# Recovery Process for Two Financially Distressed Cities

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Washington DC Financial Control Board and the City of Detroit Financial Emergency

# Congress Asked GAO To Review Causes of Financial Crisis In DC

- Review and testimony focused on several areas
  - What gave rise to DC's financial crisis?
  - Why wasn't the crisis detected and reported by DC's external auditor?
  - How did other financially troubled cities address their financial crisis?
    - New York

- Philadelphia
- Cleveland
- How should the Congress respond to City's financial crisis?

# District of Columbia What Caused the Financial Crisis

- Declining population and revenue no strategies to adjust budget
- Government was bloated

- Disconnect between available cash and budget authority
  - DC General Hospital loans were really subsidies
  - Changing property tax year created budget revenue but no cash to fund expenditures
  - Poor collection of taxes No one took tax enforcement seriously
  - Looming unfunded pension liability
- Services deteriorating
- Lengthy and ineffective procurement process

# **Creation of Control Board Act**

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- Created a Board of 5 people appointed by the President of the U.S.
  - All the powers of previous control boards from other cities and the power to pass or reject laws of the District of Columbia Council
  - Power to declare any position no longer needed
  - Power to create a staff of professionals led by an Executive Director
- Created a CFO appointed by Mayor with advice and consent of Control Board
  - Once appointed, could only be removed by Control Board
  - All financial staff of City reported to and served at pleasure of CFO
  - Independent from Mayor, and has the last word on revenue estimation, financial impact of legislation, and whether budget was balanced. Position continues to this day

# Creation of Control Board Act (cont.)

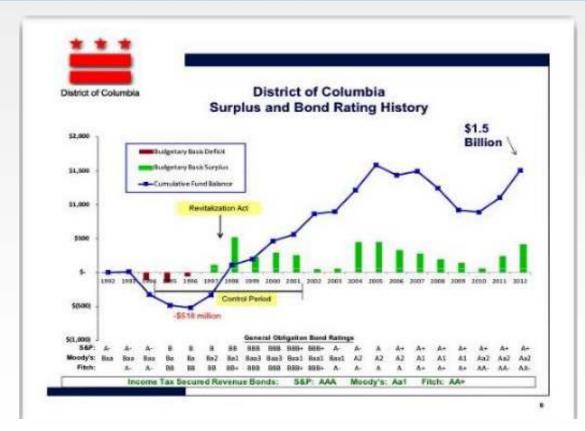
- Set criteria to meet in order for Control Board to sunset
  - 4 years of balanced budget

- 4 years of unqualified audit opinions
- Repayment of all borrowings from Treasury
- Ability to meet all obligations in the normal course of business
- Control Board sunset was about 6 years after its creation
- Control Board will be called up again if any of the issues mentioned in the criteria reoccur
- Independent CFO remains with all financial staff at will and independent authority to set revenue projection



# Financial Results of Control Period

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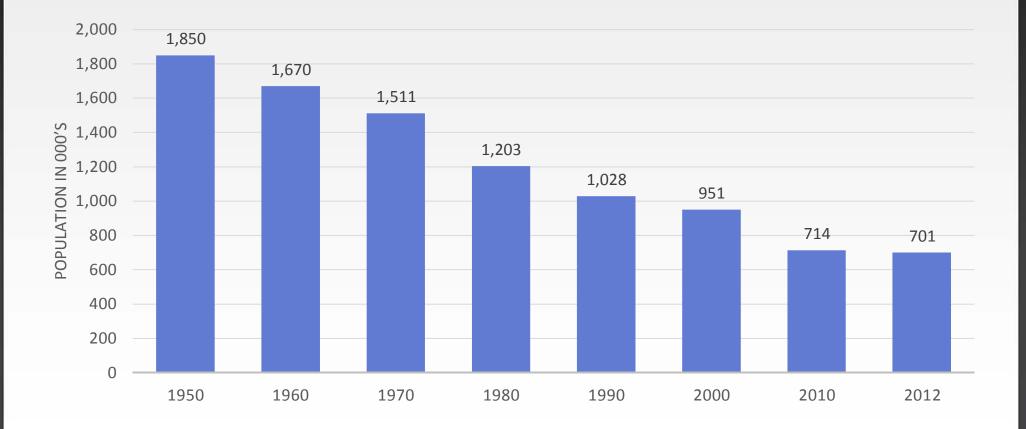
# City of Detroit What Caused the Financial Crisis

- Loss of jobs and steady decline in number of residents over many years
- Significant depletion of cash- projections estimated a cumulative cash deficit of \$100M by June 30, 2013
- General fund had not experienced a positive fund balance since FY2004. Without debt issuances, accumulated deficit would have been \$937M
- As of June 30, 2012, the City's long term liabilities, including unfunded actuarial accrued pension liabilities and OPEB, exceeded \$14B
- Disinvestment in infrastructure and systems of control





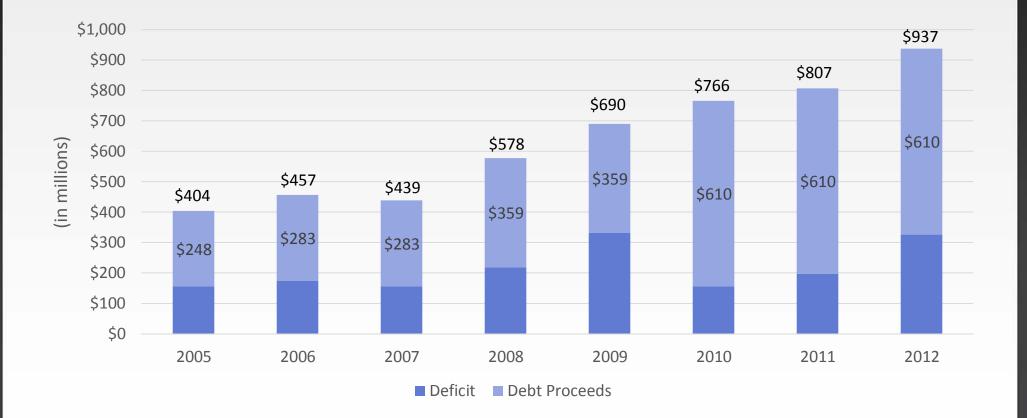
# Population Decline of Over 60%





# **General Fund Accumulated Deficit**

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# History of Financial Emergency

- December, 2012- Preliminary review leads State of MI's Treasurer, Andy Dillon, to conclude a serious problem exists and recommends the appointment of a Financial Review Team
- February, 2013- Financial Review Team unanimously concluded that no satisfactory plan exists to resolve the City's financial problems
- March, 2013- Governor Snyder declared a financial emergency and appointed Kevyn Orr as Emergency Manager

# History of Financial Emergency (cont.)

- May, 2013- Preliminary financial and operating plan submitted to State Treasurer, stating Detroit's cash flow crisis made it insolvent and unable to borrow
- June, 2013- Published creditor plan, including pension and retiree health care cuts, offers of less than 10 cents on the dollar to some creditors, decision to stop unsecured debt payments
- July, 2013- Filed petition for municipal bankruptcy in U.S. District Court
- December, 2013- Judge Rhodes ruled Detroit was eligible for bankruptcy, insolvent, and dismissed challenges to the State's Emergency Manager law and ruled that pensions are not protected by the State Constitution

# Financial Recovery is Underway

• Plan of Adjustment filed with the Court

- Court ordered mediation with major creditors are occurring
- \$120M of Post Petition Financing for restructuring efforts, with a focus on capital spending and blight remediation, has been approved by Court
- Detroit hopes to exit bankruptcy by October 15, 2014

## Must Be A Greater Strategy Around Recovery

- Goals must be clearly defined and achievable
- Must explain to the citizens what is happening and why
  - Analysis of problems and solutions tap into service improvements, our citizens deserve better
  - Fix internal systems and publicize efforts that citizens will understand
    - Tax returns high profile cheats

- Records in disarray quick refunds
- Trash pick up, education, procurement process, community policing
- Must engage elected officials in reform

## City of Detroit: A Complicated Recovery

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- A new Mayor and a restructured council- must develop a strategy for meaningful engagement or unconstructive power plays are inevitable
- Many of the major systems that reforms depend on are broken- Must Stabilize Systems
- Short time period, conditions that give rise to sunset of Emergency Manager may not be met- Is there a need for independent CFO function for period of time?
- Multiple recovery plans by various stakeholders, no clear implementation
- Post Bankruptcy structure still under review with various models being suggested
- Role of Detroit's business community in reform to be determined- DC business community played a major role in supporting key reforms in the District of Columbia

### Plan of Adjustment to Drive Recovery

• Invest approximately \$1.5 billion over 10 years to, among other things:

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- Improve and provide essential municipal services to the City's 700,000 residents, including police, fire and emergency medical services, garbage removal and functioning streetlights
- Attract and retain residents and business to foster growth and redevelopment
- Improve the City's information technology systems, thereby increasing efficiency and decreasing costs
- Provide pension treatment that is intended to deliver pensions that the City can afford and by which retires can continue to meet their needs
- Lay the foundation for a solvent Detroit that can live within its means and meet realistic obligations
- Continue to explore various management and ownership options for water and sewer department
- Emphasize negotiated solutions- including through continued federal mediation- that maximize creditor recoveries while allowing the City to meet its obligations and have a viable future

# Key Differences: DC Compared to Detroit

- Congress acted quickly to provide direct oversight of DC government
- Delays in addressing financial crisis in Detroit have made it much more difficult to address
- DC was 6 years under control period

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• Detroit post bankruptcy structure and length of time is yet to be determined