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TO: Detroit City Council

FROM: David Whitaker, Director
 Legislative Policy Division 

DATE: August 10, 2017

RE: Exploring the Restoration of Pension Cuts

Council President Brenda Jones asked the Legislative Policy Division (LPD) to explore a funding source for the possible restoration of pension cuts suffered by retirees through the City of Detroit's bankruptcy process. The Detroit retirees have asked that surplus dollars be used to restore pension cuts.

Description of Pension Cuts from Bankruptcy Process

The following chart describes the pension cuts endured by retirees of the General Retirement System (GRS) and the Police & Fire Retirement System (PFRS) from the bankruptcy process:

City of Detroit Pension Savings from Bankruptcy			
Per Plan of Adjustment (\$1.7 Billion Estimated Pension Savings)			
General Retirement System (GRS)			
	Total		
	% Pension Liabilities	% of Total	Bankruptcy Savings
4.5% pension cut	4.5%	16.4%	\$161,181,818
Annuity Savings Recoupment ("Clawback"), up to 15.5% of a member's annual pension benefit	9.0%	32.7%	\$322,363,636
2.5% Cost of Living (COLA) Elimination	14.0%	50.9%	\$501,454,545
Total GRS Reductions	27.5%	100.0%	\$985,000,000
Police and Fire Retirement System (PFRS)			
PFRS COLA Reduction (55% per POA)			\$697,000,000
Total Bankruptcy Savings Legacy Pensions			\$1,682,000,000

As the chart indicates, these pension cuts amounted to approximately \$1.7 billion in savings to the City of Detroit's general fund¹. The chart also shows estimated amount of the savings attributable to the category of pension cut².

Pension Cut Restoration Process

It is important to remind the Council that the Plan of Adjustment (POA) bankruptcy document specifically establishes a methodology for the restoration of the 4.5% pension cut, COLA elimination and Annuity Savings clawback (i.e., "pension cuts"), if pension system funding levels exceed certain targets. Judge Steven Rhodes' supplemental opinion approving the bankruptcy provides a good summary of this complicated process:

"As part of the (pension) settlement, the parties agree upon certain provisions for the restoration of pension benefit payments if funding levels for the retirement systems exceed certain targets. Through 2023, the funding targets for purposes of benefit restoration are 75% for GRS and 78% for PFRS.

If at any time these targets are exceeded, the amount by which the targets are exceeded will be credited to a restoration reserve account. When the assets credited to the restoration reserve account can fully fund certain percentages of the reduced benefits (for example, when the GRS reserve account can fund 0.5% of the 4.5% benefit reduction), restoration payments will begin. As more money becomes available in the restoration reserve accounts, more benefits will be restored. If funding levels for the retirement systems drop, money in the restoration reserve accounts may no longer be available and restoration payments will be suspended"³.

The GRS is 64% funded as of June 30, 2016 according to a Gabriel Roeder actuarial report. The PFRS is 74% funded as of June 30, 2016 according to a Gabriel Roeder actuarial report. As a result, the funding levels of the pension systems are insufficient to trigger the restoration process at the present time.

LPD does not think there is any legal means for the City to restore pension cuts outside of the POA. Council may want the Law Department to provide a legal opinion regarding this issue.

Use of City of Detroit Surplus Dollars

According to the 2016 Comprehensive Annual Financial Report (CAFR), the City ended with a \$63 million surplus as of June 30, 2016. In addition, the OCFO recently presented a City of Detroit financial report for the eleven months ended May 31, 2017 to the FRC indicating that the City

¹ Source: An Office of the Chief Financial Officer (OCFO) power point entitled "Overview of Plan of Adjustment" presented to the Financial Review Commission (FRC) during November 2014.

² Savings by category is based on percentage of pension liabilities. The source of these percentages is from page 141 of Martha Kopacz's Expert Report on the feasibility of the Plan of Adjustment bankruptcy 10-year financial plan.

³ Chapter 9, Case No. 13-53846, Hon. Steven W. Rhodes "Supplemental Opinion Regarding Plan Confirmation, Approving Settlements, and Approving Exit Financing", page 37. Also, see [Attachment I](#) for a more detailed explanation of the pension restoration process. Additionally, in the POA Disclosure Statement, Exhibit II.B.3.q.ii.C and Exhibit II.B.3.r.ii.C provide a very detailed explanation of the pension cut restoration process for the PFRS and the GRS, respectively.

could end up with a \$59 million surplus as of June 30, 2017 (these are unaudited numbers, however). According to a recent newspaper article, Detroit retirees have asked that budget surplus dollars be used to restore pension cuts⁴.

Unfortunately, however, the POA highly restricts the use of surplus dollars. Attachment II represents the 10 year financial plan per the POA. According to this plan, the POA assumes no bond sales for 10 years for capital projects. As a result, the POA requires use of surplus dollars for capital and blight expenditures.

In addition, for the past three fiscal years after emerging from bankruptcy, the City has budgeted the use of surplus dollars for capital and blight expenditures. In the fourth year after bankruptcy, FY 2017-18, the City continues to budget the use of surplus dollars for capital and blight expenditures. Parenthetically, the City does have exit financing or Quality of Life (QOL) dollars and unused general obligation bond (which are minimal and only available for specific purposes and insufficient for the City's capital needs) for capital projects, but these funds could be exhausted in two or three years. In addition, City pays debt service on the exit financing.

It is also important to note that Council has approved the use of surplus dollars since FY 2016 to set aside funding in a retiree protection trust fund to help finance a huge looming pension obligation due in 2024, which was a credit positive per the Moody's credit rating agency⁵. However, to initiate the start of this pension funding strategy, Council agreed to use contingency funds in the POA to do so. Attachment III represents the pension funding strategy.

Conceivably, the City could contribute to the pension plans in an attempt to raise funding levels to trigger the pension restoration process prior to FY 2024. However, it is unlikely the City will have large enough surpluses to significantly fund the legacy pension plans, given the competing priorities such as for capital, blight and retirement pension trust spending, as previously discussed. Also, any increase in salaries from departmental restructuring efforts and union negotiations would further limit general fund surpluses. Furthermore, the OCFO does not favor direct funding of the legacy pension plans for concern over investments losing value.

As a result, the amount of any remaining available surplus dollars after the funding of capital, blight, retiree protection trust fund spending, as well as other budget priorities, to help restore pension cuts outside the POA pension restoration process, if it is legal to do so, would most likely be minuscule.

One positive event that could occur starting in FY 2024 when the retirement pension trust fund starts to make cash contributions to the legacy pension system is the triggering of the pension cuts restoration process previously discussed, as the pension funding level should improve from these cash contributions.

⁴ "Budget surplus ignites fight for Detroit retirees", Nicquel Terry and George Hunter, The Detroit News, July 27, 2017.

⁵ "Detroit, Michigan, Plans to Establish Pension Funding Reserve, a Credit Positive", Moody's Investors Service, March 20, 2017.

Retiree Health Care Cuts in the POA

Unfortunately, in addition to pension cuts, approximately 90% of retiree health care costs (a/k/a other post-employment benefits, "OPEB" costs) were eliminated during the bankruptcy process amounting to \$3.8 billion in savings to the general fund (\$4.3 billion OPEB liability minus \$493 million for the establishment of VEBAs)⁶. Retiree health care cuts has in many cases significantly added to the financial burden suffered by retirees after the bankruptcy process.

There are currently approximately 22,000 pensioners, according to the Retirement Systems City of Detroit website. One possible solution to reduce retiree health care cost somewhat is for the City to facilitate the process of pensioners joining a pool or shared group to achieve a group rate on health care coverage. As of this report date, LPD is currently awaiting to hear from the Human Resources Department regarding the viability of this idea. Once LPD hears from Human Resources, we will report to the results as soon as possible.

Please let us know if we could be of any more help.

⁶ Source: An Office of the Chief Financial Officer (OCFO) power point entitled "Overview of Plan of Adjustment" presented to the Financial Review Commission (FRC) during November 2014.

Attachment I



Pension Restoration

- Program to allow for the potential restoration of accrued benefits, including COLA and ASF Recoupment, that were reduced as part of the POA.
- Driven by improvement in the GRS & PFRS Funded Level (investment returns, actuarial experience, outside contributions).
- Supervised and administered by the respective Boards and the new Investment Committees.
- Restoration flows through 3 Waterfall Classes of participants.



GRS Pension Restoration

WATERFALL CLASSES

There are three Waterfall Classes:

- Waterfall Class 1 – Retirees in retirement benefit pay status as of June 30, 2014, and their surviving spouses and beneficiaries.
- Waterfall Class 2 – Retirees who entered into retirement benefit pay status after June 30, 2014, and their surviving spouses and beneficiaries, and who are in pay status as of the end of the GRS Fiscal Year prior to the year in which the restoration decision is made.
- Waterfall Class 3 – All other GRS participants who are not in retirement benefit pay status.

RESTORATION of BENEFITS

- If the projected Funded Level is above the Restoration Target, Assets are transferred to a Restoration Reserve.
- If assets in the Reserve sufficient to fund a restoration increment for the actuarial life expectancy to a Waterfall Class, GRS Restoration is provided:
 - 4.5% benefit cut is restored in .5% increments until full restoration of 4.5% to each Waterfall Class;
 - COLA restored in 10% increments of COLA to Waterfall Classes in accordance with schedule;
 - ASF may be recouped as well – first non-retirees to retiree level, then all other ASF

PFRS RESTORATION of BENEFITS

- If assets in the Reserve sufficient to fund a restoration increment for the actuarial life expectancy to a Waterfall Class, PFRS Restoration is provided:
 - COLA restored in 10% increments (i.e., 1.0% COLA to 1.225%) to Waterfall Class 1 until an amount sufficient to fund 66% of the value of future COLA payments (i.e., 1.5% COLA) has been funded and then in 10% increments to Waterfall Classes 2 & 3 under the same terms in accordance with schedule;
 - After restoration of 66% of COLA to all waterfall classes then to 76%, and then to 100%.



GRS Restoration Program Guidelines

Period	Funding Target	Restoration Target	Reserve Suspension	Restoration Reduction
Until 6/30/23	70%	75%	Below 71%	Below 70%
7/1/23 – 6/30/33	Actual 2023 Funded Level	Funding Target +3%; Min. 73%	Below Funding Target + 1%	Below Funding Target
7/1/33 – 6/30/43	Actual 2023 Funded Level	Funding Target + 3%; Min 73%	Below Funding Target +1%	Below Funding Target



PFRS Restoration Program Guidelines

Period	Funding Target	Restoration Target	Reserve Suspension	Restoration Reduction
Until 6/30/23	75%	78%	Below 76%	Below 70%
7/1/23 – 6/30/33	Actual 2023 Funded Level + 3%	Funding Target +3%; Min. 81%	Below Funding Target + 1%	Below Funding Target
7/1/33 – 6/30/43	Actual 2023 Funded Level + 3-6%	Funding Target + 3%; Min 84%	Below Funding Target +1%	Below Funding Target

PERMANENT RESTORATION

- Generally, in the event the projected funded level falls below the applicable Funding Target, transfer of assets from the Restoration Reserve to the Pension Plan will occur and future restoration benefits may be suspended, diminished or terminated.
- In the event the GRS or the PFRS satisfy the Permanent Restoration Targets in 2028, 2033 and 2043, (additional 1% outperformance above Restoration Triggers); restoration benefits in effect at that time which are fully funded shall be permanently restored and not subject to suspension, diminishment or termination.

A t t a c h m e n t I I

General Fund Revenue and Expenditure Projections

City of Detroit Plan of Adjustment

Preliminary Forecast (\$ Millions)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023	2024-2033
Revenues												
Municipal income tax	\$247.9	\$256.2	\$262.3	\$268.3	\$274.0	\$279.9	\$286.0	\$292.2	\$298.5	\$304.9	\$2,770.3	\$3,510.0
State revenue sharing	191.2	196.6	198.7	200.3	202.0	203.8	205.6	199.1	200.8	202.5	2,000.5	2,121.0
Wagering taxes	169.9	168.2	169.0	169.9	171.6	173.3	175.0	176.8	178.6	180.3	1,732.6	1,905.6
Property taxes	114.9	102.6	100.8	102.4	102.6	103.9	106.8	109.7	113.3	117.0	1,074.0	1,369.6
Utility users' taxes	20.1	24.5	24.9	25.5	26.0	26.4	26.8	27.2	27.6	28.0	257.2	304.3
Sales and charges for services	131.5	118.0	115.8	113.6	111.4	109.2	107.0	104.4	103.3	104.0	1,118.0	1,161.2
Other revenue	79.8	86.2	78.0	66.5	65.3	65.5	65.8	66.2	66.6	66.9	706.9	747.2
General Fund reimbursements	29.8	43.7	41.7	21.4	21.4	21.4	21.4	21.4	21.4	21.4	265.0	238.8
Transfers in for UTGO ¹	66.5	62.6	57.7	57.6	56.5	54.1	53.4	52.7	37.7	33.9	532.8	147.6
Restructuring:												
Department revenue initiatives	-	95.2	45.1	49.7	52.9	42.5	46.9	46.8	51.3	52.5	482.9	586.2
QOL / exit financing proceeds (net)	-	217.7	23.7	-	-	-	-	-	-	-	241.4	27.5
Total revenues	\$1,051.6	\$1,371.6	\$1,117.7	\$1,075.1	\$1,083.7	\$1,080.0	\$1,094.8	\$1,096.5	\$1,099.0	\$1,111.5	\$11,181.5	\$12,119.1
Expenditures												
Salaries/overtime/fringe - Public Safety ²	(245.2)	(263.3)	(276.7)	(277.5)	(284.4)	(291.5)	(297.4)	(303.3)	(309.4)	(315.6)	(2,864.3)	(3,524.5)
Salaries/overtime/fringe - Non-Public Safety	(85.7)	(86.9)	(88.1)	(86.1)	(88.0)	(90.2)	(92.0)	(93.8)	(95.4)	(97.3)	(903.8)	(1,087.2)
Health benefits ³	(173.0)	(67.1)	(52.4)	(55.9)	(60.0)	(63.6)	(66.1)	(68.7)	(71.5)	(74.3)	(752.6)	(928.2)
OPEB payments - future obligations ²	-	(6.1)	(3.1)	(3.1)	(3.2)	(3.2)	(3.3)	(3.3)	(3.4)	(3.4)	(32.2)	(37.0)
Active pension plan ²	-	(52.1)	(34.1)	(34.9)	(35.8)	(36.7)	(37.4)	(38.2)	(38.9)	(39.7)	(347.9)	(443.6)
Other operating expenses ⁴	(291.3)	(320.1)	(326.5)	(303.5)	(304.8)	(302.0)	(302.2)	(303.3)	(309.4)	(310.3)	(3,073.2)	(3,437.4)
Restructuring:												
Additional operating expenditures	-	(72.6)	(45.3)	(39.9)	(35.6)	(33.0)	(33.0)	(33.3)	(32.5)	(32.1)	(357.5)	(359.1)
Escrow proceeds (2012 refunding bonds)	-	64.7	-	-	-	-	-	-	-	-	64.7	-
Working capital	13.4	(34.2)	4.0	4.0	4.0	4.0	4.0	-	-	-	(0.8)	-
Secured debt service	(35.4)	(39.4)	(39.4)	(39.4)	(39.4)	(39.4)	(39.5)	(39.5)	(39.5)	(39.6)	(390.5)	(391.0)
Contributions to income stabilization funds	-	(2.5)	(2.3)	(2.3)	(2.2)	(2.1)	(2.1)	(2.0)	(1.3)	(1.1)	(17.8)	(2.2)
COPs swaps / swap settlement payments	(45.9)	(58.2)	-	-	-	-	-	-	-	-	(104.1)	-
QOL / exit financing debt service payments	(0.7)	(10.3)	(15.8)	(15.8)	(15.8)	(15.8)	(39.8)	(62.4)	(59.6)	(56.9)	(292.9)	(126.0)
Reorganization (Capital investments)	0.0	(139.5)	(106.4)	(65.6)	(50.2)	(43.6)	(51.9)	(46.0)	(40.4)	(38.6)	(582.2)	(442.7)
Restructuring professional fees	(49.4)	(127.6)	-	-	-	-	-	-	-	-	(177.0)	-
Blight (excludes heavy commercial)	-	(82.0)	(46.0)	(50.0)	(50.0)	(51.0)	(52.0)	(45.0)	(25.0)	(19.0)	(420.0)	-
PLD decommission	-	(2.5)	(5.0)	(15.0)	(10.0)	(10.0)	(10.0)	(12.5)	(10.0)	-	(75.0)	-
Contingency	-	(11.5)	(10.9)	(10.8)	(10.8)	(10.8)	(10.9)	(11.0)	(11.0)	(11.1)	(98.9)	(120.9)
Reinvestment deferrals	-	-	25.4	15.2	(2.7)	1.5	7.4	35.3	3.6	(20.5)	65.0	200.4
Total expenditures	(\$913.3)	(\$1,311.1)	(\$1,022.7)	(\$980.7)	(\$988.9)	(\$987.5)	(\$1,026.2)	(\$1,027.1)	(\$1,043.7)	(\$1,059.6)	(\$10,360.9)	(\$10,699.3)
Funds available for unsecured claims	\$138.4	\$60.4	\$95.0	\$94.4	\$94.8	\$92.5	\$68.6	\$69.4	\$55.3	\$51.8	\$820.6	\$1,419.8
Memo: RRI spending⁵	-	(\$294.1)	(\$197.7)	(\$155.5)	(\$135.8)	(\$127.6)	(\$136.9)	(\$124.3)	(\$97.9)	(\$89.8)	(\$1,359.6)	-

1. Direct to UTGO debt service, income stabilization funds and CDS pension payments.
 2. Assumes pending DPOA & DFAA deals are cash flow neutral.
 3. Health benefits include \$142.8m of OPEB payments for current retirees in FY 2014 (\$123.8m) and FY 2015 (\$19m).
 4. The impact of the first decade increase in DPOA subsidy is assumed to be offset by operational savings beyond 2023.
 5. Reinvestment & Revitalization Initiatives (RRI) spending is the sum of the following expenditures line items above: Additional Operating Expenditures, Reorganization and Blight, RRI spending breakdown by function over 2014-2023 is: Blight (\$440.3MM), including \$20.3MM of grant income located in Reorganization, Public Safety (\$410.3MM), Transportation & Other Resident Services (\$106.2MM) and Services Infrastructure (\$102.6MM).



General Fund Sources and Uses¹

20 Year Projections

Preliminary forecast (\$ Millions)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023	2024-2033
Sources												
Funds available for unsecured claims	\$138.4	\$60.4	\$95.0	\$94.4	\$94.8	\$92.5	\$68.6	\$69.4	\$55.3	\$51.8	\$820.6	\$1,419.8
Revenue stream from DWSD	-	65.4	45.4	45.4	45.4	45.4	45.4	45.4	45.4	45.4	428.5	-
Pension	-	2.6	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	21.7	44.3
OPEB (12.1% to current retirees)	-	1.4	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	14.2	11.9
POC (11.5% of total POC)	-	69.4	49.4	49.4	49.4	49.4	49.4	49.4	49.4	49.4	464.4	56.1
Subtotal: Revenue stream from DWSD	-	-0.2	4.7	5.3	3.9	3.7	6.9	6.8	6.7	6.6	44.4	56.9
Reimbursement from other funds	-	18.3	18.3	18.3	18.3	18.3	18.3	18.3	18.3	18.3	164.7	201.3
Grand Bargain funding	-	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	45.0	55.0
Foundation fundraising	-	194.8	-	-	-	-	-	-	-	-	194.8	-
DIA contributions	-	-	-	-	-	-	-	-	-	-	-	-
State settlement	-	-	-	-	-	-	-	-	-	-	-	-
Total sources	\$138.4	\$347.7	\$172.4	\$172.4	\$171.3	\$168.9	\$148.2	\$148.9	\$134.7	\$131.1	\$1,733.9	\$1,789.1
Uses												
Retiree payments	-	(114.3)	(18.3)	(18.3)	(18.3)	(18.3)	(18.3)	(18.3)	(18.3)	(18.3)	(260.7)	(617.7)
PPRS pension payments	-	(188.2)	(76.9)	(76.9)	(76.8)	(76.6)	(56.5)	(56.5)	(55.2)	(54.9)	(718.5)	(630.4)
CRS pension payments	(9.1)	-	-	-	-	-	-	-	-	-	(9.1)	-
PPRS OPEB payments - current retirees	(10.9)	-	-	-	-	-	-	-	-	-	(10.9)	-
CRS OPEB payments - current retirees	(20.0)	(302.5)	(95.2)	(95.2)	(95.1)	(94.9)	(74.8)	(74.8)	(73.5)	(73.2)	(999.2)	(1,248.1)
Subtotal: retiree distributions	-	(45.8)	(41.5)	(41.5)	(40.5)	(38.4)	(37.8)	(37.1)	(24.1)	(20.8)	(327.6)	(40.8)
Note and cash payments	-	(55.0)	-	-	-	-	-	-	-	-	(55.0)	-
Note A1 (UTGO)	-	(12.6)	(25.3)	(25.3)	(25.3)	(25.3)	(25.3)	(25.3)	(25.3)	(25.3)	(214.9)	(470.2)
Note A2 (LTGO)	-	(0.5)	(0.4)	(0.4)	(0.4)	(0.4)	-	-	-	-	(2.2)	-
Note B (LTGO)	-	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)	(89.8)	(29.9)
36DC cash payments	-	(124.0)	(77.2)	(77.2)	(76.2)	(74.0)	(73.0)	(72.4)	(59.4)	(56.1)	(689.5)	(541.0)
Note C (LTGO)	-	-	-	-	-	-	-	-	-	-	-	-
Subtotal: note and cash payments	-	(20.0)	(77.2)	(77.2)	(76.2)	(74.0)	(73.0)	(72.4)	(59.4)	(56.1)	(689.5)	(541.0)
Total distributions / total uses	(\$20.0)	(\$426.5)	(\$172.4)	(\$172.4)	(\$171.3)	(\$168.9)	(\$147.9)	(\$147.2)	(\$132.9)	(\$129.3)	(\$1,688.7)	(\$1,789.1)
Surplus / (deficit)	\$118.4	(\$78.8)	\$-	\$-	\$-	\$-	\$0.3	\$1.7	\$1.7	\$1.8	\$45.2	\$-
Ending cash balance	\$154.4	\$75.6	\$75.6	\$75.6	\$75.6	\$75.6	\$75.9	\$77.6	\$79.4	\$81.2	\$81.2	\$81.2
Memo:												
FY14 expenditures spent in FY15	-78.8	78.8	-	-	-	-	-	-	-	-	-	-
Adjusted surplus / (deficit)	\$39.6	\$-	\$-	\$-	\$-	\$-	\$0.3	\$1.7	\$1.7	\$1.8	\$45.2	\$-

1. Source: City of Detroit Plan of Adjustment - 40 year projections



Attachment III

