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# Opinion

Columnists



MARCH 14, 2013 AT 11:51 AM

**Daniel Howes**

## Howes: EM likely first step to bankruptcy for Detroit

DANIEL HOWES  
52  
COMMENTS

Gov. Rick Snyder's appointment of an emergency financial manager for Detroit, expected to be announced as early as today despite opposition from the City Council, may be heralded as the last bad option for the cash-strapped city.

But Detroit's harrowing financial position is far worse than headline-grabbing numbers. That means the apparent alternative to Chapter 9 bankruptcy instead is likely to be a precursor to the ignominy of being the largest city in American history to go bankrupt.

An emergency financial manager answerable to the governor would be barred from violating protections for vested pensions enshrined in the state Constitution. Only a federal bankruptcy judge is empowered to order sweeping changes to dangerously underfunded pension funds covering police, fire and municipal retirees.

"If the moderate- to worst-case scenarios are true, then I don't see how Detroit avoids bankruptcy," Eric Scorsone, a Michigan State University economics professor specializing in public finance, told The Detroit News Wednesday. "The pensions are probably dramatically underfunded. Even an emergency manager wouldn't be able to touch pensions."

"You'd be talking about hundreds of millions that would need to be paid into those pension funds. There's a case that you want to try an emergency manager and see if it works because bankruptcy is a very expensive process."

The city's General Retirement System, adjusted for market value of assets and actuarial assumptions, is just 32 percent funded, according to individuals familiar with analysis conducted for the city by an independent consultant. For the Police and Fire Retirement System, the corresponding funding level is 50 percent, in both cases substantially less than officially reported by Detroit.

Of the city's estimated \$14 billion in long-term liabilities, \$1.57 billion are due over the next five years. That means roughly \$300 million of Detroit's \$1.1 billion annual budget would go to pay obligations before the first police officer or firefighter is paid, before catch-up contributions are made to dangerously under-funded pension funds.

It is true that all those obligations — exacerbated by early retirement schemes that burn fund assets at a faster rate — are not due and payable today, next month or next year. But they exist and they must be funded over time from revenue collected by the city lest their unfunded status keep growing.

Job one? Embrace reality and move quickly to stop the bleeding. The people who will bear the brunt of chronic mismanagement and financial delusion — active municipal employees and retirees — are the same people elected officials purport to defend with their intransigence.

Under the new emergency financial manager law, or Public Act 436, due to take effect March 28, an emergency manager could seize control of the city's pension boards if funding levels drop below 80 percent. The manager could remove and appoint pension board members, and could shift management of the funds to the well-run Michigan Employee Retirement System.

It gets worse.

Detroit's liability for retiree health care, also known as "other post-employment benefits," totals \$5.7 billion, according to the city's 2012 annual financial audit. Those benefits are not covered by the constitution's pension protections, meaning they could be reduced or eliminated by an emergency manager, a bankruptcy judge or both.

"You take care of everything you can outside of bankruptcy," said Douglas Bernstein, managing partner of the bankruptcy and creditors' rights practice of Plunkett Cooney in Bloomfield Hills. Chapter 9 is a "50-50 likelihood," he said, adding:

"If you're collecting pension benefits today, the vested benefits cannot be touched under the state constitution. The ones truly at risk are the ones working today and not collecting" their pensions yet.

Appointment of an emergency financial manager also could trigger repayment of \$440 million in interest-rate swaps owed to counter-parties, provided the lenders press terms of their agreements instead of choosing to negotiate with the new manager or bankruptcy lawyers.

Detroit is a financial mess proving to be way too much for its elected leaders to tackle. Years of mismanagement, corruption and inane grandstanding are culminating in an unelected emergency manager hired to make very tough calls.

And that includes increasingly likely Chapter 9 bankruptcy.

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