

PENSIONS IN DETROIT OUT MORE THAN \$2 BILLION - ILL-ADVISED, HIGH-RISK VENTURES CITED AS PART OF THE PROBLEM RETIREMENT FUND WOES

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Author: JENNIFER DIXON and TINA LAM, FREE PRESS STAFF WRITERS

Detroit's public pensions lost more than \$2 billion, 30% of their value, in an 18-month period ending in December - which may eventually require the deficit-ridden city to double contributions to the plans.

While the national economic collapse has buffeted pension funds everywhere, Detroit's losses have been especially severe, in part because Detroit's pension funds have invested in some ill-advised, higher-risk ventures.

Indeed, an adviser to Detroit's Police and Fire Retirement System has warned that the fund may face a liquidity crisis this year.

A Free Press review found that trustees for the two pension funds acknowledged last year losing nearly \$140 million in five soured deals.

Another \$90 million is at risk, including a \$30-million investment in a bankrupt cargo airline whose principal owner has claimed he felt pressured to make illicit payments to win additional investments.

Experts say the boards' losses could deepen this year as pension funds around the country revalue holdings in commercial real estate, mortgages and other investments.

Documents obtained by the Free Press show the Police and Fire Retirement System may face a cash-liquidity crisis in 2009.

A board investment analyst, Richard Huddleston, said in a Jan. 28 memo to trustees that while the board has assets of \$3.1 billion, only \$1.27 billion is readily available - including for payments to retirees and investment commitments.

"The cash requirements are dangerously high," Huddleston wrote, adding that cash management could become an "untenable proposition."

The city's other pension fund is the General Retirement System.

Detroit, of course, is not alone in its pension problems. Public and private pension funds across the country have suffered huge losses in the stock market meltdown.

A survey by Pensions & Investments magazine last month said the nation's 1,000 largest public and private funds lost an estimated \$1.7 trillion from Sept. 30, 2007, through the end of 2008 - an average loss of 23.3%.

But Detroit's losses appear steeper still and are likely to sting more, given the city's grave finances and the likelihood that city taxpayers would pay for higher contributions.

"I'm concerned," said Barbara-Rose Collins, a city councilwoman and trustee on the police and firefighters fund. "We should be responding to this as an emergency."

Recovery needed

Without a stock market recovery in the next few years, the city might have to raise contributions to the police and fire fund from about 25% of employee payroll now to as much as 50% by 2011, said actuary Norman Jones, of the fund's private firm, Gabriel Roeder Smith & Co. of Southfield.

An increase would be cushioned by the fact that the boards are financing their contributions over 30 years with pension obligation bonds.

Contributions to the general retirement fund, now 10% of employee payroll, might also double, he said. The city's payroll contributions to the two funds is expected to add up to about \$90 million this year. Jones said it's too early to know exactly how much the city's future contributions might be.

"It's implausible that the market will recover fully in the next few years," Jones said.

He added, though, that the two funds - which support more than 20,000 city retirees - are in no danger of running out of money anytime soon and retirees' pensions are safe; it's taxpayers who would pay to keep the pensions adequately funded.

Views on investments

The Rev. Wendell Anthony, a general retirement board member for the past eight years, said the bad investments are just "the nature of this business. You always have some investments that do well and some that do not. ...

"We've had more better years than years when investments have not performed as well as we would have liked."

But George Orzech, a captain with the Detroit Fire Department and a trustee of the police and fire system for 21 years, said mayoral appointees on his board pushed some bad investments.

"Politics, absolutely," Orzech said.

Detroit is hardly the only local pension fund suffering. Macomb County's Employees' Retirement System lost about 31% over the same 18-month period.

And the State of Michigan's public retirement systems - which cover Michigan public school employees, state workers, state police and judges - lost more than \$17 billion over that span, a fall of about 28%.

Terry Stanton, a spokesman for the Michigan Treasury Department, which handles pension funds' investments, said the state's public pensions are sound and designed to withstand investment ups and downs.

He said state workers and retirees do not need to be worried about their pensions, which are constitutionally guaranteed.

The city's current figures could be optimistic because the Detroit pension boards have invested heavily in commercial real estate, mortgages, small businesses and alternative investments such as the cargo airline TradeWinds, as well as complicated collateralized loan and debt obligations, which experts say are difficult to value.

For example, the police and fire fund's outside auditing firm, Plante & Moran, has noted that, as of last June, one-fourth of its assets - about \$1 billion worth - were not publicly traded and therefore difficult to value.

Real estate decline expected

James Shilling, a finance professor at DePaul University in Chicago, said he believes investments in commercial real estate and mortgages will continue to decline, perhaps as much as 20% in 2009.

In some cases, the police and fire board said its investments were worth as much as it paid for the properties, a position that Shilling viewed with skepticism.

The board, for example, says it had invested \$469 million in real estate as of December, including office, retail and industrial properties across the country. The fund pegged the current value of those investments at \$459 million.

Shilling said those investments likely lost value, given the national free fall in real estate.

The city's pension funds also invested hundreds of millions of dollars in risky alternative investments. These investments are not publicly traded and, according to the police and fire board's auditor, are often a higher risk. In a report to the board in December, auditors said the retirement system "should consider tracking the performance of the consultants" who investigate proposals the board invests in.

One adviser signed off on several deals that later fell apart, costing the board tens of millions, the Free Press found.

Controversial money losers

One of the biggest, most controversial money losers is a hazardous waste deep injection well in Romulus. The police and fire fund first invested \$5 million in the well in the 1990s, a stake that ballooned to more than \$43 million. Despite fierce opposition from the well's neighbors, state and federal regulators granted permission for it to open in December 2005.

Less than a year later, in October 2006, environmental regulators shut the well down after finding leaks and record-keeping violations.

In April 2008, the pension fund's trustees declared the investment worth just \$10 million.

Another questionable investment was with GVC Networks, a telecommunications company founded by Detroit businessman **Kirkland Dudley** .

Detroit's two pension boards agreed to each invest \$10 million in GVC in the fall of 2006 but didn't actually turn over the money until early 2007. The company never repaid its debt as it came due later in 2007.

The boards lost the \$20 million and spent \$3 million more trying to salvage the deal.

While pension boards, both private and public, will invariably guess wrong on some funds, the Detroit boards' investments in GVC were notable for the number of red flags that apparently were ignored or dismissed by trustees.

In 2004, three years before the pension funds' investments, U.S. District Judge Victoria Roberts ordered **Dudley** and one of his companies to pay \$415,000 to IBM Credit Corp. for unpaid bills.

In fall 2006, the Free Press raised questions about GVC after it was one of several firms awarded part of a \$58-million Detroit Public Schools technologies contract. The deal was rebid after the paper revealed then-Superintendent William Coleman had referred a friend who was under criminal investigation to perform work for a GVC subcontractor.

Moreover, GVC claimed in its school bid that it was based in Detroit, which earned it extra points in the selection process.

But the Free Press reported that GVC never occupied the empty suite downtown that it listed as its address. And it identified its chief operating officer as "Mr. X." A lawyer for GVC did not return a call seeking comment.

Contact JENNIFER DIXON at 248-351-2993 or jbdixon@freepress.com. Contact TINA LAM at 313-222-6421 or tlam@freepress.com.

(sidebar: WHO'S ON DETROIT PENSION BOARDS?)

The Police and Fire Retirement System board is made up of the mayor (or proxy), one member of City Council, the city treasurer, the chief of police, the fire commissioner, three elected members from the Police Department and three elected firefighters.

The General Retirement System board includes the mayor (or proxy), one council member, the city treasurer, five elected city employees, one elected retiree and one citizen appointed by the mayor.

(sidebar: QUESTIONABLE PENSION INVESTMENTS)

The trustees of Detroit's two public pensions - the General Retirement System and the Police and Fire Retirement System - declared several investments to be worthless last year while others also are at risk, according to pension auditors and Free Press research. Questionable deals include:

Investment:

\$43 million, hazardous waste deep injection well, Romulus.

Problem:

The police and fire system's investment dates to the 1990s. The well operated only briefly before being shut down in 2006. Last April, the board estimated that its investment had sunk to \$10 million.

Investment:

\$40.7 million, Everest Energy Fund, Macomb County, since 2001.

Problem:

The money was invested in drilling deep wells in Wyoming to produce coal-bed methane gas, but the wells instead pumped mostly water. Both police and fire and the general retirement systems decided their investment was worth virtually nothing in April. The General Retirement System also lent Everest another \$9.5 million in 2004 but has been repaid less than \$1 million, according to the latest available board minutes.

Investment:

\$40 million in a collateralized loan-obligation fund, Miller & Jacobs Capital, St. Croix, U.S. Virgin Islands.

Problem:

CLO market collapsed. Similar investments in the boards' portfolios have not done as poorly, suggesting there may have been other issues with this fund. The boards declared their stakes virtually worthless last year.

Investment:

\$30 million, TradeWinds Airlines Inc., a cargo airline connected to a Birmingham, Ala., businessman.

Problem:

The pension boards say TradeWinds defaulted on its credit agreement. It now is in bankruptcy in Florida. The boards are suing businessman Donald Watkins and his company, Watkins Aviation, the majority shareholder of TradeWinds, saying his company defaulted on the \$30 million. Watkins responds that the boards wrongfully declared him in default only after he refused to participate in a pay-for-play scheme. He claims one pension trustee pressured him to contribute \$100,000 to then-Mayor Kwame Kilpatrick's legal defense fund in exchange for additional investment funds.

Investment:

\$20 million, GVC Networks, communications firm, Detroit.

Problem:

GVC failed to make payments to the two boards after receiving \$10 million from each pension. The boards put in another \$3 million to try to save the deal, then sued to recover last March. The company has declared bankruptcy. Last April, both funds declared their investments worth \$100,000 each.

Investment:

\$5.2 million, Atheneum Hotel, Detroit

Problem:

The Police and Fire Retirement System acquired \$5.2 million in stock in the hotel beginning in 1992 to fund cost overruns and start-up expenses. As of November 2007, the board had received just two dividend payments of \$100,000 each, according to internal pension documents obtained by the Free Press. In April, the Police and Fire Retirement System put the value of the investment at \$2 million.

Investment:

The general retirees' fund loaned \$2.75 million in 2007 to Asian Village, a restaurant complex near the Renaissance Center in Detroit.

Problem:

Just more than a year later, Asian Village defaulted on its lease and was padlocked.

(caption from chart: PENSION FUNDS HIT HARD ACROSS U.S.)

Detroit's two pension funds lost about 30% of their value over an 18-month span, a period when public and private pension funds across the country suffered deep declines. Here is a summary of the Detroit funds' performance, with a survey of how some other funds have fared:

IN BILLIONS PERCENT

6/30/07 12/31/08 CHANGE

Detroit General Retirement System \$3.9 \$2.7* -30.8

Detroit Police and Fire Retirement System \$4.4 \$3.1* -29.5

Virginia Retirement System \$0.9 \$0.6 -30.7

Macomb County's Employees' Retirement System \$59.9 \$41.8 -30.2

Maryland State Retirement and Pension System \$39.4 \$27.6 -29.9

Illinois State Board of Investment \$12.6 \$8.9* -29.4

Florida Retirement System Pension Plan \$136.3 \$97.3* -28.6

Michigan Retirement Systems \$61.9 \$44.5* -28.1

Ohio Public Employees Retirement System \$82.0 \$59.3* -27.7

Texas Employees Retirement System \$24.4** \$17.7 -27.5

California Public Employees' Retirement System \$251.4 \$184.3 -26.7

Philadelphia City Retirement System \$4.9 \$3.6 -26.5

North Carolina Retirement System \$75.0 \$60.0 -20.0

* Preliminary figure

** Assets as of Aug. 31, 2007

NOTE: Totals may not add up due to rounding; losses also include payments to beneficiaries

ILLUSTRATION: Chart DAVID PIERCE Detroit Free Press;Photo

CAPTION: One public pension acquired \$5.2 million in Atheneum Hotel stock.

MADALYN RUGGIERO / Special to the Free Press

The Asian Village, a restaurant complex, got a \$2.75-million loan.

AMY LEANG / Detroit Free Press

GVC Networks, a communications firm, got \$20 million.

CAPTIONWRITER: ANNIE O'NEILL / Detroit Free Press

MEMO: CHART ATTACHED. SIDEBAR ATTACHED.

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