

Municipal Bankruptcy Update

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Introduction

- Since 1938, over **650 municipal bankruptcy cases** filed in federal court with over 280 of those filings filed from 1980 to date.
- Municipal debt market currently accounts for \$3T+ in current bond issuances with household investors holding the bulk of the issuances
- According to Federal Reserve (2012), 2500+ municipal defaults since 1950 mainly related to:
 - Industrial Development Bonds (28%)
 - Health and Human Services Bonds (23 %)
 - Special Assessment Bonds(8%)
 - Pension Bonds (5%)

Municipal Bankruptcy (known as Chapter 9) History

- Municipalities were given bankruptcy protection under federal law in 1934 due to large amounts of local government defaults
 - Municipal bond defaults went from 678 in 1932 to 4,770 bond defaults by end of 1930's
 - First municipal bond default on record occurred in 1839 – Mobile, Alabama
- Last amendment to law in **1994** - states had to specifically authorize municipalities to file for Chapter 9 bankruptcy protection – Bridgeport, CT filing

Primary Purpose of Chapter 9

- Primary purpose – provide protection for a municipality to adjust its debts when they become fiscally distressed
 - Municipality **may continue to operate** while it adjusts or refinances its creditor claims
 - Municipality **not** subject to involuntary filing (similar to farmers and charitable corporations)
 - Five statutory requirements:
 1. Meet the definition of municipality
 2. Municipality must have specific authority to file under state law
 3. Must be insolvent – interpreted by courts as either not paying debts or unable to pay debts as they come due
 4. Must demonstrate a desire to implement a plan to adjust, satisfy, or discharge its debts
 5. Must show a willingness to negotiate, in good faith, with its creditors over their claims or demonstrate to court where negotiations are “impracticable”

State Authorization after 1994

Approach	States
Hands Off (where authorizing legislation is in place; no additional requirements at the state-level)	Alabama , Arizona, Arkansas, Minnesota, Missouri, Nebraska, Oklahoma, South Carolina, Texas
Resolution by Local Government	Idaho, Montana, Washington
Mixed Approach (where both hands off, approval, and no specific authorization are in place for different types of municipalities)	Kentucky, Oregon, Iowa
Approval by Governor	Connecticut, Wyoming
Approval by State Commission or Board	Illinois, Louisiana, Ohio, California
Approval and Intervention System (normally administered by a state agency)	Florida, Michigan, Nevada, New Jersey, New York, North Carolina, Pennsylvania
Prohibits Filing (explicitly through legislation)	Georgia, Kansas, Massachusetts
No statutes found (no specific authorization to file for municipal bankruptcy)	Alaska, Delaware, Hawaii, Indiana, Maine, Maryland, Mississippi, New Hampshire, New Mexico, North Dakota, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin



Municipal Bankruptcies Statistics 1980 - 2014

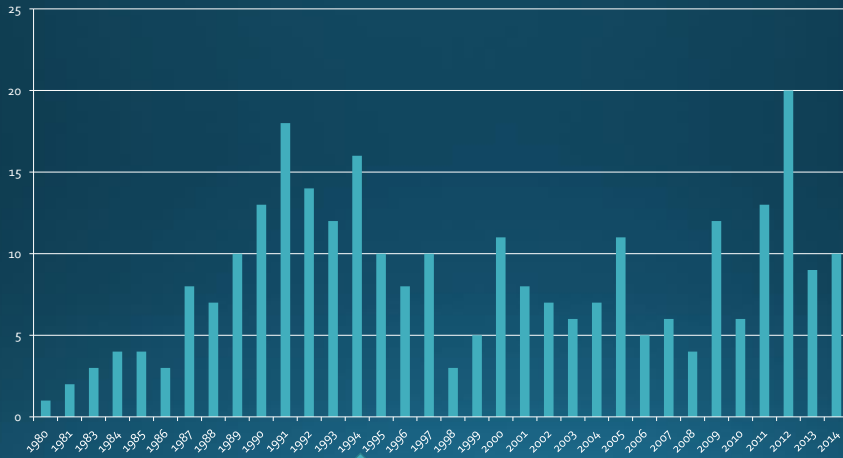
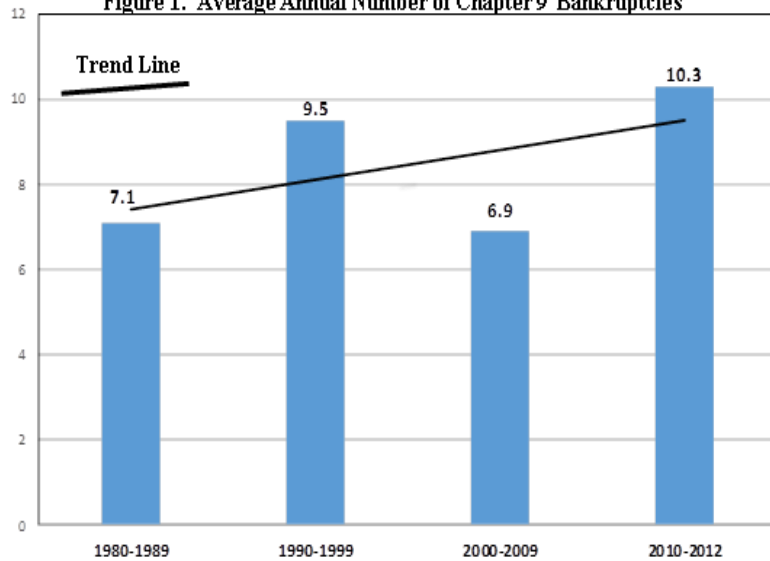
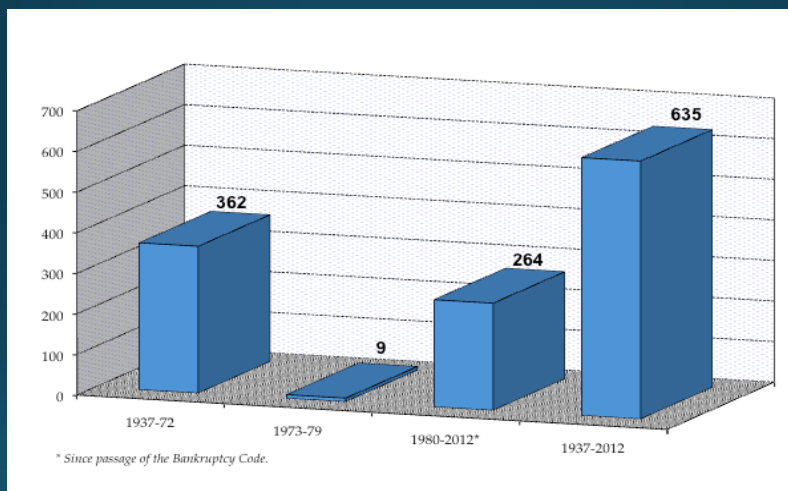


Figure 1. Average Annual Number of Chapter 9 Bankruptcies¹



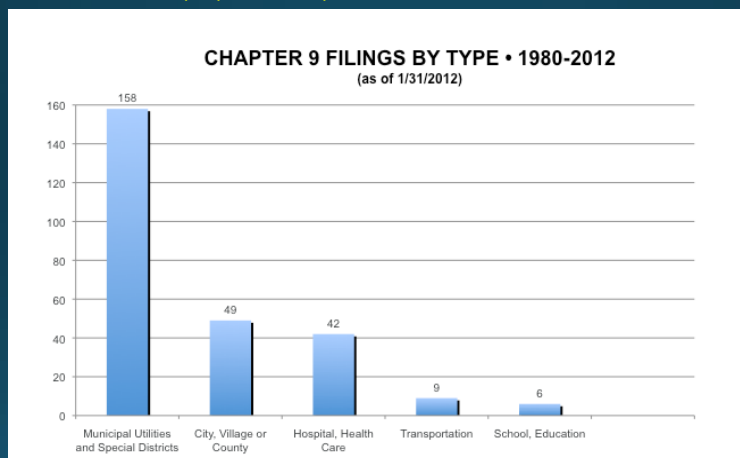
Chapter 9 Filings from 1937 – 2012

[Taken from Bankruptcy Primer, Spiotto, 2013.]



Chapter 9 Filings by Type

[Taken from Bankruptcy Primer; Spiotto, 2013.]



Studies on Municipal Bankruptcy

- Advisory Commission on Intergovernmental Relations (ACIR) [1973] studied the financial condition of 30 major cities in the United States in an attempt to identify factors that contributed to the fiscal decline in local governments - "unsound" financial management found to be main cause.
- ACIR [1985] again studied 18 cases of municipal bankruptcy since 1973 report and found financial mismanagement, along with inadequate planning, were the primary factors of financial strain in bankruptcy cases.
- Baldassare (1998) studied Orange County, CA Chapter 9 filing (1994) and pointed to three conditions – political fragmentation, voter distrust, and state fiscal austerity as main cause of bankruptcy

Studies on Municipal Bankruptcy

- Park (2004) studied several filings and found "... bankruptcy is a form of government failure, not just a market failure" (p. 251). Essentially, Park found that political factors rather than economic factors played a heavier role in the financial failure.
- Watson, Handley and Hassett (2005) studied the Prichard, AL (1999) filing and identified five socio-economic conditions to be significant contributors to fiscal stress in local governments: (1) financial mismanagement, (2) decline in population, rising per capita costs, (3) structural change in the economic base, (4) natural or man-made disasters, and (5) civic distrust.

Studies on Municipal Bankruptcy

- Research in the public finance and legal sector has also suggested that poor financial management in local governments have caused municipal bankruptcies. These bankruptcies are correlated with a negative impact on the state's overall credit rating and borrowing power in the credit markets (ACIR, 1973, 1985; Spiotto, 1995; Baldassare, 1998; Tung, 2002; Deal and Bowling 2009).
- Deal, Kamnikar, Kamnikar (2009) studied Greene County, AL (1999) bankruptcy and found rapid drop in racing revenues, corresponding low tax base, poor planning and lack of financial management as main cause of \$187M filing.

GASB Guidance on Municipal Bankruptcy/Fiscal Stress

- GASB #4 (1986) discussed transparency in government pension reporting.
- GASB #38, (2001) dealt with note disclosures on fund balances and short-term debts;
- GASB #41 (2002) focused on the disclosure of budgetary comparisons.
- GASB #44 (2005) required disclosing the effect of economic conditions on the municipality.
- GASB #58 (2009) required municipal governments to **remeasure** liabilities due to bankruptcy proceedings and a restructuring of the payment plans
- Current Project at GASB – Economic Condition Reporting – Financial Projections

Focus of Research Project

- In 1973, ACIR received request by Congress to study financial emergencies in local governments. Revisited in 1985.
 - Impending financial crisis in NY City and Cleveland, OH
 - Found 8 indicators/warning signs of financial stress that led to municipal bankruptcy which may appear alone or in tandem
 1. Operating Fund where current expenditures exceed revenues
 2. Consistent overage of expenditures over revenues for several years
 3. Excess of current liabilities over current assets
 4. Short-term operating loans outstanding at end of fiscal year
 5. High property tax rates coupled with high delinquency in property tax collections
 6. Sudden substantial decrease in assessed property values unexpectedly
 7. Under-funded pension funds
 8. Poor budgeting, accounting and reporting techniques

Focus of Research Project

- Since the ACIR (1973) identified the eight warning signs or common characteristics to SLG experiencing fiscal strain and the number of Chapter 9 filings have increased since 1990, this research will focus on case studies of recent filings since 1994 to determine whether these characteristics still exist as the main problem or other indicators are in play with the current economic fiscal strain on SLG.
- Research involved archival review of bankruptcy case documents, financial statements, public documents involving local government minutes and interviews with local and state government officials.

Alabama State Fair Authority (1995)

- No financial statements found with authority or City of Birmingham that appropriated \$600,000 annually to authority
- Court documents showed that the organization owed over 90 entities (individuals, corporations, IRS, surrounding municipal governments) over \$750K in unpaid liabilities, employee claims, tax claims
- Filing after State of AL, JeffCo, and City had given authority over \$700K additional funding in 1994 for unpaid liabilities
- Incurred a loss on annual state fair since 1989 and authority continued to take on debt in order to operate fair annually

West Jefferson Amusement Public Park and Authority (2002)

- No financial reports or record of an audit found
- Court documents and interviews with public officials source of information
- 11 municipalities formed authority in 1997 and pledged collective \$3M annually to fund venture
- Heavy debt burden of \$90M for construction and operations before opening
- Four years of losses of approximately \$3.2M due to low attendance, malfunctioning attractions, accidents to visitors, etc.
- Authority only made 1 bond payment in 5 year period
- Owed \$10 million to creditors including past-due payroll taxes, management fees, utility and leasing costs, marketing, insurance, and accounting services
- After sale (\$5.25M) of park in 2005 – 11 municipalities continued to pay on original funding agreement through 2007 despite bankruptcy

Greene County, Alabama (1996)

- 2nd U.S. county government to file for Chapter 9 bankruptcy
- Financial mismanagement by county administrators with 27 audit findings pertaining to state legal compliance, agency operations, and inappropriate financial procedures
 - The Alabama Examiners of Public Accounts audit report on Greene County for the years 1991-1994 issued on August 23, 1996, stated that the County Commission had over \$1.7 million in mismanaged funds
- The county's problems were further compounded by decrease in tax revenues from Greenetrack which amounted to \$908,000 in 1990 to \$14,400 in 1996
- \$3.5M in liabilities and future bond issuances non-rated and non-insured and was considered a junk bond by a financial industry analyst plagued the County through 2000

City of Vallejo, California (2008)

- Contractual personnel agreements main issue of filing according to Vallejo official along with depletions of reserves in 2007 - Vallejo has faced increasing police and fire salaries, and even with cutting those salaries by 6.5% and cutting funding to other city services still faced a deficit in general fund.
- Three FY prior to 2008, expenditures exceeded revenues by \$3-4M per year
- Depleted rainy day reserves by 2008
- Projected shortfall for FY 2009 was expected to be \$16M, approximately 23%, of \$69M general fund budget.
- Slump in housing market also an issue - Assistant City Manager, Vallejo, California, Craig Whittom characterized the situation as follows: "Our sales tax, our core property tax, our transfer tax is flat or in decline as with many other communities. And Vallejo does not have a large corporate tax base. So in times when the residential market slows down, we are hit hardest."

City of Vallejo – Emerging from Bankruptcy Aftermath (2013)

- Emerged from bankruptcy in 2013
- City still struggles to balance budget and provide basic services
- Operates with almost half of the police protection it did pre-bankruptcy
- Still seeking concessions from the police union
- Residents are now more engaged and have approved an increase in sales tax
- City has invested in technologies to fill some of personnel gaps
- Standard and Poor's recently upgraded city bond rating

New York City Off-Track Betting Corporation (2009)

- OTB's total bets, known as the handle, fell to just below \$1 billion a year in recent years due to other legal gambling options such as online available and interest in horse racing waned.
- Rising operating costs led to deficits after the Legislature increased OTB's mandatory distributions to state/city and horse farm operations/New York Racing Operations by an average of \$8M a year from 2003 to 2005.
- Short-term loans at time of filing were approximately \$83M and had been consistently above \$50M annually since 2003.
- Creditors and retirees of system were not paid when OTB closed its doors – instead racetracks and bettors who had accounts with OTB were paid out the funding balance of over \$14M leaving approximately \$700,000 in current assets to \$100M in current liabilities.

Stockton, California (2011)

- Median home prices rising 200 percent between 2000 and 2006 which increased the property tax revenue stream.
- City officials signed employee contracts and created new departments of services that proved unaffordable. Pay structure tied to the city's tax receipts: In strong revenue years, workers got 7 percent raises, but even if revenues declined, they got 2.5 percent raises.
- The median home price in Stockton fell 70 percent from 2006 to 2009. In many states, municipalities raise property tax rates when values fall; that's illegal in California, so plummeting home prices meant plummeting tax receipts. But even as tax receipts were falling, compensation costs per employee continued to rise.
- In 2007 Stockton issued \$125 million in pension obligation bonds and invested in stocks/market which declined in value in 2008 and the city is stuck with both a pension liability and a bond liability.
- Top creditors include investors holding \$124.3 million of Stockton's pension obligation bonds, \$40.4 million of the city's variable rate demand obligations, \$35.1 million of the city's public facilities fees bonds and \$31.6 million of the city's parking garage debt.

Central Falls, Rhode Island (2011)

- Unfunded liability of \$80M for pension and retiree health benefits
- Deficit of \$5M for general operating budget of 18,000
- Plan of adjustment shows a cut in retirement benefits to the city's 133 retirees and general unsecured creditors to receive a maximum of 45% of their claims from a bankruptcy fund administered by receiver
- According to receiver, the city would be unable to fund any public safety, public works, or debt service for 5 years to fund the pension liability
- Financial mismanagement as well as employee benefit packages that were grossly unmanageable contributed to the fiscal strain which began 20 years prior to the bankruptcy filing
- Annexation with City of Pawtucket and retirees/creditors agreeing to plan along with raising taxes on population of 18,000 end result

City of San Bernardino, CA (2012)

- In 2011, 7 of the top 10 cities hit with the foreclosure crisis in the U.S. were in CA which experienced over 1M foreclosures since 2008. Number of SB foreclosures 2008-2011: 102,147
- Projected \$46M shortfall at time of filing due to related loss from both housing and sales tax revenue streams
- Also noted accounting errors of overstating budgetary balances and deficit spending coupled with rising labor and pension costs for fiscal years back to 2007
- \$50M in unpaid GF bonds along with unfunded liabilities of \$296M including \$195M for pensions and \$61M for retirement medical benefits

1973 ACIR Findings to Current Cases

ACIR Common Characteristics Found in Financial Case Studies of Chapter 9 Filings	#1	#2	#3	#4	#5	#6	#7	#8
Alabama State Fair Authority (1995)	X	X	X	X				X
Greene County, Alabama (1996)	X	X	X	X				X
West Jefferson Amusement Public Park and Authority (2002)	X	X	X	X				X
City of Vallejo, California (2008)	X	X	X				X	X
New York City OTB Corporation (2009)	X	X	X	X			X	X
Stockton, California (2011)	X	X	X	X	X	X	X	X
Central Falls, Rhode Island (2011)	X	X	X	X			X	X
City of San Bernardino, California (2012)	X	X	X	X	X	X	X	X

Recent Filings of Municipal Bankruptcies

- Union Hospital District, SC (2014)
- Natchez Regional Medical Center, MS (2014)
- Palm Drive Health Care District, CA (2014)
- Adair County Public Hospital District Corporation, KY (2013)
- City of Detroit, Michigan (2013)
- Hardeman County Hospital District, TX (2013)
- Pauls Valley Hospital Authority, OK (2013)
- Hospital Authority of Charlton County, GA (2012)
- Sylamore Valley Water Association Public Facilities Board of Izard County, Arkansas (2012)
- Mammoth Lakes, CA (2012)
- Mendocino Coast Health Care District, CA (2012)
- Barnwell County Hospital, SC (2011)

JeffCo (2011)

- Total claims against county in original filing in **2011 - \$4.8B** – \$1.9B disputed by County
- Sewer system serves approximately 500,000 residents and rates increased 600% between 1970 and 1980 to .49CCF – between 1997 and 2008 – increased 329% to \$7.40 CCF. Rates now average \$8.54 CCF.
- Debt issuances and swaps - \$600M – 1997; \$953M – 1999; \$1.4B – 2001-2002 – spiraled out of control with 2008 economic downturn
- 20 individuals found guilty for corruption practices to do with construction and financing of construction – 2 former Commissioners; 5 County employees; 9 individual contractors and 4 organizations
- \$35 million paid in legal fees 2010 – 2013 alone
- **Reduction of sewer debt to \$1.8B** replaced \$3.14B debt with sewer rates for residents to increase 7% per year beginning in 2013 thru 2017 and 3.5% annually through 2053
- Satellite court houses closed and inpatient care no longer offered at county funded hospital – Cooper Green Mercy Hospital

According to Governing.com

- Only 8 of the 47 filings since 2010 were by General-Purpose Local Governments (as of November 2014):
 - City of Detroit
 - City of San Bernardino, Calif.
 - Town of Mammoth Lakes, Calif. (Dismissed)
 - City of Stockton, Calif.
 - Jefferson County, Ala.
 - City of Harrisburg, Pa. (Dismissed)
 - City of Central Falls, R.I.
 - Boise County, Idaho (Dismissed)

Concluding Comments on Current Fiscal Climate & Challenges to Fiscal Managers

- **Factors pressuring city budgets** include infrastructure costs, public safety costs, employee-related costs for health care, pensions, wages, and cuts in state and federal aid.
- **Cities are maintaining local services while continuing to reduce** personnel costs for pensions, health care benefits, and employee wages.
- Municipalities dealing with **shrinking tax base** due to either unemployment or lower property values/foreclosures in the current economic climate.
- **Municipal bond market is wary** of long-term stability of government-issued bonds from municipalities with lower revenues, higher service costs, and growing pensions.

Overall Findings of Research To Date

- ACIR initial study in 1973 was profoundly prophetic and similar public financial management policy problems **are still being experienced** due to financial mismanagement **ALONG** with lack of state mandated financial management policies for the municipal governments.

Future Research

- Future research to focus on impact of increased filings on reduced funding/change in financial condition as a result of **2009 American Recovery and Reinvestment Act** funding to local governments for 2 years.
- **More publicly-funded healthcare organizations** seeking Chapter 9 – research as to what are common factors and how to avoid loss of healthcare services from public sector.
- Future research to focus on implementation of **GASB 58** and whether financial management practices/accounting procedures introduced by state governments as a result of GASB 58.

Questions/Discussion?????

- THANK YOU FOR ALLOWING ME TO SPEAK AT THE GULF REGION 2015 PDT!!!! 😊
- Hope to see you ALL at the NATIONAL AGA PDT IN NASHVILLE – JULY 2015!

thank you!