

City of Detroit

CITY COUNCIL

IRVIN CORLEY, JR.
DIRECTOR
(313) 224-1076

FISCAL ANALYSIS DIVISION
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 218
Detroit, Michigan 48226
FAX: (313) 224-2783
E-Mail: irvin@cncl.ci.detroit.mi.us

ANNE MARIE LANGAN
DEPUTY DIRECTOR
(313) 224-1078

TO: CITY COUNCIL MEMBERS

FROM: Irvin Corley, Jr., Fiscal Analysis Division Director *ICJ*

DATE: November 21, 2011

RE: City Council's Plan to Address the City of Detroit's Cash Crisis and Structural Deficit

Why are we here

- After the City received \$250 million in fiscal stabilization bonds in March 2010, the City had a cash balance of \$280 million.
- By June 30, 2011, the City had only \$13 million left to spend, meaning the City missed the opportunity to reduce expenditures, improve existing revenue streams and find new revenue streams to provide more cash to support expenditures.
- The major reason why the current fiscal year 2011-2012 starts with a \$95 million cash balance is due to the receipt of \$55 million in delinquent property tax receipts from Wayne County and the receipt of \$20 million from the DTE Escrow Account (a one-time revenue).
- Meanwhile, the City continues to spend more money than it receives. For the last three years, the City has spent almost \$100 million more than received each year. Spending more than collecting in revenue leads to a structural deficit.

City of Detroit's Structural Deficit

- The City's structural deficit could reach \$140 million this fiscal year if nothing is done to reduce spending or provide more revenues.

- The structural deficit is made up of the following:

Projected cumulative net cash flow for 2011-12	(\$73.4) million
Risk adjustments for 2011-12	(66.1) million
Structural deficit (risk adjusted) for 2011-12	(\$139.5) million

- Risk adjustments include the following - the City will spend more on DDOT than is budgeted; City Council's reductions in 2011-2012 are not being implemented in total; revenue collections from income tax and parking boot initiatives are not materializing.

City of Detroit's Cash Crisis

- The City's cash crisis is depicted as follows:

Beginning cash flow balance at July 1, 2011	\$95.3 million
Cumulative net cash flow for 2011-12 based on estimated operating receipts, disbursements, pension obligation bond and other debt payments	(\$73.4) million
Ending cash balance at June 30, 2011	\$21.9 million
Risk adjustments	(\$66.1) million
Projected ending cash balance (risk adjusted) at June 30, 2011	(\$44.2) million

- Based on this level of overspending, the City runs out of cash by April 2012.

Making the case for the need of layoffs and concessions now to address cash flow crisis

- 60% of the City's budget is employee-related costs (salary and benefits).
- The City has significant debt outstanding and high legacy cost (pension and health care cost for active employees and retirees).
- This leaves little room to reduce cash outflows.
- It should also be noted that of the 7,300 general fund employees, 3,900 of them are uniform employees and 3,400 of them are civilian employees.

City Council's short term solution considerations to immediately address cash crisis and structural deficit this year

- These solutions were derived primarily by the joint committee established by the Fiscal Analysis Division. The joint committee comprised of
 - * Councilman Kenneth Cockrel, Jr., Chair of the Budget, Finance and Audit Committee
 - * Council President Pro Tem Gary Brown
 - * Irvin Corley, Jr., Fiscal Analysis Division Director
 - * Jerry Pokorski, Financial Consultant for Fiscal Analysis
 - * Mark Lockridge, Deputy Auditor General
 - * Chris Brown, Chief Operating Officer
 - * Cheryl Johnson, Group Executive-Finance Director
 - * Coit Ford, Chief Policy Analyst for Councilman Cockrel
 - * Representatives of the Ernst & Young accounting firm
- It should be noted that short term solutions must include both layoffs and concessions to provide the most dollar savings and minimize the number of layoffs.
- But having said that, a large number of layoffs cannot be avoided due to the City's huge cash crisis and structural deficit.

<u>- Scenario 1- 1700 Layoffs plus 100% union concessions:</u>	<u>Cash Savings</u>	<u>Cash Balance</u>
1. 1,700 layoffs -5 months savings	\$23.5 million	
2. 10% uniform pay cut (civilians already under 10% cut)	13.5 million	
3. Medical concessions -active	7.4 million	
4. Medical concessions -retiree	8.3 million	
5. Work rules - 50% of Administration's estimate	10.0 million	
6. DPS receipt	15.0 million	
7. DDOT outsource	9.5 million	
Total savings	<u>\$87.2 million</u>	
Total savings from Scenario 1		\$87.2 million
Ending cash balance (risk adjusted) at June 30, 2011		(44.2) million
New ending cash balance at June 30, 2011		<u>\$43.0 million</u>

- All estimated savings have been projected by the Administration with Ernst and Young.
- Even with 1,700 layoffs, 10% uniform pay cut, and 100% union concessions, the City ends up with a \$43 million cash balance.
- Ideally, the ending cash balance should be about 15% of operating revenue, which is \$180 million.
- \$43 million cash balance is not even 5% of operating revenue, which is \$60 million.
- Mayor Bing's plan (see Attachment I) includes 1,000 layoffs, 10% uniform pay cut, 100% union concessions, and other to end up with \$118 million in savings.
- But when you back out \$20 million to come from a restoration of the 3% resident, 1.5% non-resident, and 1.9% corporate income tax rates; \$10 million from work rules (he had \$20 million); and \$12 million from vendors 10% cut (the City is behind on vendor payments), the City ends up with a \$33 million cash balance.

<u>- Scenario 2- 2300 layoffs & No union concessions:</u>	<u>Cash Savings</u>	<u>Cash Balance</u>
1. 2,300 layoffs - 5 months savings	\$36.4 million	
2. 10% uniform pay cut (civilians already under 10% cut)	0.0 million	
3. Medical concessions -active	0.0 million	
4. Medical concessions -retiree	0.0 million	
5. Work rules	0.0 million	
6. DPS receipt	15.0 million	
7. DDOT outsource	9.5 million	
Total savings	<u>\$60.9 million</u>	
Total savings from Scenario 2-no union concessions		\$60.9 million
Ending cash balance (risk adjusted) at June 30, 2011		(44.2) million
New ending cash balance at June 30, 2011		<u>\$16.7 million</u>

- Obviously, a \$16.7 million end cash balance is essentially razor thin with 2,300 layoffs and no concessions.

- Scenario 3- 2300 layoffs & 100% union concessions):	<u>Cash Savings</u>	<u>Cash Balance</u>
1. 2,300 layoffs -5 months savings	\$31.8 million	
2. 10% uniform pay cut (civilians already under 10% cut)	13.5 million	
3. Medical concessions -active	5.9 million	
4. Medical concessions -retiree	8.3 million	
5. Work rules	10.0 million	
6. DPS receipt	15.0 million	
7. DDOT outsource	9.5 million	
Total savings	<u>\$94.0 million</u>	
Total savings from Scenario 3-100% union concessions		\$94.0 million
Ending cash balance (risk adjusted) at June 30, 2011		(44.2) million
New ending cash balance at June 30, 2011		<u>\$49.8 million</u>

- Although ending cash is better, the City still ends up with cash below 5% of operating revenue, or \$60 million, under Scenario 3.
- Please note that the removal of subsidies to airport, DIA, Historical, Eastern Market, Zoo, AAHM, Ethics, EDC and DEGC saves about \$5 million in the current fiscal year.
- Council should also get a tally of the number of retirements since July 1, 2011, which has escalated, and should reduce the number of layoffs needed; but probably not substantially.
- Other short term solutions from Council members
- Councilwoman Watson:
 1. Receive \$220 million in state revenue sharing the State owes Detroit.
- Councilman Kenyatta (see Attachment II).
- Councilman Spivey (see Attachment III).

City Council's mid term solution considerations to address cash flow and structural deficit next year

- Please remember, structural deficit has ranged from \$100 million to \$140 million in recent years.
- Using the scenarios above as the basis, the savings are annualized.

- Scenario 1-1700 Layoffs & 100% union concessions):	<u>Annualized Cash Savings</u>	<u>Cash Balance</u>
1. 1,700 layoffs	\$77.9 million	
2. 10% uniform pay cut (civilians already under 10% cut)	27.0 million	
3. Medical concessions -active	29.4 million	
4. Medical concessions -retiree	33.1 million	
5. Pension-active	15.0 million	
6. Pension-retiree	10.0 million	
7. Work rules	20.0 million	
8. DPS receipt	0.0 million	
9. DDOT outsource	30.0 million	
Total savings	<u>\$242.4 million</u>	
Total annualized savings from Scenario 1		\$242.4 million
2011-12 structural deficit		(140.0) million
Year ending cash balance		<u>\$102.4 million</u>

- If overspending of \$100 million plus does not stop, the "cushion" in 2013 goes away.
- The large number of layoffs and concessions are necessary to appropriately address structural deficit

-Scenario 2- 2300 layoffs & no union concessions):	Annualized Cash Savings	Cash Balance
1. 2,300 layoffs	\$114.5 million	
2. 10% uniform pay cut (civilians already under 10% cut)	0.0 million	
3. Medical concessions -active	0.0 million	
4. Medical concessions -retiree	0.0 million	
5. Pension-active	0.0 million	
6. Pension-retiree	0.0 million	
7. Work rules	0.0 million	
8. DPS receipt	0.0 million	
9. DDOT outsource	30.0 million	
Total savings	<u>\$144.5 million</u>	
Total annualized savings from Scenario 1		\$144.5 million
2011-12 structural deficit		<u>(140.0) million</u>
Year ending cash balance		\$4.5 million

- This scenario leaves no room for overspending.

-Scenario 3- 2300 Layoffs & 100% union concessions):	Annualized Cash Savings	Cash Balance
1. 2,300 layoffs	\$103.5 million	
2. 10% uniform pay cut (civilians already under 10% cut)	27.0 million	
3. Medical concessions -active	23.5 million	
4. Medical concessions -retiree	33.1 million	
5. Pension-active	15.0 million	
6. Pension-retiree	10.0 million	
7. Work rules	20.0 million	
8. DPS receipt	0.0 million	
9. DDOT outsource	30.0 million	
Total savings	<u>\$262.1 million</u>	
Total annualized savings from Scenario 1		\$262.1 million
2011-12 structural deficit		<u>(140.0) million</u>
Year ending cash balance		\$122.1 million

- Comments for Scenario 1 apply here.

State (annualized savings):

1. Increase residents income tax rate from 2.5% to 3.0%; non-residents from 1.25% to 1.5%; and businesses from 1.0% to 1.9%. Increase in revenue earmarked for paying off general fund debt.	\$50.0 million	structural change
2. 15% cut in general fund contractual services	\$5.0 million	structural change
3. Health Department shared service	\$6.0 million	structural change
4. ITS data consolidation	\$2.3 million	structural change

3. Health Department shared service	\$6.0 million	structural change
4. ITS data consolidation	\$2.3 million	structural change
5. Space consolidation	\$2.5 million	structural change
6. Release of DTE Escrow	\$1.0 million	one time change
7. Sell of parking revenues		one time change
8. Sell of tunnel rights		one time change
9. Eliminate subsidies	\$5.0 million	structural change
10. Allocation to fix payroll system to implement health care and pension changes	(\$30.0) million	one time fix
11. Ensure enterprise agencies are covering full costs of City services provided to the enterprises.		
Total additional annual cash savings/revenue generation to help address structural deficit	<u>\$41.8 million</u>	

- Long term solutions provided by Fiscal Analysis Division based primarily on review of past blue ribbon reports:
 1. Impose payment in lieu of taxes (PILOT) on non-profits to reimburse City for basic city services
 2. Review solid waste fee to ensure it is covering full cost of refuse collection and disposal services.
 3. Review the use of tax exemptions.
 4. Develop a federal urban agenda, organizing large city mayors and U.S. Congressional delegation to stronger advocates in Congress for cities.
 5. Present a regional sales tax proposal to the tri-county area of Metro-Detroit to fund a regional transit system.
 6. Create a performance based budget that measures outcomes.
 7. Develop a competitive benchmarking model comparing city service delivery externally and internally.
 8. Institute more union participation in city decision making and delivery of services. Reward workers for cost saving ideas.
 9. Develop a plan to transfer more city-owned property to the tax rolls.

Attachments

cc: Council Divisions
 Auditor General's Office
 Kirk Lewis, Chief of Staff
 Chris Brown, Chief Operating Officer
 Cheryl Johnson, Finance Director
 Pamela Scales, Budget Director
 Floyd Stanley, Deputy Budget Director
 Denise Gardner, Mayor's Office

ICJ:\Cash Flow\Council's Plan to Address Cash Flow and Structural Deficit November 2011 Final.xls

Revenue initiatives and cost savings (\$ in millions)

	FY 2012 savings	Annual savings	Ask	Timing
Income tax revenue	\$20m	\$50m	■ Increase residents 2.5% to 3.0%, non-residents 1.25% to 1.5%, and corporations 1.0% to 1.9%	1/1/2012
Debt collection	\$15m	zero	■ Collect outstanding past due receivables	12/1, 1/1, 2/1
Payroll (40% share)	\$13m	\$27m	■ Eliminate furlough days and implement 10% pay reduction	1/1/2012
Medical	\$7m	\$27m	■ Change cost share to 70/30, implement plan changes, phase out more expensive plans (BCBS Traditional, BCBS MM, and US Health)	4/1/2012
Pension (GRS)	zero	\$15m	■ Pension changes not expected to result in cash savings in FY 2012	7/1/2012
Workforce	\$20m	\$40m	■ Allow work out of class at current rates and limit OT to reduce by 50%	1/1/2012
Referrals	\$8m	\$43m	■ Medical (\$33m annual) – Accept same medical changes as active employees ■ Pension (\$10m starting in FY 2013) – Eliminate excess earnings distributions	4/1/2012
DBDP	\$9m	\$30m	■ Outsource management	4/1/2012
Vendors (100% share)	\$12m	\$25m	■ Cut A/P vendor disbursements by 10%	1/1/2012
Sub-total	\$104m	\$257m		
Payroll (40% share)	\$14m	\$45m	■ Savings are net of accrued compensation payouts; unemployment comp of \$9m not included	2/1/2012
TOTAL	\$118m	\$302m		



Talking Points:

Labor Concessions

- The City of Detroit cannot afford to pay its employees under its current compensation model.
- Whether we do it ourselves or someone else does it, City employees will be forced to accept a different pension and benefit model.
- The City operates inefficiently. Work rules prevent our managers from managing.

Public Safety

- The Administration has asked Police for the same 10% pay cut as other Employees. Headcount will only be reduced as a last resort.
- Shot Spotter will assist police in getting where they need to go faster. City council should immediately pass this contract and support DPD in reducing violent crime.

Public Lighting

- The electrical system has deteriorated beyond repair and the streetlights require over 100mm in upgrades. The City cannot afford to do this itself nor does it have the capacity. Working with a private utility is the only viable option.

Busing

- Administration made the decision to return overtime to mechanics to help alleviate the pain the crisis was causing citizens
- There will be a noticeable difference in 30 days. Within 90 days service will be back to acceptable levels. These are the words of Lemon Wilson, president of the mechanics union, to City Council.
- Most Cities do not run their own system. Either the service is outsourced or operated under an independent authority

Emergency Manager

- The Mayor does not want an EM but financial reality may require one. The City needs to cut expenses in order to pay its bills. This is why we are asking labor Unions to help us avoid this scenario by voluntarily offering to open contracts and make them manageable.

Attachment II

City of Detroit CITY COUNCIL

KWAME KENYATTA
COUNCIL MEMBER

PRIVILEGED AND CONFIDENTIAL City of Detroit Revenue Generating Proposals

- 1) Support the recommendations of the Purchasing Working Group by enacting a temporary suspension of equalization incentives for six months and re-evaluate its effectiveness during the budget process of 2012-2013.
- 2) Eliminate furlough days and replace this with an across the board 10% cut for all workers.
- 3) Enter into an agreement with Detroit Public Schools to certify their DPS officers as full-fledged police officers whereupon they would be given the responsibility to police all crime in the neighborhoods near the schools where they are located.
- 4) Enact an emergency ordinance allowing unions to bid on service contracts.
- 5) Close the People Mover on the weekends with the exception of operating during large and special events. Raise the fare to \$1.00 and shut it down after 10pm during winter. Run it only during the peak hours of Monday-Friday.
- 6) Immediately begin a hiring freeze on all new hires except replacements.
- 7) Freeze the purchase of all unnecessary supplies and contracts with vendors.
- 8) Cut the salaries but not the departmental budgets of all police and fire fighters by 10%.
- 9) Reconfigure trash pick up to occur on one-side only.
- 10) Install parking meters at Eastern Market within lots where parking is currently free.
- 11) Merge PDD and Human Rights with DEGC and investigate reprogramming CDBG for DEGC to oversee service providing according to federally established criteria.
- 12) Eliminate all change orders.

City of Detroit

CITY COUNCIL

KWAME KENYATTA
COUNCIL MEMBER

PRIVILEGED AND CONFIDENTIAL

City of Detroit Revenue Generating Proposals continued

- 13) Identify redundancies and cut unnecessary spending in the course of processing city work.
- 14) Obtain input from city workers through an emailed survey to identify other sources of redundancies and waste. If possible, an incentive for workers who successfully assist the city in increasing revenue and/or decreasing costs should be implemented e.g. \$1,000 bonus.
- 14) Institute performance bonds to ensure that contractors complete work expeditiously and that work is done to the market standard. Work that is documented as incomplete or subpar would result in a certain percentage being deducted from the amount owed.
- 15) Create an incentive based health care program for workers to reduce costs where certain lifestyle choices impact the prevalence of particular medical procedures.



MEMO

To: President Charles Pugh
From: Councilman André L. Spivey
Date: November 18, 2011
RE: Proposed Fiscal Fixes

In the City's effort to fix our fiscal issues, it has become apparent that there are really two issues that this Honorable Body and the Mayor must address.

Can we eliminate the City of Detroit's accumulated debt WITHOUT the intervention of the State via the appointment of an emergency manager?

AND

Can we make the structural changes necessary to secure the long-term viability and financial security of the City?

I believe that the answer to both questions is a resounding yes! The mayor identified some major revenue initiatives and cost savings in his November 16th press conference including union and retiree concessions, tax increases, outsourcing, etc. While some of the initiatives may achieve the desired savings, most are likely to be impractical to achieve the short-term savings we require to remain solvent through the remainder of the fiscal year.

Consequently, I am proposing the following initiatives to push us toward resolving both questions, while buying us more time to implement initiatives to address the City's ballooning legacy costs, lopsided union obligations, operational deficiencies and long-term economic viability.

Fiscal Stabilization Bonds

On February 4, 2010, both the Michigan House and Senate passed legislation clearing the way for the City of Detroit to sell up to \$250 million in fiscal stabilization bonds (Public Act 4 of 2010). This legislation allowed for a municipality to sell bonds in excess of the previously capped amount of \$125 million. Given that Governor Snyder has indicated his reluctance to impose an emergency manager on the City of Detroit, the Mayor should request that the state legislature again authorize the sale of additional fiscal stabilization bonds. However, this time for the amount of the entire deficit along with a refinancing of the 2010 bond debt to take advantage of lower interest rates.

The Governor's acknowledgement of the more than \$250 million in revenue-sharing monies promised to Detroit over a decade ago should also motivate the Governor and the Legislature toward this resolution of our accumulated deficit.

For such a measure to be realized, it would, no doubt, have to be accompanied (or preceded) by the achievement of major union concessions such as: workday modifications, deferred compensation initiatives (similar to the DPS arrangement with DFT), conversion to a defined

contribution plan, etc. The City's current deficit elimination plan would have to be modified to include all aspects of our renewed effort.

Union Concessions

Work Day Modifications – Rather than permanently cutting employee salaries by 10% while still requiring them to work a regular 80-hour work week, the creative use of flex-time for workers or a four-day work week should be contemplated. The morale blow to workers who are already being asked to take a 10% pay cut while losing the benefit that a weekday off provides would only make union negotiations even more tense and tedious and ultimately result in a decline in the quality of service provided to citizens.

In addition to work day modifications (i.e. 4 days/week, 10 hours/day), the desired savings could also be achieved through deferred compensation initiatives. For example, the Detroit Public Schools have an arrangement where employees agreed to have a certain portion of their bi-weekly salary deducted and placed into an escrow account where it can be reclaimed upon retirement if they remain with the system.

Public Safety Employees – Given the critical job of our uniformed public safety employees, the mayor should contemplate alternative methods to achieve the savings that a 10% pay cut could provide. The police and fire unions may be far more amenable to volunteering a specified number of hours per week. For example, officers may work a 10 hour day, but be paid for only 8 of those hours. This strategy could alternatively be used to reduce overtime utilization. Are officers willing to volunteer two hours of work time if the City guarantees pay for a full eight-hour work day? This would equal a 10 hour work shift per uniformed employee.

Defined Contribution Plan -- Conversion of employees to a defined contribution plan must be achieved (i.e., all employees with less than five years of service).

Public Lighting

The mayor and Council should hold joint meetings with top non-competitor electric industry professionals to assess the possibility of converting what is now a liability to a generator of significant revenue for the City. An RFP should then be issued for a long-term joint venture/lease agreement with a partner who is willing to manage the system, provide the necessary upgrades and split the net revenue on, perhaps, a 60/40 basis.

Buses

The City of Detroit can no longer afford to subsidize a transportation system. Right-sizing of the department through management outsourcing, maintenance outsourcing and union concessions could make the department more attractive to those seeking to merge DDOT into a regional transportation authority. Enticing other entities into partnership in an independent authority may also be eased if the City provides to the authority the same subsidy that we currently provide to DDOT for the first year or two.

Of course, all of these suggestions ultimately require savings projections accompanied by timelines in order to gauge their potential to provide timely cost savings. I am optimistic that Mayor Bing will continue to work closely with the City Council to provide us all of the information necessary to work together to both resolve our impending cash flow shortfall and leave the legacy of a viable and vibrant Detroit.

Cc: Robbie Jabtecki, City Council Committee Clerk, City Clerk's Office
Irv Corley, Fiscal Analyst, Detroit City Council
Colleagues