

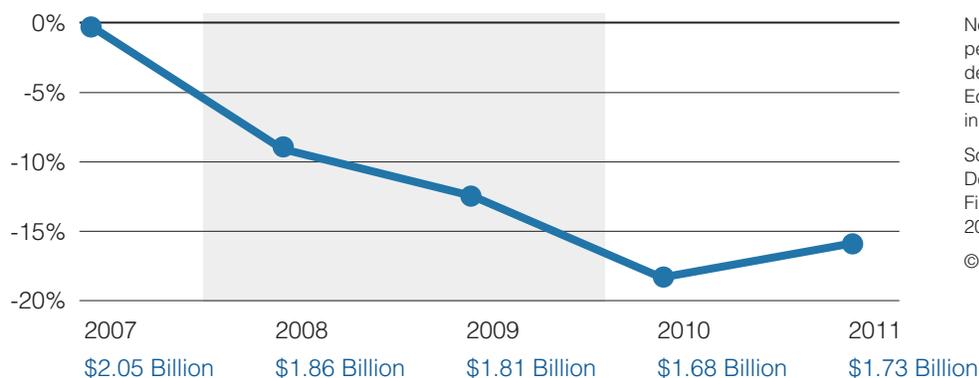
Detroit

The Great Recession accelerated Detroit's downward trajectory

As of 2011, Detroit's revenue was far below its prior peak, and the city faces continuing financial challenges, including a bankruptcy process that may be protracted and contentious. Like Michigan as a whole, Detroit was already in a prolonged economic slump before the Great Recession. The downturn compounded an already weak economy marked by a faltering automotive industry and ongoing population losses. Revenue fell \$374 million from 2007 to 2010. (See Figure 1.) Significant spending cuts, workforce reductions, and privatization have not been enough to address the city's fiscal woes and retiree liabilities.¹

FIGURE 1

Detroit Governmental Revenue, Percent Change From Pre-downturn Peak, 2007-11



Note: Shaded area indicates the period of the Great Recession as defined by the National Bureau of Economic Research. Amounts are in 2011 dollars.

Source: Pew calculations from Detroit's Comprehensive Annual Financial Reports for fiscal 2007-11.

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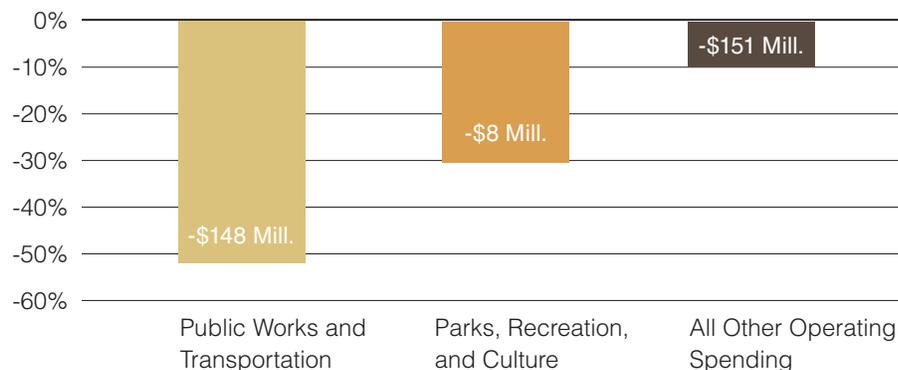
A modest increase in intergovernmental aid wasn't enough to offset spiraling revenue declines

Revenue fell 18 percent between the measurement period peak in 2007 and the bottom in 2010, after adjusting for inflation. Declining income and property taxes contributed to the city's overall revenue decline, along with drops in charges and fees.² Nontax revenue, however—including investment earnings, revenue from use of assets, and premiums for the city's self-insurance Risk Management Fund—lost the most of any major revenue category, falling \$125 million between 2007 and 2010.³ Increases in intergovernmental aid barely helped offset sharp revenue declines—even though the American Recovery and Reinvestment Act injected \$208 million into the city's economy from 2009 through 2010.⁴

To some degree, the population decline not only affected revenue but also reduced demand for services, and budget downsizing was to be expected. Overall operating expenditures declined 14 percent, or \$270 million, between 2007 and 2010. City officials drastically reduced spending on public works and transportation by eliminating services to sparsely populated areas, including streetlights, buses, and trash collection, in an effort to direct resources to remaining residents elsewhere.⁵ (See Figure 2.) After further cuts threatened the city's 17 recreation centers, area companies set up a charitable trust to pick up the tab.⁶

FIGURE 2

Percent Change in Key Detroit Operating Expenditures, 2007-11



Note: Amounts are in 2011 dollars.

Source: Pew calculations from Detroit's Comprehensive Annual Financial Reports for fiscal 2007-11.

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Despite the spending cuts, Detroit still had trouble balancing its budget and resorted to a number of short-term fixes, such as the sale of city-held assets and privatization of services.⁷ Although these moves helped Detroit temporarily, they proved insufficient to address broader imbalances in the city's finances.

Managing the future: Borrowing and persistent deficits have propelled Detroit's road to default

Demand for services, investment decisions, and revenue performance will be key factors in Detroit's financial well-being. Several long-term factors of financial health, which can be analyzed using the data available, are pensions and retiree health care obligations and reserve levels.

Having tapped its reserves during the 2001 recession and without rebuilding its cushion, Detroit had no options when the Great Recession hit. So the city ran a deficit that had to be filled with money from other reserve funds. In 2009, the shortfall prompted Standard & Poor's to downgrade Detroit's credit rating from BBB to BB, which is typically considered noninvestment grade.⁸ The rating was downgraded further in subsequent years.⁹

Detroit's pension system was 92 percent funded in 2010, but that was largely because it borrowed \$1.5 billion in 2005 to shore up its pension funding. The city now must make payments on that bond as well as confront lower-than-expected investment returns and other fiscal pressures.¹⁰ As a result, the city has again fallen behind on growing annual pension contributions.¹¹ In addition, Detroit had set aside less than 1 percent of the money needed to cover its \$5 billion retiree health care commitment.¹² Recently, the city implemented reduced pensions, temporary pension freezes, and higher out-of-pocket health care payments in order to reduce the cost of retiree benefit commitments.¹³

The city's growing debt is now estimated to exceed \$18.5 billion.¹⁴ In March 2013, Michigan Gov. Rick Snyder stepped in, appointing an emergency financial manager who in turn declared the city insolvent and raised the potential of bankruptcy just two months later.¹⁵ In June 2013, in accordance with the financial management plan, Detroit did not pay a \$34 million debt payment and instead used that money for operating expenses.¹⁶ The city declared bankruptcy in July 2013, marking the largest municipal bankruptcy in the nation's history. Depending on how the bankruptcy process plays out, it could allow Detroit to discharge a meaningful amount of its pension, retiree health care, and other long-term debt.

See Pew's 30-city interactive at pewstates.org/City-Fiscal-Conditions-Interactive for complete data.

Endnotes

1 See the full study methodology at pewstates.org/City-Fiscal-Methodology for a detailed explanation of the terms used in this profile and view the underlying data at pewstates.org/City-Fiscal-Conditions-Interactive.

2 Losses in income tax revenue were driven largely by the recession's impact, particularly on auto workers. City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2010* (2010), 25, <https://www.detroitmi.gov/Portals/0/docs/finance/CAFR/2010%20CAFR%20draft%20122010%20.pdf>. Property taxes rebounded sharply the following year, gaining \$47 million between 2010 and 2011. Decline in charges was led by a reduction of personal services revenue, primarily central staff services. City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2010*, 9.

3 City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2010*, 25; City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2012* (2012), 28, <http://www.detroitmi.gov/Portals/0/docs/finance/CAFR/Final%202012%20Detroit%20Financial%20Statements.pdf>; and "The Risk Management Fund is a self-insurance fund established by Section 18-8 of the City Code in 1995 to cover liability to third parties for any loss or damage arising out of negligence, tort, contract or otherwise accruing, payable by the City from and after July 1, 1994. The City may be liable under Workers' Compensation or Disability Benefits Law, or under any similar laws, or for damage to property or personal injury," 46, <http://www.detroitmi.gov/LinkClick.aspx?fileticket=IC1dyuMzYuU%3D&tabid=3716&mid=5554>.

4 City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2010*, 11.

5 Michael Muskal, "Michigan Governor Declares Financial Emergency in Detroit," *Los Angeles Times* (March 1, 2013), <http://articles.latimes.com/2013/mar/01/nation/la-na-nn-michigan-declares-financial-emergency-in-detroit-20130301>.

6 Cecil Angel, "Private Money to Fund Detroit Recreational Centers, Keeping 17 Open," *Detroit Free Press* (Aug. 23, 2012), <http://www.freep.com/article/20120823/NEWS01/308230188>.

7 City of Detroit, *Comprehensive Annual Financial Report, for the Fiscal Year Ended June 30, 2009*, 19, <https://www.detroitmi.gov/Portals/0/docs/finance/CAFR/Detroit%20CAFR%20FINAL%206-5-10.pdf>.

8 In 2009, the general fund shortfall reached 26 percent of revenue. Reuters, "S&P Downgrades Detroit Bonds to Junk Status" (Jan. 7, 2009), <http://www.reuters.com/article/2009/01/07/us-detroit-sp-idUSTRE50608720090107>.

9 *Detroit News*, "S&P Lowers Detroit's Bond Rating" (Oct. 2, 2013), <http://www.detroitnews.com/article/20131002/METRO01/310020125>.

10 Citizens Research Council of Michigan, "Legacy Costs and Indebtedness of the City of Detroit" (December 2011), 1, <http://www.crcmich.org/PUBLICAT/2010s/2011/rpt373.pdf>.

11 Moody's Investors Service, "Rating Update: Moody's Downgrades Detroit (MI)'s General Obligation Unlimited Tax and Certificate of Participation Debt to B2 and GOLT Debt to B3," rating update (2012), 2 and 4.

12 For more information and analysis on the state of retirement funding in the 30 cities, see The Pew Charitable Trusts, American cities project issue brief, *Cities Squeezed by Pension and Retiree Health Care Shortfalls* (March 2013), http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_city_pensions_brief.pdf.

13 Matt Helms and Suzette Hackney, "City Unions Object, but Cuts Look Like Done Deal," *Detroit Free Press*, sec. Front Page (July 17, 2012), <http://www.freep.com/article/20120717/NEWS05/207170412/Detroit-unions-object-but-city-pay-cuts-look-like-done-deal>.

14 Bernie Woodall and Steve Neavling, "Detroit Defaults on Some Debt to Avoid Bankruptcy Filing," Reuters (June 14, 2013), <http://www.reuters.com/article/2013/06/14/us-usa-detroit-creditors-idUSBRE95D00S20130614>.

15 Steve Neavling, "Michigan Governor Names Bankruptcy Attorney to Run Detroit," Reuters (March 14, 2013), <http://www.reuters.com/article/2013/03/14/usa-detroit-emergency-idUSL1N0C69N020130314>; and Nick Carey and Steve Neavling, "Detroit Emergency Manager Says City 'Clearly Insolvent,'" Reuters (May 13, 2013), <http://www.reuters.com/article/2013/05/13/us-usa-detroit-emergencymanager-idUSBRE94C0YD20130513>.

16 The financial manager's plan calls for reinvesting \$1.25 billion over the next decade to boost crucial services such as police and fire, increase blight removal, and transform the operations of an antiquated, failing city government. Matt Helms, Joe Guillen, and Alisa Priddle, "Orr: Detroit to Halt Debt Payments, Reinvest \$1.25 Billion in City," *Detroit Free Press* (June 14, 2013), <http://www.freep.com/article/20130614/NEWS01/306140083/Orr-Detroit-halt-debt-payments-reinvest-1-25-billion-city>.