Judge Declares Detroit Bankrupt; Gives OK to Cut Pensions, Burn Creditors

In the opening to his hour-long statement to a packed courthouse on Tuesday, federal bankruptcy court Judge Steven Rhodes said:

> It is indeed a momentous day. We have here a judicial finding that this once proud and prosperous city can't pay its debts. It's insolvent.
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> It's eligible for bankruptcy. At the same time it has an opportunity for a fresh start.

He reeled off the list of problems the city is facing: another deficit this year approaching $400 million, similar to those the city has run up every year since 2008, pension liabilities and debt service that eat up nearly 40 cents of every dollar of revenue, half of property owners not paying their real estate taxes, police departments that solve less than 10 percent of crimes, 78,000 empty houses, streetlights gone dark, ambulances that don't run, citizens fleeing to the suburbs, tax base eroding, bad decisions, political corruption — the list went on and on.

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He blamed the burgeoning retiree healthcare and pension plan costs, the borrowing to cover those deficits over the past five years, poor record keeping, antiquated computers and software, and "13th-month" checks.

And then he dropped the bomb: Pension benefits are a contractual right and are not entitled to any heightened protection in a municipal bankruptcy.

Translation: Guarantees in the Michigan state constitution that such benefits are sacrosanct just evaporated. That means that some 23,000 retirees and another 9,000 current city employees are going to have to tighten their belts, along with banks, bond investors, and other institutions who bought up Detroit's bonds over the years.

How much of a cut? When Kevyn Orr, the financial manager appointed to oversee Detroit's difficulties by Michigan Governor Rick Snyder, offered creditors the opportunity to swap $11 billion of their debt for a $2 billion "note" — a haircut of 82 percent — they walked away from it, setting in motion the bankruptcy filing in July and the ruling earlier this week. Now it appears they'll be lucky to get 10 cents on the dollar.

Pensioners are bracing for the worst. Rumors abound that some will lose at least 10 percent of their benefits, others up to 50 percent. Articles offering alternatives have suggested "tiers" of benefit cuts that would affect older retirees less, younger ones more, using some sort of staged reductions over time. Those expecting higher payouts may be cut more, while those still working will likely see less and have to wait longer to get them.

A union immediately filed an appeal claiming that Rhodes erred in overriding the state's constitution while Bruce Babiarz, a spokesman for the Detroit Police and Fire Retirement System, bluntly stated:

"[Ours] is one of the strongest protected pension obligations in the country…. If [Rhodes'] ruling is upheld, this is the [dead] canary in the coal mine for protected pension benefits across the country. They're gone."

Orr has given himself until January to come up with a plan, and everything is on the table: pension and healthcare cuts, bond haircuts, selling city-owned art and other assets, including the Coleman A. Young International Airport, Belle Isle Park, and half of the Detroit-Windsor Tunnel. Said Orr: "We're trying to be very thoughtful, measured and humane. The reality is there is not enough money to address the situation no matter what we do."

While most of the headlines are focusing on the judge's ruling, something else is happening in Midtown Detroit: The micro-economy there is booming. As Karen De Coster has repeatedly noted:

> [Downtown] Detroit has become the place to be, and has thus moved from being a city known for white flight to a city where all kinds of people — including white people — can't get there fast enough.
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> Occupancy rates in popular Midtown have pushed over 95%….
>
> I've lived here my whole life and I have never before seen such a fun and amazing hodgepodge of people.

Writing for the *Detroit News*, Nolan Finley said, "Downtown seems to be immune to Detroit's broken finances. It's booming, thanks to private investments and its sudden emergence as a cool city for young people to live and work in. Private dollars take care of everything from street clean-up to security."

Pensioners, city workers, bond holders, and banks are learning the hard way about the inevitability of mathematics. Those lessons are going to be hard on many unsuspecting, trusting individuals. And some of those lessons haven't yet been learned by those who should know better.

Six days after Orr moved to declare bankruptcy, the state of Michigan approved plans for a bond issue to help pay for a new $444-million arena for the Detroit Red Wings hockey team. Taxpayers would be enlisted to pay off those bonds, of course, all in the name of "stimulating" the economy. Governor Snyder said that such a project would be "a huge momentum shift" for economic activity, and that it would tie in nicely with nearby baseball and football stadiums. He said, "It's something that hopefully will be a tax-base generator. Not the arena as much per se, but all the surrounding development."

Orr himself, who has witnessed first-hand how such spending on "hopeful" projects in the past has driven the city's finances into the ground, added:

> There's always a debate about does this pan out?
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> The reality is we are so needy of some economic development, I can't see how we don't pursue it because if we don't, what's left?

These are the lyrics of the same song sung back in 1997 when Detroit built the 40,000-seat baseball park for the Detroit Tigers (shown). Then Governor John Engler said the new stadium would "symbolize" the city's renewal.

And in 1999 when the city decided to build Ford Field for the Detroit Lions football team, Chairman William Ford said this would "showcase the city's turnaround."

Some lessons have to be learned over and over. Allowing individuals to make financial decisions based on the free market is always the way to simulate an economy. That's what's driving Midtown.

On the other hand, politicians making promises that can't be kept, to be paid for by others, is the lesson that the Detroit bankruptcy is able to teach, but only to those willing to listen.

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