

# Deficit plan stops short of solutions

Options narrow as city's cash ebbs

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The city of Detroit is set to run out of cash by April, if not sooner, and a plan announced last week by Mayor Dave Bing was short on solid short-term savings and long on policy changes that could take months.

One of Bing's proposals, a call to raise the corporate income tax from 1 percent to 1.9 percent, may not even be possible without voter approval.

Another idea, privatizing or finding outside managers for the city's Public Lighting Department and Detroit Department of Transportation, would save the city dollars, but Bing said the city was only beginning to explore those options.

Layoffs announced last week -- 1,000 of the city's current 11,000 workers -- are a short-term fix that could improve cash flow, saving the city a projected \$14 million in the current fiscal year.

However, the overall shortfall the city will face by the end of June is estimated at \$45 million.

And that means the city faces an uphill battle -- and tough choices.

Gov. Rick Snyder responded to the mayor's plan last week by saying he expects the mayor to initiate a state financial review soon, the first step on the road to a state takeover. So far, Bing says he won't do it.

City Council President Charles Pugh and President Pro Tem Gary Brown said the announced layoffs didn't go far enough to help the city emerge from its financial day of reckoning.

The city has four options: Bing and the Detroit City Council could solve the city's long-term and short-term fiscal crises without state intervention. The council could enter into a consent agreement with the state that would bestow some of the powers of an emergency manager on an elected city official. The state could appoint an emergency manager. Or the city could declare bankruptcy.

## Emergency manager route

Municipal finance experts say an emergency manager has to be decisive, experienced and unafraid.

"An emergency manager would need the confidence that his/her actions would be controversial (and) would adversely impact whole groups of folks as oxen would be gored left and right, and yet exhibit the confidence that the controversial actions would ultimately result in a fiscally healthy Detroit able to provide core services at an acceptable level for Detroit citizens and the surrounding region," Deputy Oakland County Executive Robert Daddow wrote in an email.

A bit of political savvy wouldn't hurt, said Chuck Moore, senior managing director at Birmingham-based turnaround firm Conway MacKenzie Inc.

"Certainly the community aspect of being able to navigate through the different constituencies will be a very important element," he said.

An emergency manager should have a track record of making deep cuts and should start from a blank slate to completely restructure city budgets, Moore said -- "and obviously have very strong leadership

skills because there is going to be a lot of negotiation that is going to be necessary."

A report by the Detroit City Council's financial analyst before Bing's announcement of 1,000 job cuts estimated that 1,500 layoffs would be necessary immediately to stave off a liquidity crisis in April. And that's with union concessions.

Without union concessions, it's more like 2,300, according to the report. The labor unions that represent most of the city's workers haven't shown much willingness to negotiate. A joint council/administration working group met several times after distribution of the Ernst & Young report predicting the shortfall, but the meetings ended abruptly when the mayor went public with his financial plan last week.

Bing has said he'd be willing to serve as Detroit's emergency manager, but Sara Wurfel, Snyder's press secretary, told Crain's in June that Bing as Detroit's emergency manager "wouldn't be an option" and "didn't make sense." Wurfel said last week that analysis hasn't changed.

The big targets are health care costs for current and retired employees, and the cost of the city's pension system.

But the first task for an emergency manager would be the city's short-term cash flow.

The city's ability to borrow is tapped out. Bing was required to get state approval to sell deficit elimination bonds last year and pledge state revenues to securitize the bonds. Detroit's low credit rating makes short-term borrowing too expensive, long-term borrowing would require state legislation, and the city lacks a revenue stream to pledge as security for another bond sale.

"You've got to address the short-term funding problem," said G. Allen Bass, of counsel at Detroit-based law firm Lewis & Munday PC. "It was short-term liquidity that brought New York City to its knees in 1975."

If the city can't fix its liquidity problem with short-term actions like layoffs and concessions, Moore said, another option could be restructuring the city's debt payments.

## Bankruptcy

But that could be easier said than done, outside of a bankruptcy filing.

"(Bankruptcy would be) a horrible thing to happen to the Motor City, so let's hope it doesn't happen," said Jim McTevia, managing partner of Bingham Farms-based turnaround firm McTevia & Associates and an unabashed Bing supporter who says the mayor should be first pick for emergency manager.

"But there are a lot of things that happen in bankruptcy," McTevia said. The city could write down its bonds, lowering its debt.

"The same thing can be done out of court, but it is more difficult," he said. "When you're negotiating with one bondholder, they're going to want to know what kind of deal you just cut with the person you just dealt with, and what kind of deal you're cutting with the next person."

An emergency manager could declare bankruptcy, McTevia said, or use the threat of bankruptcy to convince bondholders to negotiate.

The plan an emergency manager is required to file within 45 days of appointment can provide for the sale of assets, said Bettie Buss, a senior research analyst at the nonpartisan Citizens Research Council -- assets like Belle Isle or the Detroit Water and Sewerage Department.

"An EM can sell any asset that doesn't put residents in danger or that doesn't impair a legal obligation," she said. "There's about \$5.2 billion of water and sewerage debt outstanding, and also pension and other post retirement obligations for employees, so that would be very complicated, but maybe not impossible."

Buss said any assets owned by the city outright that aren't necessary for the health, safety or welfare of residents -- and she said an argument could be made that parks are necessary for residents' health and welfare -- can be sold.

"City-owned land, buildings, equipment, furnishings, and collections would all be eligible, as long as the health and welfare of residents and legal rights of bondholders and other lenders are protected," she said.

But selling isn't likely to fix the city's problems, said Joseph Harris, Detroit's former auditor general and CFO, currently serving as emergency manager of Benton Harbor.

"We can't sell our way out of a structural deficit" currently estimated at more than \$100 million annually, he said. "Even if we had something of value to sell, it only solves a temporary cash shortage. Until we reduce expenditures to (the level of) or less than revenues, the hole will get deeper."

Daddow notes that it's not enough for an emergency manager to bring revenues in line with expenses. Because of the city's accumulated general fund deficit, as much as \$184 million, revenues must exceed expenses for a number of years.

But Harris believes that an emergency manager can fix the city's problems.

"There is a way. Nobody seems to be thinking strategically, or they're shying away from the politically incorrect decisions."

The ripple effects

The question of whether an emergency manager can balance the city's budget doesn't take into account something almost as important: Can solving the city's financial problems address Detroit's deepest need, for new residents and new businesses.

"It's something I've been thinking about a lot for the last couple of weeks," said Detroit City Council member Saunteel Jenkins. "The truth is we really don't know how (an emergency manager would) impact the city. My feeling is that the interest we have in people moving downtown will be halted, and a lot of the businesses moving here will reconsider."

Jenkins said she believes that the mayor and the council, working together, can solve the city's problems without an emergency manager.

Detroit City Council President Pro Tem Gary Brown advocates a consent agreement that would bestow on an elected official some of the powers of an emergency manager. But a consent agreement, unlike an emergency manager or a bankruptcy court, wouldn't include the power to alter union contracts.

"An emergency manager can ... change how city government looks but can do much less about the underlying economic factors in a city," Buss said. "An emergency manager can create a government structure that functions within the revenues available, but whether it meets the need of citizens is an entirely different question. Is that what Detroit needs? Detroit needs more resources, period."