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CITIZENS RESEARCH COUNCIL OF MICHIGAN

106 YEARS OF UNCOMPROMISING POLICY RESEARCH

Analysis of FY2023 City of Detroit Budget

A Publication of the Detroit Bureau

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Key Takeaways

- The City of Detroit's FY2023 $1.2 billion General Fund budget has been lauded as a "return to normal" spending plan to restore the pre-pandemic status quo and manage fiscal risks with contributions to reserves and spending restraint.
- City revenues have recovered from their pandemic hit with income tax revenue gains from non-resident workers returning to their Detroit workplaces and the addition of blue collar and service industry jobs aided. Appropriation highlights focus on returning operating department funding to pre-pandemic levels, paying off debt and putting tax dollars into various savings accounts.
- While the approved FY2023 budget is balanced, the long-term budget forecast projects that on-going revenue growth will not be sufficient to meet estimated spending pressures in the near future. This forecast, based on a number of assumptions, presents a small, but growing, operating budget shortfall beginning in FY2027.

Executive Summary

The FY2023 City of Detroit Budget has been lauded as a "return to normal" budget restoring the pre-pandemic status quo and managing risks with contributions to reserves and spending restraint. When the pandemic struck, the mayor outlined nearly $350 million in pandemic-related spending cuts to maintain a balanced budget without laying off any full-time city employees. Since then, the city has seen revenue growth beyond initial projections and appropriated funds in the new FY2023 budget are set to restore all pandemic-related budget cuts.

The FY2023 overall budget of $2.5 billion is balanced. It marks a 4.9 percent increase from the $2.3 billion budget in FY2022. Operating budget balance is achieved without use of rainy day fund reserves or one-time federal COVID-19 relief dollars.

The FY2023 budget is a reflection of the city's revenue outlook which continues to improve following two challenging fiscal years of revenue losses driven by the pandemic. Recurring city revenues that make up the city's general fund are forecasted to exceed pre-pandemic levels.

Budget stabilization was aided largely by strong recovery in onsite wagering taxes and collection of new internet gaming and sports betting tax revenues. More favorable projections of remote work also bolstered city revenues as municipal income tax collection estimates were higher than had previously been expected.

The city's $826 million in federal American Rescue Plan Act (ARPA) funds add stability to the city's budget and financial standing by accelerating projects to improve the tax base and community well-being while preserving reserves and resources that would have otherwise been used to fund improvements and shortfalls. None of the city's funds are being used as revenue replacement or for recurring expenses which place the city in a good position to increase its annual budget.

The FY2023 General Fund budget includes increases in recurring expenses as well as one-time spending items. The FY2023 budget makes targeted investments in key areas of the city such as beautification, transit, city reserves, and pension funds. It also aims to restore the pre-pandemic status quo budget as the economy and revenues of the city continue to recover post pandemic.

However, the budget does face some significant revenue risks that must be monitored to avoid disrupting the current balance between ongoing revenues and expenses. These risks include slower than projected growth in General Fund revenues, slower than anticipated employment and wage growth, the persistence of remote work models, economic impacts from changing workplace and consumer behavior, reductions in local funding from the state and federal government, additional COVID-19 variant-related economic disruptions, inflation, the war in Ukraine, and continued supply chain issues.

In addition to these potential revenue risks, the city will have to resume annual contributions to its two pension funds from the General Fund in FY2024. Part of Detroit's historic bankruptcy agreement included a debt-cutting plan and a nine-year break from dealing with most of the pension related debt; instead, those pension costs were met through contributions from private parties and the State of Michigan, part of the Grand Bargain agreement that followed the city's bankruptcy. That reprieve is almost up.

The city will have to fund a substantial portion of the obligations for the General Retirement System and the Police and Fire Retirement System beginning 2024. This will impact the city's bottom line in a way that it has not since the 2014 bankruptcy agreement.

The FY2023 budget manages risks by making concerted contributions to reserves and employing spending restraints. As it stands, the budget is balanced because of the city's conservative financial and economic forecasts that are a result of strong institutional frameworks and strong fiscal discipline supported by policies, transparency, and action.

While the approved FY2023 budget is balanced, the city's long-term budget forecast shows that projections of on-going revenues will not be sufficient to meet spending pressures in the near future. This forecast, based on a number of assumptions, presents a small, but growing, operating budget shortfall beginning in FY2027. City officials must monitor the long-term health of the budget and take all necessary steps to maintain operating balance or risk heighted oversight from the Financial Review Commission.

Since the Plan of Adjustment, the city has implemented many programs and departments that have been funded by one-time contributions. Much of the spending related to improvements in infrastructure, neighborhood beautification, and addressing equity issues is coming from one-time contributions. While this spending has been important and necessary for the city's growth it may prove to be unsustainable in the long run because the city will not have the revenue baseline to support the additional infrastructure, services, and personnel.

Structurally, this creates a potential problem for the city's future because one-time contributions do not account for service needs that will need to continue to be funded once those one-time expenditures are exhausted. The city's revenue baseline will have a hard time sustaining expenditures in the future that will require more government spending to maintain new infrastructure, personnel and services.

In addition to the pension contribution payments that will resume in FY2024, the city has to continue growing its tax base to increase city revenues in a manner that will sustain new, acquired expenditures or use more restraint when considering new expenditures to live within realistically expected revenues.

Introduction

The adoption of the City of Detroit's Fiscal Year (FY)2023 budget continues a trend that began following the adoption of the 2014 Plan of Adjustment of crafting sensible balanced budgets that are conservative, practical, and responsible. The pandemic could have easily derailed the city from this path, but Detroit's revenues continue to grow which have improved its budget position. It has been able to build up its reserves in both the rainy day fund and the Retiree Protection Fund.

The city's revenue outlook continues to improve following two fiscal years of revenue losses driven by the pandemic. The FY2023 budget is supported by this strong financial standing as the city has initiated its long-term recovery from the pandemic. The city was able to sustain its reserves and offset severe revenue losses through quick cost reductions and use of one-time federal COVID relief funding. The budget is also based upon estimates that show recurring city revenues exceeding pre-pandemic levels due to stronger income tax collections and increased casino wagering tax revenues due to the enactment of internet gaming and sports betting in 2021.

At the onset of the pandemic, economic forecasters were grim about the impact that job losses and remote work would have on the city's income tax revenue. Two years later, the city's income tax collections have proven to be resilient as projections for the amount of remote work and employment rates have been adjusted more favorably.

Long term, the city does face some risks. Annual pension contributions to two different retirement funds were put on hold for a time following bankruptcy and are scheduled to resume in 2024. This presents risks to the budget because the annual required contributions for these payments can vary substantially if investment and acturarial assumptions are not realized. The city has been making voluntary contributions to a Retiree Protection Fund that will provide some cushion against the uncertainty of future pension costs. However, recent actions to shorten the amortization period for the city will require larger annual contributions upfront, thus impacting the city's bottom line.

The city's revenue recovery post-pandemic and the pace of economic recovery on the city, state, and federal levels all present potential risks to the city's budget. The city has limited revenue-raising ability and existing revenue is sensitive to economic fluctuation. Risks remain from the future of remote work, changes in economic behavior due to inflation and the war in Ukraine, and changes in legalized gambling behavior.

The increasing and changing composition in the city's workforce are positives for the city's income tax collections but could present risks in the future as a post-pandemic "new normal" for work takes shape. In addition, the pandemic is not over yet and there are still risks from future COVID variant-related economic disruptions.

Overall, the city presents a balanced budget for FY2023, but the city will have to remain proactive to maintain balanced budgets in coming years. Since the Plan of Adjustment, the city has implemented new programs and departments. Much of the spending related to improvements in infrastructure, neighborhood beautification, and addressing equity issues is coming from one-time contributions. While this spending has been important and necessary for the city's growth it may prove to be unsustainable in the long run because the city will not have the revenue baseline to support the additional infrastructure, services, and personnel.

Detroit's General Fund

The city's budget is composed of various funds: the General Fund is the primary discretionary operating fund and supports much of the city's core services including several of the city's primary services such as police, fire, parking, public works, and community and youth services.

Other major funds include enterprise funds, grant funds, and various other restricted funds. Revenue from these funds are generally earmarked for specific purposes. Grant funds are made up of a mix of funding sources from the federal and state government, as well as from other sources.

Enterprise funds account for business-type activities where the intent is to recover, in whole or in part, the costs of providing goods or services through user charges.

Restricted funds are used for activities such as paying off debt service or dealing with solid waste collection and disposal. Examples of restricted funds include the Solid Waste Management Fund, the Urban Renewal Fund and the Internal Service Fund.

Revenues

The majority of the General Fund revenues support operation of both executive and legislative branch departments. It is funded through a variety of taxes and charges for services, including: property, income, utility users', and casino wagering taxes and proceeds from state revenue sharing payments to the city. In FY2020, the General Fund received $960.4 million in total revenue, $747.6 million of which came from these five major sources (see **Chart 1**).

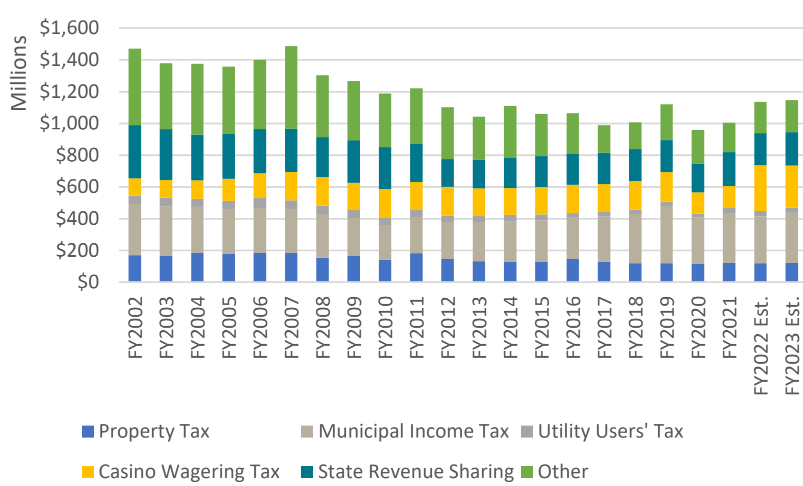
FY2023 General Fund revenues are forecasted to increase 0.87 percent over FY2022 budgeted revenues as pandemic effects on nonresident remote work and casino gambling tax revenue continue to wear off. The conservative forecasts for FY2024 through FY2026 show modest annual growth of around 2.9 percent.

Revenue from the five major tax sources have varied over the years with a general downward trend. However, they have started to trend upward in recent years and are projected to reach pre-bankruptcy levels by FY2026.

The COVID-19 pandemic in FY2020 contributed to the revenue losses. In FY2021, together the five primary revenue sources raised $819.3 million, and are expected to increase 9.3 percent to $895.1 million in FY2022 and 5.4 percent to $943.3 million in FY2023.

Chart 1

General Fund: Revenue Sources, FY2002 to FY2023

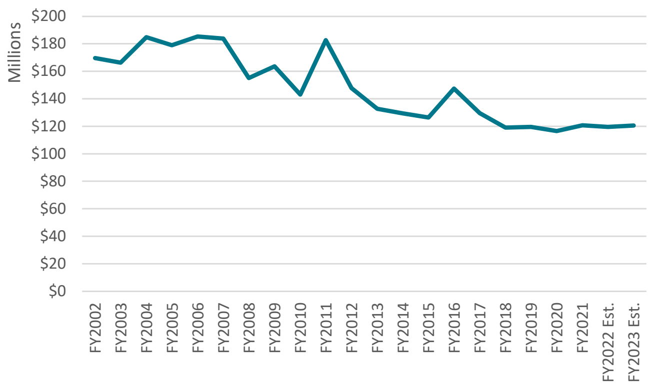


Source: City of Detroit OCFO - Office of Budget

Note: "Other" includes revenues from interest, penalties, fees, assets, permits, licensing, investment earnings, etc.

Chart 2

Property Tax Revenue, FY2002 to FY2023



Source: City of Detroit OCFO - Office of Budget

Property Tax

The city levies property taxes to fund general operations (19.9520 mills) and to support unlimited tax debt (9.0 mills). Detroit residents and businesses also pay overlapping property taxes to retire debt and to fund a number of entities including the Detroit Public Library, Detroit Public Community School District, Wayne County, a number of special authorities, and the State of Michigan.

Population loss and declining taxable values in the city have contributed to a steady downward trend in property tax revenues declining property values have eroded the tax base, and more structures continue to be foreclosed and demolished (see **Chart 2**).

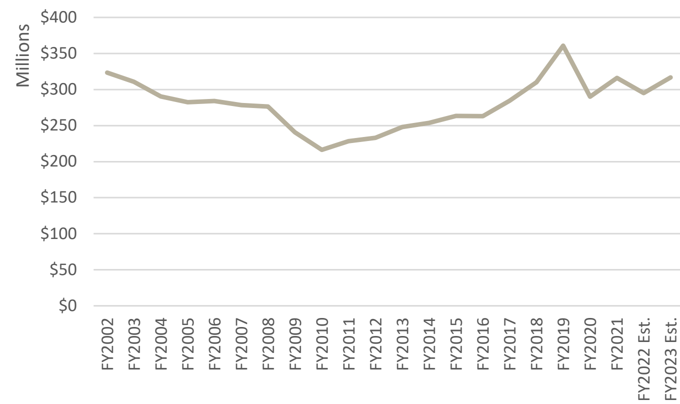
Between FY2007 and FY2018, property tax revenue dropped by 35.2 percent due in part to the impact of the Great Recession. Revenues have since been flat with small annual variances. Property tax revenues for FY2022 and FY2023 are projected to remain flat.

Municipal Income Tax

Detroit is one of 24 Michigan cities that levies an income tax. Detroit's city income tax rates are the highest among these cities, with a resident rate of 2.4 percent and non-resident rate of 1.2 percent. The corporate rate is 2.0 percent. Non-residents pay income tax on income earned while physically working in the city.

Chart 3

Income Tax Revenue, FY2002 to FY2023



Source: City of Detroit OCFO - Office of Budget

Income tax revenues totaled $323 million in FY2002. Between FY2002 and FY2010, because of declining employment and rate cuts, income tax revenues dropped 33 percent before exhibiting a steady rise through FY2019 when it totaled $361 million – an increase of almost 67 percent from the FY2010 low.[a] However, with the pandemic's disruptions, tax revenue fell by 19.7 percent between FY2019 and FY2020 as workers who typically worked in the city shifted to remote work from home, thus avoiding city income tax liability (see **Chart 3**).

Current forecasts expect FY2022 revenue to drop $20.9 million (6.6 percent) below FY2021. However, in FY2023, those estimates are expected to increase

a Public Act 500 of 1998 provided for reductions of the Detroit personal income tax rate for resident and nonresident taxpayers. Beginning with a tax rate of 3 percent on residents and 1.5 percent on nonresidents in 1999, the law provided that the resident tax rate be reduced by one-tenth of a percentage point per year, with the nonresident rate reset to one-half of the resident rate, over a ten-year period until the new rates were 2 percent and 1 percent. However, as a result of safeguards in Act 500 and amendments to the Act, the tax rate reduction was suspended. Starting in 2012, Detroit met only two of the required criteria in Act 500 to continue to suspend the income tax rate rollback. The Act was later amended to freeze the process. Therefore, the targeted rollback was never completed and the income tax rates remain at 2.4 percent for residents and 1.2 percent for nonresidents.

$21.6 million (7.3 percent) above FY2022 estimates due to adjusted remote work projections.

Recent projections expect the prevalence of remote work to decrease. Revenue reductions associated with remote work are now estimated to be most pronounced in FY2021 and FY2022, but are expected to flatten out modestly through FY2026.

Two types of workers are driving growth in the city's income tax revenues. The bulk of employment gains are expected to come from the blue collar sector made up of jobs in manufacturing, transportation, warehousing, and utilities and lower-educational attainment service jobs in accommodations, food services, arts, entertainment, and recreation.[1] People who hold these jobs cannot typically work remotely due to the nature of the work.

According to the Detroit Economic Outlook report by the University of Michigan, Detroit has now recovered four-fifths of its job losses from the start of the pandemic.[2] The city is expected to see 27,200 job gains between 2022 to 2026. It is expected that the job count will return to pre-pandemic levels in 2023. When the pandemic hit in 2020, Detroit's unemployment rate maxed out at 22 percent but fell to 10 percent in 2021.

Utility Users' Tax

The five percent utility users' excise tax produced about $32 million in FY2021, which is a 38.8 percent decrease from the FY2002 yield. Tax yields consistently decreased over the last two decades, much of which is related to population loss. Since FY2016, revenues for this tax have been growing at 4.6 percent annually (see **Chart 4**).

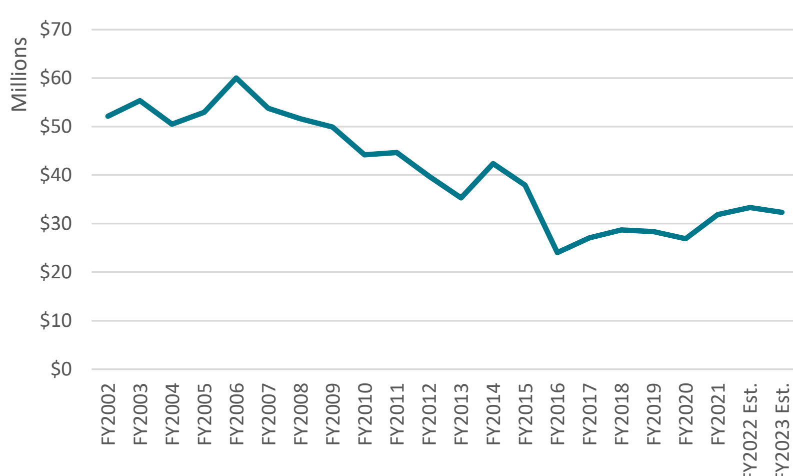
Casino Wagering Tax

Detroit is home to three casinos, the only non-tribal casinos in Michigan. The city's 10.9 percent tax on gross wagers at the casinos generated $184 million in FY2019. Once the pandemic hit and casinos were forced to close in 2020, FY2020 tax revenue losses were staggering, reflected in the onsite gaming numbers for FY2020 and FY2021. FY2021 had the most pronounced losses in onsite gaming revenue dropping down to $110 million.

Michigan launched online gaming and sports betting in 2021, which helped to offset the revenue losses from onsite gaming. Between FY2022 and FY2026, online gaming and sports betting is projected to add an average of $74.8 million every year. In that same period, total casino wagering tax revenue is projected to average about $273.5 million (see **Chart 5**). Online gaming brought in $26.6 million in casino wagering

Chart 4

Utility Users' Tax Revenue, FY2002 to FY2023

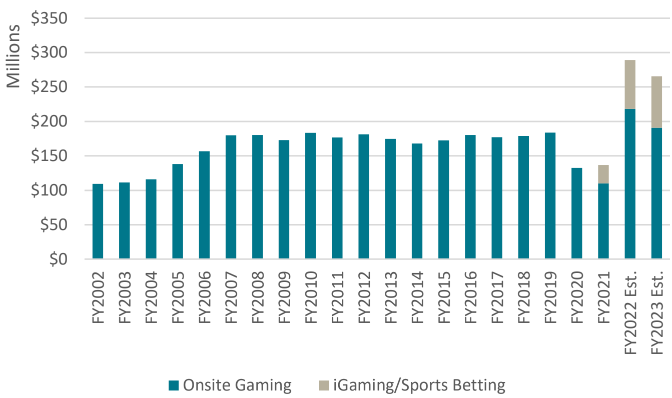


Source: City of Detroit OCFO - Office of Budget

Note: Starting in FY2016, $12.5 million of the utility users' tax has been dedicated to Public Lighting Authority bonds.

Chart 5

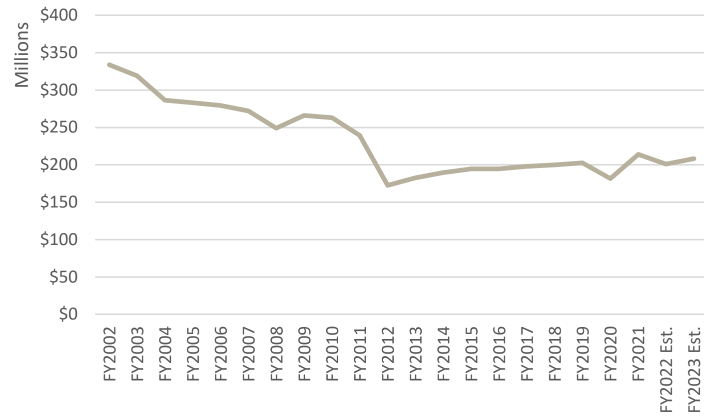
Casino Wagering Tax Revenue, FY2002 to FY2023



Source: City of Detroit OCFO - Office of Budget

Chart 6

State Revenue Sharing, FY2002 to FY2023



Source: City of Detroit OCFO - Office of Budget

tax revenue in FY2021 and is projected to bring an additional $71.1 million for FY2022.

State Revenue Sharing

Detroit receives unrestricted revenue sharing from the state consisting of portions of sales tax revenues that are constitutionally and statutorily dedicated. For years, the state's revenue sharing program has been reduced significantly with only modest growth at the beginning of the last decade (see **Chart 6**).

Between FY2002 and FY2012, the city had gradual annual decreases in the amount of state shared tax revenue. Revenue sharing dropped by 48.3 percent ($161 million) during this period, dramatically impacting the city's bottom line. Between FY2012 and FY2021, state revenue sharing has gradually increased, rising about 24 percent ($41.3 million) in total.

The drop in FY2020 was a result of state cuts to all cities during the annual August revenue sharing payments, which functioned as a pandemic budget balancer. However, the state gave municipalities replacement revenue that exceeded the revenue sharing cut in the form of a one-time Coronavirus Aid, Relief, and Economic Security (CARES) Act grant which was reported outside the General Fund. Estimates for FY2022 and FY2023 are expected to remain stable with historical amounts.

Potential Risks and Upsides of Revenue Forecast

The expected changes in the composition of the overall workforce in the coming years has caused the city to adjust its projections for the amount of remote work that will take place. Contrary to previous projections, this signals a future that is more similar to the pre-pandemic era as more of the labor force will be composed of in-person work.

However, this shift results from white-collar jobs being replaced with lower-paying, lower-educational attainment blue collar industry jobs. This workforce change presents concerns about tax revenue sustainability. Many lower-educational attainment and blue collar industry jobs tend to be part-time or temporary, creating the potential for wage gaps and smaller income tax collections.

The city is projecting economic growth based on actions initiated before the pandemic. Big development projects including the opening of the Stellantis Mack Avenue Assembly plant, the retooling of General Motors' Factory Zero, construction of the Gordie Howe International Bridge, and Ford Motor Company's new Detroit campus bolster blue-collar employment in the city. This is contributing to the projected growth in jobs, wages and income tax revenue.

While projections suggest a promising financial picture for the city's future and continued recovery of employment and wage gains, many of the new jobs coming to Detroit are temporary. For example, many blue-collar jobs are in construction which are more likely to go away once a major project is completed.

For income tax revenues to sustain their projected growth the city will need to see more job growth in the higher-educational attainment service industries such as healthcare, finance, biotechnology, and public administration. These jobs tend to be more permanent than jobs in lower-educational attainment service sectors, enhancing long-term growth. More opportunities in higher-educational attainment service industries will increase the average wage gain in the city and create more sustainable jobs for the city's economy.

Jobs located in the city may also attract residents, thus growing the tax base. A return to pre-pandemic revenue levels is a good sign but the city still has work to do to develop growth of the tax base and a non-transient employment base.

Revenue risks also lie in the city's income tax revenues as downtown workers continue to work remotely due to the pandemic's effect on the work environment. Expectations around remote work have changed, impacting income tax revenue projections in a positive way.

Detroit projects a $53.2 million tax revenue loss this fiscal year from remote work and is projecting a $35 million tax revenue loss from remote work in the 2026 fiscal year, signaling the permanent change to office work in the city.

On the other hand, recent projections expect the prevalence of remote work to decrease. According to the February 2022 report, remote work losses are estimated to be most pronounced in FY2021 and FY2022, but are expected to flatten out modestly through FY2026.[3] This is due to the changing composition in the city's work force as more blue collar jobs from high profile development projects become available.[4]

The growth of sports betting and remote gambling options has provided the city with revenue streams that have helped to offset some of the tax revenue losses since the pandemic. However, the boom in tax revenue from online gaming and sports betting is not guaranteed to persist as changes in gaming behavior could occur in the future. The online gaming substitutions for onsite gaming presents an even bigger risk. As of now it is projected that online gaming and sports betting will add to existing onsite casino revenue.

However, another scenario may occur where online gaming replaces some of the onsite gaming. Patrons of the casino who normally engage in onsite gaming may now stay at home and gamble on the computer instead of physically going to the casino. If a situation like this happens, the current projections for casino wagering tax revenue will be too high. This presents a question about long-term economic sustainability for the city's tax revenues.

For all of the investment in major projects in Detroit, property tax revenue projections are flat. Tax incentives and limitations on growth of the taxable value of property result in few gains to fund government services.

The FY2023 Budget

Approved Budget

The FY2023 budget totals $1.2 billion for General Fund operations and $2.5 billion across all city funds (see **Table 1**).

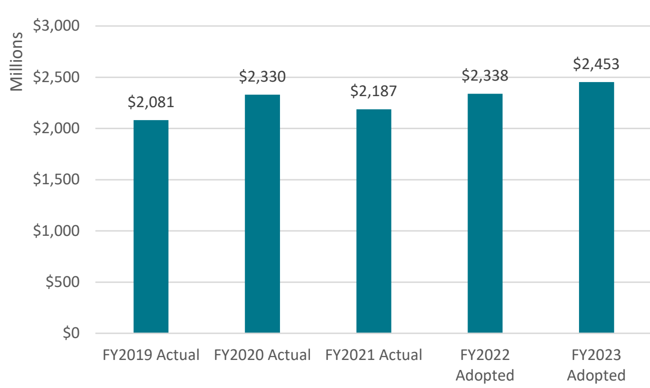
Compared to the FY2022 adopted budget, the current General Fund budget is set to increase by 7.4 percent ($84.8 million). The $1.2 billion General Fund budget includes more than $1.1 billion in recurring funds and $76.7 million in one-time spending available as unused balances from the current budget.

Table 1
City of Detroit Budget FY2022 and FY2023
(dollars in millions)

	FY2022 (Adopted)	FY2023 (Adopted)	Dollar Increase	Percent Change
General				
Recurring Budget	$1,055.1	$1,146.5	$91.4	8.7
One-Time Budget	$83.3	$76.7	-$6.6	-7.9
Total	**$1,138.4**	**$1,223.2**	**$84.8**	**7.4**
Other Funds				
Recurring Budget	$1,179.5	$1,171.4	-$8.1	-0.7
One-Time Budget	$20.0	$58.7	$38.7	193.5
Total	**$1,199.5**	**$1,230.1**	**$30.6**	**2.6**
All Funds				
Recurring Budget	$2,234.6	$2,317.9	$83.3	3.7
One-Time Budget	$103.3	$135.4	$32.1	31.1
Total	**$2,337.9**	**$2,453.3**	**$115.4**	**4.9**

Source: City of Detroit OCFO - Office of Budget

Chart 7
Total City of Detroit Budget, FY2019 to FY2023



Source: City of Detroit OCFO - Office of Budget

The overall city budget can be compared historically to assess how the city's fiscal health has been trending over the years (see **Chart 7**). The city budget has increased by 17.9 percent since FY2019.

Budget Highlights

The budget is a reflection of the city's revenue outlook which continues to improve following two challenging fiscal years of revenue losses driven by the pandemic. Recurring city revenues that make up the city's General Fund are forecasted to exceed pre-pandemic levels.

With the big revenue gains the city is forecasting for this upcoming fiscal year and future years, the budget includes an $89 million increase in recurring funding over the FY2022 budget. However, most of this growth reflects restorations from previous pandemic

Table 2
Major Funding Changes in FY2023 Budget
(dollars in millions)

	General Fund Budget
Replacement of Federal Transit Relief	$26.5
Restoration of City Workforce	$40.5
Increases in City Employee Salaries	$16.1
Retiree Protection Fund	$5
Existing Debt Service	$0.8

Source: City of Detroit OCFO - Office of Budget

budget cuts. A $67 million increase is spread across the Department of Transportation, the Police and Fire Departments, and all other General Fund positions to restore the city's budget from pandemic cost-cutting. Another highlight is a $16 million increase for city employee salaries, including bus operators and firefighters (see **Table 2**).

The city's $826 million in American Rescue Plan Act (ARPA) funds add stability to the city's budget and financial standing by accelerating projects to improve the tax base and community well-being while preserving reserves and resources that would have otherwise been used to fund improvements and shortfalls. None of the city's funds are being used as revenue replacement or for recurring expenses which places the city in a good position to increase its annual budget.

Retiree Protection Fund

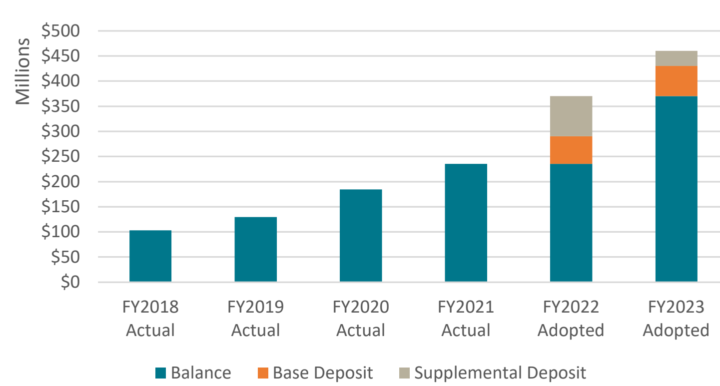
Beginning in FY2024, the city will resume annual pension contributions for its closed and frozen legacy pension plans per the bankruptcy Plan of Adjustment. To prepare for this upcoming return to actuarially based funding of its pension obligations, the city has been setting aside funds in a Retiree Protection Fund.

The FY2023 budget includes $60 million in recurring base funding for the Retiree Protection Fund, up by $5 million from the FY2022 level. This ongoing funding is supplemented by an additional one-time deposit of $30 million. This deposit will bring the total balance of the Retiree Protection Fund to $460 million (see **Chart 8**).

One-Time Spending

In addition to the funding increases adopted in the General Fund budget, it includes other one-time items. The city has not used the $826 million in ARPA fiscal recovery funds to directly support the city's annual General Fund budget either in FY2022 or FY2023. Instead, ARPA funding has been designated as one-time spending, separate from the ordinary city budget. Table 3 provides some one-time spending highlights from the budget, some of which come from ARPA funding.

Chart 8
Retiree Protection Fund, FY2018 to FY2023



Source: City of Detroit OCFO - Office of Budget

Table 3
Supplemental One-Time Funding in FY2023 Budget
(dollars in millions)

	City Budget
Rainy Day Fund Deposit	$30.7
Blight Remediation and Beautification Programs	$16.4
Municipal Facilities Improvements	$10.0
Parks and Recreation Improvements	$10.7
Public Safety, Parks, and General Vehicle Replacements	$10.4
Charles H. Wright Museum of African American History	$2.7
Detroit Historical Museum	$1.5
Coleman A. Young International Airport Improvements	$2.3
Match funds leveraging new state, federal, and private grant opportunities	$2.0
Neighborhood Planning Studies	$2.0
Housing Trust Fund	$3.5
Property Tax Over Assessments Program	$2.0
Updating the City's Master Plan	$2.0

Source: City of Detroit OCFO - Office of Budget

The budget allocates $16.4 million for blight remediation and neighborhood beautification programs and $49.1 million for maintaining buildings, parks, neighborhood planning studies, contributions to the city airport and museums, match grant funding, property tax over assessments program, and updating the city's master plan.

The budget also allocates $3.5 million of increased funding for the Housing Trust Fund. An additional $2 million will be allocated for the Property Tax Over Assessments Program for legacy Detroiters meant to support residents overtaxed by more than $600 million in the years after the Great Recession. As a part of that allocation, there is a request to bolster the program with $4 million more in federal funds.

Rainy Day Fund

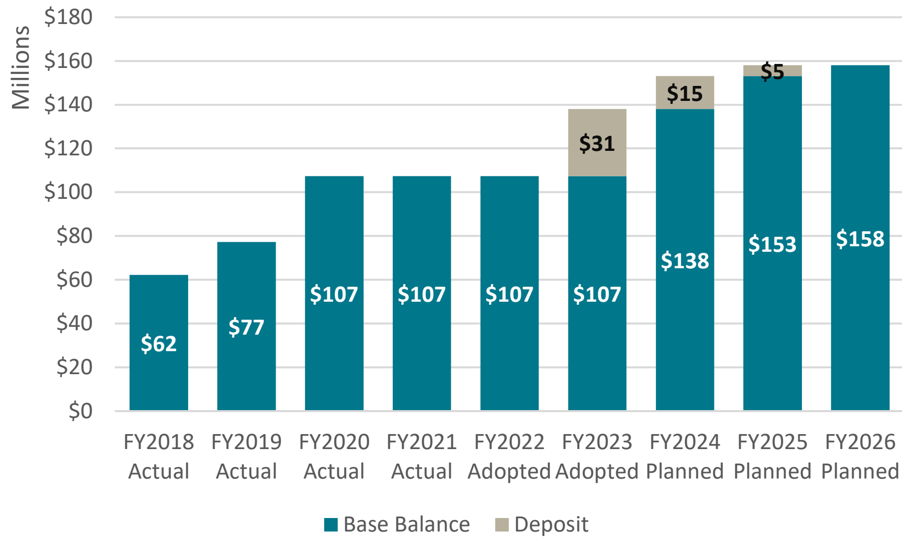
Rainy day funds are effectively budget reserves that help cities prepare for revenue volatility. Rainy day funds are separate from general operating funds and account balances. They function almost like a savings account. Generally, the percentage of a government's annual spending that could be covered by its rainy day fund is viewed as a leading indicator of fiscal health. While the city determines that amount of funding that is assigned to its rainy day fund, Detroit's city charter requires that it be kept above 5 percent.

The city expects to have $130 million remaining from FY2022 that the mayor has suggested to be appropriated in one-time allocations. One of those payments will be made towards the city's rainy day fund with a deposit of $30.7 million increasing the balance to $138 million. The city plans to add an additional $15 million in FY2024 and $5 million in FY2025, bringing its total reserves to $158 million (see **Chart 9**).

Fortunately, during the pandemic the city did not have to tap into its rainy day fund. The one-time deposits being made into the rainy day fund will increase it to over 12 percent of the budget.

A rainy day fund that is equivalent to 12 percent of

Chart 9
Rainy Day Fund, FY2018 to FY2026



Source: City of Detroit OCFO - Office of Budget

the city's budget is a good indicator of fiscal health and that is promising for the city of Detroit. The big three credit rating agencies generally favor a rainy day fund balance equal to 15 percent of the city budget.[5] This goal does not seem far-fetched based on where its budget reserve is now.

The city's rainy day fund will be an important buffer as the city ramps up its spending in future years with the start of pension contributions in FY2024. Cost pressure from the restored pension contributions are expected to push city spending above available revenue starting in FY2027, reinforcing the need for contributions to be made to reserves as well as exercising spending restraint and identifying budget effiiciencies.

Department and Agency Spending

Table 4 provides a breakdown of some of the more significant appropriations contained in the FY2023 budget by city department and agency.

General Services The General Services Department will receive a notable 26.1 percent funding increase. It is in charge of the city's vehicle fleet, forestry services, vacant lot maintenance, city-owned building maintenance, and park and recreation center planning, design, improvements, and programming. The department directly operates or partners in the maintenance and improvement of 310 public parks and 18 recreation centers. Funding for the General Services Department in the FY2023 budget is $12.1 million (9 percent) above what it was in FY2019.

Operating budget highlights for the General Services Department include an addition of $1.7 million to include additional cuts for vacant lots, a $700,000 increase in funding for the Summer Host Sites program, $1.5 million for park capital maintenance, and $852,000 for streetscape maintenance to ensure the city's new assets maintain a state of good repair.[b] There will also be an additional $1.7 million to keep

b The Summer Host Sites program procures organizations around the city to serve as a host for running summer programming for youth. The City of Detroit seeks out organizations as a way to provide more opportunities for Detroit youth right in their neighborhoods.

Table 4
Department and Agency Spending (FY2023)
(dollars in millions)

Department	FY2022 Budgeted	FY2023 Budgeted	Dollar Increase	Percent Change
Executive Agency				
Demolition	$8.0	$10.7	$2.7	33.8
Public Works	$149.2	$151.2	$2.0	1.3
Fire	$128.6	$131.9	$3.3	2.6
Civil Rights, Inclusion & Opportunity	$5.9	$7.2	$1.3	22
Innovation & Technology	$22.6	$35.6	$13.0	57.5
Law	$18.2	$22.6	$4.4	24.2
Municipal Parking	$10.1	$11.6	$1.5	14.9
Housing & Revitalization	$69.9	$65.6	-$4.3	-6.2
Police	$341.0	$366.8	$25.8	7.6
Planning & Development	$5.2	$9.3	$4.1	78.8
General Services	$116.4	$146.8	$30.4	26.1
Legislative Agency				
City Clerk	$2.5	$3.1	$0.6	24
Elections	$12.3	$14.3	$2.0	16.3
Enterprise Agency				
Public Library	$27.8	$33.6	$5.8	20.9
Transportation	$135.1	$138.9	$3.8	2.8

pace with cost inflation across various maintenance and security contracts and allocation of $11.7 million to the Blight Fund which will cover vacant lot mowing, corridor trades, murals, graffiti removal, and Detroit Land Bank Authority cleanouts.

Fire and Police Both Fire and Police Departments are set to receive a budget increase. Compared to FY2022, the Fire Department would receive a $3.3 million (2.6 percent) increase while the Police Department would receive a $25.8 million (7.6 percent) increase (see **Chart 10**).

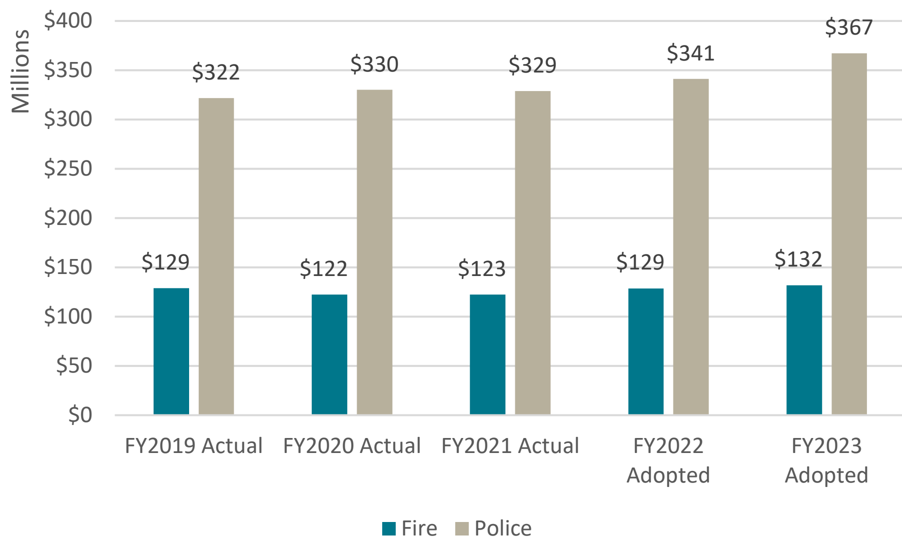
Operating budget highlights for the Fire and Police Department include General Fund budget restoration of personnel funding reduced in the FY2022 budget and anticipated increases in wages. Police and fire employees will be allocated $11.4 million for wage increases and $29 million to restore funding for police and fire positions.

Over the past five fiscal years, funding for the Fire and Police Departments has stayed relatively consistent. Funding for the Fire Department in the FY2023 budget is $3.1 million (2.4 percent) above what it was in FY2019. Funding for the Police Department in the FY2023 budget is $45.1 million (14 percent) above what it was in FY2019.

Public Works The Department of Public Works provides environmental and infrastructure services which are designed to ensure the cleanliness and safe and efficient mobility of residents, visitors, and customers of the city. DPW also provides oversight and management of solid waste collection activities performed by private contractors, including citywide curbside recycling.The Department of Public Works (DPW) is set to receive a $2 million increase (1.3 percent) under the FY2023 budget. Appropriations for this department have stayed relatively stable over the last five fiscal years. Operating budget highlights

Chart 10

Fire and Police Department Appropriations, FY2019 to FY2023



Source: City of Detroit OCFO - Office of Budget

for DPW include the addition of $1 million to support increased participation in trash removal and recycling hauling.

Innovation and Technology The Department of Innovation and Technology (DoIT) connects Detroiters to city government by making sure city workers have the latest technology to do their jobs and creating outlets for residents to communicate with city departments and agencies. The budget allocates a $13 million increase (57.5 percent) to the DoIT budget compared to FY2022.

When the pandemic hit, budget cuts reduced funding to the department. Even with the proposed increase, funding for DoIT would still be $7 million (16.4 percent) below what it was in FY2019. Operating budget highlights include $7.9 million for the consolidation of existing Police Department information technology-related funding into the DoIT, and $3.8 million in new funding for police body camera cloud storage.

Demolition The Detroit Demolition Department was created after Proposal N was approved by voters in 2020 to authorize a $250 million comprehensive plan to address vacant houses in Detroit through preservation or demolition. It is a continued effort of the mayor's blight remediation program. The Demolition Department is tasked with demolishing an additional 8,000 blighted homes and preserving 6,000 blighted homes. The Demolition Department will receive a significant $2.7 million increase (47.5 percent) over the FY2022 budget amount.

Transportation The Department of Transportation (DDOT) will also receive a budget increase of $3.8 million (2.8 percent) compared to the FY2022 budget. In addition to the budget increase, DDOT will be receiving contributions from the General Fund that will help restore the department's budget to pre-pandemic levels.

The FY2023 budget allocates $26.5 million to replace federal transit grants with General Fund support for DDOT and the People Mover. DDOT will also leverage $10 million of DDOT's allocation of American Rescue Plan Act transit funding to stabilize service while farebox revenue remains depressed. There is also an additional $5.8 million increase to improve Paratransit Service and Vehicle Operations. DDOT's operating budget also includes an extra $1 million to support cost increases in the department's insurance policy.

Elections With the upcoming 2022 midterm elections, the city is allocating 16.3 percent more funding for elections compared to FY2022. The $2 million increase would cover items including security, infrastructure, postage, redistricting costs, and expenses related to the pandemic.

Housing and Revitalization The Housing and Revitalization Department is responsible for sustaining and growing neighborhoods that are inclusive of quality affordable housing opportunities. It also provides services to city residents by expanding economic opportunities through management of federal housing, economic and community development funding, steering local housing policy, and maintaining and creating mixed-income and mixed-use housing opportunities.

While almost every department in the executive branch is set to receive an increase in funding with the FY2023 budget, one department is slated to have a mark down. Comparing the FY2023 budget to FY2022, the Housing and Revitalization Department would receive a 6.2 percent decrease in funding.

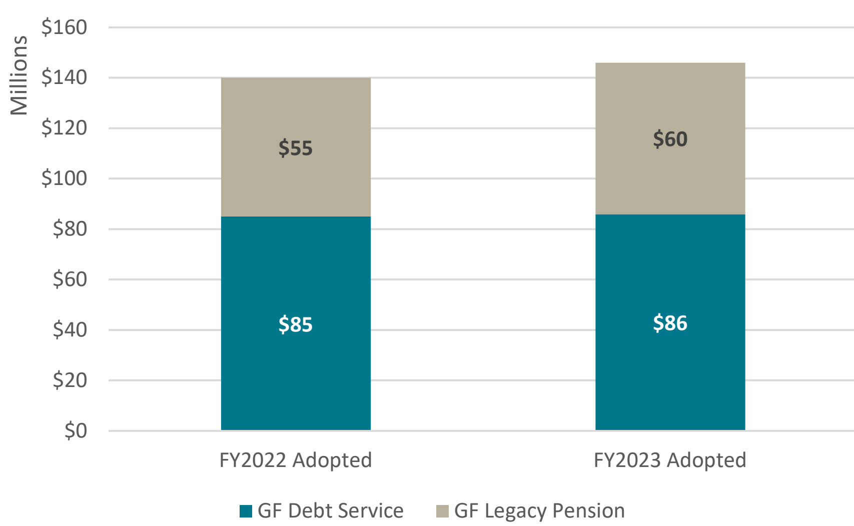
This department has had funding reduced after the significant boost in federal funding it received in FY2020. Funding for the Housing and Revitalization Department in the FY2023 budget is $9.9 million (13.1 percent) below what it was in FY2019. The decision to defund the Housing and Revitalization Department from General Fund dollars correlates with its ARPA spending. The city is maintaining overall spending on these items through funding sources like the American Rescue Plan Act, Coronavirus Aid, Relief, and Economic Security Act, and block grants that are off budget.

About $67 million of ARPA funds is programmed towards combatting intergenerational poverty that include home repairs, affordable housing/services, and homelessness prevention. Another $50.5 million of ARPA money is programmed towards neighborhood investments that include providing block club and neighborhood grants, as well as funding Community Health Corps and services. These are all services that would traditionally be funded through the Housing and Revitalization Department.

Debt Service Debt service payments from the General Fund increase $900,000 between FY2022 and FY2023. The graph below combines the General Fund shares of limited tax general obligation debt service and legacy pension contributions based on current debt service and the Retiree Protection Fund funding plan ramp up (See **Chart 11**).

Chart 11

Debt Service Payments, FY2022 and FY2023



Source: City of Detroit OCFO - Office of Budget

Evaluating the Budget

The city's budget took a major hit two years ago with budget cuts of $350 million as the pandemic disrupted the economy and dealt unanticipated revenue losses. The $2.5 billion FY2023 budget is balanced. It marks a 4.9 percent increase from the $2.3 billion budget in FY2022. Operating budget balance is achieved without the use of rainy day fund reserves or one-time federal COVID-19 relief dollars.

State law requires that local governments' budgets be balanced, meaning that projected revenues are sufficient to cover appropriations. Detroit's FY2023 budget is balanced based on the best available estimates of city revenues and spending.

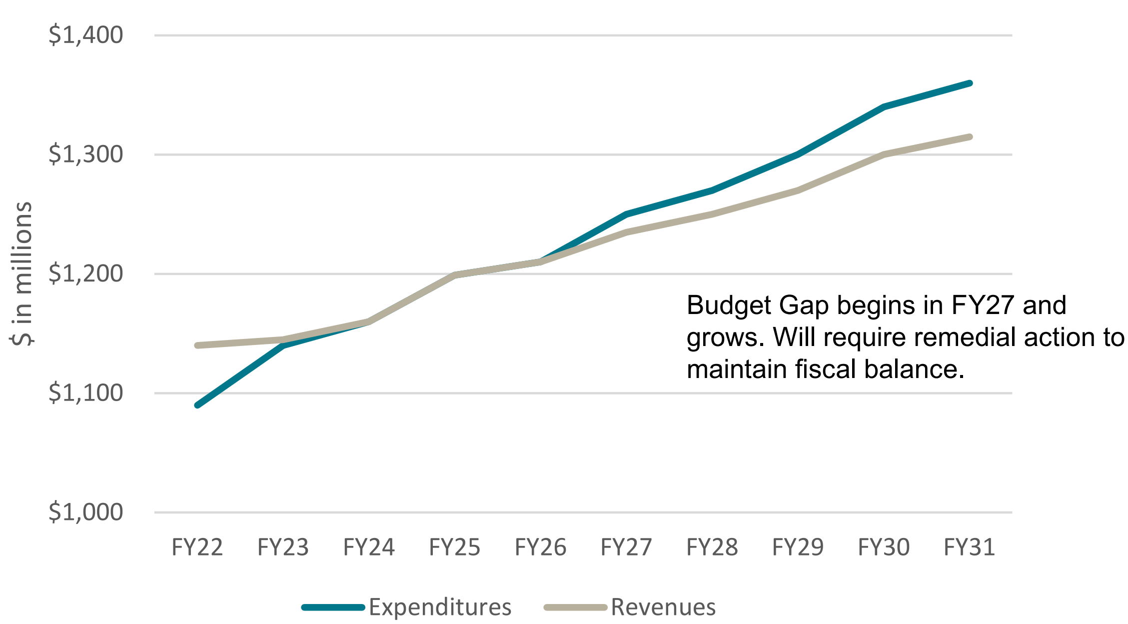
Looking forward into the city's budget forecast, however, expenditure growth begins to outpace revenue growth beginning in FY2027. Future revenue growth generally continues along revenue conference trends. This assumes remote work remains at the favorably adjusted levels that were estimated during the February 2022 conference and no material revenue loss from potential substitution effects on internet gaming versus onsite gaming.

As it relates to expenditures, long-term forecasts are projecting pension costs that are based on FY2021 actuarial valuation projections to be the main driver that will cause expenditures to outpace revenue growth in FY2027 (see **Chart 12**).

Amortization schedules for the General Retirement Service Fund is 30 years while the Police and Fire Retirement Service is 20 years (per adopted funding policy). This budget gap requires remedial action to maintain fiscal balance.

Near term, revenues and expenditures are expected to be in balance. Beginning in FY2027, annual revenues are expected to grow at about 1.8 percent per year, while annual expenses are expected to grow about 2.5 percent per year. These are all based on baseline trends and known labor contract growth, pension contributions, debt service, and

Chart 12
Baseline Budget Forecast, FY2022 to FY2031



Source: City of Detroit OCFO - Office of Budget

other factors. This translates to a baseline budget gap of about $11 million in FY2027 that grows about $10 million larger every year as expenses continue to outpace revenues.

Current forecasts show a slowly growing deficit starting in FY2027. If revenue projections end up being accurate, that would mean the city would need to tap the brakes to slow spending growth from its current trend or find new revenue to fill the gap.

If revenues perform better than the city's baseline forecast then the budget gap would be delayed by two years and would not develop until FY2029. Potential revenue upsides include revenue gains from development projects that are underway, proposed state revenue sharing increases, and state-shared marijuana excise tax revenues. Under a more pessimistic scenario, the budget gap would occur immediately; as soon as next fiscal year. Downside revenue risks assumes 30 percent nonresident remote work persists and a 10 percent onsite gaming gap versus pre-pandemic levels. This would require the city to take immediate action to maintain a balanced budget.

Annual Pension Contributions

The contributions from the city's General Fund that will come due once again in 2024 for its two pension funds is a looming challenge. Required contributions to police and fire retiree pensions challenged the city's budget before its 2014 bankruptcy agreement. After a brief respite, required payments still loom over its future. Part of Detroit's historic bankruptcy agreement included a debt-cutting plan and a nine-year break from dealing with most of the pension related debt; instead, those pension costs were met through contributions from private parties and the State of Michigan, part of the Grand Bargain agreement that followed the city's bankruptcy. That reprieve is almost up.

To prepare for a return to full actuarially-determined pension funding, the city has been annually increasing its budget allotment for pensions. Instead of funding payments to pension plans, however, the city began making deposits into a Retiree Protection Fund established in 2018 to function as a savings account to help cushion the blow of the pension cliff, dedicating hundreds of millions of dollars to tackle the upcoming pension payments. This would allow it to meet required payments through a combination of increasing payments from the General Fund budget and draws on the Retiree Protection Fund.

Under the FY2023 budget, the Retiree Protection Fund will now have a total of $460 million available for future pension payments. The first payment in FY2024 is projected to be $135.4 million. Once the Retiree Protection Fund is depleted, all future pensions costs become a General Fund cost to the city. The larger the required contribution, the more it will hurt the city's ability to afford other ongoing city services. It is important to note that none of the city's $826 million ARPA allocation can be used to fund pension contributions.

Pension Amortization Period

Additional risks to the Four-Year Financial Plan include the amortization period that is currently used for legacy pension obligations. Under current funding policy, the unfunded accrued liabilities of the Police and Fire Retirement Service Fund are spread over a 20 year period and the General Retirement Service Fund over a 30 year period.

The plan of adjustment provided for a 30-year amortization period. The Police and Fire Retirement System Board adopted a 20-year payment schedule. The Board has the ultimate authority to make such a decision. It did so because it found it was the best move to ensure the solvency of the pension funds. This change in pension funding, however, drastically increases the city's costs on the front end.

The mayor is considering going to bankruptcy court to litigate over the 20-year amortization schedule for the Police and Fire Retirement Service Fund in hopes to return to a 30-year amortization schedule. Spreading legacy pension costs over a shorter 20-year time horizon means higher upfront annual costs for the city. For example, the city's pension forecasts that incorporate lower investment returns and a 20-year amortization period for both the Police and Fire Retirement Fund and the General Retirement Services Fund estimate that these factors would increase the annual legacy contribution by $25 million to $160 million. That would exacerbate the future budget gaps discussed in the previous section and exhaust the Retiree Protection Fund sooner. This could result in potential budget cuts. A 20- versus 30-year payment schedule is important because of the major impacts it could have on the city's bottom line, its ability to spend on services for businesses and residents in the future and the pension systems that serve retirees.

Inflationary Impacts on the Economy and the Ukrainian War

While the city is projected to see promising job and wage gains driven by blue-collar jobs and service industry jobs, the impacts of inflation on income growth still looms over as a threat to the city's budget. Initially, the sharp uptick of inflation during the pandemic was expected to moderate as the COVID-19 recession receded, but ongoing supply chain disruptions and higher input costs have pushed local inflation to 8.5 percent year-over-year in March.

As the economy adjusts to a post-pandemic landscape, the higher inflation reflects lingering price pressures that may impact the budget and the city's economic forecast. High inflation impacts government expenditures more than it does government revenues. This may have implications on the city budget. Additionally, inflation impacts consumer behavior which may have adverse effects on how consumers spend and the amount of state sales tax revenue. This could also have impacts on state revenue sharing that the city receives, in turn, impacting the city's budget and economic forecast.

In addition, the Federal Reserve has already signaled it will increase interest rates to try to help contain the growing inflation. Higher interest rates will likely dampen economic growth at least in the short run. Slower economic growth means a greater probability of slower revenue growth as well.

Inflation has been expected to rise a bit in the first quarter of 2022, tail off for the rest of 2022 and then gradually moderate to the mid-2 percent range until 2026.

Inflationary impacts on the economy may be exacerbated by the war in Ukraine. Russia is the largest natural gas exporter in the world and their invasion of Ukraine has led to uncertainty in that market, which has increased demand. Gas prices have increased significantly since the start of the war, and this is happening in tandem with the rising prices from inflation. The two factors acting together could have a more pronounced effect on consumer behavior and government spending.

In addition, the Ukrainian War is having adverse effects on the continuing supply chain disruptions. Michigan automakers are reliant on computer chips, of which there is a continued shortage of now. The shortage of computer chips could continue as semiconductor plants deal with cutbacks in Ukrainian supplies of the neon needed for lasers. Carmakers will also be affected from the higher prices for palladium used in car manufacturing as it is a major Russian export.

Conclusion

The FY2023 City of Detroit budget has been lauded as a "return to normal" budget restoring the pre-pandemic status quo and managing risks with contributions to reserves and spending restraint. When the pandemic struck, the mayor outlined nearly $350 million in pandemic-related spending cuts to maintain a balanced budget without laying off any full-time city employees. Since then, the city has seen revenue growth beyond initial projections and appropriated funds in the new FY2023 budget are set to restore all pandemic-related budget cuts.

The FY2023 General Fund budget includes increases in recurring expenses as well as one-time spending items. The FY2023 budget makes targeted investments in key areas of the city such as beautification, transit, city reserves, and pension funds. It also aims to restore the pre-pandemic status quo budget as the economy and revenues of the city continue to recover post pandemic. The FY2023 budget manages risks by making concerted contributions to reserves and employing spending restraints. As it stands, the budget is balanced because of the city's conservative financial and economic forecasts that are a result of strong institutional frameworks and strong fiscal discipline supported by policies, transparency, and action.

These fiscal practices have proven to work thus far to keep the city solvent in the post-bankruptcy era. In addition, a few items are providing substantial relief for the FY2023 and the upcoming FY2024 budget. The first is the drop in the estimated income tax remote work loss which has been projected to decrease from 30 percent to 20 percent ongoing. And second, the actuarially set hybrid contribution rates have decreased from about $186 million a year to about $135 million a year. These factors place the city in a favorable position financially. And with revenue estimates projecting to exceed pre-pandemic levels, the city's FY2023 budget will prove to be sustainable.

Two of the major credit agencies – Moody's and S&P Global – that provide bond assessments for cities' credit ratings raised Detroit's credit rating giving the city its fifth such boost in seven years. The bond rating system is a measurement of the quality of the city's debt or how likely it is to repay that. It is a proxy of the city's overall financial health functioning as an important indicator of the city's status post-bankruptcy. Moody's upgraded Detroit's credit rating to Ba2 designating a positive outlook for the city.[6] S&P Global upgraded Detroit's Unlimited Tax General Obligation bond debt to BB from BB-, also designating a positive outlook.[7]

These upgrades reflect Detroit's growing revenues and improved budget position, sustained reserves, and overall financial flexibility from supplemental federal and state funding. Both upgrades emphasize the improving fundamentals in Detroit's economy which indicates that the city's budget is estimated to be sustainable in the coming years.

While the approved FY2023 budget is balanced, there is still a question about the long-term structural sustainability of the budget. The city's long-term baseline expenditure forecast is predicted to outpace forecasted revenue growth beginning in FY2027. In addition, much of the spending the city is undergoing related to improvements in infrastructure, neighborhood beautification, and addressing equity issues are coming from one-time contributions.

Structurally, this creates a potential problem for the city's future because one-time contributions do not account for service needs that will need to continue to be funded once those one-time expenditures are exhausted. The city's revenue baseline will have a hard time sustaining expenditures in the future that will require more government spending to maintain new infrastructure, personnel and services. In addition to the pension contribution payments that will resume in FY2024, the city has to continue growing its tax base to increase city revenues in a manner that will sustain new, acquired expenditures or use more restraint when considering new expenditures to live within realistically expected revenues.

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