Bond Case Briefs

Municipal Finance Law Since 1971

How Detroit Battled Its Way Out of Bankruptcy.

Unlike wine, serious municipal financial problems, such as underfunded pensions, do not improve with age.

That was a major lessons learned from the 2013 bankruptcy of the city of Detroit, said Eugene Driker, a mediator during the bankruptcy process, who spoke at a municipal finance session at the 2018 ULI Spring Meeting in Detroit.

“The city failed to grasp the seriousness of the situation,” said Driker, of the Detroit-based law firm Barris, Sott, Denn & Driker. “Every day was Christmas in the eyes of some people who had some kind of unrealistic outlook and failure to grasp problems. They were hoping some savior would come in and save them.” Other U.S. cities have pension shortfalls and retiree health care obligations that dwarf those that were faced by Detroit, he noted.

Driker and other panelists noted that the period of bankruptcy was a major time of upheaval for the city, but Detroit has emerged fiscally stronger and now is poised for greater growth. Detroit filed a voluntary petition for relief under Chapter 9 of the U.S. Bankruptcy Code in July 2013.

“I was one of five mediators who helped mediate the creditor claims in bankruptcy,” Driker said. “When we started, none of us thought it would end in five years, and no one thought it would end in 16 months. Since the end of bankruptcy in November 2014, there’s been a remarkable transformation of the city. You see it every day in the neighborhood I live in—and all other places. Many of you are amazed that what you see doesn’t match the dystopian image the city has had for years.”

In bankruptcy, the city shed some $7 billion in debt, restructured another $3 billion in debt, and put an estimated $1.7 billion into improved services. In the bankruptcy, the city cut $7.8 billion from payments to its retired workers and $4.3 billion in retirement health care benefits.

Under the deal dubbed the “grand bargain,” state money was used to support Detroit’s pension funds, and donations from private foundations and the Detroit Institute of Arts were used to protect city-owned art masterpieces from being sold to raise money to pay creditors.

Detroit’s bankruptcy marked a turn in the city’s fate. Along with the city’s economic downfall, however, came rare opportunities for investment, creation, and collaboration. Shortly after filing for bankruptcy, the city began to see major changes in its downtown and Midtown neighborhoods, but more recently Detroit’s resurgence is gaining traction in areas that have been disinvested for decades.

Detroit was insolvent when it filed for bankruptcy protection, said John Naglick, chief deputy chief financial officer and finance director for the city. “The city’s operating strategy had been to issue debt, but the deficit would have been worse,” he explained. “Detroit had gone from 1.8 million residents in 1950 to 700,000 residents at the time of the filing. Legacy costs were consuming 40 percent of the budget and were projected to could climb to 60 percent by 2016. We had three times as many pensioners as workers."

When the city eliminated $7 billion in debt and unfunded liabilities, "pensioners and retirees took the biggest hit—$3.8 billion," he said. "It was harsh on retirees, but it allowed the city to restore basic service to residents."

Bankruptcy allowed the city to have another life, said Jed Howbert, group executive for planning, housing, and development for the city. "I joined the city in May of 2014, and my concern was less about how bankruptcy affected the city but more about where do we go from here?" he said. "There was a feeling of confidence in the future of the city. With the finances on a firm footing, it was a huge bonus in attracting business to the city."

Following the bankruptcy, there was accelerated growth downtown, which in turn created a stronger real estate market and has led to growth now moving beyond downtown.

"The most important thing that has changed is the narrative of the city—how Detroiters are talking about themselves," Driker said. "People have a bounce in their step now. There's a buzz about the city worldwide that has changed the outlook of the city."

The period during bankruptcy was not a fun time to be in the city, said Sonya S. Mays, president and chief executive officer of Develop Detroit, which builds vibrant, resilient communities and expands opportunities for residents. She was working on Wall Street at the time and decided to come home to help.

"It was deeply personal for me because there were some people in my family who were retirees," she said. "It was a pretty tough environment, but I never lost sight of the human toll. I got focused on the future of Detroit."

Once Detroit emerged from bankruptcy, Mays decided to stay rather than return to Wall Street. "It was clear that downtown was doing better, but what about the other areas of Detroit?" she said. "We are trying to create development in parts of the city that haven't seen development in some time."

Urban Land Magazine

By Mike Sheridan

May 7, 2018