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Legacy costs dig deeper fiscal hole for Detroit

Rising retiree pension and health benefit costs worsen city's precarious finances

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Detroit— The city's coffers are being drained by retiree pension and health benefits, making so-called "legacy costs" the biggest hurdle facing Mayor Dave Bing as he struggles to stabilize Detroit's finances.

The city's obligations to its 20,000 retirees have become unsustainable as the number of active employees dwindles and Detroit's tax base declines, municipal finance experts say.

A December report by the Citizens Research Council of Michigan noted the city is carrying about \$7.7 billion in debt, which equates to about \$10,800 per resident. The crushing debt load was among the problems cited in a state review that concluded last week that Detroit is suffering "probable financial stress," a precursor to a potential emergency manager. The report painted an even direr picture of Detroit's problem, concluding that its long-term debt load exceeds \$12 billion, not including interest.

Both reports note Detroit has a much higher debts-to-assets ratio than other cities, both statewide (Flint) and nationally (Los Angeles).

"The city made promises in good faith that it thought it was going to be able to keep," said Bettie Buss, who compiled the research council's report. "The city has finally come to a place that there is just not enough money to keep the promises.

"You have to start squeezing down and you do that with less employees and stingier benefits. It's just a whole bunch of stuff that happened over decades and it's now coming to the point that there's just not enough money to maintain service levels and keep all of the promises that were made."

Fiscal experts say overhauling overly generous pension and benefit packages are key to restructuring a city government that's in the midst of the largest fiscal crisis in nearly three decades. City administrators, elected officials and unions have been meeting for weeks to hammer out a budget plan to stave off further state intervention.

The 29-page research council report points out that city income tax revenue declined from \$278.3 million in 2006-07 to \$212 million in 2009-2010. Property tax revenues for general operations declined \$25 million over the same period.

Without structural changes, retiree benefits will continue to absorb many general fund dollars, leaving less money for essential city services, the report notes.

Costs past and present

Detroit has about 12,300 city employees on the payroll, but the city is obligated to pay pensions and benefits for about 20,000 retirees as of 2010. Pension payouts amount to 25 percent of the city's \$1.2 billion general fund this year and would grow to 50 percent by 2015, city officials have said.

But the city also pays 6.3 percent of the total operating budget on other fringe benefits for retirees, including health care, hospitalization, and eye and dental care. That's a total of \$157.3 million.

Detroit pays up to 90 percent of coverage for employees who retired before Jan. 1, 1984.

It also pays spousal health care for as long as the employee continues to receive a pension. The city also pays dental and vision coverage for retirees and spouses.

"The (research council) report underscores a key challenge the city has with sustaining long-term costs in an era of declining revenue, and how we develop realistic remedies to get these costs in line with how much total revenue we have to spend for core city services," said Bing's chief of staff, Kirk Lewis.

"We're working toward meaningful structural changes in health care and pensions for employees and retirees that reflect best practices in other governmental entities and today's economic conditions. This is just but one significant piece of Mayor Bing's plan to achieve \$102 million in savings this fiscal year."

In November, Bing proposed a plan seeking \$40 million in concessions from city workers and proposed outsourcing public lighting services and management of city buses. The plan calls for \$8 million in givebacks from retirees to make Detroit competitive with other municipalities and reduce excess payments from the system. The moves would have to be negotiated with union officials.

Bing also is moving forward with plans to lay off 1,000 employees by February. His plan aims for \$102 million in savings in the 2012 fiscal year and \$258 million in the 2013 fiscal year. The city also wants to change how existing pensions are calculated and move new employees to a contribution plan similar to a 401(k), ending city contributions. The city paid \$200 million this year toward pensions.

The city pays another \$191 million a year in health care to employees and retirees. Administrators want to save \$90 million a year by persuading unions to pay 20 percent of the costs. City employees pay about 10 percent for health insurance now. Costs have increased 40 percent in the past four years, even though payroll has declined by \$40 million, officials have said.

"The way to get out of this is to get out of a defined benefit system and get into a defined contribution," Council President Pro Tem Gary Brown said.

"That's a structural fix we've been talking about in terms of long term fixes to the system," Brown said. "(The city) had the ability for several years to move out of a defined benefit to a defined contribution, but it's never been executed. It's never been acted on for a lot of different reasons. We're still a long way in moving in that right direction."

Search for solutions

But some political experts and others are advocating more radical change. Instead of simply talking layoffs, dealing with pension and health care costs for retirees has to be the central focus of negotiations, said Charles Moore, a municipal bankruptcy expert.

Generally speaking, "it's nearly impossible to change benefits for individuals who have already retired," said Moore, a senior managing director at Conway MacKenzie Inc.

"The primary focus on reducing pension costs will be done related to active or current employees as well as those who haven't started work yet. Detroit has been impacted more by the significant reduction in the population than it has been for granting overly generous benefits. There's just fewer active employees and a smaller tax base to absorb the costs."

But Moore said all parties currently negotiating a deal to save the city from state intervention must understand this is the one shot to right the fiscal ship. "The parties are all going to want to know what they are proposing to give, it's going to be enough," Moore said. "There has to be a belief that by doing those things it will be a comprehensive solution. Nobody is going to be doing something on a temporary basis."

Political expert Eric Foster has suggested the city pare operations down to about 17 departments. Foster, a consultant to Bing's campaign, is critical of mayors dating back nearly 50 years who chose not to change operations.

"People haven't wanted to accept the reality that what the city has been doing doesn't work. It hasn't worked since (former Mayor Jerome) Cavanagh," Foster said.

Foster advocates that the city get out of health, human services, public lighting, finance, water and transportation. He also believes the city could get out of running the Detroit Public Library and City Airport.

"If you go in that direction, you can create a budget surplus," Foster said. "That's what really has to happen."

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