CRC MEMORANDUM

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The Fiscal Condition of the City of Detroit

The "Great Recession" that began in December, 2007 has exacerbated the effects of population loss, poverty, and disinvestment on the City of Detroit. The tax base, already stressed, has deteriorated significantly, as the number of businesses and jobs has declined, unemployment has increased, and population has dwindled. The recently published Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2007-08 (FY2008) indicates that the city's general fund deficit increased from $155.6 million at the end of FY2007 to $219.2 million at the end of FY2008. (For purposes of preparing the FY2010 budget, prior to the availability of the FY2008 CAFR, the city had estimated that the FY2008 general fund accumulated deficit had declined slightly, to $155.0 million.) No CAFR is available for FY2009, but city officials budgeted a $280 million prior years accumulated deficit for FY2010 (based in part on the underestimated 2007-08 deficit), and they estimate the current year general fund operating deficit to be in the range of $80 to $100 million. The Crisis Turnaround Team appointed by Mayor Bing to assess city operations and make recommendations estimated that, absent major changes, the average annual (structural) budget deficit for Fiscal Years 2010 through 2012 would be $260 million, and the accumulated deficit would grow to $750 million by the end of FY2012.

The Economic Base

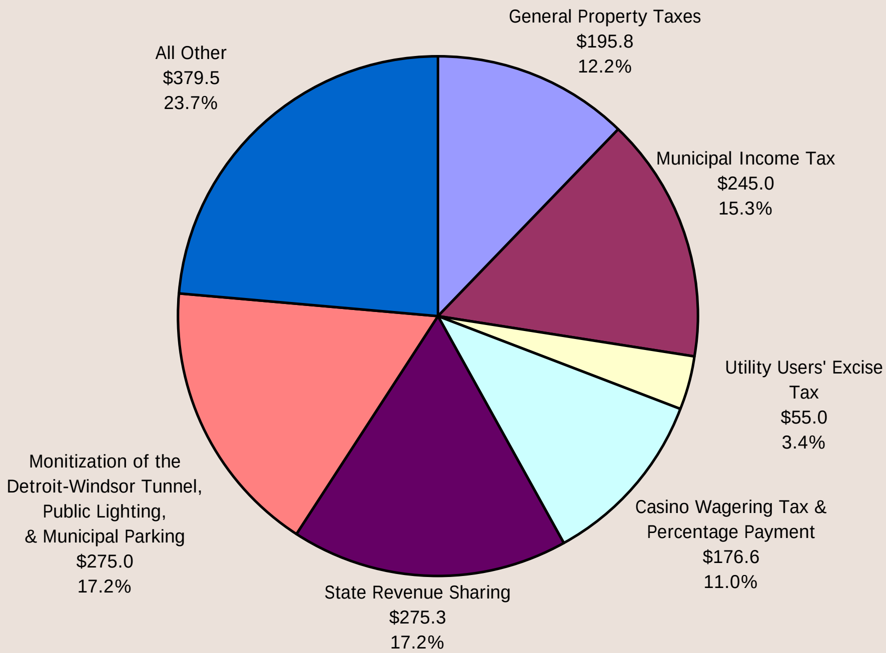
The deterioration of the economic base of the city has accelerated. There were an estimated 81,754 vacant housing units (22.2 percent of the total) in Detroit before the recession; that number increased to an estimated 101,737 (27.8 percent of the total) in 2008. The foreclosure crisis has exacerbated the problem: the U.S. Department of Housing and Urban Development was among the ten largest property taxpayers in Detroit in FY2008. The average price of a residential unit sold in the January through November, 2009 period was $12,439, down from $97,847 in 2003. Remaining businesses and individuals are challenging property tax assessments on parcels that have lost value and, in some cases, cannot be sold at any price. Proposal A guarantees that any recovery in real estate values will be reflected in tax levies on only a limited basis (at a maximum annual growth rate of the lesser of five percent or the rate of inflation).

More than half of employed city residents work outside the city limits; the metro area has the highest unemployment rate of the 100 major metro areas in the U.S. Detroit residents are 82.7 percent Black, 11.1 percent White, and 6.9 percent Hispanic or Latino. They are significantly less likely than the national average to have completed high school (23.9 percent without a high school diploma in Detroit compared to 15.1 percent in the U.S.) or earned a Bachelor's degree (10.8 percent in Detroit compared to 27.7 percent in the U.S.). They are less likely to be in the labor force (55.3 percent in Detroit compared to 65.9 percent in the U.S.) and more likely to live in poverty (33.3 percent in Detroit compared to 13.2 percent in the U.S.).

Revenues

Detroit has a more diversified tax revenue base than any other Michigan city. The tax burden on residents is comparatively high, especially on middle and higher income households, and includes property, income, and utility users' taxes. (Only 22 Michigan cities impose a municipal income tax; no other Michigan city imposes a utility users' excise tax or casino wagering tax.) Six major revenue sources provide 76 percent of Detroit's general fund revenues included in the budget's fiscal plan for FY2010 (See **Chart 1**).

Chart 1
Major Revenue Sources in the City of Detroit FY2010 Budget (Dollars in Millions)



Source: City of Detroit FY2010 Budget

At the time the budget was prepared, the tax revenue estimates were not out of line for this shrinking city in normal times. However, the extreme effects of the restructuring of the auto industry, including massive layoffs, plant closures, and extended suspension of production, have had a disproportionate effect on Detroit. All major tax revenues will be below budgeted levels, significantly so in some cases.

State revenue sharing was budgeted at an amount equal to the prior year budget, but state budget problems will result in reductions that could add $40 million or more to the projected deficit.

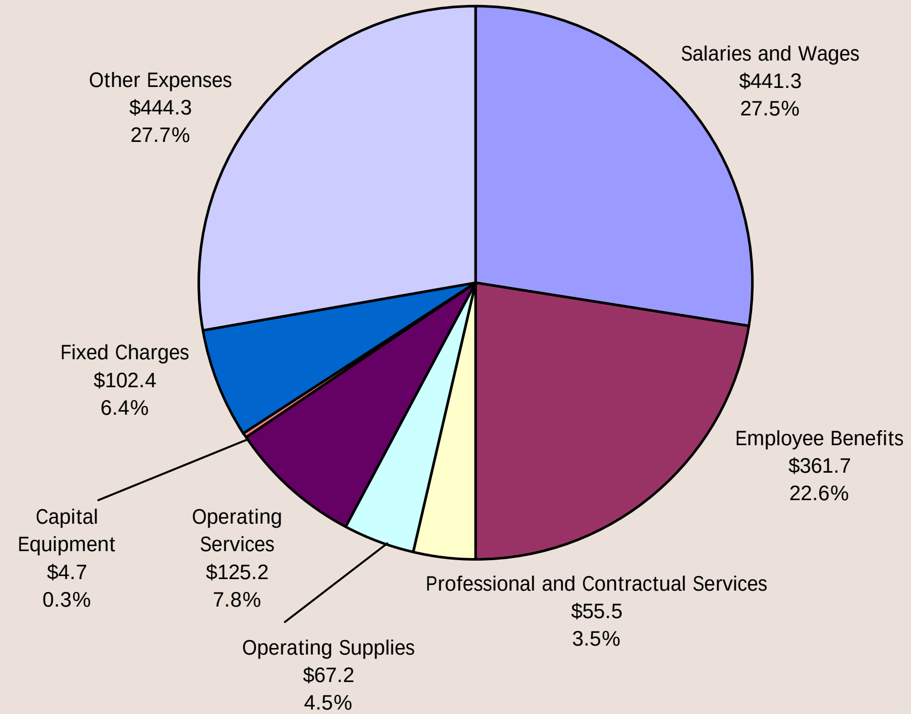
The city budgeted $275 million as revenue from the monetization of assets. Although there is precedent for the sale of future revenue streams in other cities and states (Chicago leased the Chicago Skyway Toll Road and parking meters, and tried but failed to lease Midway Airport), it is highly unlikely that Detroit can sell future revenues from the parking and lighting departments. Discussions on the Detroit-Windsor Tunnel have occurred, but, even if an agreement were to be reached, the sale would not generate the amount included in the budget. These three revenue items were included to balance the $280 million estimated prior years deficit, which had to be budgeted as an appropriation in the current year. There was no realistic plan in the budget to address that accumulated deficit.

Expenses

The general fund budget includes the appropriations summarized in **Chart 2.**

As Detroit has lost population, the number of city government employees has declined. In 1951, the city government had 29,004 employees; in 1989, there were 20,036 city government employees. The 2009-10 budget includes 14,539 full time equivalent positions, of which about 13,000 are filled. About 9,000 of these are in the general and transportation funds, and half are uniformed police and fire employees.

Chart 2
Appropriations by Major Classification, City of Detroit General Fund, FY2010 (Dollars in Millions)



Source: FY2010 City of Detroit Budget

The Potential Deficit

The city could well end the year with an accumulated deficit that is over a quarter of the total $1.6 billion general fund:

Budgeted prior years accumulated deficit	$280 million
Estimated increase in prior years accumulated deficit	$46 million
Estimated current year general fund operating deficit	$80-$100 million
Potential state revenue sharing shortfall	$40 million
Possible general fund deficit	$446-$466 million

Personnel costs are 50.1 percent of all general fund appropriations. The plan for reducing expenditures includes a ten percent wage cut and layoffs. If laid off employees earn salaries in the $30,000 to $50,000 range and if civilian pension and fringe benefit costs are 65 percent of salaries, about $66,000, less unemployment benefits, could be saved per laid off employee in the first full year. One thousand layoffs would therefore produce a savings of $66 million, less unemployment benefits, in the first full year of the layoff. Because the city's fiscal year started on July 1, the longer the delay in laying employees off, the larger the number of layoffs must be to accomplish required savings.

The general fund includes an appropriation of over $80 million to support the Department of Transportation, which operates a bus system within the city limits (there is a separate suburban bus system funded by a voter approved, dedicated property tax). Although it is technically an enterprise agency, layoffs in the Department of Transportation will reduce the general fund subsidy and, therefore, the general fund deficit.

Potential Solutions

Clearly, the city government cannot afford to remain at its present size. There are four ways the government can downsize:

- The elected mayor and city council can develop and implement required changes.
- The mayor and city council can implement changes specified in a consent agreement reached with a review team appointed by state officials under the Local Government Fiscal Responsibility Act
- An emergency financial manager appointed under the Local Government Fiscal Responsibility Act can negate the authority of the mayor and city council, can implement changes, and can renegotiate (but not abrogate) contracts.
- If an emergency financial manager recommends, and the state approves, reorganization and restructuring can occur under protection of bankruptcy, which does allow contracts to be abrogated. No Michigan municipality has ever filed under federal bankruptcy laws.

In order to address what could be an accumulated general fund deficit exceeding $400 million, Detroit city government must be restructured. The new structure must reflect both the reduced tax base and the limited ability of state government to provide shared revenues. Restructuring will necessitate process improvements, load shifting, load shedding, privatizing, concentrating service delivery on an area smaller than 138 square miles, and other strategies. The most recent Crisis Turnaround Team has recommended closing facilities, privatizing services, improving and centralizing processes, renegotiating contracts, improving debt collection, restructuring debt, and other actions. It remains to be seen whether the city's elected officials will be able to implement these recommendations.