Everything you need to know to talk about Detroit's bankruptcy

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Economic Decline

- Exodus of Population & Business
  - ~2 million in 1952 to ~650,000 today
  - Decline spread across cities 139 square miles
  - Burden of maintaining services to all properties
- Created cycle of higher taxes and more exodus
  - Detroit residents among the highest taxed in the nation
- Race has been and remains a defining issue

Failure to Downsize City Government

- Failure to reduce city workforce to reflect declining population
  - City employment seen as social employment program
- Salaries and pensions were healthy (not exorbitant)
  - 13th checks prevented pension trust from growing
- People run for office with the intent of improving the lives of their neighbors, not cutting services, laying off city employees, hurting former employees, or selling off the city's assets.
  - Detroit was not electing the best and the brightest in the years leading up to bankruptcy
  - Inability and unwillingness to address financial problems

Borrowing and Cash Flow

- Borrowing increased in 15-20 years leading up to bankruptcy
  - Both for capital needs and cash flow (RANs and TANs)
  - For the most part, city was not struggling to pay debt
- Borrowing masked the city's structural budget problems
  - Only in government does borrowed money count as revenue
- City was stumbling through to manage cash flow
  - Taxes collected by city were not passed on until absolutely needed
  - Although bond rating not junk status, city's credit was no good

The Final Straws

- $1.44B swap agreement entered into for pension costs
  - Traded soft obligation for a hard one
  - Backfired when interest rates increased
- Foreclosure crisis
  - Hit Detroit very hard because of predatory lending
  - Deflation of property values increased the ratio of debt to property value
- State withholding of State Revenue Sharing
  - Equal to amount of Grand Bargain

One thing you need to know

- Chapter 9 of the bankruptcy code requires the residents of a municipality to file for bankruptcy
  - Detroit was taken into bankruptcy by a state appointed emergency manager
  - No one asked the opinion of Detroit residents
- Michigan's emergency manager law was created to head off problems before they become a crisis
  - Usually past city managers or people with municipal finance experience
- Kevyn Orr, a corporate bankruptcy attorney, was appointed Detroit's emergency manager
  - What did you think was going to happen?

The Plan

- Current and former employees were the hardest hit
  - Pensioners took hair cut
  - OPEB gutted
- Pensioners hair cut made possible because of "Grand Bargain"
  - Monetized value of art in the Detroit Institute of Art
- Limited and Unlimited Tax General Obligation bondholders agreed to less than full repayment of investments
- Assets monetized to satisfy swap agreement bond holders
- Judge considered whether process improved service delivery

Lessons Learned

- For government finances, it is all about <u>cash flow</u>
- The rules and norms of government finance didn't matter to emergency manager, lawyers, or judges in the process
- Municipal bankruptcy so rare that it is like inventing the wheel each time
  - Corporate bankruptcy attorneys controlled the process using the processes they knew
- Detroit missed many opportunities that may come back to haunt it
  - Real pension reform
  - Turn liabilities into assets
  - Regionalize services
- Things that are turning around the city are largely external to the bankruptcy
  - Created cover and a plan to move forward
  - Instilled new sense of confidence

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