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Detroit's debt crisis even worse than thought, state's review reveals

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How the money doesn't add up

LANSING -- A state financial report released Wednesday moved Detroit closer to appointment of an emergency manager and painted a bleak picture of a city digging an ever-deeper hole by taking on long-term debt to pay its everyday bills.

The findings by the Treasury Department trigger a more in-depth study by a team of state-appointed officials and set the stage for a possible consent agreement that would head off a state takeover.

City Council President Pro Tem Gary Brown warned that the city could be broke if it waits for Gov. Rick Snyder to name an emergency manager and called for immediate negotiation of a consent agreement.

"We need to give unions the motivation to accept meaningful cuts in health care and pension benefits before we are run into bankruptcy," Brown said.

The new study can take 60 days, though Treasurer Andy Dillon said he would expedite it, as Detroit could run out of cash by April. The preliminary review could have taken 30 days but was done in half that time.

"We continue to implore the mayor and the City Council to come together on the development of a workable recovery plan," Dillon said.

The report pegged the city's long-term debt, including unfunded pension liabilities, at more than $12 billion. That's $2 billion higher than Dillon's estimate when he asked for the preliminary review earlier this month.

Mayor Dave Bing pledged continued cooperation with the state but said the report told him nothing he doesn't already know and insisted his plan would right the city's finances.

Last year, the city -- whose three biggest revenue sources for its general fund total $538 million -- spent more than $597 million just to make debt payments, the report said. Though Bing was unfazed, others found the numbers unsettling.

Van Conway, CEO of Conway MacKenzie, a Birmingham-based turnaround firm that has helped reorganize municipalities and school districts, said the city's condition is so dire that only an emergency manager with the authority to sell city assets, gut union contracts and privatize and slash services will save Detroit from bankruptcy.

"It's going to be very painful," Conway said. "There has got to be massive cuts. You have a city on a major downslide. The state can't wait much longer to appoint an emergency manager. The city is about to run out of money."

Under a bill Snyder signed into law in March, emergency managers may take near-total control of financially distressed cities and school districts and can amend or scrap union contracts. Under a consent agreement, there would be no emergency manager and local officials get increased powers to take corrective action. They can't scrap contracts but could impose new ones when existing ones expire in June.

A petition drive is under way to have the emergency manager law repealed. That complicates the picture, because if the required signatures are certified, the law could be suspended from early next year until the November election. Snyder and legislative leaders may seek an interim replacement law.

Dillon's report points out another potential complication. Because of complex financial transactions Detroit undertook, significant changes in its financial status, which could include a credit downgrade or appointment of an emergency manager, could force the city to terminate certain debt deals at a cost of $280 million to $400 million, the report said.

In 2010, the city had net assets worth $265.1 million and long-term debts of $8.6 billion, according to the report and Treasury officials. This year, the value of the city's net assets is a negative number, and its long-term debt exceeds $12.3 billion.

Last year, Detroit had $33 of long-term debt for every $1 of net assets. That number compares unfavorably to even financially distressed cities such as Flint -- already under an emergency manager -- which has only about 59 cents in long-term debt for every $1 of net assets.

Detroit violated the state's budgeting and accounting act by not adjusting its budget on a timely basis, and it had not filed an adequate plan to eliminate its nearly $200-million deficit, Dillon said. He also cited mounting debt, difficulty making payments to pension plans and the pending cash shortfall.

The new review is to be conducted by a team that includes: Dillon or his designee; Department of Technology, Management and Budget Director John Nixon or his designee; a nominee of Senate Majority Leader Randy Richardville, R-Monroe, and a nominee of House Speaker Jase Bolger, R-Marshall. Snyder also may appoint others to the team.

Opponents warned that state intervention will lead to community resistance.

"We are going to mobilize and continue to organize around this issue," said the Rev. Charles Williams II, a civil rights activist who is helping lead an anti-emergency manager protest outside Snyder's house in Superior Township on Martin Luther King Day next month. "We are going to send Snyder a strong message that we care about our communities and our democracy, and we won't tolerate dictators in our community."

State Rep. Tupac Hunter, D-Detroit, urged Snyder to appoint community leaders to the review team.

Snyder spokeswoman Sara Wurfel said the review team will be named soon, possibly next week.

Amber McCann, a spokeswoman for Richardville, said a final decision on his appointee has not been reached.

Richardville wants someone with ties to Detroit who believes in the city's future, McCann said, but hasn't set any specific criterion.

"We need to find the right, willing person," she said.

Despite the dismal picture, Brown was alone among city leaders in urging limited state intervention. Council President Charles Pugh and Bing said Detroit can solve the crisis alone if unions accept deep concessions to save more than $100 million a year.

"The council has done our part and will continue to look at ways we can save," Pugh said. "Cumulatively, we've given up approximately 27% of our budget. From this process, I believe we will ultimately avoid a consent agreement or emergency manager." Bing echoed that sentiment.

"I firmly believe that the remedy to the city's financial crisis is my plan that seeks savings of $102 million for this fiscal year and $258 million in fiscal year 2012-13," he said.

Bing's plan includes structural reforms in health care and pensions, work rule changes and wage reductions. "We will continue to negotiate with union leadership with a goal of forging an agreement soon," he said.

But the mayor's plan doesn't address the city's long-term debt, though it's unclear how state intervention could fix issues more commonly dealt with in bankruptcy court.

Ballooning costs

A major cause of the long-term debt is ballooning pension costs. The number of retirees continues to increase, while the work force that helps pay for pension obligations has reached historic lows. The city makes health care and pension payments to more than 20,000 retirees, while only about 11,000 employees are on the active payroll. In 1975, there were two active employees for every retiree.

During the past four years, pension and health care costs increased from $266 million to $391 million, even with a $40-million drop in payroll.

Though union leaders agree negotiations are progressing, many expressed doubt that they'll approve the sweeping demands from the administration. And police and firefighters have been unwilling so far to consider 10% pay cuts.

Jeffrey Guilfoyle, president of the Citizens Research Council, studied Detroit's finances earlier this month and pegged unfunded retirement and debt costs at $14.1 billion, equaling $20,000 per city resident.

"It's pretty clear that they're in a dire situation," he said. "They're not putting any money aside for future retirees. That is a real millstone around the city's neck."

State Rep. Rashida Tlaib, D-Detroit, said her greatest concern is that the process will lead to further reductions in services, such as fewer police on the street or less frequent garbage collection. Detroit residents "love the city. They don't want to leave the city, and many of them can't leave," she said.

Flint, Ecorse, Pontiac, Benton Harbor and Detroit Public Schools are currently under the control of emergency managers.

Pontiac emergency manager Louis Schimmel said a consent agreement for Detroit is a likely outcome.

Pontiac reached a consent agreement with the state but didn't live up to its terms. An emergency manager was named for the city in 2009.

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Not enough income

In the coming fiscal year, the three major sources of city revenue -- income taxes ($227 million), property taxes ($133 million) and casino revenues ($178 million) -- will total about $538 million. So if the city stopped paying for all services, it still would fall about $60 million short of paying off its debt.

Too much debt

Most cities have more assets than debts. Detroit, by contrast, has nearly $33 in debt for every $1 in assets. By contrast, Grand Rapids has 39 cents of debt for every $1 in assets.

Ballooning pension costs

In 1975, the city had two active employees paying into the pension system for every retiree. Today, there are 11,000 active employees and 20,000 retirees. In the past four years, pension and health care costs have jumped from $266 million to $391 million.