



# **Detroit Public Schools Financial Crisis**

Detroit Association for Business Economics

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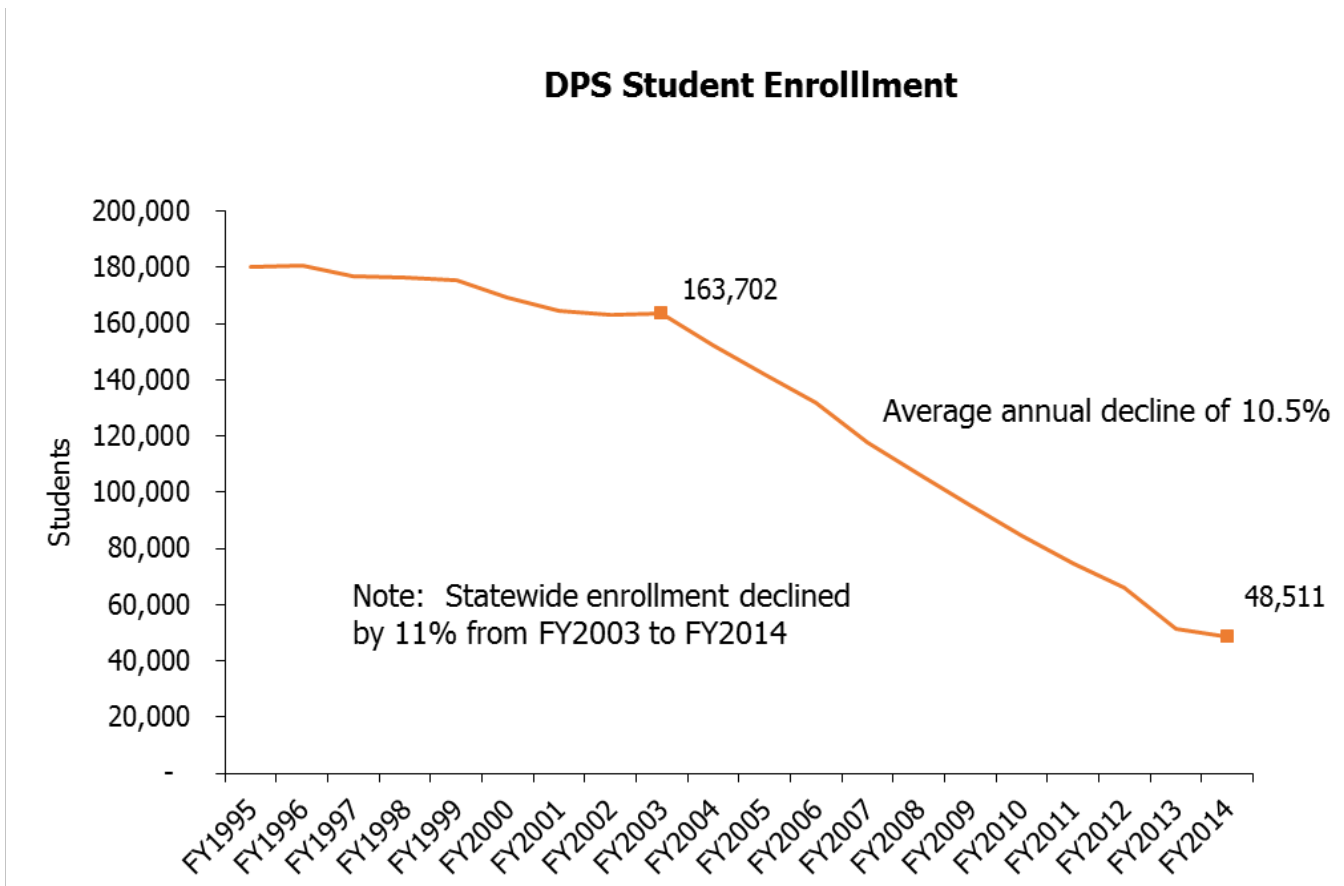
## **Current Situation**

### *Nothing Short of a Crisis*

- Crisis years/decades in the making
- Five state-appointed emergency managers since 2009; each unable to solve financial problem
- Academic performance at bottom
- General Fund deficit balloons from \$83M (FY2012) to \$335M (FY2016)
- Legacy debts total \$440M at start of this year
- April cash shortage averted, but lays dormant
- DPS continues to hemorrhage students (revenue)
- Aging and deteriorating capital facilities

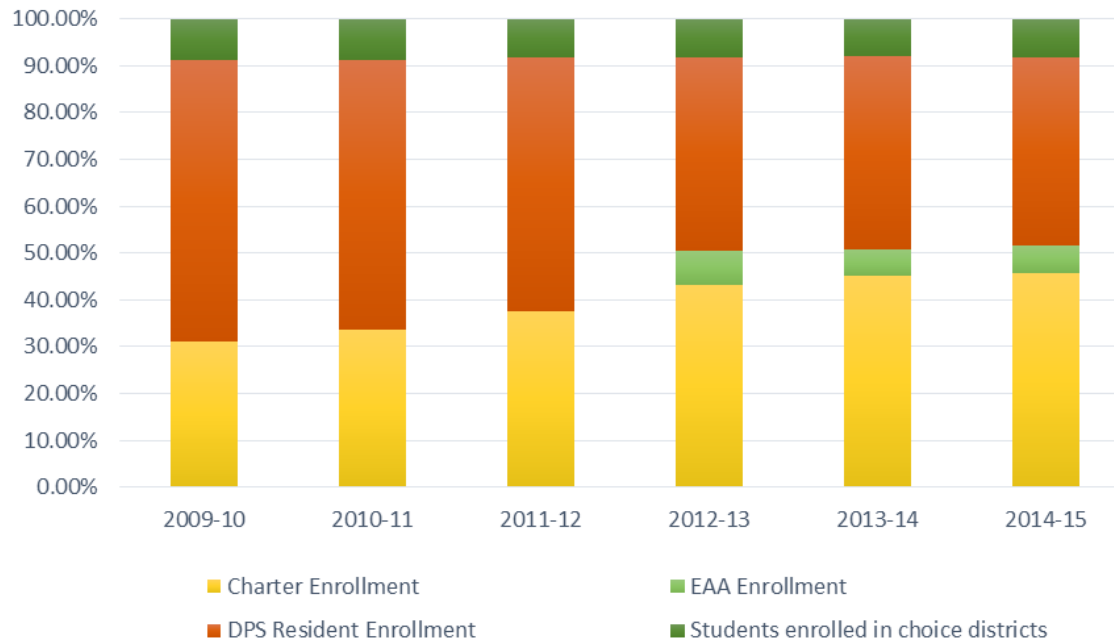
# Enrollment Plummets 70% Since FY03

## *Declining Enrollment Since Early 1970s*



# Expanding School Choice in Detroit

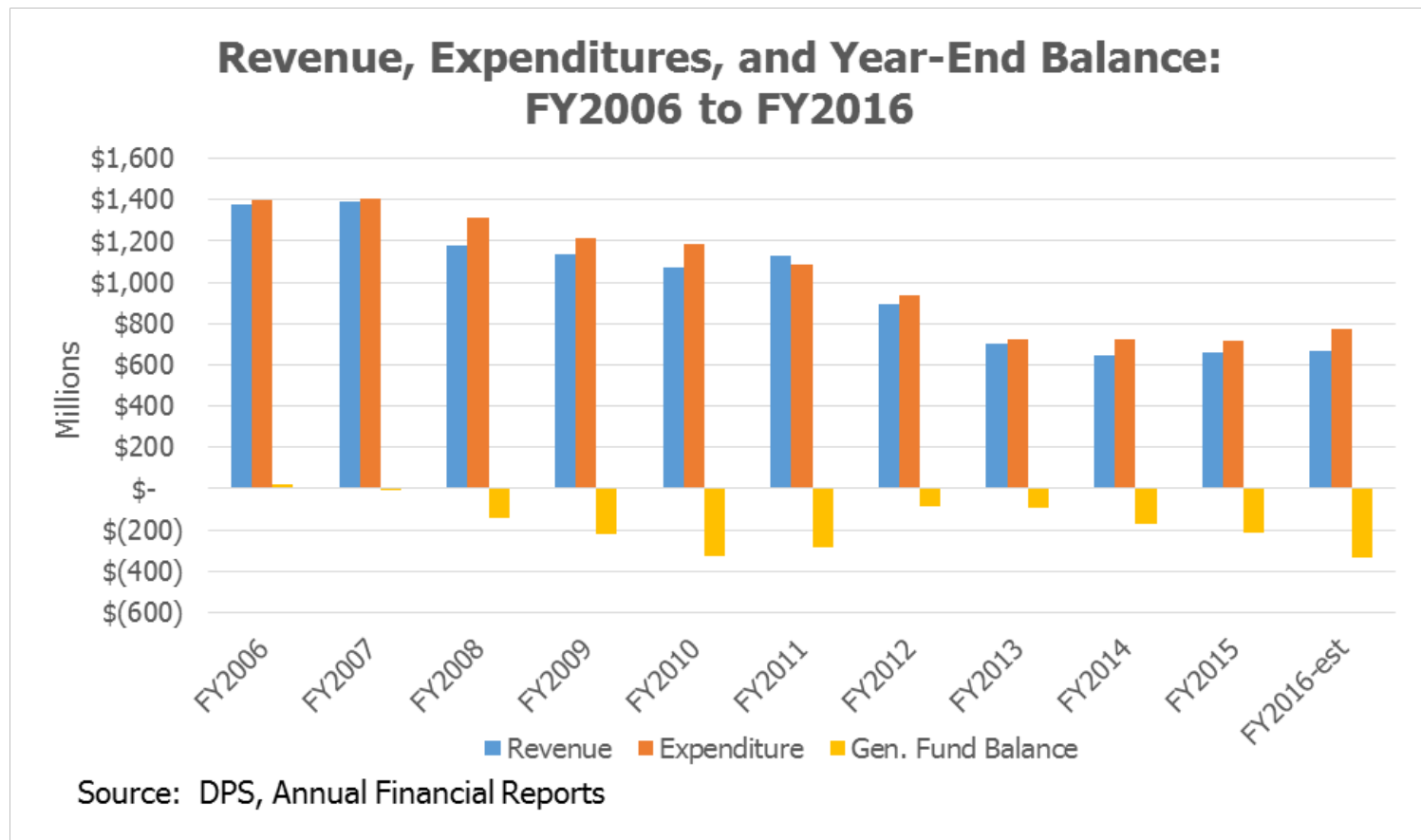
Enrollment Type as % of Total Detroit Public School Enrollment



*Charters Educate More Detroit Children Than DPS*

# Spending Declines, but Not Fast Enough

## *District Overspent Nine of Last Ten Years*

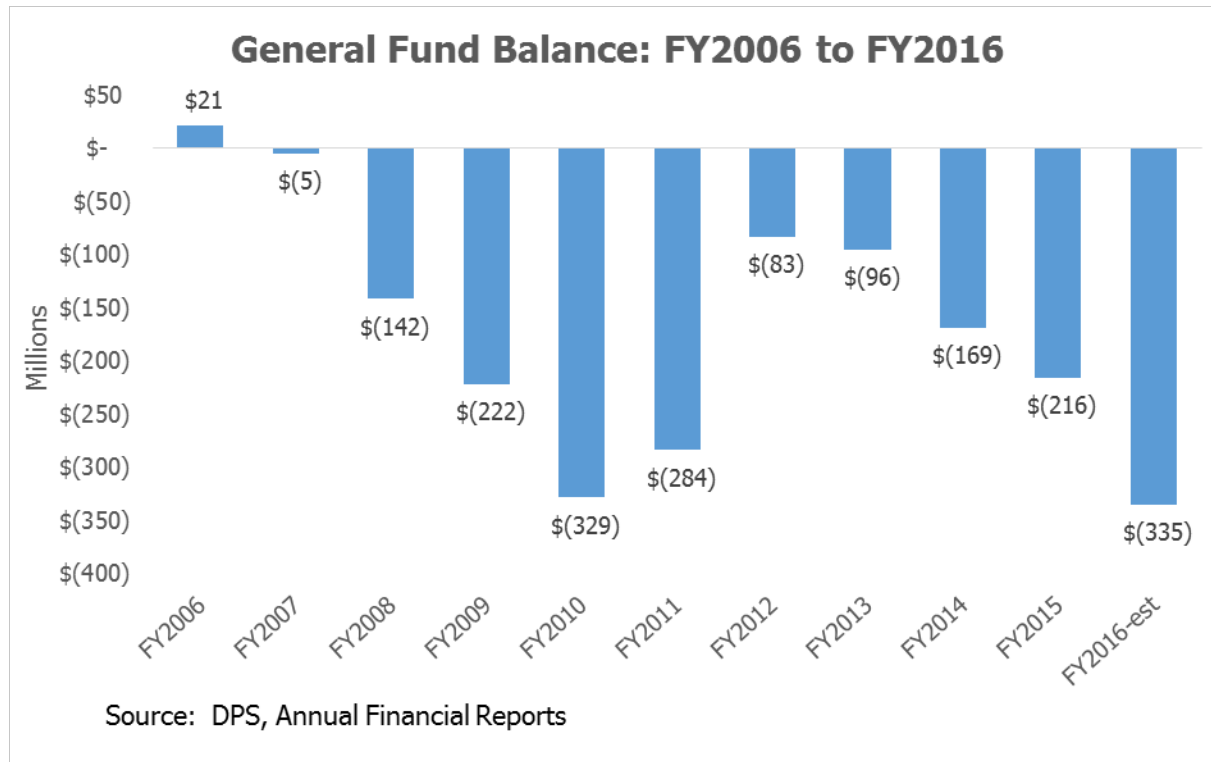


# Challenges of Managing Down

## *School Spending is Sticky in Short Run*

- Michigan school funding model is based on enrollment – per-pupil foundation (\$7,391)
  - Accounts for two-thirds of operating revenue
  - Declining enrollment – revenue declines faster than spending pressures
- Public education is a personnel-intensive endeavor
  - 60% of district GF budget is instruction
- Short run, instructional costs are sticky as student losses are spread across buildings and classrooms
  - Districts are required to have balance budgets

# Deficit Grows Every Year



*\$231M in Bonds Issued to Pay Down FY2011 Deficit*



# Legacy Costs

*Mostly Unfunded Pension Benefits*

|  | <b>Amount</b><br><b>(\$millions)</b> |
|--|--------------------------------------|
| <b><u>Operating Liabilities - Legacy Costs</u></b>             |                                      |
| MPSERS - Pension Unfunded Actuarially Accrued Liability (UAAL) | \$ 872.7                             |
| MPSERS - Retiree Health UAAL                                   | 443.8                                |
| Delinquent MPSERS payments                                     | 80.9                                 |
| Termination Incentive Plan - UAAL                              | 16.6                                 |
| <i>Subtotal - Legacy Costs</i>                                 | <u>\$ 1,414.0</u>                    |

# Operating Debts

*Mainly Refinanced Cash Flow Borrowings*

| <b><u>Operating Liabilities - Debts</u></b>   | <b><u>Amount<br/>(\$millions)</u></b> |
|---|---------------------------------------|
| Refinanced 2005 and 2011 cash flow borrowings | \$ 259.2                              |
| Refinanced 2014 cash flow borrowing           | 82.8                                  |
| 2015 cash flow borrowing                      | 121.0                                 |
| <i>Subtotal - Debts</i>                       | <u>\$ 463.0</u>                       |

# Total Debts of \$3.5B

## *Operating Liabilities of \$1.9B*

### Detroit Public Schools Legacy Costs and Other Liabilities, 2015 (Dollars in millions)

| <u>Operating Liabilities</u>                                   | <u>Amount</u>        |
|--|----------------------|
| MPSERS – Pension Unfunded Actuarially Accrued Liability        | \$872.7              |
| MPSERS – Retiree health Unfunded Actuarially Accrued Liability | 443.8                |
| Delinquent MPSERS payment (principal and interest)             | 80.9                 |
| Termination Incentive Plan – UAAL                              | 16.6                 |
| Refinanced 2005 and 2011 cash flow borrowings                  | 259.2                |
| Refinanced 2014 cash flow borrowing                            | 82.8                 |
| 2015 cash flow borrowing                                       | <u>121.0</u>         |
| <i>Subtotal – operating liabilities</i>                        | <i>\$1,877.0</i>     |
| <br><u>Capital Liabilities</u>                                 |                      |
| “Qualified” general obligation bonds                           | 1,452.1              |
| School Loan Revolving Fund loan (principal and interest)       | <u>198.7</u>         |
| <i>Subtotal – capital liabilities</i>                          | <i>\$1,650.8</i>     |
| <br><b>Total</b>   | <br><b>\$3,527.8</b> |

Source: Comprehensive annual financial reports of Detroit Public Schools from multiple years, comprehensive annual financial reports of the Michigan Public School Employees Retirement System, official prospectuses for various borrowings by Detroit Public Schools, and State of Michigan sources. Information is reported for the most recent fiscal year (FY2015) when available.

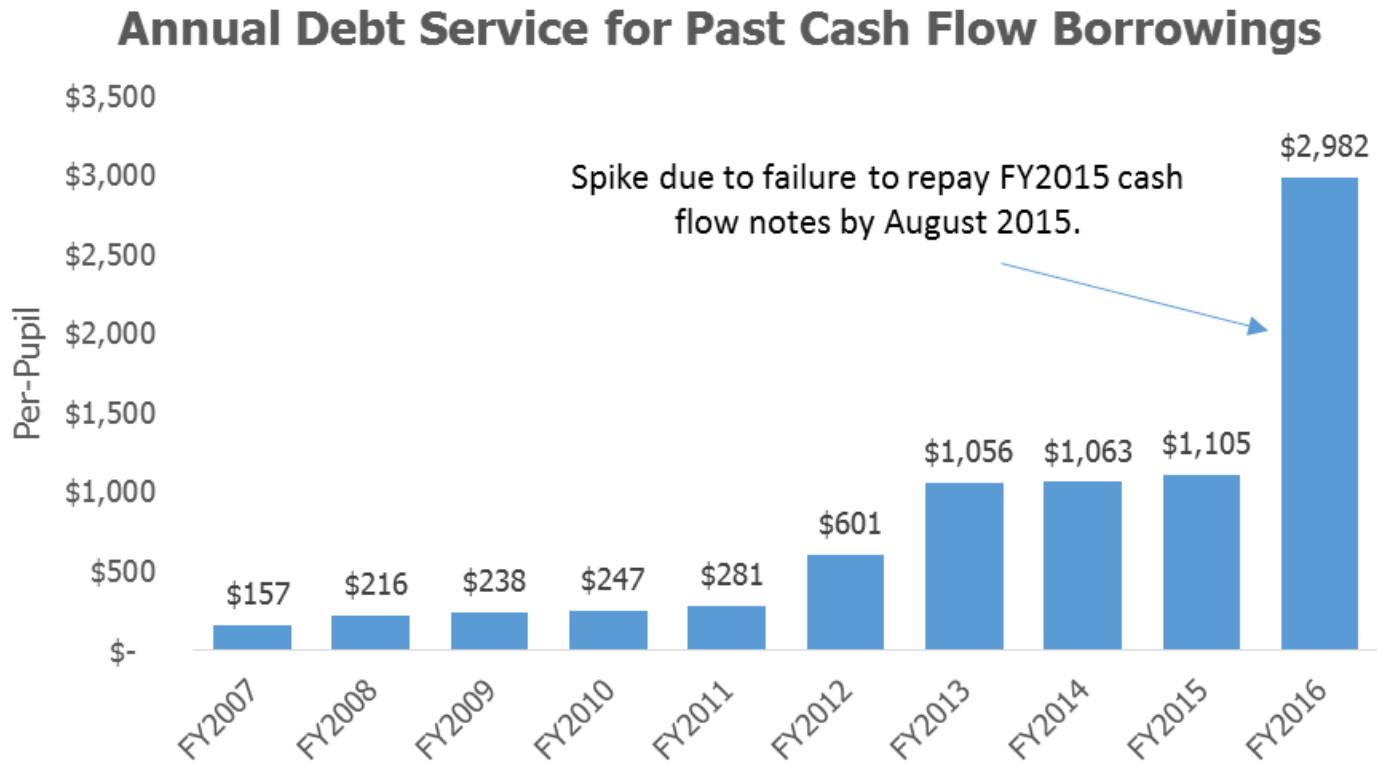
# Emergency Managers' Responses

## *Convert Short-Term Debt to Long-Term Debt*

- DPS run by the State of Michigan since 2008
- Unable to address the structural imbalance in DPS finances, officials have repeatedly pushed costs into the future, examples:
  - 2009 – Termination Incentive Plan
  - 2011 and 2015 – Refinanced cash flow notes
  - 2015 – Unpaid pension contributions
- Additionally, growing legacy costs for retired employee benefits associated with state system
- Result: Costs being borne by current students

# Per-Pupil Debt Service Payment Grows

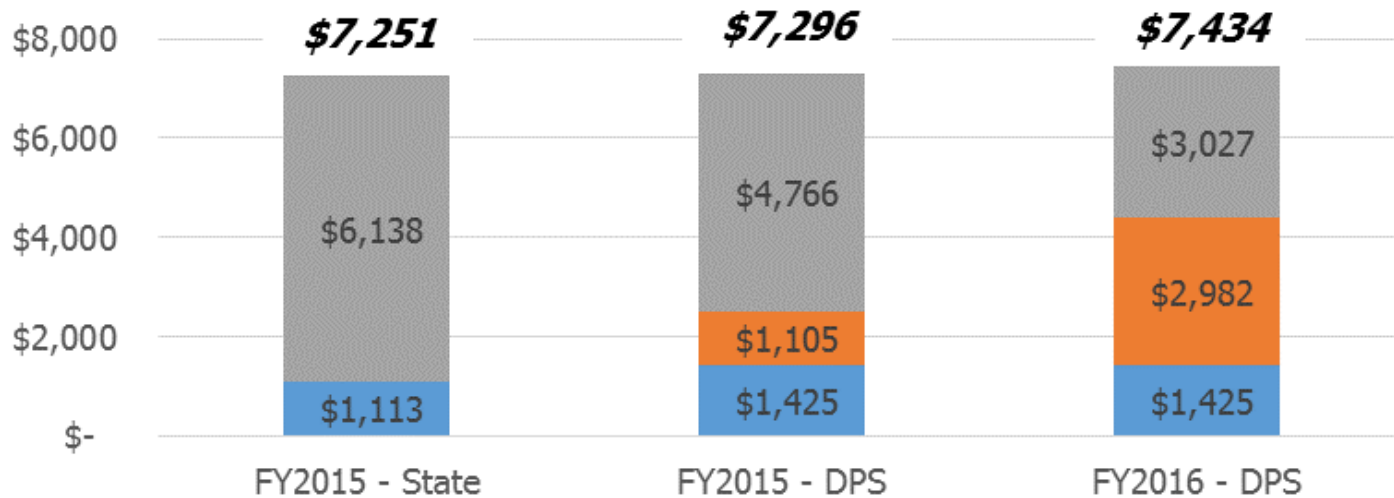
## *Additional Debt and Declining Enrollment*



# Legacy Costs and Debt Service

*Account for 60% of Per-Pupil Grant in FY2016*

**Allocation of Per-Pupil Foundation Allowance**



Allocated For:

- employee legacy costs
- debt service
- current operations

## Assessment of Financial Situation

- Emergency manager law not effective for DPS
- Current students paying price for past decisions
- Financial solution will have to involve substantial additional state resources
- At least three major problems must be addressed to set up the district for long-term success: financial, academic, and governance
- Waiting for legislative response
- Time to act was YESTERDAY!

# Legislative Response

## *Cash Crisis Averted*

- DPS faced cash shortage in early April
- \$48.7M appropriation approved to get thru this school year
  - Cash shortage will occur again next year if operating debts not repaid
- Relieved some immediate pressure
- Longer-term reforms still being worked out – financial, governance, academic



# Senate Proposal

## *"Old Co./New Co. Model"*

- Split DPS into two entities
  - Same model used in other distressed districts
  - Old district – exists only to repay \$717M debts
  - New district – educate students
- **Community School District** - elected board
- Under review of **Financial Review Commission**
- Creates **Detroit Education Commission**
  - Responsible for siting new schools in Detroit
- Creates a new **A-F Accountability System** for all Detroit schools
- **House** plan still in works

## **If the Legislature Fails to Act** *Bankruptcy Likely Only Option*

- Options not on table - dissolution, “charterize”
- Chapter 9 is an option under EM law
- Unlike City of Detroit, nearly all of DPS’s \$1.9B operating debts are backed by State of Michigan
  - \$1.3B unfunded retirement liabilities fall to other districts and state
  - Various cash flow borrowings issued by Michigan Finance Authority
- Capital debt/loans (\$1.7) secured by property tax
- Either way, state responsible for DPS debts

# Structural Challenges

*Even if Debts Settled, Other Issues Remain*

- Declining student enrollment likely to continue
- DPS covers 140 sq. miles (~100 schools)
- Employee legacy costs equal to 21% of payroll
- Structure of school funding model
- High concentration of at-risk and special education students
- Financing capital facilities is a local responsibility
- Term limits and prospects for a long-term fix