Detroit Public Schools:

Options for the Future

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Executive Summary

Detroit Public Schools (DPS) is in financial and academic crisis. The district has a current operating deficit of $331.4 million. In 2009, DPS fourth graders posted the worst scores on record on the National Assessment of Educational Progress (NAEP) for math. For the past two years, the district has been operated by Robert Bobb, the state-appointed emergency financial manager. Under his tenure, student enrollment has continued to decline, and the debt has risen. And now, as his appointment comes to an end, the state must decide if, and how, to intervene in the district.

Focusing just on an academic or a fiscal outcome is not a viable solution in the short or long term—the two are too closely linked. An academic solution cannot be crafted without first addressing the financial concerns of the district; otherwise, strong academic interventions fall short when funding is not available to implement them. Solving these problems is not the goal of this analysis. Rather, the goal is to outline several options available to DPS, provide a framework for discussion of these problems, and identify "first steps" to engage and educate policymakers, businesses, and the community at large in a meaningful conversation about possible options and avenues for change.

What Can the State Do in the Short Term?

There are a number of short-term options to address the financial crisis in the DPS, and they vary in their degree of political palatability. The advantages and disadvantages of each option will be explored in greater depth in the body of this report.

Appoint a new emergency manager, and execute the Deficit Elimination Plan (DEP)

Robert Bobb's contract has been extended through June 30, 2011. At this time, the governor will be responsible for deciding whether to appoint a new emergency financial manager or not. Because of the continuing financial emergency in the DPS, it is widely believed that the governor will appoint a new emergency manager later this spring. This appointee will likely be charged with implementing the DEP, which currently aims to eliminate the district's deficit by 2014. The DEP, as approved by State Superintendent Mike Flanagan, includes plans to close 100 schools by 2013, increase class sizes to 62 at the high school level, eliminate student transportation, and move to having principals serve four high schools—among other steps.

Restructure debt

Restructuring the debt could take several forms, all of which would likely require a change to state law. First, the state could pay some or all of DPS's debt. Second, the state could require the district to implement reforms (such as new academic requirements, hiring practices, merit pay, and more) in exchange for state debt relief. Finally, the state could also help the district convert DPS's short-term debt into long-term debt, as it did in 2005.

Raise taxes

The DPS and all of the school districts in the state operate under constitutional limits regarding the level of local property taxes that can be levied to support school districts. The DPS has no ability, under current state law, to ask the local voters to approve a property tax increase to finance operating expenditures in the district. Any type of revenue increase that would provide more operating funding for the DPS would have to be the result of a change in the state constitution and a vote of the local electors.

File for federal bankruptcy protection

The DPS could also file for federal bankruptcy protection. Bankruptcy is seen by some as attractive mainly because the court can restructure the school district's debts. Bankruptcy, however, carries inherent risk. These risks will be analyzed in greater depth later in this report.

Reorganize the DPS

The district could also cease to exist in its current form. This reorganization could take several forms and will be explored more in the body of this report.

- **Smaller**: The district could break up into smaller districts serving smaller parts of the city.
- **Portfolio**: The DPS could also take a form similar to that of post-Katrina New Orleans school system. Rather than having a centrally run school system, New Orleans operates under a "portfolio model" wherein the school district authorizes, but does not operate, individual schools.
- **Regional**: The district could also consolidate with a neighboring suburban district to form a regional school district—much like Indianapolis or Memphis.
- **Charter**: Mr. Bobb has recently recommended turning over some of the DPS schools to charter operators.

What Can the State Do in the Long Term?

Michigan will have to consider alternatives to the current per-pupil funding model and institute a funding mechanism for schools that takes into consideration the changing demographics of the state. Detroit is one of many districts across the state facing declining enrollment. The challenge is that enrollment, to which state funding is tied, tends to decline more quickly than does the ability of districts to adjust operating expenditures. This, coupled with budgetary constraints at the state level, makes accurate planning a difficult task.

In addition to reevaluating Michigan's per-pupil funding mode, created by voters through Proposal A in 1994, the state must also be more proactive with financially troubled districts. Budget crises are usually not created in one year's time, and it often takes more than one year to resolve them. Intervening when budget problems seem small may prevent a DPS-like crisis in the future.

How Can the Discussion Move Forward?

Unfortunately, there is no "right" choice in this discussion. One thing is evident—everyone has a role in creating and implementing a plan for the DPS, and any resolution will require the support of each and every stakeholder to be successful. For too long, Detroit has complained that Lansing does not understand the intricacies of the problems faced by the city schools, and Lansing retorts that continually carving out one-time "Detroit solutions" detracts from the state's ability to enact effective or meaningful reform. The result has been an ongoing struggle between state and local leaders to implement lasting reform, and the proliferation of short-term solutions that have failed to improve the overall financial or academic operations of the district.

With a deficit of more than $330 million, the problem has reached a critical mass. There is no solution that does not involve state, local, and regional players—all of whom have a vested interest in righting the ship and doing so quickly. The single biggest hurdle will be for these stakeholders to decide which course of action best suits the city and the schools in the long term and then place themselves solidly behind that solution in a unified manner. **This will require bold leadership as state, regional, and local leaders involve parents, business leaders, and community members in a discussion as to why dramatic, and perhaps disruptive, change is essential.**

Detroit Public Schools:
Options for the Future

Over the past several years, the impact of significant declines in employment in Michigan combined with large drops in property tax revenues and a decline in enrollment across the state has placed the financial health of many school districts under serious strain. There has been considerable discussion in the state regarding the possibility that school districts might be forced to seek protection under federal bankruptcy laws. Detroit Public Schools (DPS) is one of the school districts in Michigan facing major financial stress. This paper will consider (1) how the state manages financial emergencies at the local level through state and federal law, (2) look at the financial stressors facing the DPS, and (3) explore what options are available to deal with those problems in Detroit, as well as school districts with similar financial problems around the state.

PART I: STATE AND FEDERAL LAWS GOVERNING FINANCIAL EMERGENCIES AT THE LOCAL LEVEL

The State of Michigan has several laws that contain statutory language that addresses the potential financial stress on school districts. These laws include:

- Public Act 2 of 1968: Uniform Budgeting and Accounting Act
- Public Act 451 of 1976: Revised School Code
- Public Act 94 of 1979: State School Aid Act
- Public Act 72 of 1990: Local Government Fiscal Responsibility Act
- Public Act 4 of 2011: Local Government and School District Fiscal Accountability Act

Overview of Michigan State Laws

Public Act 2 of 1968: Uniform Budgeting and Accounting Act

This law specifies the procedures under which school district budgeting must occur. It also establishes the accounting procedures that must be followed by school districts and provides for the financial audits of school districts on an annual basis.

Public Act 451 of 1976: Revised School Code

This act provides for general state oversight of school districts in the state, and includes discussion of everything from school board powers to curriculum to teacher certification. The act also includes provisions regarding the accounting of funds and the issuance of debt by school districts. In particular, Section 1225 of the act (MCL 380.1225) provides for the issuance of short-term notes by school districts for cash flow borrowing needs. Subsection 3 of this section lists the provisions that apply if a school district is unable to repay these short-term notes in a timely manner. The provisions in Subsection 3 were applied in 2005 by the State of Michigan and the DPS to convert short-term notes into long-term bonds in order to help balance the DPS budget. The issuance of these long-term bonds by the DPS resulted in increased debt service obligations of approximately $22 million per year for the next 15 fiscal years.

Public Act 94 of 1979: State School Aid Act

This law provides for the general state control over the financing of school districts. Section 102 of the act (MCL 388.1702) speaks to the issue of school districts operating under a budget deficit. The law requires that school districts that close the prior fiscal year with a budget deficit must submit a plan to the Department of Education outlining the steps that they will take to eliminate the budget deficit. The law allows the Department of Education to withhold state school aid payments to a school district that does not have a plan approved by the Department of Education to eliminate a budget deficit.

Public Act 72 of 1990: Local Government Fiscal Responsibility Act

Recent legislative action has repealed Public Act 72 of 1990. A discussion of Public Act 72 of 1990 remains relevant here because it highlights the fact that much of the process and emergency financial manager responsibilities outlined in Public Act 4 of 2011 were prescribed previously in statute.

This law provides the framework under which financial distress is addressed. The primary purpose of the act is to outline a set of procedures that the State of Michigan and school districts must follow before a school district is allowed to file for federal bankruptcy protection due to severe financial stress. The act provides for similar procedures for financial emergencies in municipalities as well as school districts.

The first step outlined in the act initiates a process under which the State of Michigan investigates the extent of the financial problems. This **process for school districts begins** when one or more of the following conditions exist or any of the entities mentioned below file a written notice with the state treasurer alleging that a financial emergency exists:

- The school district has completed the most recent fiscal year with a deficit in one or more of its operating funds.
- The school board of the school district adopts a resolution declaring that the district is in a financial emergency.
- A creditor of the school district is owed $10,000 or more or at least 1 percent of the general fund budget of the school district, and the school district is at least six months past the payment date on the obligation.
- A Citizen Petition alleging the existence of a financial emergency is signed by 10 percent or more of the registered electors in the last gubernatorial election in the school district.
- A trustee, paying agent, note holder, or bondholder files a written notice that a school district is not meeting its debt service obligations.
- A resolution is passed by the House of Representatives or the Senate.
- Conditions of the Revenue Bond Act or the Municipal Finance Act are violated.
- Conditions dealing with the Uniform Budgeting and Accounting Act are violated.
- The school district fails to file an annual financial report required under provisions of the Revised School Code.
- A court-ordered tax is levied without the approval of the local governing board.

The presence of any of the conditions listed above triggers a process that must be followed by the State of Michigan Superintendent of Public Instruction (state superintendent). The state superintendent will then notify the governor and the State Board of Education that a serious financial problem exists in a school district. Following this notification by the superintendent, the **second part of the process** under the act begins.

Within 30 days of such a notification, the governor must appoint a review team to investigate the financial problems in the school district. The review team includes the state superintendent, the state treasurer, the director of the Department of Management and Budget, and nominees from the Speaker of the House and the Senate Majority Leader. The review team then proceeds with a financial review of the school district if one or more of the following conditions exist:

- The state superintendent informs the governor that a financial emergency exists.
- The school district is in default on a debt service payment.
- The school district fails to pay its employees within five days of a scheduled payday.
- The school district fails to make a required payment to the Public School Employees Retirement System.
- The school district has not conformed to the provisions of a deficit reduction plan approved by the superintendent.
- The state treasurer notifies the governor that the review team needs to proceed to protect the credit rating of the school district or the state.

If the **governor then determines that the review team should begin its evaluation** of the health of the school district, the review team will perform the following functions:

1. Examine the financial records of the school district.
2. Utilize the services of other state agencies or employees and professionals from the private sector to complete the financial analysis of the school district.
3. Sign a consent agreement with the superintendent of the school district. This consent agreement may provide for initial short-term efforts to begin the process of putting the school district on a path toward financial recovery. Before any such consent agreement becomes effective, the consent agreement must be approved by a majority vote of the school board.

The review team will provide the governor with a report of its findings no later than 30 days following the appointment of the review team. This report will be provided to the school district and the members of the Michigan legislature, and will contain one of the following **conclusions** regarding the school district:

- The school district does not have a serious financial problem.
- The school district does have a serious financial problem, but a consent agreement to solve the problem has been approved by the school board.
- The school district does have a serious financial problem and the school board has not approved a consent agreement to resolve the financial problem.

If the report determines that a serious financial problem exists and the school board has not approved a consent agreement to resolve the financial problem, the state superintendent will notify the school district of this determination. The school district then has ten days to request a hearing with the state superintendent to discuss this finding. If the school district does not request a hearing on the state superintendent’s report or if the state superintendent rejects the appeal of the school district in such a hearing, the next step of the process involves the **appointment of an emergency financial manager** for the school district.

The state superintendent will then prepare a list of potential names for the position of the emergency financial manager for the school district. Potential emergency financial managers must show competence in fiscal matters and must not have been employed by the school district in the past five years. There is no provision requiring that the emergency financial manager be a resident of that school district. The state superintendent's recommendations for potential emergency financial managers will be reviewed by the State Board of Education; from these recommendations, the names of not more than three potential emergency financial managers will be forwarded to the governor. From the list of nominees, the governor will appoint the emergency financial manager.

The emergency financial manager will serve a term of office for a period of time established by the governor, but not to exceed one year. The appointment of the emergency financial manager will be by written contract and the contract may be renewed on an annual basis for not more than one additional year.

The emergency financial manager then **takes over the financial control of the school district**. In consultation with the school board, the emergency financial manager will prepare a financial plan for the school district. This financial plan will provide for a balanced school district budget based on the spending and revenue estimates prepared by the emergency financial manager and will ensure the full payment on any debt obligations outstanding in the school district. This financial plan will be made public by the emergency financial manager and modified as financial conditions with the school district change.

The emergency financial manager has the following authority over the finances of the school district:

- Examine the books and records of the school district
- Review payroll or other financial claims against the school district
- Negotiate, renegotiate, approve, or enter into contracts on behalf of the school district
- Receive and disburse all of the funds of the school district
- Adopt a final budget for the next fiscal year and amend the current fiscal year budget of the school district
- Act as an agent for the school district in terms of any collective bargaining agreements
- Analyze factors contributing to the financial problems of the school district and make recommendations to the legislature for steps to improve the financial condition of the school district
- Require compliance with orders given, by court action if necessary
- Require the attendance of witnesses and the production of any books, materials, or contracts relevant to the finances of the school district
- Recommend to the governor and the legislature the potential reorganization of the school district
- Consolidate divisions and functions within the school district to include the removal of any school district employees, within any existing legal provisions
- Create any new positions within the school district and approve the hiring of new full-time employees within the school district
- Seek approval from the State Board of Education for a reduced class schedule in accordance with provisions of the State School Aid Act
- Employ, or enter into employment contracts with, at the expense of the school district and with the approval of the state superintendent, the professional staff necessary to carry out the duties of the emergency financial manager
- Reduce expenditures of the school district

- Borrow money on behalf of the school district
- Approve or disapprove the issuance of debt by the school district
- Order the holding of school millage elections as necessary under provisions of state law
- Sell assets of the school district
- Exercise all of the powers and authority of the emergency financial manager of the school district as prescribed by state law

After giving written notice to the state superintendent, the emergency financial manager **may authorize that the school district enter into bankruptcy protection** under Chapter 9 of Title II of the United States Code – which will be discussed in the next section.

The emergency financial manager will provide to the governor and the legislature detailed financial information regarding the school district. This information will include a description of each expenditure made in excess of $10,000, a list of contracts entered into in excess of $10,000, a description of any loan entered into in excess of $10,000, and a description of any new positions created or positions eliminated by the emergency financial manager. This detailed report will be prepared every six months beginning six months after the starting date of the emergency financial manager.

The state superintendent may determine the conditions of the revoking of the declaration of the financial emergency in the school district at any time. This revoking of the declaration of a financial emergency will be based on recommendations by the emergency financial manager that a balanced budget is in place in the school district and a plan has been put in place to eliminate any accumulated budget deficits.

Public Act 4 of 2011: Recent Changes to Public Act 72 of 1990

On March 16, 2011, Governor Rick Snyder signed into law amendments to Public Act 72 of 1990. The bill signed into law by the governor (Public Act 4 of 2011) repealed Public Act 72 of 1990 and replaced it with a new law titled the Local Government and School District Fiscal Accountability Act. One of the primary purposes of the new act is to consolidate the provisions of Public Act 72 dealing with municipalities and school districts into a single format. Public Act 4 of 2011 makes **minor changes to the process** of appointing an emergency financial manager (now called an "emergency manager") and **expands the emergency manager's powers** in several significant ways. These changes are summarized below.

C**hanges to the process** of appointing an emergency manager:

- Allows various modest changes to the existing conditions that would trigger a review of the financial condition of a school district and the eventual appointment by the state of an emergency manager in a school district
- Alters the qualifications for an emergency manager to include individuals who have at least five years of experience in business, financial, or local or state budgetary matters
- Requires the competitive bidding of any contracts in excess of $50,000 entered into by the emergency manager unless a waiver is granted by the state treasurer
- Continues to allow the emergency manager to enter the school district into bankruptcy under federal law, but only following the approval of this action by the governor

In addition to the process changes outlined above, **the emergency manager would have the power to**:

- Reject, terminate, or modify existing labor contracts
- Exercise solely all powers and authority prescribed by law to the school board and superintendent (including control over academic operations)
- Eliminate the salary and powers of the chief administrative officer and governing body members for the duration of the emergency manager's tenure
- Require an emergency manager to adopt a two-year budget for the school district before term is over
- Recommend to the governor that the district be reorganized with one or more contiguous school districts

Public Act 4 of 2011 makes many other minor changes to the existing requirements outlined in Public Act 72 of 1990, but clearly the major changes in the bill passed by the house are (1) giving the emergency financial manager the power to reject, terminate, or modify existing labor contracts, (2) requiring the emergency manager to obtain approval from the governor before entering the school district into federal bankruptcy protection, and (3) giving emergency managers full academic and financial control of school districts.

Overview of Federal Laws

Federal Bankruptcy Protection for School Districts

While Michigan State law provides the statutory guidance for supporting school districts facing emergency financial pressures, **it is possible to place a school district under federal bankruptcy protection**.

During the Great Depression of the 1930s, the U.S. Congress enacted laws dealing with municipal government bankruptcy protection, specifically Public Law Number 251, 48 Stat. 796 of 1934. This law outlined the procedures under which municipalities could be placed under federal bankruptcy protection. Municipalities are defined as units of local government and school districts. The U.S Supreme Court ruled the 1934 act unconstitutional as an improper interference with the sovereignty of states under the Tenth Amendment to the U.S. Constitution (which provides the states with the power to regulate the finances of its political subdivisions, including municipalities). Congress then passed a revised municipal bankruptcy law in 1937 (Public Law Number 302, 50 Stat. 653 1937), which was upheld by the Supreme Court. In the 74 years since Congress enacted this law, fewer than 500 municipal bankruptcy petitions have been filed.

The general purpose of a municipal bankruptcy filing is to provide a financially stressed local governmental unit with the opportunity to reorganize the outstanding debts of the municipality under the protection of the federal bankruptcy court. **This protection typically involves the restructuring of outstanding debt by (1) extending the terms of the debt, (2) reducing the interest paid on the debt, or (3) refinancing the outstanding debt.**

These protections are significantly different from provisions of federal bankruptcy laws for the private sector. Most notably, there is no provision under municipal bankruptcy laws for the liquidation of a municipality's assets in order to distribute the proceeds of any liquidation to the municipality's creditors. It is widely believed that such a provision would violate the powers of state governments under the Tenth Amendment to the Constitution. It is important to note that state governments are not allowed to enter into federal bankruptcy protection. Federal law requires that the state law under which the municipality operates allow a federal bankruptcy filing. This is clearly the case in Michigan under provisions of Public Act 4 of 2011.

The typical scenario for a municipality to enter federal bankruptcy protection occurs when the municipality does not have the financial ability to service the debt obligations on outstanding bonds. Once a federal municipal bankruptcy case begins, the outcome of the case will be a restructuring or refinancing of the existing debts of the municipality. This reorganization of debt will involve the input of the municipality and the creditors that hold the municipal debt.

PART II: UNDERSTANDING DETROIT'S FINANCIAL CRISIS

Detroit Public Schools offers an excellent example examining how current law works in practice. This case study begins in 1999, when the state first intervened in Detroit, and continues to the present day with a discussion of the district's current, state-approved Deficit Elimination Plan.

Background: Changes to Governance Structure

The state first intervened in the DPS when, in 1999, due to concerns by then Governor John Engler and the Michigan legislature, the district was placed under the governance of a seven-member reform board pursuant to Public Act 451 of 1999. The reform board included six members appointed by the mayor of the City of Detroit and one member appointed by the governor. The locally elected school board was eliminated under this law. The reform board managed the DPS from April 1999 through October 2004. **Under the reform board's management, the DPS closed fiscal year (FY) 2004 with a $63.7 million general fund budget deficit.**

Beginning in October 2004, the DPS was again under the control of a locally elected 11-member Board of Education. In late 2008, the State of Michigan began proceedings against the DPS under the terms of Public Act 72 of 1990. These proceedings led to the eventual appointment of Robert Bobb as the emergency financial manager of the DPS in March of 2009. The appointment of an emergency financial manager for the DPS is the only appointment of an emergency financial manager for a school district under provisions of Public Act 72 of 1990.

The size of DPS's annual operating budget deficit and the size of the accumulated operating deficit have

Case Study: Federal Bankruptcy Avoided in New York City

Although the federal bankruptcy court has limited powers over municipal bankruptcy proceedings, it has the ability to restructure the existing outstanding debt of a municipality. The federal bankruptcy court cannot eliminate or void contracts or order the sales of municipal assets. In Michigan, these functions are assigned to state-appointed emergency managers under Public Act 4 of 2011.

The vast majority of the nearly 500 municipal government units that have entered into federal bankruptcy protection since 1937 have been small units, such as water and sewer authorities. Bankruptcy proceedings involving large municipalities are rare. Often, the threat of federal bankruptcy protection leads the holders and issuers of municipal debt to work out a restructuring of the debt before the federal court becomes involved.

The financial problems of New York City in the mid-1970s are a classic example of this threat. During this time period, the city was running a massive operating deficit and was able to continue operating only by borrowing funds on the short-term credit markets. As the financial sector became increasingly concerned about New York City's ability to service its outstanding debt, the city lost the ability to borrow funds on the financial markets and faced the threat of federal bankruptcy protection.

Federal bankruptcy protection was avoided in this case because the federal government, the State of New York, and the city worked out a major restructuring of debt which was accepted by the city's creditors. New York City raised local taxes, and the local employee pension funds agreed to loan funds to the city. The State of New York also appointed a Financial Control Board to oversee the financial affairs of the city. In the end, federal bankruptcy protection was not necessary, but certainly the threat of such a bankruptcy filing provided the incentive to address New York City's financial problems.

grown since the appointment of Robert Bobb as the emergency financial manager. Exhibit 1 provides a summary of the DPS general fund revenues, expenditures, operating budget, and accumulated year-end budget deficit for the period FY 2008–09 through the current estimates for FY 2010–11. (For the purposes of this analysis, an operating deficit refers to the difference between current year revenues and expenditures, and an accumulated year-end deficit is the combination of a current year deficit and any deficits carried forward from prior fiscal years.)

EXHIBIT 1
Detroit Public Schools Three-Year General Fund Budget Summary
(millions of dollars)

	FY 2008–09	FY 2009–10	FY 2010–11
Beginning Fund Balance	–$139.7	–$218.9	–$331.4
Current Year Revenues	1,138.2	1,071.8	994.2
Current Year Spending	1,217.4	1,184.3	994.2
Current Year Operating Balance	–79.2	–112.5	0.0
Accumulated Year-End Deficit	–218.9	–331.4	–331.4

SOURCE: DPS Comprehensive Financial Report and June 30, 2010, Adopted Budget.

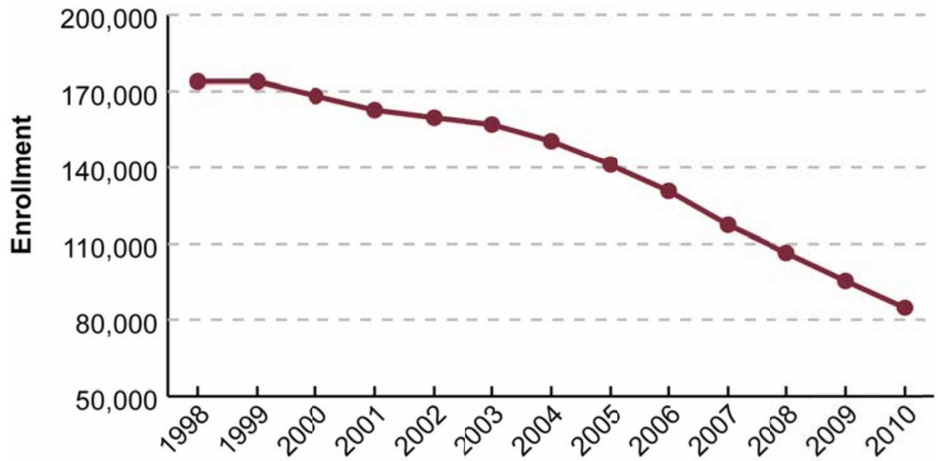
Following the appointment of Mr. Bobb, the DPS closed the FY 2008–09 budget with an operating annual deficit of $79.2 million. When this annual operating deficit is combined with the beginning year deficit of $139.7 million, it leads to an accumulated deficit of $218.9 million at the close of the fiscal year. During FY 2009–10, the operating deficit increased to $112.5 million, pushing the accumulated deficit at the close of the fiscal year up to $331.4 million. The current budget for FY 2010–11 assumes a balance between estimated current year revenues and expenditures, leaving the accumulated deficit at the close of FY 2010–11 at $331.4 million.

Continued Financial Troubles

In spite of the numerous different arrangements dealing with the governance of the DPS over the past dozen years, the DPS continues to suffer severe financial stress. In many respects this financial stress has been due to the inability of DPS managers to reduce expenditures at a pace that is sufficient to keep up with declining revenues of the school district. This decline in revenues can be attributed primarily to major declines in DPS enrollment. Since 1994, the State of Michigan has provided funding to all school districts in Michigan based on the number of students enrolled in each district.

Since the 1999 takeover of DPS management by the state under Public Act 451 of 1999, the number of students enrolled in the DPS has declined from 173,848 in FY 1998–99 to 84,877 in FY 2009–10. This is a decline of 51.2 percent of the students over a dozen years. Exhibit 2 provides a summary of DPS enrollments over the past 12 fiscal years. The management of the DPS has not been able to reduce expenditures enough to keep up with this enrollment decline and the impact of the enrollment decline on the operating funding of the DPS.

EXHIBIT 2
Detroit Public Schools Enrollment by Fiscal Year



NOTE: Enrollment at the Detroit Public Schools has declined by 88,971or by 51.2% over the past 12 fiscal years.
SOURCE: Detroit Public Schools *Comprehensive Financial Report*.

These financial troubles become clear upon review of a single page of the most recent *Comprehensive Financial Repor*t released by the DPS. According to the report, in FY 2001, the DPS had an enrollment of 162,693 and total operating expenditures of $1.53 billion. This equates to an operating cost per pupil of $9,418. During FY 2010, the DPS had an enrollment of 84,877 and total operating expenditures of $1.17 billion, or an operating cost per pupil of $13,782. Enrollment in the DPS declined by 51.2 percent over this time period, but operating expenses declined by only 23.7 percent, placing financial pressures on the DPS budget. This financial pressure was only partially alleviated by a 16.3 percent increase in the base funding per pupil provided to the DPS over this same time period.

Deficit Elimination Plan

At the close of FY 2010, the DPS carried on its books a $331.4 million unreserved general fund deficit. This deficit equaled 27.7 percent of the total general fund expenditures during the same fiscal year. Mr. Bobb is currently operating under a deficit elimination plan (DEP) approved by the Michigan Department of Education (MDE) that would eliminate this general fund operating deficit by FY 2014. Mr. Bobb is working on revisions to this state-approved deficit reduction plan, which is due to the state by the end of May 2011. The current version of the plan (approved by the MDE on February 8, 2011) includes dramatic changes to the education delivery system in the district, including:

- Closing 30 schools in FY 2011, 40 schools in FY 2012, and 30 schools in FY 2013
- Raising class size to 31 in K–3 classrooms, 39 in grades 4–5, 47 in the middle schools, and 62 students at the high schools
- Closing career and technical schools, as well as alternative schools
- Eliminating student transportation for general education students
- Moving to a regional principal model, which provides for one principal for every four high schools
- Providing two guidance counselors and one assistant principal in each high school

Certainly, the elimination of a 27.7 percent general fund operating deficit will be a major challenge for the DPS, especially in light of expected continuing declines in the enrollment of the DPS and potential declines in the level of base per-pupil funding provided to the DPS by the state in the coming fiscal year.

PART III: OPTIONS FOR THE FUTURE

While the state of Michigan has intervened aggressively in the DPS by appointing Mr. Bobb, his tenure has shown that appointing an emergency manager is no guarantee that a district will quickly become financially solvent. If an emergency manager does not successfully balance a school district's budget, what options exist? In order to identify possible solutions, four questions must be addressed:

- Does the state have an obligation to intervene beyond the appointment of an emergency manager?
- What can the state do in the short term to support the DPS?
- What can the state do in the long term to avoid local financial crises?
- How can the discussion move forward?

Does the State Have an Obligation to Intervene?

By law, Michigan is required to investigate potential financial crisis and, if necessary, appoint an emergency financial manager. There is **no statutory guidance for what the state must do if the emergency financial manager is not successful in balancing the local budget**, as is the case in the Detroit Public Schools.

The state does, however, have a constitutional obligation to provide a public education to all children across the state. The DPS's financial situation is impacting the district's ability to provide a public education to children in Detroit, and the state should intervene.

What Can the State Do in the Short Term?

There are a number of short-term options to address the financial crisis in the DPS, and they vary in their degree of political palatability. But in order to solve this worsening crisis, tough decisions will have to be made to help balance the DPS budget, and ultimately improve academic offerings.

- Appoint a new emergency manager, and execute the DEP
- Restructure debt
- Raise taxes
- File for federal bankruptcy protection
- Reorganize the DPS

Appoint a New Emergency Manager

Robert Bobb's contract has been extended through June 30, 2011. At this time, the governor will be responsible for deciding whether or not to appoint a new emergency financial manager. Because the financial emergency still exists in the DPS, it is widely believed that the governor will appoint a new emergency manager later this spring. This appointee will likely be charged with implementing the DEP, which currently aims to eliminate the district's deficit by 2014.

This approach has the potential to eliminate the deficit over the next three years – assuming the plan's assumptions about enrollment and per-pupil funding hold. Implementing the DEP as is, however, will most likely lower the quality of the district's academic offerings. Increasing class size alone is likely to have a negative impact on student achievement. Eliminating student transportation in a city that lacks a large public transit system is likely to lower attendance rates, which directly correlates with increased risk for drop out.

Although it is possible that the DPS will emerge financially stronger and better equipped to provide educational services in 2014, the district's students will have had three years of subpar education – and the cost of catching them up will be high.

Restructure Debt

The state could also restructure, or attempt to assume, all or a portion of the outstanding operating debt of the DPS. **Restructuring the debt would allow for more of the DPS budget to go directly to instruction and operations** – rather than debt obligations. Presumably this allows the district to spend money on improving its educational offerings, which in turn could lead to increased enrollment and revenue.

Restructuring the debt could take several forms, all of which will likely require a change to state law. First, the state could pay some or all of DPS's debt. Second, the state could require the district to implement reforms (such as new academic requirements, hiring practices, merit pay, and more) in exchange for state debt relief. Finally, the state could also help the district convert Detroit's short-term debt into long-term debt – as it did in 2005.

In the short term, there are several hurdles to restructuring the debt. First, any state assumption of the DPS debt would open the door for other deficit school districts to ask for similar treatment. Second, and most important, the state of Michigan does not have surplus funds that could be used to forgive debts incurred by the DPS, or any other school district in the state. If the state chooses to allocate resources to the DPS, it is very likely that other state programs, potentially including state aid to other school districts, would have to be reduced to ensure a balanced state budget.

In addition to short-term considerations, there is also a concern about the long-term ability of the DPS to manage its finances – even after any sort of state support is offered. The question of DPS's long-term ability to manage finances is especially relevant because of its recent financial history. During 2005, the state allowed the DPS to convert $210 million of short-term operating debt into long-term debt. While this change allowed the DPS to temporarily balance its operating budget, five fiscal years later the DPS is dealing with another accumulated operating deficit of $331.4 million.

Raise Taxes

Another option is to raise local taxes in order to raise revenue to repay the debt. In theory, this allows the residents of Detroit to take local action to address the district's financial crisis. Under the state constitution, however, raising taxes is not a viable option.

The DPS and all of the school districts in the state operate under constitutional limits regarding the level of local property taxes that can be levied to support school districts. **The DPS has no ability, under current state law, to ask the local voters to approve a property tax increase to finance operating expenditures in the district.** Any type of revenue increase that would provide more operating funding for the DPS would have to be the result of a change in the state constitution and a local vote of the people.

On the other hand, the governor and the Michigan legislature could raise state taxes to assist in the funding of the DPS or any other school district. A statewide tax increase could take many forms and would create a direct revenue source for debt repayment, meaning other programs would not have to suffer budget cuts to support the DPS. In light of the current political environment, however, a tax increase of any kind seems unlikely. Additionally, Governor Rick Snyder's FY 2011–12 state budget recommendation calls for reduction in the state support of school districts, making a state tax increase for the DPS or any other school district in the state even more improbable.

File for Federal Bankruptcy Protection

The DPS could also file for federal bankruptcy protection. Bankruptcy is seen as attractive mainly because the court can restructure some or all of the school district's debts.

Bankruptcy, however, is a risky decision. Because school districts are typically stable entities, they are considered safe investments by lenders, and are thus able to borrow money at lower interest rates. When a school district files bankruptcy and defaults on its loans, lenders raise interest rates, making it more expensive for the district to borrow money. In the case of the DPS, increased interest rates may not be as much a concern because the district is likely already seen as a risky investment and subject to higher interest rates.

In addition to concerns for Detroit, bankruptcy may also impact similar entities across the state and region. From a lender's point of view, if the DPS can file bankruptcy, so can Grand Rapids or Flint. This is certainly something the state will consider when deciding whether to allow the DPS to file for bankruptcy protection.

Under the current deficit elimination plan agreed upon by Mr. Bobb and the state superintendent, Mr. Bobb is not allowed to declare bankruptcy during his tenure. Once a successor is named, bankruptcy becomes an option. Public Act 4 of 2011 allows emergency managers to file for bankruptcy, but this action requires the approval of the governor.

Reorganize the DPS

The district could also cease to exist in its current form. Each of the options discussed below allows the city to build a system that has the potential to promote fiscal responsibility, twenty-first-century skills, high academic standards – and other qualities that are essential for a successful urban school district. None of the options below inherently embodies these qualities, but each provides an opportunity to evaluate current practice and create a stronger school district.

Smaller: The district could break up into smaller districts serving smaller parts of the city. By breaking up the district, communities would have more control over the schools in their neighborhoods, and the bureaucracy created to run a large, urban district would be eliminated.

Portfolio: The DPS could also take a form similar to post-Katrina New Orleans. Rather than having a centrally run school system, New Orleans operates under a "portfolio model" wherein the school district authorizes, but does not operate, individual schools. Under this model, individual schools are given full authority over budget, staffing, and more – operating much like charter schools, but under the umbrella of a public school district. This option too breaks up the bureaucracy of DPS and allows for more neighborhood input.

Regional: The district could also consolidate with a neighboring suburban district to form a regional school district – much like Indianapolis or Memphis. This would allow the DPS to take advantage of the capacity in other districts to run a central office and support individual schools. Consolidating could also lower administrative costs for both the DPS and neighboring districts.

Charter: Mr. Bobb has recently recommended turning over some of the DPS schools to charter operators. In late March, he listed schools that would be available for charter takeover and started recruiting charter authorizers. This model is similar to the portfolio model discussed above. Mr. Bobb's efforts have illuminated some of the problems associated with such a model. Most important, it relies heavily on high-quality charter operators – a group Detroit has historically struggled to recruit.

State law is unclear about whether the debt would be immediately eliminated if the DPS were reorganized. Section 380.12–380.13 of the Revised School Code outlines how debt is managed in the event of district dissolution. In most instances, the debt this section refers to is for capital construction projects (e.g., a new high school). This section explains that debt remains tied to the original district and allows the board of the new district to levy taxes for bonded indebtedness. Clearly, if the DPS were to be disbanded, the new school district would be responsible for the continuing debt service payments on capital bonds. **The section does not directly address the issue of what would happen to the accumulated operating deficit that exists in the DPS at this time.** This is an important issue that would have to be discussed further if any form of disbanding the DPS were considered.

What Can the State Do in the Long Term?

In addition to addressing short-term problems, it is also important to identify ways to avoid this situation in the future. Detroit's financial condition was created by a combination of significant declines in enrollment and failure to make cuts fast enough to keep up with declining enrollment and falling per-pupil allocations. This suggests that **Michigan might have to consider alternatives to the current per-pupil funding model** and institute a funding mechanism for schools that takes into consideration the changing demographics of the state. Detroit is one of many districts across the state facing declining enrollment. The challenge is that enrollment, to which state funding is tied, tends to decline more quickly than does the ability of districts to adjust operating expenditures. This, coupled with budgetary constraints at the state level, makes accurate planning a difficult task.

In addition to reevaluating Proposal A, the state must also be more proactive with financially troubled districts. Budget crises are usually not created in one year's time, and they often take longer to solve than one year. Intervening when budget problems seem small may prevent a DPS-like crisis in the future.

How Can the Discussion Move Forward?

> *"Without getting into too many details, I am extraordinarily concerned about the poor quality of education, quite frankly, the children of Detroit are receiving … I think we have a moral obligation to get dramatically better there, [and] to really challenge the status quo."*
> *— Secretary of Education Arnie Duncan, 2009*

Unfortunately, there is no "right" choice in this discussion. Stakeholders in Detroit, Lansing, and across Michigan must consider many interests and constraints when crafting a "Detroit solution." Clearly, the magnitude of Detroit's financial instability is far greater than that of any other district in the state. The fact remains, however, that the finances of the entire state are problematic, and the radical solutions required to solve Detroit's problems will require a degree of assurance and evidence of progress which have yet to be seen.

One thing is evident – everyone has a role in creating and implementing this "Detroit solution," and any resolution will require the support of each and every stakeholder to be successful. For too long, Detroit has complained that Lansing does not understand the intricacies of the problems faced by the city schools – and Lansing retorts that continually carving out one-time "Detroit solutions" detracts from the state's ability to enact effective or meaningful reform. The result has been an ongoing struggle between state and local leaders to implement lasting reform – and the proliferation of short-term solutions, which have failed to improve the overall financial or academic operations of the district.

With a deficit of more than $330 million, the problem has reached a critical mass. There is no solution that does not involve state, local, and regional players – all of whom have a vested interest in righting the ship and doing so quickly. The single biggest hurdle will be for these stakeholders to decide which course of action (federal bankruptcy protection, debt restructuring, disbanding the district, or state forgiveness) best suits the city and the schools in the long term and then place themselves solidly behind that solution in a unified manner. This will require bold leadership as state, regional, and local leaders involve parents, business leaders, and community members in a discussion as to why dramatic, and perhaps disruptive, change is essential.