the FAC will include up to 240 hours of accrued annual leave multiplied by the rate of pay as of the date of the switch. The hours will be paid at separation.

A member may retire and receive a monthly benefit after attaining:

1. age 60 with 10 or more years of credited service; or
2. age 55 with 30 or more years of credited service; or
3. age 55 with at least 15 but less than 30 years of credited service. The benefit allowance is permanently reduced 0.5% for each month from the member's age on the effective date of retirement to the date the member will attain age 60.

Employees in covered positions are eligible for supplemental benefits and may retire after attaining:

1. age 51 with 25 or more years in a covered position; or
2. age 56 with 10 or more years in a covered position.

In either case, the three years immediately preceding retirement must have been in a covered position. Employees in covered positions are responsible for the custody and supervision of inmates.

(4) Deferred Retirement

Any member with 10 or more years of credited service who terminates employment but has not reached the age of retirement is a deferred member and is entitled to receive a monthly pension upon reaching age 60, provided the member's accumulated contributions have not been refunded. Deferred retirement is available after five years of service for State employees occupying unclassified positions in the executive and legislative branches and certain Department of Community Health employees subject to reduction in force layoffs by reason of deinstitutionalization.

- (5) Non-Duty Disability Benefit
A member with 10 or more years of credited service who becomes totally and permanently disabled not due to performing duties as a State employee is eligible for a non-duty disability pension. The non-duty disability benefit is computed in the same manner as an age and service allowance based upon service and salary at the time of disability.
- (6) Duty Disability Benefit
A member who becomes totally and permanently disabled from performing duties as a State employee as a direct result of State employment and who has not met the age and service requirement for a regular pension, is eligible for a duty disability pension. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of the pension benefit and increase the minimum annual payment. If the member is under age 60, the duty disability allowance is now a minimum of \$6,000 payable annually. At age 60 the benefit is recomputed under service retirement.
- (7) Survivor Benefit
Upon the death of a member who was vested, the surviving spouse shall receive a benefit calculated as if the member had retired the day before the date of death and selected a survivor pension. Certain designated beneficiaries can be named to receive a survivor benefit. Public Act 109 of 2004 amended the State Employees' Retirement Act to change the calculation of Duty Death benefits and redefines eligibility for deceased member's survivors. The new minimum duty-related death benefit has been increased to \$6,000.
- (8) Pension Payment Options
When applying for retirement, an employee may name a person other than his or her spouse as a beneficiary if the spouse waives this right. If a beneficiary is named, the employee must choose whether the beneficiary will receive 100%, 75% or 50% of the retiree's pension benefit after the retiree's death. The decision is irrevocable. A description of the options follows.

Regular Pension - The pension benefit is computed with no beneficiary rights. If the retiree made contributions while an employee and has not received the total accumulated contributions before death, a refund of the balance of the contributions is made to the beneficiary of record. If the retiree did not make any contributions, there will not be payments to beneficiaries.

100% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 100% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

75% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 75% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the

beneficiary. The reduction factor is lower than the factor used in the 100% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

50% Survivor Pension - Under this option, after the retiree's death, the beneficiary will receive 50% of the pension for the remainder of the beneficiary's lifetime. If this option is elected, the normal retirement benefit is reduced by a factor based upon the ages of the retiree and of the beneficiary. The reduction factor is lower than the factor used in the 100% or 75% option previously described. If the beneficiary predeceases the retiree, the pension "pops-up" to the regular pension amount; another beneficiary cannot be named.

Equated Pension - An equated pension may be chosen by any member under age 65 except a disability retiree and an early supplemental retiree. Equated pensions provide an additional amount until age 65 and may be combined with Regular, 100%, 75% or 50% option. At age 65 the monthly amount is permanently reduced. The initial and reduced amounts are based on an estimate of social security benefits at age 65, provided by the Social Security Administration Office. In order to calculate this benefit, members choosing this option must provide ORS with an estimate from the Social Security Administration Office. The actual amount received from social security may vary from the estimate.

(9) Post Retirement Adjustments

One-time upward benefit adjustments were made in 1972, 1974, 1976, 1977 and 1987. Beginning October 1, 1988, a 3% non-compounding increase, up to a maximum of \$25 monthly, is paid each October to recipients who have been retired 12 full months. Beginning in 1983, eligible benefit recipients share in a distribution of investment income earned in excess of 8% annually. This distribution is known as the supplemental payment. The supplemental payment is offset by one year's cumulative increases received after the implementation of the annual 3% increase in benefits. These adjustment payments were not issued during fiscal years 1991 through 1994. Members who retired on or after October 1, 1987, are not eligible for the supplemental payment.

C. Contributions

(1) Member Contributions

Under Public Act 264 of 2011, members who voluntarily elected to remain in the DB plan contribute 4% of compensation to the retirement system. In addition, members may voluntarily contribute to the System for the purchase of creditable service, such as military service or maternity leave, or a universal buy-in. If a member terminates employment before a retirement benefit is payable, the member's contribution and interest on deposit may be refunded. If the member dies before being vested, the member's contribution and interest are refunded to the designated beneficiaries.

(2) Employer Contributions

The statute requires the employer to contribute to finance the benefits of plan members. These employer contributions are determined annually by the System's actuary and are based upon level-dollar value funding principles so the contribution rates do not have to increase over time. For fiscal year 2016, the MSF's contribution rate was 26.1% of the defined benefit employee wages and 22.8% of the defined contribution employee wages. The MSF's contribution to SERS for the fiscal year ending September 30, 2016, was \$464,846.

D. Actuarial Assumptions

The MSF's net pension liability was measured as of September 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2014, and rolled-forward using generally accepted actuarial procedures. The total pension liability was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Wage Inflation Rate	3.5%
Projected Salary Increases	3.5 – 12.5%, including wage inflation at 3.5%
Investment Rate of Return	8%
Cost-of-Living Pension Adjustment	3% Annual Non-Compounded with Maximum Annual Increase of \$300 for those eligible

Mortality rates were based on RP-2000 Male and Female Combined Healthy Life Mortality Tables, adjusted for mortality improvements to 2015 projections scale BB. For retirees, 100% of the table rates were used. For active members, 50% of the table rates were used for males and females.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major 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. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of September 30, 2016, are summarized in the following table:

Asset Allocation		
Asset Class	Target Allocation	Long-Term Expected Real Rate of Return*
Domestic Equity Pools	28.0%	5.9%
International Equity Pools	16.0%	7.2%
Private Equity Pools	18.0%	9.2%
Real Estate and Infrastructure Pools	10.0%	4.3%
Fixed Income Pools	10.5%	0.9%
Absolute Return Pools	15.5%	6.0%
Short-Term Investment Pools	2.0%	0.0%
TOTAL	100.0%	

*Long-term Rate of Returns are net of administrative expenses and 2.1% inflation

E. Discount Rate

A discount rate of 8.0% was used to measure the total pension liability. This discount rate was based on the long term expected rate of return on pension plan investments of 8.0%. The projection of cash flows used to determine this discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. 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.

F. Net Pension Liability

At September 30, 2016, the MSF reported a liability of \$24,908,398 for its proportionate share of SERS' net pension liability. The net pension liability was measured as of September 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2014, and rolled-forward using generally accepted actuarial procedures. The MSF's proportion of the net pension liability was based on the MSF's required pension contributions received by SERS during the measurement period October 1, 2014, through September 30, 2015, relative to the total required employer contributions from all of SERS's participating employers. At September 30, 2015, the MSF's proportion was .453%, a .03% decrease from September 30, 2014.

Assumption changes, based on the adoption of the findings of the experience study covering the period October 1, 2007, through September 30, 2012, increased the computed liabilities.

Between the measurement date of September 30, 2015, and the MSF's current fiscal year end of September 30, 2016, executive orders 2014-12 and 2015-10 went into effect that transferred WDA and MEO from the MSF to TED and LARA. TED and LARA are part of the State of Michigan's primary government. Since WDA and MEO were part of the MSF as of the measurement date, the net pension liability related to them are included in the MSF's amount. Since WDA made up 86.8% of the MSF's payroll expenditures related to State employees in FY15, we believe this change will have a significant impact to the MSF's net pension liability in future years; however, the estimated amount of that impact is unknown.

G. Pension Liability Sensitivity

The following presents the MSF's proportionate share of the net pension liability, in thousands, calculated using the discount rate of 8%, as well as what the proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current discount rate:

	<u>1% Decrease</u> <u>7.0%</u>	<u>Current Discount</u> <u>8.0%</u>	<u>1% Increase</u> <u>9.0%</u>
Component Unit's proportionate share of the net pension liability	\$ 31,831,006	\$ 24,908,398	\$ 18,943,482

H. Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in the SERS Comprehensive Annual Financial Report that may be obtained by visiting www.michigan.gov/ors.

I. Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the purpose 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 State Employee's Retirement System (SERS) and additions to/deductions from SERS's fiduciary net position have been determined on the accrual basis as they are reported by SERS. Contributions from the State are recognized as revenue when due and payable. Benefits and refunds are recognized when due and payable in accordance with the benefit terms.

For the year ended September 30, 2016, the MSF recognized pension expense of \$1,450,261. At September 30, 2016, the MSF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 70,268	\$ -
Changes of assumptions	-	-
Net difference between projected and actual earnings on investments	219,598	-
Changes in proportion and differences between actual contributions and proportionate share of contributions	200	472,068
Component Unit contributions subsequent to the measurement date	464,846	-
Total	<u>\$ 754,912</u>	<u>\$ 472,068</u>

Amounts reported as deferred outflows of resources related to pensions resulting from the MSF's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended September 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended September 30</u>	<u>Pension Expense Amount</u>
2017	\$ (517,703)
2018	(115,903)
2019	(115,903)
2020	567,306

J. Fair Value of Investments

Plan Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values comparable securities with similar yield and risk. The

fair value of private investments is based on the net asset value reported in the financial statements of the respective investment entity. The net asset value is determined in accordance with governing documents of the investment entity, and is subject to the independent annual audit. Securities purchased with cash collateral under securities lending activities are recorded at estimated fair value. Other investments not having an established market are recorded at fair value.

Defined Contribution Plan

The MSF reimburses MEDC for MEDC nonclassified employees working on the MSF programs. MEDC offers a defined contribution plan (under Section 401(a) of the Internal Revenue Code) to nonclassified employees after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to nonclassified employees upon employment. Both plans are administered by Alerus Retirement Solutions, a third party administrator, and the employees manage their own investments. Other than making contributions to the 401(a) retirement plan, neither MEDC nor the MSF have any other pension benefit obligation liability.

On August 5, 1999, the MEDC Executive Committee approved an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. Vesting of the benefits occurs over a five-year period. The MSF reimburses MEDC for an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. During fiscal year 2008, the MEDC Executive Committee approved a 12% contribution rate for employees in senior vice president positions. All contributions are made on a biweekly basis. Employees cannot contribute to this plan. MEDC made \$924,238 in contributions to the 401(a) retirement plan during fiscal year 2015 and was reimbursed approximately \$360,000 of this amount from the MSF.

Neither MEDC nor the MSF make any contributions to the 457 deferred compensation plan. Only employees make contributions to this plan.

For the State Employees' Defined Contribution Retirement Plan, the MSF is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll. The MSF's contribution to the plan was \$75,092 in fiscal year 2016. Employees participating in the defined contribution plan vest in employer contributions at 50% after 2 years of service, 75% after 3 years of service, and 100% after 4 years of service. Forfeited employer contributions are retained with the defined contribution plan are used toward future employer required contributions. The contribution requirements of plan members and the MSF are established and may be amended by the State Legislature. The State Legislature establishes the extent to which the employer and employees are required to make contributions and establishes the benefit provisions for the plans.

Other Postemployment Benefits

Along with the defined contribution required amounts the MSF also contributed 43.47% toward other postemployment benefits for most State employees in FY16. The MSF participates in the State of Michigan's postemployment benefits. State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based on vesting and other requirements. The State pays 80% of the cost of health insurance for retired employees that were hired on or before

March 30, 1997. For retired employees hired after March 30, 1997, and before January 1, 2012, the State pays between 30% and 80% of the cost of health insurance depending upon years of service. Retired employees are responsible for the balance of the costs. Employees hired on or after January 1, 2012, will not be eligible for any retiree health insurance coverage but will become a participant in the Personal Healthcare Fund where they will contribute up to 2% of their compensation into a 401(k) or 457 account, earning a matching 2% employer contribution. Also, the employee will receive a credit into a health reimbursement account at termination of employment if he or she has at least 10 years of service at termination. The credit will be \$2,000 for participants who are at least 60 years old or \$1,000 for participants who are less than 60 years old. The contribution requirements of plan members and the MSF are established and may be amended by the State Legislature. The State Legislature establishes the extent to which the employer and employees are required to make contributions and establishes the benefit provisions for the plans.

The Michigan State Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the postemployment benefits plan. That report may be obtained by visiting www.michigan.gov/ors or by calling the Customer Information Center at 1 (517) 322-5103 or 1 (800) 381-5111.

Note 8 Bonds Payable

The MSF's bonds payable as of September 30, 2016, consisted of the following bonds issued and outstanding:

A. Michigan House of Representatives, Anderson House Office Building

The MSF issued limited obligation revenue bonds Series 2008A and 2008B in the total amount of \$79,780,000 to acquire ownership in the Anderson House Office Building, located on Capitol Avenue in Lansing, Michigan. The bonds are secured by and payable from lease payments to be paid by the Michigan House of Representatives under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer or the State. Neither the full faith and credit nor the taxing power of the State are pledged to the payments coming due under the lease.

The proceeds of the bonds were used, together with other available funds, to (a) acquire an office building containing offices for the members of the House of Representatives and their staff through (i) the defeasance of the prior owner's outstanding Certificates of Participation and (ii) the discharge of a prior loan, (b) finance the acquisition and construction of improvements to the facilities, and (c) pay costs of issuing and insuring the bonds.

The scheduled payments of principal and interest on the bonds when due are guaranteed under the financial guarantee insurance policy issued concurrently with the delivery of the bonds by Assured Guaranty Corp. The Series A bonds (\$78,650,000) have a maturity schedule starting in fiscal year 2012 and ending in fiscal year 2024 with an interest rate yield in the range of 3.33% to 5.19%. The Series B bonds (\$1,130,000) matured on October 15, 2011, with an interest rate yield of 4.00%.

B. Cadillac Place

The MSF issued limited obligation revenue bonds Series 2011 in the total amount of \$119,115,000, of which \$71,235,000 were serial bonds and \$47,880,000 were term bonds, to acquire ownership in the Cadillac Place in Detroit, Michigan. The bonds are secured by and payable from lease payments to be paid by DTMB under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer or of the State. Neither the full faith and credit nor the taxing power of the State are pledged to the payments coming due under the lease.

The proceeds of the bonds were used, together with other available funds, to (a) acquire an office building containing offices for several State departments and also some private tenants through the defeasance of the prior owner's outstanding Certificates of Participation and (b) pay costs of issuing the bonds.

The serial bonds (\$71,235,000) have a maturity schedule starting in fiscal year 2015 and ending in fiscal year 2027 with an interest rate yield in the range of 2.13% to 5.02%. The term bonds (\$47,880,000) have a maturity schedule starting in fiscal year 2028 and ending in fiscal year 2032 with an interest yield of 5.30%.

C. Michigan Senate Offices Project

The MSF issued limited obligation revenue bonds Series 2015A and Series 2015B in the total amount of \$68,465,000 of which \$20,020,000 are serial bonds and \$48,445,000 are term bonds, to finance the project, which includes the costs of acquiring a certain condominium unit in the Capital View Building located at 201 Townsend Street, Lansing, Michigan. The bonds are secured by and payable from lease payments to be paid by the Michigan Senate under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer, the lessee, or the State. Neither the full faith and credit nor the taxing power of the State are pledged to the payments coming due under the lease.

The proceeds of the bonds will be used, together with other available funds, to (a) finance the project, which includes the costs of acquiring a certain condominium unit in the Capital View Building; the installation, renovation, repair, furnishing, and equipping of the unit; and payment of relocation costs; (b) pay capitalized interest on the bonds; (c) fund a debt service reserve for the bonds; and (d) pay certain expenses in connection with the issuance of the bonds.

The Series A serial bonds (\$16,580,000) has a maturity schedule starting in fiscal year 2024 and ending in fiscal year 2036 with an interest rate yield in the range of 2.57% to 3.61%. The Series A term bonds (\$48,445,000) has a maturity schedule starting in fiscal year 2037 and ending in fiscal year 2048 with an interest rate yield in the range of 3.73% to 4.23%. The Series B serial bonds (\$3,440,000) has a maturity schedule starting in fiscal year 2019 and ending in fiscal year 2027 with an interest rate yield in the range of 2.105% to 3.813%.

D. Community Colleges Skilled Trades Equipment Program

The MSF issued limited obligation revenue bonds Series 2015 in the total amount of \$40,725,000 to provide funds to finance reimbursement grants awarded to eligible community colleges under the Community Colleges Skilled Trades Equipment Program (CCSTEP). The bonds are secured by and payable from Security, which includes appropriated funds to be paid by the State of Michigan under the reimbursement agreement and other revenues and funds pledged under the indenture. The reimbursement agreement is not a general obligation of the issuer, or the State. Neither the full faith and credit nor the taxing power of the State are pledged to provide the appropriated funds under the reimbursement agreement.

The proceeds of the bonds will be used, together with other available funds, to (a) provide funds to finance reimbursement grants awarded to eligible community colleges under CCSTEP, and (b) pay certain costs associated with the issuance of the bonds.

The serial bonds (\$40,725,000) have a maturity schedule starting in fiscal year 2016 and ending in fiscal year 2027 with an interest rate yield in the range of .43% to 2.92%.

E. Facility for Rare Isotope Beams Project at Michigan State University

The MSF issued limited obligation revenue bonds Series 2014 in the total amount of \$82,685,000 to provide a grant to fund the community share portion of the Facility for Rare Isotope Beams on the campus of Michigan State University. The bonds are secured by and payable from Security, which includes appropriated funds to be paid by the State of Michigan under the reimbursement agreement and other revenues and funds pledged under the indenture. The reimbursement agreement is not a general obligation of the issuer, or the State. Neither the full faith and credit nor the taxing power of the State are pledged to provide the appropriated funds under the reimbursement agreement.

The proceeds of the bonds will be used, together with other available funds to (a) provide a grant to fund the community share portion of the Facility for Rare Isotope Beams, which is a new national user facility for nuclear science to be constructed on the campus of Michigan State University, and (b) pay certain costs associated with the issuance of the bonds.

The serial bonds (\$82,685,000) have a maturity schedule starting in fiscal year 2015 and ending in fiscal year 2031 with an interest rate yield in the range of .18% to 4.13%.

The following table summarizes debt service requirements for all outstanding bonds:

Fiscal Year Ending September 30	Principal	Interest	Total
2017	\$ 15,595,000	\$ 17,332,126	\$ 32,927,126
2018	16,890,000	16,557,651	33,447,651
2019	18,360,000	15,698,858	34,058,858
2020	19,930,000	14,739,270	34,669,270
2021	21,380,000	13,695,048	35,075,048
2022-2026	111,690,000	50,812,528	162,502,528
2027-2031	91,925,000	26,049,116	117,974,116
2032-2036	14,965,000	11,986,500	26,951,500
2037-2041	15,360,000	8,764,775	24,124,775
2042-2046	22,130,000	4,515,600	26,645,600
2047-2048	10,955,000	444,900	11,399,900
TOTAL	\$ 359,180,000	\$ 180,596,374	\$ 539,776,374

Changes in total bonds payable for the fiscal year ended September 30, 2016, were as follows:

	Beginning		Amounts Due			
	Balance	Additions	Reductions	Ending Balance	Within One Year	Amounts Due Thereafter
Bonds Payable	\$ 373,450,000	\$ -	\$ 14,270,000	\$ 359,180,000	\$ 15,595,000	\$ 343,585,000
Unamortized premium	\$ 22,024,882	\$ -	\$ 1,554,272	\$ 20,470,608		
Total bonds payable	\$ 395,474,882	\$ -	\$ 15,824,274	\$ 379,650,608		
Current portion				\$ 15,595,000		
Long-term portion				\$ 364,055,608		

Note 9 Limited Obligation Debt - Private Activity Bonds (PABs)

The MSF and a predecessor entity (the Michigan Job Development Authority) issued industrial development revenue bonds. In addition, the MSF issued bonds under its PAB and Taxable Bond Programs. The bonds issued are payable solely from the net revenues or other funds as described in the bond indentures and are not obligations of the MSF or the State of Michigan. After the bonds are issued, all financial activities are assumed by a trustee, depository, or paying agent. Accordingly, these obligations are not reported in the MSF financial statements. Information regarding the status of such bond issues must be obtained from the trustee or depository for bonds, the industrial or commercial enterprise benefited by the bonds, or some other knowledgeable source.

The total amount of PABs issued by the MSF and its predecessor entity for the period January 1, 1979, through September 30, 2016, was \$10,315,603,200. The amount of tax-exempt bonds issued during fiscal year 2016 was \$39,435,231. There were no taxable bonds issued by the MSF under the Taxable Bond Program for fiscal year 2016.

Note 10 Other Long-Term Liabilities

The following table summarizes the changes in other long-term liabilities of the MSF for the fiscal year ended September 30, 2016:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Capital Access Program	\$ 6,577,875	\$ 650,735	\$ 1,310,430	\$ 5,918,180	\$ 400,000
Compensated Absences*	\$ 600,323	\$ 271,388	\$ 187,850	\$ 683,861	\$ 440,495
Net Pension-Liability	\$ 24,835,567	\$ 72,831	\$ -	\$ 24,908,398	\$ -

*Beginning balance restated (see B below for details)

A. Capital Access Program

Liabilities for the Capital Access Program consist of an obligation to reimburse financial institutions for possible future loan defaults on high-risk business loans. An asset for the same amount represents the available cash balance that can be used to reimburse the financial institutions for future loan defaults. Increases in the Capital Access Program liabilities represent fees paid by the financial institution, the MSF, and the borrower to fund the program and recoveries of defaulted loans. Reductions are payments to the financial institutions for defaulted loans. As of September 30, 2016, there were 31 financial institutions participating in the Capital Access Program.

B. Compensated Absences

Liabilities for compensated absences were included in the statement of net position, which is on the accrual basis, and not in the governmental fund balance sheet, which is on the modified accrual basis. These liabilities represent unused sick, banked, and annual leave accrued, which will be paid when the employees terminate employment by the applicable funds that account for the salaries and wages of the related employees. The liability is calculated using 100% of the employees' applicable annual, banked leave, sick and vacation time plus the Employer's share of social security and retirement contributions based on the pay rates in effect as of September 30, 2016. The beginning balance for compensated absences was restated from \$2,147,686 to \$600,323 due to the transfer of WDA to TED per Executive Order 2014-12.

C. Net Pension Liability

Liabilities for the net pension liability were included in the statement of net position, which is on the accrual basis, and not in the governmental fund balance sheet, which is on the modified accrual basis. Additional disclosures describing the net pension liability are provided in Note 7.

Note 11 Fund Balance

Restricted fund balance (in millions) as of September 30, 2016, consists of:

Restricted by enabling legislation:	
Jobs for Michigan Investment Fund	\$ 439.6
Michigan Film Promotion Fund	69.9
Other restricted fund balance:	
SSBCI funded programs	81.1
Cadillac Place	0.1
Michigan Senate Office Projects	13.9
Community Colleges Skilled Trades Equipment Program	42.1
Facility for Rare Isotope Beams Project	7.3
Debt Service Fund	232.7
Total restricted fund balance	<u>\$ 886.8</u>

Committed fund balance of \$48,730 represents grant application fees authorized to be collected through the MSF's annual appropriations act. Assigned fund balance of \$10,009,195 consists of encumbrances funded with the State General Fund and unspent grant funds. Remaining fund balance is considered unassigned.

Note 12 Subsequent Event

Executive Order No. 2016-23, effective March 2017, transfers the portion of the administration of the Community Development Block Grant Program and the Michigan Main Street Program performed by the Michigan State Housing Development Authority (MSHDA) to the MSF. The transfer includes MSHDA's personnel who assist with the administration of the programs. Administrative and funding details related to this reorganization will be determined over the next few months.

On October 27, 2016, the MSF issued limited obligation revenue refunding bonds Series 2016 in the total amount of \$48,345,000 to defease portions of the MSF's limited obligation revenue bonds Series 2008A which were used to acquire ownership in the Anderson House Office Building. The bonds are secured by and payable from rentals to be paid by the House of Representatives of the State of Michigan under the lease and other revenues and funds pledged under the indenture.

REQUIRED SUPPLEMENTARY INFORMATION

MICHIGAN STRATEGIC FUND
Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation
For the Fiscal Year Ended September 30, 2016

Budgetary Comparison Schedule (Statutory Budgetary Basis)	Original Budget	Final Budget	Actual	Variance with Final Budget
Beginning budgetary fund balance	\$ 251,174,606	\$ 251,174,606	\$ 251,174,606	\$ -
Resources (inflows):				
Revenues and other sources				
Charges for services	\$ 5,500	\$ 5,500	\$ 1,619,862	\$ (1,614,362)
Operating grants and contributions	53,488,900	53,488,900	32,104,263	21,384,637
Payments from the State of Michigan				
From General Fund	77,928,600	77,909,634	79,812,345	(1,902,711)
From 21st Century Jobs Trust Fund (Note 2)	456,041,287	456,041,287	170,474,359	285,566,928
Other miscellaneous (Note 3)	35,536,604	35,536,604	87,461,711	(51,925,107)
Total revenues and other sources	<u>\$ 623,000,891</u>	<u>\$ 622,981,925</u>	<u>\$ 371,472,540</u>	<u>\$ 251,509,385</u>
Total resources available	<u>\$ 874,175,497</u>	<u>\$ 874,156,531</u>	<u>\$ 622,647,146</u>	<u>\$ 251,509,385</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Community Development Block Grants	\$ 49,773,300	\$ 49,773,300	\$ 32,505,457	\$ 17,267,843
Other interest	-	-	18,469,198	(18,469,198)
Debt service principal redemption	-	-	14,270,000	(14,270,000)
Jobs for Michigan Investment Fund	484,788,740	484,788,740	191,975,769	292,812,971
Payments to MEDC:				
Administration	3,026,900	3,026,900	3,026,900	-
Job creation services	14,051,700	14,051,700	13,606,768	444,932
Community Ventures Program	9,800,000	9,800,000	9,800,000	-
MSF, Special Grants	5,150,000	9,550,000	9,275,000	275,000
IDRB, MEGA, and tribal gaming revenue (Note 3)	-	-	41,237,721	(41,237,721)
Michigan Film Office and other programs	87,214,216	82,814,216	87,721,151	(4,906,935)
Arts and Cultural Grants	10,150,000	10,150,000	9,778,702	371,298
Miscellaneous	8,450,951	8,450,951	9,284,687	(833,736)
Total charges	<u>\$ 672,405,807</u>	<u>\$ 672,405,807</u>	<u>\$ 440,951,353</u>	<u>\$ 231,454,454</u>
Reconciling items:				
Changes in noncurrent assets	\$ -	\$ (34,181,087)	\$ (34,181,087)	\$ -
Net reconciling items	<u>\$ -</u>	<u>\$ (34,181,087)</u>	<u>\$ (34,181,087)</u>	<u>\$ -</u>
Ending budgetary fund balance	<u>\$ 201,769,690</u>	<u>\$ 167,569,636</u>	<u>\$ 147,514,705</u>	<u>\$ 20,054,931</u>
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 622,647,146	
Differences - Budget to GAAP				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes.			(251,174,606)	
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance.			<u>\$ 371,472,540</u>	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 440,951,353	
Differences - Budget to GAAP:				
Loans and economic development equity programs are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes.			(77,007,677)	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance.			<u>\$ 363,943,676</u>	

See accompanying notes to required supplementary information.

Notes to Required Supplementary Information— Budgetary Reporting

Note 1 Statutory Budgetary Presentation

The State of Michigan provides annual legislative appropriations to the MSF for the CDBG Program, the Jobs for Michigan Investment Fund, the Michigan Film Office, Arts and Cultural Grants, and other State programs. The MEDC administers the other State programs. The MSF transfers the funding for the State programs to MEDC as required by an interlocal agreement between the MSF and MEDC.

For programs financed from restricted revenues, spending authorization is generally contingent upon recognition of the related revenue.

The budgetary comparison schedule presents both the original and final appropriated budgets for fiscal year 2016, as well as the actual resource inflows, outflows and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into annual appropriations acts, as amended, for fiscal years 2006 through 2016 and include encumbrances and multi-year projects' budgetary carry-forwards from the prior year.

The budgetary fund balance represents the total fund balance, net of reserves for noncurrent assets. Reserves for noncurrent assets do not represent current financial resources available for appropriations and are not included for budgetary purposes.

Note 2 21st Century Jobs Trust Fund and Jobs for Michigan Investment Fund

The Michigan Legislature passed a series of public acts in 2005 related to securitizing a portion of the tobacco securitization settlement funds and depositing those funds in the 21st Century Jobs Trust Fund. The MSF Act (Act 270, P.A. 1984) was also amended in 2005 to offer programs and provide funding in the form of loans, equities and grants for competitive edge technology and to diversify the economy. From the inception during fiscal year 2006 through fiscal year 2016, the Legislature has appropriated \$994.5 million from tobacco securitization settlement funds. The funds are retained in the 21st Century Jobs Trust Fund at the Department of Treasury and are reimbursed to the MSF as the disbursements are made. In addition to this, starting in fiscal year 2012, funds appropriated from the State General Fund (\$444.9 million) for the MSF's Business Attraction and Economic Gardening programs were transferred to the 21st Century Jobs Trust Fund pursuant to Act 252, P.A. 2011.

The MSF has received a work project authorization for all 21st Century Jobs Trust Fund-related appropriations and is thus permitted to spend unspent appropriations over multiple years. The original budget amounts for appropriation year 2006 through appropriation year 2015 reflect carry-forward of unspent appropriation from these years.

Total charges for fiscal year 2016 were \$192.0 million, of which \$77.0 million was disbursed for economic development equity programs (EDEPs) and loans. EDEPs and loans are not expenditures for financial reporting purposes and are thus listed as a budget-to-GAAP reconciling item.

The MSF received revenue of \$170.5 million from the 21st Century Jobs Trust Fund for fiscal year 2016.

Note 3 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$56.9 million. The payments to MEDC expenditures include a portion of the tribal gaming revenue transferred to MEDC according to the interlocal agreement.

Schedules of Required Supplementary Information—Pension Liability

Schedule of the MSF's Proportionate Share of Net Pension Liability
State Employees' Retirement System
Last 10 Years*

	2015	2016
MSF's proportion of the net pension liability	0.483%	0.453%
MSF's proportionate share of the net pension liability	\$24,835,567	\$24,908,398
MSF's covered-employee payroll	\$12,767,302	\$ 1,917,480
MSF's proportionate share of the net pension liability as a percentage of its covered-employee payroll	194.52%	1,299.02%
Plan fiduciary net position as a percentage of the total pension liability	68.07%	66.11%

The amounts presented for each fiscal year were determined as of the prior fiscal year.

*This schedule will be expanded to include 10 years as information becomes available.

Schedule of the MSF's Contributions
State Employees' Retirement Plan
Last 10 Fiscal Years*

	2015	2016
Statutorily Required Contribution	\$ 3,211,137	\$ 464,846
Contributions in relation to the statutorily required contribution	\$ 3,211,137	\$ 464,846
Contribution deficiency (excess)	\$ 0	\$ 0
MSF's covered-employee payroll	\$12,767,302	\$1,917,480
Contributions as a percentage of covered-employee payroll	25.15%	24.24%

*This schedule will be expanded to include 10 years as information becomes available.

Notes to Required Supplementary Information— Pension Liability

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension and other postemployment benefit obligations as a factor.

The Schedule of Contributions is presented to show the responsibility of the Employer in meeting the actuarial requirements to maintain the System on a sound financial basis.

The Schedule of the Proportionate Share of the Net Pension Liability and Schedule of Contributions are schedules that are required in implementing GASB Statement No. 68. The Schedule of the Proportionate Share of the Net Pension Liability represents in actuarial terms, the accrued liability less the market value of assets. The Schedule of Contributions is a comparison of the employer's contributions to the actuarially determined contributions.

The information presented in the Schedule of Contributions was used in the actuarial valuation for purposes of determining actuarially determined contribution rate. Additional information as of the latest actuarial valuation for the pension plan follows.

Valuation:

Actuarially determined contribution amounts are calculated as of September 30, each year, which is 1 day prior to the beginning of the fiscal year in which contributions are reported.

Methods and Assumptions Used to Determine Contribution for Fiscal Year 2016:

Actuarial Cost Method	Entry age, normal
Amortization Method	Level dollar, closed
Remaining amortization period	22 years
Asset valuation method	5-year smoothed market
Inflation	2.50%
Salary increase	3.5% wage inflation
Investment Rate of Return	8% net of investment and administrative expenses
Retirement Age	Experienced-based table of rates that are specific to the type of eligibility condition
Mortality	RP-2000 Male and Female Combined Healthy Life Mortality Tables, adjusted for mortality improvements to 2015 projection scale BB. For retirees, 100% of the table rates were used. For active members, 50% of the table rates were used for males and females.