THE PENSION GRAND BARGAIN

A NEW REFORM MODEL FOR CITIES

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About the Author

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During 1987–2006, Husock was director of case studies in public policy and management at Harvard University's Kennedy School of Government, where he was also a fellow at the Hauser Center on Nonprofit Organizations. His publications on the nonprofit sector have appeared in the *Wall Street Journal, National Affairs, Society, Chronicle of Philanthropy, Public Interest,* and Townhall.com. Husock has written widely on U.S. housing and urban policy, including in his book *The Trillion-Dollar Housing Mistake: The Failure of American Housing Policy* (2003) and his monograph *Repairing the Ladder: Toward a New Housing Policy Paradigm* (1996). His work has appeared in the *Journal of Policy Analysis and Management, Philanthropy,* and *The Wilson Quarterly.*

A former broadcast journalist and documentary filmmaker whose work won three Emmy Awards, Husock serves on the board of directors of the Corporation for Public Broadcasting. He holds a B.A. from Boston University's School of Public Communication and was a 1981–82 mid-career fellow at Princeton University's Woodrow Wilson School of Public and International Affairs.

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Executive Summary

Detroit's municipal bankruptcy was novel in many respects. Few American cities file for bankruptcy; Detroit is by far the largest to have done so. The way in which Detroit successfully emerged from bankruptcy—which allowed the Motor City to put its troubled financial house in order and restore essential city services—was unprecedented, too.

In 2013, as Detroit's crippling overhang of retiree pension-payment obligations hung over its bankruptcy negotiations, a daring move by a dozen major foundations broke the logjam. Led by a $125 million pledge by the Ford Foundation, the philanthropic consortium collectively pledged $366 million toward the city's pension liability, on the proviso that their contributions would leverage contributions from private corporations, state government, and public-employee unions (which would forgo various benefits, such as cost-of-living adjustments). Their "grand bargain" gambit worked: federal courts approved the plan, and Detroit began, slowly and literally, to turn its lights back on.

This paper examines whether a Detroit-style grand bargain could be successfully applied to four other midwestern cities facing the dangerous combination of significant pension costs and curtailed city services: Buffalo, Chicago, Cleveland, and St. Louis. These cities have pension liabilities similar to, or greater than, those in pre-bankruptcy Detroit—liabilities that threaten the provision of core city services. Like Detroit, these cities also have robust local philanthropic communities, as well as high levels of household poverty and stagnant property-tax revenues.

This paper finds that philanthropic assets in the aforementioned cities are more than sufficient to support a Detroit-style grand bargain—if paired with contributions proportionally equivalent to those made by other Detroit stakeholders (corporations, government, and labor)—to reduce such cities' pension debt, as well as to improve municipal services and/or reduce taxes. This paper does not suggest that every detail of Detroit's grand bargain should be slavishly followed. Nor does it argue that philanthropy should, as a general rule, direct its resources to providing services historically associated with local government. But by addressing its financial problems in a highly promising, innovative manner, Detroit has pioneered a model worthy of imitation.

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I. Introduction

In the summer of 2014, as Detroit searched for ways to emerge from the largest municipal bankruptcy in U.S. history, its chances of doing so without drastic cuts to city services—or to pension benefits for retired employees—seemed remote. Detroit's annual required contributions to its two major employee pension funds totaled approximately $119 million—such a significant part (more than 8 percent) of its overall 2014 budget that it would remain unable to provide the core services that the city desperately needed.[1] So dire was the situation of the once-great American manufacturing hub that thousands of the city's streetlights were broken, encouraging crime and stoking fear.

In Detroit's search to meet its pension obligations and restore public services, it had begun, under the supervision of a federal bankruptcy judge, to consider drastic options, including the sale of world-famous paintings housed in the city-owned Detroit Institute of Arts. Such a fire sale would have realized hundreds of millions of dollars; when coupled with reductions to retiree benefits, the sale would have allowed Detroit to emerge from bankruptcy with a plausible plan to restore services for its nearly 700,000 residents.

Yet this scenario had an entirely different effect: it mobilized a philanthropic consortium of the city's major foundations (primarily Detroit's old industrial fortunes preserved, in part, for charitable purposes) to take unprecedented action. Twelve of those foundations, led by the Community Foundation for Southeast Michigan (CFSM), would pledge a collective $366 million in assets over 20 years (**Figure 1**), toward a grand bargain: a combination of philanthropic, corporate, and state of Michigan donations, matched by public-employee-union agreements to accept reduced benefits, that would make Detroit much closer to being financially whole.

FIGURE 1.

Detroit's Grand-Bargain Philanthropic Consortium

Foundation	Pledge ($, Thousands)
Community Foundation for Southeast Michigan	10,000
William Davidson Foundation	25,000
Fred A. and Barbara M. Erb Family Foundation	10,000
Max M. and Marjorie S. Fisher Foundation	2,500
Ford Foundation	125,000
Hudson-Webber Foundation	10,000
Kresge Foundation	100,000
W. K. Kellogg Foundation	40,000
John S. and James L. Knight Foundation	30,000
McGregor Fund	6,000
Charles Stewart Mott Foundation	10,000
Paul and Carol C. Schapp Foundation	5,000
Net Total*	366,000

*Sum of above pledges minus credits to Detroit Institute of Arts commitments
Source: Community Foundation for Southeast Michigan

Nominally, the consortium set out to halt the sale of art masterpieces, which would likely have occurred at low, emergency prices. (The Detroit Institute of Arts was itself able to secure pledges of an additional $100 million, including $26 million from General Motors, Ford, and Chrysler.)[2] In practice, says Mariam Noland, executive director of CFSM, "[t]his was a chance for philanthropy to save a city."[3] Traditional philanthropic causes, such as education or neighborhood revitalization, would "make no difference if you don't have the city itself functioning," adds Noland.

This view led to the formation of the Foundation for Detroit's Future (FDF), a supporting organization of CFSM, to receive private funds—to be used only to pay pension obligations—and to distribute them under the terms of Detroit's bankruptcy agreement.[4] The result was significant: $816 million in assets, raised over 20 years, from the consortium (led by $125 million from the Ford Foundation),[5] corporations, and the state of Michigan; and significant union concessions, including a 4.5 percent reduction in current-retiree pension payments, an end to annual cost-of-living adjustments (though with safeguards for low-income pensioners), and a freeze on new-employee entries into the existing pension plan (to be replaced by a hybrid pension system combining employee and employer contributions).

The goal: give Detroit a fiscal fresh start, unburdened by legacy obligations. By buying art held by the Detroit Institute of Arts, which would now become a private nonprofit, the consortium would inject funds, over time, into the Motor City's budget.[6] Wrote the *New York Times*: "A plan to save the collection from sale—which came together over the last several months and is being called 'the grand bargain'—raised more than $800 million from foundations, private donors and the State of Michigan essentially to ransom the museum from city ownership. The bargain provided the money to help save public workers' pensions, as long as the museum was protected and owned by an independent charitable trust, as are most large American museums."[7]

As part of the grand bargain, the charitable contributions were $268.7 million (net-present-value dollars, 2015), the state contribution was $194.8 million, and retiree and labor contributions, via pension reform, were roughly $1.33 billion. Though Detroit's remaining net pension liability after the agreement was roughly $1.13 billion, the city will receive a reprieve from its required contributions until 2024.[8] All this has allowed Detroit to reduce its annual pension-fund contribution from $104 million in 2012 to $20 million in 2016, thereby sparing the city from a counterproductive property-tax increase and allowing more spending on core services, such as street lighting and police.

Detroit is far from alone in facing municipal financial capacity that cannot support both the costs associated with retirees and those necessary to provide crucial public services. Indeed, it is a problem confronted by many "legacy cities," once engines of the U.S. industrial economy but now seeking a new economic role and often saddled with vast fixed costs owed for past services. Consider Chicago. Despite that city's record $543 million 2015 property-tax hike, Moody's downgraded Chicago's bond rating after the credit-rating firm estimated that Chicago's $20 billion pension-fund debt would continue to rise.[9] The success of Detroit's grand bargain suggests that, even in the absence of municipal bankruptcy, a similar—albeit not identical—approach would benefit other postindustrial U.S. cities with some, or all, of Detroit's pre-bankruptcy characteristics, including:

1. High pension and retiree-benefit costs, as well as annual contribution requirements coincident with reductions in other city services.
2. Rising, or elevated, property taxes and/or a declining tax base.
3. A locally attached philanthropic community that can preserve the overwhelming majority of its assets but still make grants that reduce a significant portion of municipal pension-fund costs.

This paper models the viability of applying Detroit's grand-bargain model to four other U.S. cities—Buffalo, Chicago, Cleveland, and St. Louis—that face similar, proportionally large annual pension liabilities. To do so, the paper examines asset levels of the major philanthropic foundations in those cities; it then estimates the potential increase in spending on core city services that such a grand bargain might enable. While philanthropy and government typically have distinct, complementary roles, this paper finds that, to facilitate a one-time structural adjustment, the aforementioned cities would greatly benefit from a Detroit-style grand bargain.

II. Are Buffalo, Chicago, Cleveland, and St. Louis Comparable with Detroit?

Detroit's grand bargain was prompted by extreme financial duress, largely because of benefits owed to retirees. Such benefits included an overall unfunded pension liability for two major funds (a general fund and a police fund) totaling $2.9 billion.[10] As a result, Detroit faced an annual required contribution of $119 million, or 5 percent of the city's 2014 budget. The nearly $49 billion in assets held by the foundations that contributed to the city's grand bargain loomed as an untapped reservoir that could be used to partially offset the city's fixed costs, without threatening the long-term financial viability of the foundations' endowments.

Buffalo, Chicago, Cleveland, and St. Louis all possess significant foundation wealth, relative to municipal expenses (**Figure 2**). For the purposes of this paper, a group of leading foundations in each city was chosen on the basis of total net assets, as measured by the National Center for Charitable Statistics. Within the list of these IRS-registered organizations, only those designated by the IRS as public charities or private foundations were considered. Further, only foundations that have, historically, made grants to their local communities were included.

FIGURE 2.

Foundations' Net Assets and Municipal Budgets

City	Net Assets of Leading Foundations[11] ($, millions)	Total Municipal Expenditures ($, millions)
Detroit	48,856	1,326
Buffalo	2,219	585
Chicago	13,573	7,172
Cleveland	6,052	768
St. Louis	888	816

Source: Foundation Center and public disclosure of listed foundations

The sources of the foundation endowments examined herein are connected to the historical sources of wealth specific to the respective cities. Just as the Ford Foundation traces its wealth to Detroit's legendary automaker, so, too, can Chicago's foundation wealth be traced to famous Chicago firms central to the city's economic growth, such as Bankers Life (MacArthur Foundation), the *Chicago Tribune* (Robert R. McCormick Foundation), its building-supply industry (Crown Family Philanthropies), railway boxcars and manufacturers (Pritzker Traubert Family Foundation), as well as more recent wealth (Oprah Winfrey Foundation). The story is similar in Buffalo, whose John R. Oishei Foundation traces its wealth to the invention and manufacture of automobile windshield wipers; in Cleveland, whose manufacturing history includes the industrial-parts fortune of the Mandel Foundation; and in St. Louis, which spawned the Stupp Bros. Bridge & Iron Co. Foundation.

Chicago, Cleveland, St. Louis, and Buffalo are also characterized by high levels of household poverty and low median household incomes (**Figure 3**), making it difficult for their municipal budgets to support both high retiree costs and core public services. It is also true that many major foundations that originated in these cities have long acknowledged a special relationship with their birth city. The Oishei Foundation includes among its areas of focus "stable neighborhoods" and "education in Buffalo."[12] The McCormick Foundation pledges to focus on grants "to improve the lives of those underserved and the communities they live in," including violence-wracked Englewood on Chicago's West Side.[13] The Cleveland Foundation's priorities include local education, neighborhood services, and youth development.[14] In other words, not only are there deep links between the philanthropic wealth of these cities and their economic history; in many cases, such foundations already target local needs that their financially strapped city governments cannot address.

FIGURE 3.

Poverty Rates and Median Household Income

City	Poverty Rate (%)	Median Household Income ($)
Detroit	39	25,769
Buffalo	31	31,919
Chicago	22	48,734
Cleveland	39	24,701
St. Louis	29	35,959

Source: U.S. Census[15]

Tax Rates and City Services

Absent a grand bargain, making both legacy-cost payments and maintaining, or improving, local municipal services would require ongoing increases—such as by raising property taxes—in local revenue. During 2009–13, property-tax rates rose in Chicago and St. Louis, remained unchanged in Cleveland, and fell in Buffalo (**Figure 4**). In all four cities, property-tax revenue rose during 2013–14 (**Figure 5**).

FIGURE 4.

Property-Tax Rates per $1,000 Assessed Value, 2009–13 (%)

City	2009	2010	2011	2012	2013
Buffalo[16]	9.7	9.4	9.3	9.2	8.9
Chicago	9.9	10.2	11.1	12.8	13.4
Cleveland	12.7	12.7	12.7	12.7	12.7
St. Louis	13.2	13.6	14.2	14.7	14.8

Source: 2014 comprehensive annual financial reports of respective cities

FIGURE 5.

Increase in Property-Tax Revenue, 2013–14

City	Increase ($, millions)
Buffalo	0.4
Chicago	20.1
Cleveland	7.3
St. Louis	1.4

Source: 2014 comprehensive annual financial reports of respective cities

Spending on pensions is crowding out spending on core city services (**Figure 6**). In 2005, Chicago devoted 5.9 percent (or $340 million) of its budget to street maintenance and sanitation; in 2014, 3.8 percent (or $269 million). Or consider Buffalo: during 2005–14, as a share of total spending, the city trimmed resources available for public safety (29.8 percent down to 26.2 percent), street maintenance and sanitation (5.2 percent to 2.4 percent), and education (15.9 percent to 12.0 percent).

FIGURE 6.

Municipal Spending on Key Services, Total and as Share of Budget, 2005 v. 2014

City		2005 ($, millions)	2005 (%)	2014 ($, millions)	2014 (%)
Buffalo	Public Safety	133	29.8	153	26.2
	Streets/ Sanitation	23	5.2	14	2.4
	Education	71	15.9	70	12.0
	Total	447	—	585	—
Chicago	Public Safety	1,612	28.0	2,067	28.8
	Streets/ Sanitation	340	5.9	269	3.8
	Recreation	95	1.7	94	1.3
	Total	5,750	—	7,172	—
Cleveland	Public Safety	274	61.4	286	61.6
	Total	445	—	464	—
St. Louis	Public Safety	232	35.1	309	37.9
	Streets	35	5.3	38	4.6
	Parks/ Recreation	23	3.4	27	3.3
	Total	660	—	815	—

Source: 2014 comprehensive annual financial reports of respective cities

III. Modeling Detroit's Grand Bargain

This section models the effects of applying a Detroit-style grand bargain in Buffalo, Chicago, Cleveland, and St. Louis—four cities with pension liabilities and budget crunches similar to pre-bankruptcy Detroit (**Figure 7**). Such a grand bargain would require major contributions from private funds (foundations and corporations, in Detroit's case) and public funds (from the state of Michigan, in Detroit's case), as well as concessions by public-sector unions to cuts to future retiree benefits. All this would allow these cities to reduce—or, at the very least, dramatically slow—their annual pension contributions, paving the way for substantial local tax cuts and/or significant improvements to city services.

FIGURE 7.

Annual Required Pension Contributions (ARPC) and Total Spending (TS), 2015

City	ARPC ($, millions)	TS ($, millions)	ARPC as Share of TS (%)
Detroit*	118.8**	1,325.8	9.0
Buffalo	95.1	590.3	16.1
Chicago[17]	885.7	7,339.2	12.1
Cleveland*	64.2	768.4	8.4
St. Louis*	97.6	816.0	12.0

*Data are for 2014, the most recent year available.
**Detroit's true pre-bankruptcy ARPC was higher than $118.8 million—an artificially low sum produced by overly generous assumptions and an open amortization period.
Source: Author's calculations, based on data from the Foundation Center and public disclosure of listed foundations

Pension Liabilities Pre– and Post–Grand Bargain

Detroit's 2014 certified annual financial report summarizes the effect of its grand bargain on the Motor City's pension obligations:

> The latest actuarial reports "GASB Statement No. 67 *Plan Reporting and Accounting Schedules*" for the GRS [General Retirement System] and PFRS [Police and Fire Retirement System] estimated that the pre-bankruptcy exit net pension liability at June 30, 2014 was $1,786,441,192 and $1,131,584,746 respectively.... [T]he actuary projected that the net pension liability at June 30, 2014 for the GRS and PFRS as a result of the benefit changes in the Plan were $999,849,016 and $591,352,474, respectively. The net pension liability for both retirement systems decreased $1,326,824,448 ($786,592,176 GRS and $540,232,272 PFRS) because of the pension settlements.[18]

If foundations in Buffalo, Chicago, Cleveland, and St. Louis made total contributions proportionally equivalent to the $466 million contributed by Detroit's philanthropic consortium and the Detroit Institute of Arts, how much would philanthropy, government, and labor need to contribute in each city? Estimated pension liabilities for the four cities were drawn from their unfunded actuarial accrued liability (UAAL), as reported by Boston College's Center for Retirement Research.[19] The percentage contributions—as agreed in Detroit's grand bargain—for philanthropy,[20] government,[21] and labor[22] were then applied to estimate the contributions required by each stakeholder (**Figure 8**).

FIGURE 8.

Projected Unfunded Pension Liabilities—Before and After Grand Bargain (GB)*

City	Pension Liability *Before* GB ($)[23]	Philanthropy Contribution Under GB ($)	Government Contribution Under GB ($)	Labor Contribution Under GB ($)	Pension Liability *After* GB ($)
Detroit[24]	2,918,025,938	268,700,852	194,800,000	1,326,824,448	1,127,700,638
Buffalo	141,000,000	12,983,716	9,412,802	64,112,606	54,490,876
Chicago	19,352,000,000	1,781,992,006	1,291,890,367	8,799,341,494	7,478,776,133
Cleveland	719,000,000	66,207,744	47,998,614	326,928,821	277,864,822
St. Louis	431,000,000	39,687,813	28,772,465	195,975,413	166,564,309

*Figures are present value; those for Detroit are real, not projected. Note, too, that the net pension liability (NPL) is similar, but not identical, to the unfunded actuarial accrued liability: UAAL allows discretion in the choice of discount rate, asset smoothing, and other assumptions, which makes it less volatile but typically smaller than the NPL.[25] Detroit's grand bargain used a 6.75 percent discount rate; the choice of discount rate in a similar grand bargain will determine the value of required philanthropic contributions.
Source: Author's calculations, based on data from Detroit's 2014 comprehensive annual financial report and the Financial Review Commission's 2015 Biannual Report on Detroit[26]

Impact on Foundations' Assets

Can leading foundations in Buffalo, Chicago, Cleveland, and St. Louis afford to make a Detroit-style grand bargain? Yes: grand bargain–related grants would total less than 2 percent of such foundations' assets (**Figure 9**).[27] (To the extent that smaller foundations contributed, the share of assets required of any one foundation would, of course, decrease.) Indeed, Figure 9 makes clear that a grand bargain would not preclude leading foundations from pursuing their traditional initiatives.

FIGURE 9.

Leading Foundations' Projected Annual Contributions over 20 Years, as Share of Assets

City	Share of Net Assets (%)
Detroit*	0.05
Buffalo	0.05
Chicago	1.49
Cleveland	0.09
St. Louis	0.39

*Figure for Detroit is real, not projected.
Source: Author's calculations, based on data from the Foundation Center and public disclosure of listed foundations

Impact on Property Tax and City Services

The significant savings made possible by a Detroit-style grand bargain would allow cities to reduce, or minimize increases in, local property taxes and/or increase spending on core municipal services (**Figure 10**). Lower taxes can stimulate economic development and attract businesses and residents, as can safer, cleaner streets and more effective schools. Figure 10 makes clear that a grand bargain would be financially practical and would make significant funds available—for public-service provision and/or tax relief—in Buffalo, Chicago, Cleveland, and St. Louis.

FIGURE 10.

Average Projected Reduction in Household Taxes

City	Number of Households (2014)	Average Household's Annual Tax Savings over 30 Years ($)	Average Household's Lump-Sum Savings (Present Value, $)	Lump-Sum Savings for City (Present Value, $)
Detroit*	253,490	520	7,063	1,790,325,300
Buffalo	110,070	58	786	86,509,124
Chicago	1,031,672	847	11,509	11,873,223,867
Cleveland	165,984	196	2,658	441,135,178
St. Louis	137,784	141	1,919	264,435,691

*Figures for Detroit are real, not projected.
Source: Author's calculations, based on data from Census Bureau's 2014 American Community Survey One-Year Survey and public disclosure of listed foundations

IV. Further Considerations

Unlike Chicago and St. Louis, Buffalo and Cleveland do not control their local single-employer pension plans. Instead, they contribute to state-run multiemployer pension plans managed on their behalf. A grand bargain in Buffalo and Cleveland would therefore involve negotiations at both the local and state level, in a way that differed somewhat from Detroit's grand bargain. The sources of retiree costs vary across these four cities, too: in Buffalo, for instance, most of the unfunded liability is in retiree health care and other postemployment benefits; in Chicago, most of the unfunded liability is attributable to pensions. (As noted, the OPEB cuts in Detroit's grand bargain are not evaluated here.)[28]

Thus, the path charted by this paper should not be viewed as a narrow one applicable in all cases; rather, it should be considered a starting point for what can be learned and applied from Detroit's philanthropy-based model to the goals of controlling retiree-related costs and improving city services. Other variations in the grand-bargain model could include:

Philanthropic structure. The new, freestanding "pension-reduction" foundation—formed with foundation grants and established as the vehicle to provide pension funding—could be structured in numerous ways. Because its own funds would be disbursed over time and invested in the interim, the pension-reduction foundation could serve as a program-related investment for donor foundations; in other words, the new foundation's investments could provide a modest return to donors, such that the drain on their own assets would be limited.

Community foundations. The special nature of community foundations, such as the Chicago Community Trust, merits consideration. Community foundations typically have a limited amount of "discretionary" funding—funding that can be allocated by foundation staff. Instead, a community foundation's assets are largely controlled by individual "donor-advisors," who direct disbursement as they see fit; such donor-advisors would therefore have to agree to contributions to any pension-reduction foundation. (The possibility cannot be ruled out, of course, that community-minded donor-advisors would make substantially greater contributions than the gross donation percentage [9.2 percent of the pre-bankruptcy pension liability] modeled in this paper.)

State constitutions. Differences in state law would have to be considered, too. Detroit's bankruptcy, subject to federal law, effectively overrode Michigan's ban on changing the terms of public-employee pensions. For Cleveland and St. Louis, no such state complications exist: neither Ohio nor Missouri restricts changes to public-employee pensions. In Cleveland and St. Louis, agreement among local parties—foundations and other private donors, city government, and public-employee labor unions—could therefore produce a grand bargain. However, in Illinois and New York, public-employee pension payments enjoy constitutional protection. As such, in Chicago and Buffalo, any grand bargain could not be enabled through negotiations among local parties alone: a Detroit-style grand bargain would require changes to the respective state constitution.

In Illinois, state legislature supermajorities (three-fifths) are required for constitutional change; the alternative, a state constitutional convention, also requires a three-fifths general-election vote. In New York, simple majorities are required in the state legislature to initiate constitutional change, followed by a general-election vote also requiring a majority; alternatively, constitutional change, via a state convention, would have to be part of New York's constitutional-convention process, which itself requires authorization through a voter referendum.

V. Conclusion

Pension reformers in Chicago and Buffalo thus face a high bar to enacting a Detroit-style grand bargain. Yet these and many other U.S. cities face a simmering crisis, one threatening to upend their capacity to balance mandated pension payments with citizens' expectations of continued provision of reliable, core public services. In this context, extraordinary steps, such as those described in this paper and practiced in Detroit, are sensible and prudent.

As noted, this paper does not argue that philanthropy should, as a general rule, direct its resources to providing services historically associated with local government. Philanthropy has its own role to play—whether supporting the provision of services that are difficult for government to provide well or supporting innovation, from new approaches to education to medical research. This paper does not suggest, either, that Detroit's specific cost-sharing arrangement should be slavishly followed elsewhere. After all, a grand bargain is fundamentally a political agreement: negotiations among different local parties should lead to different local solutions. But by addressing its financial problems in a highly promising, innovative manner, Detroit has pioneered a model worthy of imitation.

Endnotes

[1] Detroit also faced large interest payments on pension-obligation bonds, as well as significant funding for other postemployment benefits (OPEB): 40 percent of the city's municipal budget went to debt, pensions, and OPEB upon entry into bankruptcy. See http://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/09/detroit-bankruptcy-rosen-orr-snyder/18724267.

[2] See http://money.cnn.com/2014/06/09/news/detroit-automaker-art.

[3] Author's interview.

[4] The following court-approved language was framed in terms of how Detroit was, in effect, to receive funds to pay its pension obligations as a result of the transfer of Detroit Institute of Arts property from the city to a private museum: "All payments by the Funders shall be made directly to the Supporting Organization which shall hold such payments in a segregated account (the 'Account') pending payment to the City. Notwithstanding the foregoing, any DIA Funder may make its payments to The DIA instead of to the Supporting Organization; payments by The DIA (either with respect to a Deficiency Amount or on behalf of a DIA Funder who elects pursuant to the preceding sentence to make its payments to The DIA) to the Supporting Organization shall be pursuant to the terms of an agreement which will be entered into between The DIA and the Supporting Organization in connection with the execution of the Definitive Documentation. As set forth under 'Default and Remedies' above, only the City will have recourse or claims against the Account, provided all conditions specified in 'Conditions to Future Funding Obligations' of this Term Sheet have been satisfied and as otherwise provided in this Term Sheet, and the City shall be paid when due, directly from the Account for the exclusive payment of the Pensions. The City will not be entitled to any interest or earnings on the balances of the Account. The City shall then pay such amounts to and for the exclusive payment of the Pensions in accordance with the allocation determined by the City and agreed by the Funders." See https://www.michigan.gov/documents/treasury/Detroit_-_Eighth_Amended_Plan_of_Adjustment_476086_7.pdf.

[5] Though the Ford Foundation's endowment is derived from Henry Ford's fortune, the foundation had not been recently active in its city of origin before this intervention.

[6] The Detroit Institute of Arts successfully proposed a ten-year, tri-county property-tax millage in 2012 that raises approximately $23 million annually from 2013 to 2023. If the art had been sold, the millage would have been forfeit. As a compromise, the DIA, with the help of its charitable partners, is handing over the equivalent amount of property-tax revenue from the tri-county millage to the city for the next 20 years, whether or not the millage is renewed for the second half of the 20-year funding period. See https://www.mied.uscourts.gov/PDFFIles/DBOralOpinion.pdf; and http://www.huffingtonpost.com/2012/08/08/dia-millage-detroit-institute-of-arts-_n_1753989.html.

[7] See http://www.nytimes.com/2014/01/14/us/300-million-pledged-to-save-detroits-art-collection.html?_r=2.

[8] Detroit now says that its needed contributions, beginning in 2024, were significantly underestimated by the city's bankruptcy consultants. See http://www.detroitnews.com/story/news/local/detroit-city/2016/02/23/duggan-detroit-speech/80782866.

[9] "Even with Emanuel's Record Property Tax Hike, Pension Debt to Grow for Another Decade," *Chicago Tribune*, November 11, 2015. See http://www.chicagotribune.com/news/local/politics/ct-emanuel-budget-city-tax-20151110-story.html.

[10] See http://www.michigan.gov/documents/treasury/Detroit_FY2014_CAFR_494211_7.pdf, p. 154.

[11] For Detroit, "leading foundations" consist of all the foundations that contributed to the city's grand bargain, including large nonlocal national charities that made comparatively modest contributions. In Buffalo, Chicago, Cleveland, and St. Louis, leading foundations consist of the ten to 15 largest foundations headquartered in—or near—each city. In the event of a grand bargain, it is possible that wealthy expats and regional foundations outside the cities themselves could contribute, as happened in Detroit. But to be conservative, I restricted my search to the cities' home charities alone. Foundations are: for Buffalo—John R. Oshei Foundation, Community Foundation for Greater Buffalo, Foundation for Jewish Philanthropies, Ralph C. Wilson Foundation, Margaret L. Wendt Foundation, Peter and Elizabeth C. Tower Foundation, Cameron and Jane Baird Foundation, James H. Cummings Foundation, Statler Foundation, Seymour H. Knox Foundation, and Western New York Foundation; for Chicago—Chicago Community Trust, Robert R. McCormick Foundation, Arie and Ida Crown Memorial, Jewish Federation of Metropolitan Chicago, Pritzker Traubert Family Foundation, Polk Brothers Foundation, Irving Harris Foundation, Oprah Winfrey Foundation, Crown Family Philanthropies, Gaylord and Dorothy Donnelley Foundation, Walsh Foundation, MacArthur Foundation, and Joyce Foundation; for Cleveland—Gund Foundation, Cleveland Foundation, Jack N. and Lilyan Mandel Fund, Jack, Joseph, and Morton Mandel Foundation, Morton L. and Barbara Mandel Fund, Joseph C. and Florence Mandel Fund, Jewish Federation of Cleveland, Morton and Barbara Mandel Family Foundation, Joseph and Florence Mandel Foundation, Saint Luke's Foundation of Cleveland, Ohio, Catholic Community Foundation, Mt. Sinai Health Care Foundation, Veale Foundation, Kelvin and Eleanor Smith Foundation, and William and Dorothy O'Neill Foundation; and for St. Louis—Greater St. Louis Community Foundation, Lutheran Foundation of St. Louis, Dana Brown Charitable Trust, Hauck Charitable Foundation, Ballman Family Private Foundation, Mary R. and Ettie A. Jordan Foundation, Lubin Green Foundation, Harry Edison Foundation, Rosalie Tilles Nonsectarian Charity Fund, Stupp Bros. Bridge & Iron Co. Foundation, Society of St. Vincent De Paul Archdiocesan Council of St. Louis, Enterprise Holdings Foundation, and Alvin Goldfarb Foundation.

[12] See http://www.oishei.org/index.php/what-we-fund.

[13] See http://mccormickfoundation.blogspot.com/2015/04/celebrating-25-years-of-community.html.

[14] See https://www.clevelandfoundation.org/grants/impact-areas.

[15] American Community Survey 2014 One-Year Survey.

[16] For Buffalo, the property-tax rate that applied to residential homes (the "homestead class") was used.

[17] For this paper's purposes, Chicago's pension liability does not include that of the Chicago Teachers' Pension Fund—which, as a separate legal entity, is not part of Chicago's municipal budget.

[18] See http://www.detroitmi.gov/Portals/0/docs/finance/cafr/Final%20CAFR.pdf.

[19] See http://crr.bc.edu/wp-content/uploads/2016/01/SLP_47.pdf.

[20] Detroit's philanthropic consortium's contribution totaled 9.2 percent of Detroit's pre-bankruptcy pension liabilities.

[21] The state of Michigan's contribution totaled 6.7 percent of Detroit's pre-bankruptcy pension liabilities.

[22] Detroit's public-employee unions' concessions totaled 45.5 percent of Detroit's pre-bankruptcy pension liabilities.

[23] Buffalo, Chicago, Cleveland, and St. Louis used more aggressive assumptions—including discount rates greater than the 6.75 percent specified in Detroit's grand bargain—when calculating their net pension liabilities. It is therefore likely that the unfunded actuarial accrued liabilities, if recalculated using the 6.75 percent rate, would be higher than disclosed in the reports assessed for Boston College's Center for Retirement Research and cited here. Nonetheless, these four cities' reported liabilities, though somewhat misleading, are useful for outlining the scale of the sums involved and for describing the framework of a potential grand bargain.

[24] I use Detroit's 2014 comprehensive annual financial report (CAFR) "before and after" estimates of its net pension liability, but obtained unfunded actuarial accrued liability estimates for the other four cities from Boston College's Center for Retirement Research (BC CRR) report (http://crr.bc.edu/wp-content/uploads/2016/01/SLP_47.pdf): in FY 2012, Detroit reported a mere $787 million UAAL, a sum smaller than the post-bankruptcy $1.5 billion UAAL reported in Detroit's 2014 CAFR. Though I use the estimates for Chicago, Buffalo, and Cleveland for the reasons cited in the text, Detroit's ability to hide its true unfunded liability until the point of bankruptcy gives good reason for caution in trusting the CAFRs cited for BC CRR's figures in other, less scrutinized, cities with locally operated single employer plans.

[25] See http://www.gabrielroeder.com/wp-content/uploads/2013/12/GRS-Insight-October-2013-Final-Revised.pdf.

[26] See http://www.michigan.gov/documents/treasury/Detroit_FY2014_CAFR_494211_7.pdf?20160412110500; and http://www.michigan.gov/documents/treasury/FRC_Biannual_Report_to_Governor_11-24-15_507074_7.pdf?20160412110500.

[27] This calculation assumes that, as in Detroit, all the leading foundations in the respective cities will participate; if they do not all participate, the foundations that do participate will need to make larger contributions; if no foundations participate, corporate foundations could, hypothetically, contribute instead. However, because corporate foundations lack assets of their own and serve as a means to distribute corporations' net income in any given year, it would not be useful to calculate the share of assets that a grand bargain would require of corporate foundations.

[28] See n. 1 above.

April 2016

REPORT 10

Abstract

In 2013, as Detroit's crippling overhang of retiree pension-payment obligations hung over its bankruptcy negotiations, a daring move by a dozen major foundations broke the logjam: led by a $125 million pledge by the Ford Foundation, the philanthropic consortium collectively pledged $366 million toward the city's pension liability, on the proviso that their contributions would leverage contributions from private corporations, state government, and public-employee unions. This paper examines whether a Detroit-style grand bargain could be successfully applied to four other midwestern cities facing the dangerous combination of significant pension costs and curtailed city services: Buffalo, Chicago, Cleveland, and St. Louis.

Key Findings

1. Buffalo, Chicago, Cleveland, and St. Louis have pension liabilities similar to, or greater than, those in pre-bankruptcy Detroit—liabilities that threaten the provision of core city services.
2. Like Detroit, these cities also have robust local philanthropic communities, as well as high levels of household poverty and stagnant property-tax revenues.
3. Philanthropic assets in Buffalo, Chicago, Cleveland, and St. Louis are more than sufficient to support a Detroit-style grand bargain—if paired with contributions proportionally equivalent to those made by other Detroit stakeholders (corporations, government, and labor)—to reduce such cities' pension debt, as well as to improve municipal services and/or reduce taxes.

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