CITY OF FLINT

OFFICE OF THE EMERGENCY MANAGER

Darnell Earley, ICMA-CM, MPA
Emergency Manager

January 24, 2014

Dear City of Flint Retiree,

I am writing to you about a recent court decision that will have a disastrous effect on the City of Flint's financial condition, and how that decision will directly affect you. On Friday, January 3, 2014, the U.S. 6th Circuit Court of Appeals reinstated an injunction prohibiting the City from modifying retiree health care until the case is decided. The injunction was sought by a small group of retirees who seek to prevent the City from making any changes to their health care coverage.

While I fully understand the desire to keep health care coverage the way it was, as well as frustration at the City for not continuing the previous plan, the stark reality is that the City does not have the resources to afford this level of health care coverage. If the federal district court's decision is not reversed, the City will be in an extremely precarious financial position, with insufficient resources to meet basic functions.

Our efforts to address the City's financial emergency have been painful, and that pain has been widespread. Modification of your health care coverage was but one part of our broader efforts to return the City of Flint to financial solvency. These efforts have included laying off 20% of the workforce; reducing employee compensation by 20%; re-writing union contracts; eliminating retirement health care coverage for new employees; drastically reducing services to our residents; and many other painful choices. These decisions have been extremely difficult, but are necessary if Flint is to avoid insolvency, such as the City of Detroit.

Unfortunately, this lawsuit will seriously undermine those efforts, and the injunction represents a serious setback to the progress which has been made. Reinstituting historical levels of health care is estimated to add five ($5,000,000) million annually to City expenses. In addition, the City's unfunded liability for retiree health care will skyrocket to as much as nine hundred ($900,000,000) million. These levels are totally <u>unaffordable</u>.

Even with the changes in place, the City still spends nearly eighteen ($18,000,000) million annually on retiree health care alone. That's $9,500 per retiree for 1,900 retirees and is equivalent to 30% of the City's general fund budget.

We have done everything possible to avoid insolvency. Among other things, financial insolvency triggers the exploration of a potential bankruptcy filing, as authorized under the emergency manager law, Public Act 436. As you may know from the City of Detroit's experience, this threatens severe reduction or total elimination of health care coverage for retirees, <u>and</u> allows for reduction of pensions. Since retirees are far and away the largest creditors to the City of Flint, it is likely that a bankruptcy proceeding would consider substantial modification of both health care and pension benefits.

I am enclosing an outline of the financial challenges Flint faces, and of our progress to date – progress which will be significantly reversed if we are unable to address all aspects of the City's financial structure. I ask for your cooperation and input as we continue to move through these difficult times.

The City is in the process of identifying the actions necessary to comply with the injunction. This will include a process for reimbursing retirees for qualified health expenses incurred since January 3, 2014. It will also include a process for identifying health care plans for the future which address the increased costs incurred by retirees.

You can expect further communications from the City or our agent, Cornerstone Municipal Consultants, as these processes unfold. You are encouraged to retain documentation of health care expenses incurred since January 3, 2014 which you believe is in excess of your expected costs.

We wish the circumstances were different, but must deal with the severe financial emergency confronting the City. It is important that you fully appreciate how this lawsuit may affect your future rights to health care coverage and pension benefits. We are concerned that this small group of plaintiffs has not fully informed you of the consequences their lawsuit may bring.

Thank you.

Darnell Earley

Darnell Earley, ICMA-CM, MPA
Emergency Manager

RESTORING FLINT TO FINANCIAL SOLVENCY – JANUARY, 2014 UPDATE

The challenges faced by the City of Flint are significant. For the second time, Flint is in state receivership and under the control of a state appointed Emergency Manager. As of June 30, 2012, the City had a $19 million deficit in its General Fund, and had minimal cash on hand. Flint also had one of the highest amounts of unfunded pension and health care liability in the state, on a per capita basis – nearly $11,000 per resident.

Reducing the deficit and operating within the constraints of a balanced budget has been extremely difficult. Balancing the budget for the fiscal year beginning July 1, 2013, started with projected revenues which were $25 million less than the amount needed to continue the current workforce and level of services – a gap which turned out to be even larger as the budget was finalized. Balancing the budget and beginning to return the City to financial solvency could not be achieved without reducing expenses, increasing revenues, or a combination of both.

The difficult decisions made to balance the budget have not been fair to taxpayers, employees, or retirees. Necessary decisions required sacrifices in the form of increased taxes, reduced compensation, and reduced services:

*Residents saw a 25% increase in their water and sewer rates; a 6 mill increase in property taxes; a new assessment for street lighting; and increases in fees, while seeing City services reduced.

*Employees saw a 20% reduction in the workforce, including more than 80 layoffs, and also saw a 20% reduction in compensation costs. Retiree health care was eliminated and a new pension structure was implemented for new employees. The City's workforce, which has historically been at 1,500, is now less than 650.

*Retirees saw their cost of health care increase as they were moved into the same health care plans as provided to active employees (if they were not Medicare eligible) and into a Medicare Advantage Plan if they were Medicare eligible. Major changes included a $1,000 deductible for single subscribers and 20% co-insurance to a maximum of $2,500. Some retirees were also to be subject to a $61/month premium share. These changes were projected to save $3.5 million annually.

*Residents, businesses, visitors, and students see the impact of a City government barely able to provide basic services – police and fire staffing is minimal, as evidenced by long wait times for police response; road maintenance and support is minimal and slow as most recently apparent in the recent winter weather; and parks are vacant and unused with very infrequent mowing. Other City services are also minimally staffed, making timely customer service very difficult.

These actions, while extremely difficult for all, moved the City towards financial solvency. The budget beginning July 1, 2012 was balanced and ended the year in a favorable position, with the $19 million deficit being reduced to a $13 million deficit. This year's budget was also balanced, with additional difficult decisions made to reduce expenditures, including further reducing the workforce. Prior to the Court's decision, the budget was cautiously on target, with expenses not expected to exceed revenues at years end. It also anticipated an additional reduction of at least another million dollars in the $13 million deficit.

Unfortunately, the Court's decision represents a serious setback to the progress that has been made. Reinstituting historical levels of health care for retirees could potentially add nearly $5 million annually to city expenses, and could increase the City's unfunded liability for retiree health care from its current $320 million to close to the $900 million unfunded liability which existed prior to changes in health care.

Even without the Court's decision, the City continues to face severe financial challenges as the amount of revenues anticipated to be received each year is projected to be several million dollars less than the expenses necessary to even continue the current minimal level of City services. Should the lawsuit ultimately be decided in the plaintiff's favor, the structural deficit will grow significantly, wiping out most if not all of the progress made to date in restoring the City to long term financial solvency.

Without the ability to contain one of the biggest cost elements in the City government – retiree health care - it may become necessary to consider bankruptcy - an option which City leaders have long sought to avoid. The current experience of the City of Detroit, as well as other cities across the nation, shows that bankruptcy can threaten not only reductions in health care costs for retirees, but puts health care in total at risk, in addition to pensions. And in Flint, should there be a bankruptcy proceeding, a federal bankruptcy judge would have few options other than looking at health care and pensions, because in Flint – unlike Detroit – retirees are far and away the largest creditors.