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Never Sunny in Detroit: An Only Slightly Less Modest Proposal for a Troubled Metropolis

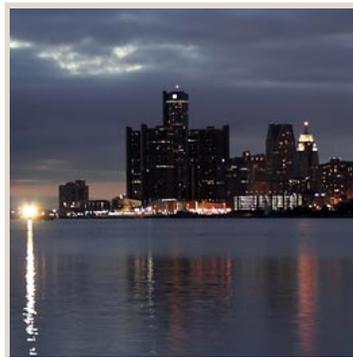
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With due apologies to Jonathan Swift (1), Detroit now finds itself in much the same situation as the children of the poor – a burden on society, possessing little hope and fewer prospects. Detroit is trapped in a state where it is the only true metropolitan area -- surrounded by communities that want none of its problems, and governed by a state executive that will have no talk of this nonsense about taxes. It is a city that is distinctive for a variety of reasons -- and most of the good ones are well in the past.



On one hand, it is home to the birth of the American auto industry -- the cradle of post-World War II American industrial dominance. The city and its neighbors are also perhaps the first widely recognized victims of the industrial outsourcing of the 1980s. The decrease of population by nearly two-thirds from its peak, and the flight of nearly 30% of its residents since the year 2000, has left the city struggling to meet the demands of a population spread over a large geographic footprint -- and all with a tax base that can't support itself. Pockets of emptiness surrounded by thin strands of population are never the hallmark of a well-served community.

The debt is another problem altogether. While the city cites some \$18 billion in accrued liabilities, accrued projections are about as reliable as a Detroit ambulance.(2) They might as well talk about health in terms of EBITDA for all the good that it does (Hint: no good at all).(3) What may be more helpful is a look at what's really going on with Detroit's debt against what opportunities it might have to address these issues. Consider, for example, the oft-cited \$2 billion in underfunded city employee pensions (which doesn't account for the police and fire employees' pensions, which are separate and are estimated to be underfunded by another \$1.437 billion). These obligations don't come due all at once -- or even anytime soon in some cases. They come due on a per-employee basis as eligible employees, or former employees, reach retirement age (as that might be defined in the retirement plan), or die.

This dynamic, endemic to the retirement plan concept, is what makes it so easy for members of the U.S. Congress to decry the underfunding of Social Security and Medicare, while at the same time doing nothing about fixing it. It's the next decade's issue. The same holds true for the nearly

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\$1.5 billion in what the city terms "pension-related 'Certificate of Participation' liabilities" on its list of the 20 largest creditors filed in the bankruptcy case. While it is speculative (according to the city) that these are even valid claims, they aren't claims due in full today -- and probably not tomorrow either. So they can wait -- as can the \$473 million in general tax revenue bonds outstanding, and the \$33.6 million owed to the Downtown Development Authority.

The problem with Detroit isn't debt -- it's the deficit. The city loses \$380 million per year on operations; if they don't do something to change either top-line revenues or outflows of cash, none of the aforementioned debt will ever be paid -- and this is all an expensive exercise benefitting a large body of professional services firms.

	Population	Housing Units	Square Miles	Per Capita Income
Detroit	701,745	349,170	138	\$15,261
Philadelphia	1,547,607	670,171	134.1	\$21,671

Detroit has to provide services to a larger footprint with half as many people, who each earn 30% less than residents of Philadelphia, for example. Bigger service areas with less tax revenue bring us to the current economic situation. Anyone even remotely experienced with a turnaround or financial crisis knows that there are only two things that will right this course; increasing revenue (which, in a municipality comes in the form of taxes, service fees and municipal aid); or reduce expenses (by spending less, which in a municipality comes in the form of doing less, providing fewer services and changing the economic assumptions underlying such services).

Consider revenue. In a crisis, one must examine all possible sources of revenue where generating such revenue won't "kill the patient." In this case, the tax base is a dry well. As the governor stated in his letter approving the filing of the bankruptcy petition, Detroit's taxes are at their legal limit, and were that limit to be lifted, the population simply can't afford to pay any increase in taxes. There's about a billion dollars of art sitting in the Detroit Institute of Art and Kevyn Orr, the city's emergency manager, has called in Christie's to start the process of appraising those assets(6). But bringing in \$800 million or so from art auctions won't fix the operating deficit. It will take care of some pension obligations or tax bond obligations, which doesn't hurt, but it doesn't stop the bleeding.

Detroit has two sets of moving, cash-generating parts, which are sports teams and an airport. Detroit Metropolitan Wayne County Airport is the 44th -- busiest airport in the world, with 32,205,358 passengers in 2012. The airport serves as the second busiest hub for both Delta Airlines and Spirit Airlines, and serves 160 destinations in the U.S. If the county or state were to impose a modest fee, perhaps ten dollars per passenger per take-off or landing, so as to preserve the state's largest city and provider of services, \$644,107,160 in revenue would be raised. Assuming that 20% of passengers would be so price sensitive as to decide to take extra routes rather than experience a \$20 price increase in airfare, that still generates an excess of \$515 million against a \$380 million annual operating deficit. If the city only wanted to reach break-even, the "Detroit Passenger Fee" would be about \$5.90 per takeoff or landing.

Sports fans can help bridge the gap. They create traffic, require police and other public services support, so why shouldn't they help a first-responder out? Detroit is home to the Lions, Tigers, Pistons (oh my!) and Red Wings. Of the four teams, only the Pistons play at a venue outside of downtown Detroit. That leaves three teams using the downtown as home. If one assumes a relatively conservative 80% attendance rate over the course of a season, then given the relative season lengths and venue sizes, there are 7,882,287 seats purchased and filled in a Detroit sports year.

Team	Venue	Seats	Fill Rate	Games/Season	Seats/Season
Lions	Ford Field	70,000	80%	13	728,000
Tigers	Comerica Park	45,051	80%	162	5,838,610
Red Wings	Joe Louis Arena	20,056	80%	82	1,315,677

Assessing an "Impact Fee" on the purchasers of these seats in some nominal amount -- say \$1.50 per seat/game -- would yield a wholly unscientific \$11,823,420. While many will say that this is nothing in the shadow of \$20 billion in debt, if it's done in combination with other revenue

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opportunities, it helps restore the city to operating surpluses, which will be needed to handle the future debt already accrued. Plus, it ties the fee to consumption of services (i.e., messing up traffic and parking by attending a sporting event). If we take the airport fee discussed above, after accounting for the \$380 million operating deficit, and add it to the sports impact fee, we get an annual surplus funds totaling \$257,930,580. Hey! With \$20 billion in debt, we're out of debt in only 77 years.

However, Detroit has no choice but to do these things, because it has to find every opportunity to increase revenue, and these, while a little off the beaten path, or redundant to fees already in place, are opportunities. Expenses are another issue. Expenses are another issue. There will have to be an adjustment to pensions earned in the future -- if 401Ks are good enough for everyone else in the country, they're just going to have to become good enough for the union rank and file. Unions, which make a not insignificant amount of money from managing their pensions, will have to figure out how to continue managing retirement funds in the form of 401Ks. The first few unions that figure out how to disintermediate retirement savings are going to be hailed as revolutionary geniuses that save American industry -- because there are entire sectors built around the problem of underfunded pensions, and that helps nobody at all. So, Detroit's future burden of retirement for its present workers is going to have to be reduced, and this should be a surprise to nobody. It's not as though this situation isn't the scourge of municipalities nationwide, and it's a situation identical to that which the U.S. Postal Service is presently facing (7).

Finally, there's the problem of the shape of the city itself -- police, fire and ambulance services are strained beyond the point of breaking, trying to service an area too geographically large for the population. The population, on the other hand, is dispersed all over the place, which is one reason why the average time for the police to respond to an emergency call is 58 minutes and more than 40% of all traffic lights are inoperative. The city outside of downtown has eroded in the general direction of the film *28 Days Later*, or if you're of a younger sort, the setting for the video to LMFAO's hit *Party Rock Anthem* (without the dancing zebra, thank you). To call it an extended urban wasteland borders on understatement in some neighborhoods, and the rate of decay has increased as population has fled. What to do about these vast tracts of land?

One option is to vacate the land. Residents in more distant areas can be moved closer to the city's nucleus, with the joint benefit of greater population density, and therefore, a more readily served population. There will also be less strain on public services, public transportation and infrastructure. Will residents want to be forcibly relocated? Probably not, but something must be done. And with vacancies such as they are, it could be possible to relocate entire neighborhoods to within close proximity. Vacant homes can be taken by the city and razed, leaving green fields where decay once prevailed. New homes can be built, old homes torn down, and families and residents moved to more realistic population patterns using a year or two of the operating surpluses mentioned above. When the outlying areas of the city are empty, and all that's left is green fields, unincorporate the land and give it to a state land trust, or push it onto the neighboring communities. Any mortgage holders still actually holding liens on these abandoned properties could receive tax deductions for their "contribution" of the liened property to a land trust. In the event a lender had a property that was being maintained and had residents, and those residents had to move, they would receive a replacement lien on the property to which the residents moved -- call it "Extreme Makeover: Portfolio Edition."

While this may be an extreme example of solving the problem of population under-density, it allows for a cash-free "contribution" from the state and county, creates and preserves green space, makes policing, firefighting, and healthcare easier to provide, and right-sizes the city. So of course, it will meet with widespread opposition.

But here's the thing -- no amount of debt reduction will do a thing if they don't address the operating deficit first. That's going to require taking tough, unpopular, but ultimately necessary actions. As my mentor Harvey Nachman used to say, "Not making a decision is making a decision."

Endnotes:

- (1) Author of [A Modest Proposal for Preventing the Children of Poor People From Being a Burden to Their Parents or Country, and for Making Them Beneficial to the Publick](#). Published 1729
- (2) "For instance, only a third of the City's ambulances were in service in the first quarter of 2013." Voluntary Petition to the United States Bankruptcy Court for the Eastern District of Michigan; Exhibit A -- "Governor's Written Approval of Recommendation", p.2
- (3) See Gavin: <http://www.forbes.com/sites/tedgavin/2011/12/28/top-five-reasons-why-ebitda-is-a-great-big-lie/>

- (4) See: <http://quickfacts.census.gov/qfd/states/26/2622000.html>
- (5) See: <http://quickfacts.census.gov/qfd/states/42/4260000.html>
- (6) See: http://www.washingtonpost.com/national/detroit-museum-seeks-meeting-with-auction-house-doing-appraisal-of-city-owned-art-collection/2013/08/14/e149f66a-0539-11e3-bfc5-406b928603b2_story.html
- (7) See Gavin: <http://www.forbes.com/sites/tedgavin/2011/12/08/how-to-fix-the-postal-service/>



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Edward (Ted) Gavin is a Certified Turnaround Professional and managing partner in Gavin/Solmonese’s Wilmington, DE office. He has more than 15 years of experience working with distressed companies and their stakeholders in diverse industries including retail, transportation, regulated and non-regulated manufacturing, pharmaceutical and healthcare, professional services construction, and metal-forming, among others. Gavin has served leadership roles in engineering, manufacturing, IT and regulatory affairs functions. He has extensive experience in strategic planning, process re-engineering, and hands-on management in for-profit, non-profit and public sector operations and he frequently testifies in bankruptcy courts in support of creditor issues and to improve unsecured creditor recoveries.

Gavin serves on the Board of Directors of the American Bankruptcy Institute and served on the American Bankruptcy Institute’s National Ethics Standards Task Force. He speaks frequently on professional ethics and creditor topics and has created educational sessions for the Delaware Bankruptcy Inns of Court. He is a member of the Board of Directors of the Chamber Orchestra of Philadelphia, Women’s Campaign International and EMILY’s List, and has worked extensively in administration of non-profit entities. More recently, Gavin has been named to the board of the National LGBT Museum, and has been elected chairperson of the Board to the newly established Oliver-Grayson Holding Company, Benefit LLC.

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