

## Local Government Fiscal Crises: The Crisis Facing Local Governments and Why It Matters



*“Even though the argument has been made that the city isn’t as broke as it says it is, I don’t think there is really anyone in the room that doesn’t think city is broke.” – U.S. Bankruptcy Judge Meredith Jury, on San Bernardino*

*“The loss of this unencumbered revenue source was rooted in the inability of the state of Alabama and its Legislature to properly enact a statute...All those who attribute Jefferson County’s bankruptcy case and Cooper Green’s plight only to conduct and actions by the county are ill-informed...The state of Alabama and its legislators are a significant, precipitating cause. Both before and after filing its Chapter 9 case, the county’s revenue-seeking activities with Alabama have been to no avail.” – U.S. Bankruptcy Judge Thomas Bennett*

*“Lock your doors and load your guns.” – San Bernardino city attorney James Pellman’s advice to residents*

*The following report is an initial of a literature review on the topic of local government fiscal crises. This paper is the first publication of a two-year project that the Center for State & Local Leadership at George Mason University is undertaking with the generous support of the MacArthur Foundation.*

In its recent report, the State Budget Crisis Task Force noted one theme arising out of the Great Recession: fiscal stress runs downhill. Local governments are confronting the greatest fiscal challenges in at least a century, struggling to balance their budgets in the wake of the greatest economic downturn since the 1930s. Despite the pressures facing local governments, providing for the continuity of essential services matters. Indeed, what distinguishes Chapter 9 municipal bankruptcy from other kinds of corporate bankruptcy in federal law is the provision to ensure continuity in the provision of essential services. When a corporation faces default, it can simply take the “keys” and hand them over to a federal bankruptcy court—which can sell the remainder assets and distribute the proceeds to the debtors and shareholders. But when a municipality faces default, that is not an option. For the child whose chance for success rests upon learning—access to schooling, to health care, to safety are uniquely local challenges—whether the local government has disparate levels of poverty, crime, inadequate fiscal resources or legal authority; the essential responsibility may not be abjured.

Yet, despite the dire predictions from commentators, the numbers of Chapter 9 bankruptcy filings or municipal bond defaults have *not* risen through the Great Recession. In fact, considering the extraordinary pressures they face, remarkably few local governments have opted to seek Chapter 9 municipal bankruptcy protection or have fallen into state receivership.

Where are the risks greatest to the most critical and essential services? What are the options for our system of federalism, especially at the state-local level, for local governments that are at risk? This study will examine the challenges facing local governments flowing from the great recession. The following literature review will place the George Mason University Local Government Fiscal Sustainability Project in the context of the existing literature that answers these questions.

## I. Local Government Fiscal Structure

Local governments, which are defined and structured differently in every state, make up not just the oldest kind of government in our country, but also the level in the United States that most directly impacts every American, every day. According to the 2012 Census of Local Governments, there are 89,004 local governments in the U.S., down from 89,476 local governments in 2007. These include general purpose governments such as counties, municipalities and towns/townships, as well as special purpose governments such as school districts or water, sanitation, or sewer districts. The most essential and critical services government provides come from local governments, which ensure the provision of drinking water, sewage treatment, safe roads, public safety, snow removal, and education.

Local governments pay to provide these services through a combination of own-source revenue, revenue from the state government, and some federal dollars. As creatures of the state, local responsibilities for service provision and their ability to raise revenue and issue debt varies from state to state. In general, locals raise own-source revenues through property taxes, sales taxes, income taxes, and user fees and charges, with property taxes comprising 75 percent of local own-source revenue – about a third of all local revenue.<sup>1</sup> State intergovernmental dollars comprise another third.<sup>2</sup> The collapse of the housing market and resultant decline in assessed property values have caused property tax revenues to decline for several years in a row, even while state aid to local governments has fallen as governors and legislatures slashed state budgets.<sup>3</sup> The National League of Cities reports that local officials expected that the previous fiscal year would mark their sixth straight year of revenue decline.<sup>4</sup>

In addition to these cyclical revenue declines, local governments also must deal with a long-term trend of diminishing support from federal and state governments. Federal aid as a share of state and local revenue (excluding social insurance funds) fell from 27 percent in 1980 to 19 percent in 1989, where it hovered until 2008.<sup>5</sup> (This share rose to 22 percent in 2009 and 24 percent in 2010, the latest figures available, due to both the decline of state and local tax revenues and an uptick in federal dollars in the form of the American Recovery and Reinvestment Act.) With federal deficit cutting measures likely to take place in the 113<sup>th</sup> Congress and going forward, this share will likely fall.

**Local government is complex.** In New York, the State Budget Crisis Task Force report notes, “local government is a complicated, costly, sprawling, and confusing mix: citizens may live under one, two, or three layers of general purpose governments, consisting of fifty-seven counties, sixty-two cities, 932 towns, and 555 villages. Counties in New York, unlike in other states, play an important role in financing Medicaid, and school districts are responsible for delivering K-12 education. Aid to K-12 education is by far the biggest portion of state aid (\$23 billion) and is the largest state-financed item in the state budget.”<sup>6</sup>

The reduction in federal aid has been felt by both state and local governments. Of particular note is the decline in federal aid for capital and general purpose operating costs. Indeed, 1980 marked the apogee of federal infrastructure investment. In effect, the Reagan years marked the period of devolution of the responsibility for infrastructure investment from the federal government to state and local governments—and the corresponding shift from “pay-as-you go” federal financing to municipal finance.

In response to this trend, access to credit markets has become even more critical for state and local governments to finance their public infrastructure projects, thereby freeing up other revenues to pay for

services and meet citizen's needs. Historically, state and local governments financed around 40 percent of capital construction with tax-exempt debt raised in the credit markets; another 40 percent was financed with current receipts, and the remaining 20 percent came from grants.<sup>7</sup> With the federal government no longer providing substantial support for drinking and wastewater, and , as the State Budget Crisis Task Force reports, "The status of the nation's physical infrastructure may be characterized as anywhere from discouraging to alarming, based on surveys of infrastructure condition and needs. Infrastructure has been 'crumbling' for so long, according to the American Society of Civil Engineers (ASCE), that its condition deserves a grade of 'D'."<sup>8</sup> The nation, in the early 1960s, spent three percent of gross domestic product on our transportation and water infrastructure alone; this figure had fallen to 2.4 percent of GDP by 2007. In the mid-1980s, the portion financed by bonds rose to around one-half, as less construction was financed with current receipts.<sup>9</sup> Local governments outspend state governments in most areas of capital expenditures; in 2008, locals spent \$248 billion on capital needs (such as airports, sewer and water systems, mass transit, compared to \$108 billion by state governments, mostly for highways.<sup>10</sup> Today the municipal bond market is a \$3.7 trillion dollar market.<sup>11</sup>

## II. Defining a Fiscal Crisis

Local governments are confronting perhaps the greatest fiscal challenges in at least a century, struggling to balance their budgets in the wake of the greatest economic downturn since the 1930s. On the revenue side, they have seen their two greatest sources of revenues – property taxes and state aid - take simultaneous hits. Even as revenues have declined, demand for services has increased—what the Pew Center on the States characterized as the "squeeze" on local budgets.<sup>12</sup> The recession has meant greater poverty, unemployment, homelessness, and crime, leading to greater demand for public safety, health, and social welfare programs

Even as they contend with greater demand for services, local officials have had to cut budgets and downsize their workforces to adjust to lower revenues. A recent report by the Rockefeller Institute finds that state and local governments have shed 681,000 jobs since 2008—a downsizing that continues still, even while private sector job numbers climb back.<sup>13</sup> These actions have strained local service delivery. In a recent poll of local government managers, a third of respondents said their local government was offering fewer services than in 2008 (before the market crash).<sup>14</sup>

Against the cyclical pressures caused by the Great Recession, the longer-term structural problems localities face in the forms of unfunded public pension liabilities, aging infrastructure, and the diminishing support of the federal government have also come to a head. The crush of cyclical pressures and structural problems are the basis for the conditions that have been painted broadly as *the* local government crisis. At the same time, a handful of high-profile bankruptcies, defaults, and state takeovers have become the public face of the local government crisis writ large. But just how exemplary are the experiences of places like Central Falls, Rhode Island; San Bernardino, Vallejo, Bell, Mammoth Lakes, and Stockton in California; Jefferson County and Pritchard in Alabama; Detroit, Pontiac, and Flint in Michigan; Harrisburg, Scranton, and other Pennsylvania cities?

In media coverage and in the public understanding, the words *bankruptcy*, *default*, *crisis*, *emergency*, *distress*, and *state takeover* are frequently used interchangeably. And while the elected officials, employees, bondholders and residents of the municipalities mentioned above would generally agree that their communities are in crisis, the exact definitions of "fiscal emergency" or a "fiscal crisis" vary from source to source and state to state.

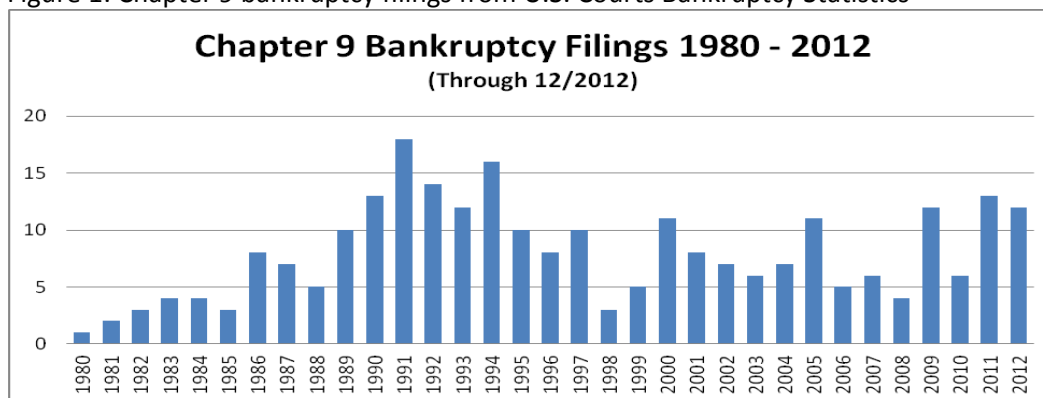
Researchers have defined a fiscal crisis as occurring when a local government’s ability to raise revenues is not sufficient to cover its legally required expenditures in a timely manner.<sup>15</sup> The Advisory Commission on Intergovernmental Relations identified several categories of financial emergency: bankruptcies, defaults, and “failure to meet other obligations and state declared emergencies,” with the latter characterized as a failure to “meet payrolls, pay vendors, pay retirement fund obligations, or failed to make other significant financial obligations.”<sup>16</sup> As any state or local financial officer can attest, fiscal stress and even fiscal distress are fundamentally different from fiscal *crises*: local government budgets can feel ongoing pressure without seeing things come to a crisis point.<sup>17</sup> The lack of a singular definition for a local government crisis, combined with the granular nature of local government financial data, mean that there is no real way to determine how frequently crises occur across the country. However, because two forms of fiscal crises -- municipal bankruptcy filings and debt defaults – are so publicized, they therefore are frequently assumed to be the defining characteristic of a local government crisis.

**Bankruptcies:** What does it mean to be a bankrupt city? Cities, counties, towns and school districts are the governments that touch most people’s lives most directly – trash must be collected, potholes filled, fires put out, citizens protected, and children taught. The critical nature of the services these governments provide is why federal lawmakers created Chapter 9 of the US bankruptcy code: in order to allow a stressed municipality to adjust (not eliminate) its debt while continuing to serve the public. States must enact legislation to authorize local governments to file for Chapter 9 federal bankruptcy protection: 26 states have such laws on the books, but there is significant variation in terms of which local governments may file and under what conditions.

While Chapter 11 and other corporate bankruptcies cause a company to cease operations while assets are liquidated and debts paid, Chapter 9 bankruptcies put an “automatic stay” on debts owed to external creditors – payments are frozen, allowing the government to continue to operate while it renegotiates external debts. Essentially, bankruptcy provides a local government with breathing room to develop a plan to adjust debts, while still continuing its day-to-day function. In order to qualify for bankruptcy protection, a government must be insolvent, have made a good faith effort to negotiate with creditors, and be allowed to file under state law.

One fundamental difference between municipal bankruptcies and those in the private sector is the infrequency with which they occur. Since 2010, there have been 31 Chapter 9 bankruptcy filings, compared to over 134,000 bankruptcy filings by businesses.<sup>18</sup> In fact, between 1980 (when Chapter 9 was established) and 2012 there have been 262 Chapter 9 bankruptcy filings, but only 43 of these were by general purpose governments.<sup>19</sup> The Great Recession has not led to a spike in Chapter 9 filings.<sup>20</sup>

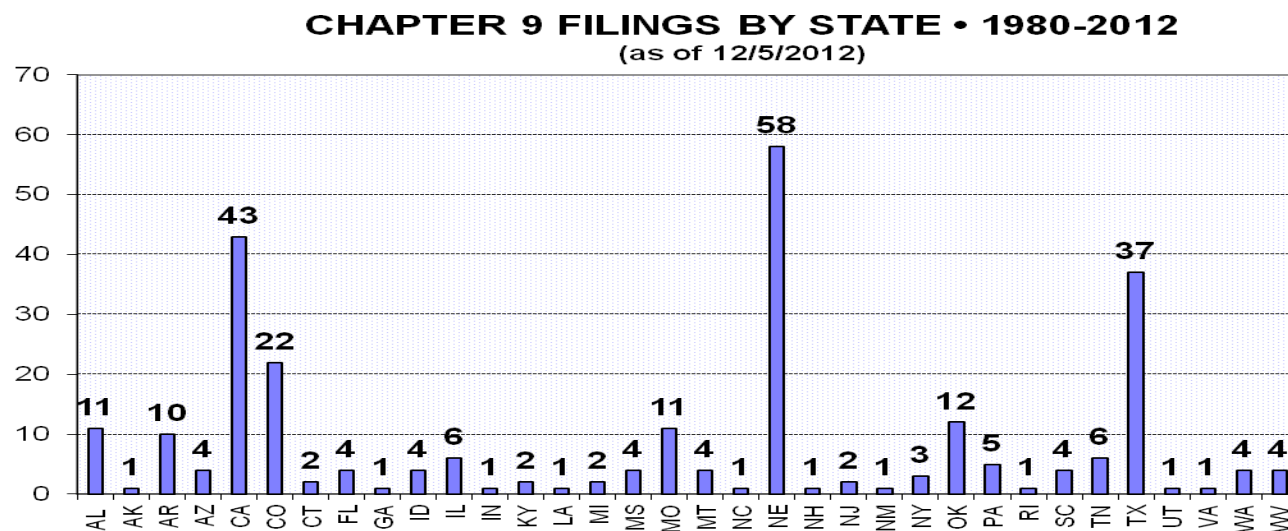
Figure 1: Chapter 9 bankruptcy filings from U.S. Courts Bankruptcy Statistics



Because state laws vary with regard to whether, and, if so, which local governments are authorized to file for Chapter 9 and under what conditions, it is not “fair” to compare local bankruptcy filings across states, especially as an indicator of the relative local financial health within states. However, a look at the state-by-state numbers can be informative. Nebraska is the Chapter 9 leader, with 58 – more than a fifth of all bankruptcies -- entities filing petitions between 1980 and 2012.<sup>21</sup> All of these are municipal utility districts, mostly on the outskirts of Omaha, created to help finance utilities for new development. Following the housing crisis, when the developments did not pan out, the taxing districts were dissolved through Chapter 9 proceedings. While Chapter 9 proceedings can be costly for cities and counties (see Vallejo’s three-year-plus slog through bankruptcy courts), the Nebraska proceedings have been relatively inexpensive, largely due to the fact that taxing districts do not have as many employees as general purpose governments have, nor do they provide the variety or level of services that general purposes have to provide-- thus allowing them to be restructured more easily.<sup>22</sup>

California, Texas and Alabama follow Nebraska as municipal bankruptcy leaders. Of the 43 general purpose governments that have filed for bankruptcy in the past three decades, five were in California (Orange County in 1994, and the cities of Desert Hot Springs in 2001, Vallejo in 2008, and Stockton and Mammoth Lakes in 2012), seven were in Alabama by six cities and counties (including one repeat), and Texas had six filings by five cities.<sup>23</sup>

Figure 2: Chapter 9 Bankruptcies by state, reprinted from Chapman and Cutler LLP 2012



*Defaults and other events:* Whereas bankruptcy is a legal process by which a local government may seek protection from creditors while it works out its debt, a default means the municipality would miss a payment on its debt. The Municipal Securities Rulemaking Board defines a “default” as a “failure to pay principal of or interest on a bond when due” (a “monetary” default) or a failure to comply with any other covenant, promise or duty imposed by the bond contract” (a less serious “technical” default).<sup>24</sup> Investors in municipal bonds fear defaults may be symptomatic of a growing local fiscal crisis, especially after financial analyst Meredith Whitney warned on *60 Minutes* of a coming “spate” of defaults on local government debt due to the increasing pressures facing state and local governments and their neglect to address structural problems such as unfunded pension liabilities.<sup>25</sup>

As with Chapter 9 bankruptcy filings, most municipal debt defaults are on special revenue-backed debt for non-governmental purposes – for example, hospital or nursing home improvements. In fact the default rate for general obligation bonds, secured by the full faith and credit of an issuer, is just 0.06 percent, compared to 11 percent for corporate debt.<sup>26</sup>

**Figure 3. Federal Reserve Bank of New York Analysis; Moody's default statistics 1970-2011; S&P statistics 1986-2011.**

	Number of Defaults		Number of Issuers	Size of Market
	Moody's	S&P		
Municipal	71	47	54,486	\$3.7 trillion
Corporate	1,784	2,015	5,656	\$7.8 trillion

Sources: Standard and Poor's (S&P); Moody's; CUSIP Service Bureau; Securities Industry and Financial Markets Association.

Note: Default time periods differ across rating agencies and asset classes.

In almost all instances, state and local officials will go to great lengths to avoid defaulting on debt, both to avoid lawsuits from creditors and an increase in borrowing costs, but, even more importantly, as a critical reflection of their respective senses of civic pride and obligation as a matter of public trust. (More on their options for avoiding default in a later section.) Because of this, defaults on municipal debt are extremely rare, according to the credit ratings agencies which assess the relative safety and financial attractiveness of municipal and corporate debt for investors.

While these numbers have soothed some investors' fears about the relative safety of local government debt, the fact remains that financial crises can take other forms beyond default on a bond. Local governments' legally required expenditures include not just debt repayment but labor contracts, pension and post-retirement benefit contributions, vendor payments, and state and federally mandated spending.<sup>27</sup> There is no single database tallying the frequency with which local governments miss a payment or are tardy with a payment on these types of expenditures. Municipal bond issuers are required to submit continuing disclosures to the Municipal Securities Rulemaking Board containing information about financial information and "events" such as delays or missed payments. These data are difficult to use for research purposes for three reasons: (1) events are defined broadly so as to include not only signs of fiscal stress (such as "unscheduled draws on debt service reserves reflecting financial difficulties") but also technicalities (such as "notices of failures to provide annual financial information on or before the date specified in the written agreement"); (2) the data only go back to 2009; and (3) not all bond issuances require continuing disclosure.

*State Classifications of Crisis.* According to analysis of state laws, at least 22 states and DC have definitions of fiscal or financial emergencies, distress, or crises in local governments, with these definitions acting as a "trigger" for state action to assist the locality.<sup>28</sup> (More on other studies of state systems to assess financial control is found in a later section of this paper.) Many of these triggers are events, such as the default or the threat of default on debt payments; missed payments to vendors, employees, the state or federal governments, or contributions to public employee pension systems; a credit rating downgrade; an intra-fund transfer that suggests a deficit somewhere in the budget; or

failure to file timely financial reports. In at least one state, triggering events can be external to the government – for example, in Nevada, the closure or downsizing of a major employer, a decline in population, or a lawsuit are among the 27 events that can trigger a financial emergency and allow the state to assist a troubled local government.<sup>29</sup>

Fiscal triggers are indicators such as deficits (either operating deficits or in end-of-year fund balance) and year-over-year revenue decline. Revenue inefficiency is an indicator of stress in at least one state: in Illinois, a municipality may be designated as suffering a “fiscal emergency” if, among other things, its tax rates are among the highest in the state but revenues are among the lowest in terms of yield.<sup>30</sup> Extraordinary levels of debt can also be an indicator of a problem; in New Jersey, local governments may enter the state’s supervision if the coming year’s appropriation for debt is more than 25 percent of the total appropriations for operating purposes in the previous year’s budget.<sup>31</sup> Again, because there are fundamental differences between “distress” – with implication of a *growing* problem – and “crisis” or “emergency” – with the implication of an *emergent* or *existing* problem – these indicators are used in some states to predict problems, and in other states to identify and deal with them.<sup>32</sup>

At least three states have triggers that refer to a local government’s inability to function, or to provide some minimum or adequate level of services to residents. New Hampshire, towns, cities, or counties may apply to the state for assistance if they are—among other things – “unable to finance the ordinary needs of government.”<sup>33</sup> The second tier of Ohio’s fiscal trouble-detection system, fiscal distress, indicates that a local jurisdiction cannot fully fund a “normal” level of service.<sup>34</sup> In Oregon, the state may step in to assist a county if it determined that the county is experiencing distress that “compromises the county’s ability to provide a minimally adequate level of public safety services.”<sup>35</sup> This type of definition was acknowledged by the Advisory Commission on Intergovernmental Relations in 1973, which pointed out that a city could be meeting all of its financial obligations but still not be adequately meeting the needs of residents.<sup>36</sup> While challenging for states to operationalize, given it may be difficult to define “adequate” levels of service, it is an important consideration for some communities whose extreme distress have left the government unable to provide services. For example, Central Falls, Rhode Island, saw its school system taken over by the state years before officials there filed for judicial receivership. And Jefferson County officials voted to end emergency room and inpatient care at Cooper Green Mercy Hospital, facing pressures to settle with creditors from the failed sewer modernization project.

### III. Causes of Fiscal Emergencies

Fiscal emergencies can arise from innumerable causes, many of which are factors largely outside of the control of elected and appointed municipal officials. Others can be linked to management factors that may be within the control of local governments. In most cases, a combination of internal and external factors contributes to acute distress. Upon superficial review of the crises of the past decade, the communities experiencing a fiscal crisis suffered from a similar array of budget circumstances: long-term decline on the revenue side, continuing pressure on the expenditure side through growth in labor and service delivery costs, and an outsized debt load.

A review of the research and of recent examples of crises points to the following preliminary list of categories. It is important to note that in almost every local crisis, multiple factors contributed to the circumstances; communities and their problems will not fit entirely into categories – nor is it productive to attempt to do so. It is possible, however, to illustrate the factors below using examples from the real world.

*External causes.* Local fiscal crises can result from a complex collection of factors that are external to the local government, such as the strength of the economy, the diminished support of a higher level of government, or a growth in the needs of taxpayer residents.<sup>37</sup> Some causes are clearly outside of lawmakers' control, for example, from natural disasters or acts of terrorism, or from extraordinary legal judgments against a local government or its employees, such as the 1997 lawsuit by real estate developers that forced Mammoth Lakes, CA, into Chapter 9 protection over a decade later.<sup>38</sup> Research has focused on the underlying economic factors – both structural, such as the decline of the manufacturing sector in the Midwest and its impact on the tax base – and cyclical, such as the Great Recession's impact on property tax revenues and on the levels of state aid to local governments. Generally, these external factors can be grouped into the following categories:

1. **Economic erosion:** Declines in population or the loss of a major employer can lead to diminished local government revenues. In the past decade, property taxes in California, Arizona, and Florida were hit hard by the housing crisis.<sup>39</sup> The decline of the automobile industry has contributed to crises in Michigan's manufacturing cities such as Pontiac and Detroit. Vallejo's economic and fiscal woes began in 1996 with the BRAC closing of the Navy shipyard there. Looking ahead, will local governments with a heavy reliance on federal dollars be more at risk?
2. **External event (natural disaster, legal judgment, other "sudden unplanned expenditure demand"):** Local governments are the first level of response to natural disasters or acts of terrorism. Localities must respond to the emergency, lead recovery, and, as we are learning from Hurricane Katrina and Superstorm Sandy, undertake much of the costs of prevention in terms of reconstruction. Because of the "Act of God" nature of these disasters, there is almost always federal and non-profit assistance provided, but this assistance rarely can cover the time and resources devoted by municipal staff during the crisis, nor does it finance future infrastructure costs. Thus, while there may be assistance in the wake of a forest fire or a storm surge, the costs of acting to prevent comparable damage in the future become, at least in part, an unanticipated fiscal burden on the municipality—even as its tax base has been devastated by the man-made or natural disaster. Legal judgments can also strain local budgets: Mammoth Lakes, the most recent CA municipality to file for bankruptcy, owed a legal judgment of more than twice the town's budget to a private litigant.
3. **State laws:** State laws that limit undermine local ability to control labor costs, impose unfunded mandates, or limit local revenue tools can contribute to municipal distress. For example, U.S. Bankruptcy Court Judge Bennett noted that the State of Alabama's failure to enact a replacement tax for Jefferson County, after ruling unconstitutional the occupational tax that the county relied on, contributed to the closure of a hospital for indigent populations.<sup>40</sup> California's Proposition 13 has limited local ability to raise revenue.

*Causes internal to the government:* While some causes of local emergencies are outside of the control of elected officials, there are some factors within their control that can at the very least increase vulnerability to a crisis. In some cases – such as a structural imbalance – the cause is not within the tenure of one governing official or body, but results from years of neglect. In other cases, the capacity or sophistication of staff could be a factor. Some factors that are *internal* to local governments are listed here:

1. **Fiscal mismanagement or neglect**



- a. Structural imbalance: A local government's expenditures continually outpace its revenues. An example is Vallejo, CA, where leaders filed for bankruptcy in part because the city could not keep up with exorbitant labor costs (compensation packages for police captains topped \$300,000 annually), while property tax revenues were depressed by the housing crisis and Proposition 13.
  - b. Pensions: A local government faces large unfunded liability in its employee pension fund. An example is Central Falls, RI, which faced \$80 million in pension obligations, even while its tax base was eroded by high poverty and a large population of undocumented immigrants.
2. Infeasible project: A local government issues revenue bonds for a project, then faces cost overruns and/or fails to see the revenues anticipated. The incinerator in Harrisburg, PA, is an example of this type of crisis (against a backdrop of long-term economic decline and structural imbalance).
  3. Financial: A local government faces ballooning debt due to unwise investment decisions. Examples could include Jefferson County (failed interest rate swap transaction) or Orange County (high-risk securities).

The complex legal and institutional issues surrounding municipal pensions appear certain to complicate both the ability and authority of state and local governments to address such distress. The city of San Bernardino, California, halted payments to the California Public Employees' Retirement System (CalPERS), the city's largest creditor, last August after filing for Chapter 9 municipal bankruptcy protection. In November, the San Bernardino City Council voted to slash more than \$26 million in spending and freeze debt payments to keep the municipality afloat through the bankruptcy process. In response, CalPERS filed a petition to the U.S. bankruptcy court, requesting to sue in state court to collect retirement contributions.

CalPERS, in its petition to the court, claimed 1) that the City of San Bernardino is not eligible to file for bankruptcy; 2) that Calpers has sovereign police powers exceeding that of the bankruptcy court, which allow it to seize city funds even over paying the salaries for police and fire protection or making municipal bond payments; and 3) that Chapter 9 only applies to unpaid claims before a bankruptcy action was filed, not the city's failure to make pension payments to CalPERS after the bankruptcy filing. At the hearing, CalPERS' attorney said San Bernardino is \$8.3 million in arrears, a figure that could increase to \$20 million by July, noting that two other California cities that declared bankruptcy in recent years, Vallejo and Stockton, continued making employee retirement payments even after filing for bankruptcy protection.<sup>41</sup> The attorney said allowing San Bernardino to skip that contractual requirement sets a bad precedent that could eventually threaten the solvency of CalPERS, the largest pension fund in the nation, with 1.65 million members and investments worth \$248.5 billion: "It ultimately could fail if enough employers don't contribute...The ongoing harm to the CalPERS system is growing rapidly." Calpers, in its petition to the court, claimed. Attorneys for three labor unions representing city workers made similar arguments.

In a hearing in late December of 2012, U.S. Bankruptcy Judge Meredith Jury denied CalPERS's request, stating that lifting the automatic stay granted to San Bernardino when it filed for Chapter 9 municipal bankruptcy would be a "death knell" to San Bernardino's effort to rebound from financial ruin. The payments also would divert scant resources from police and fire protection, as well as other essential services. CalPERS and other creditors will renew their challenges on January 22 at a special hearing.

The Calpers case has national implications. In April 2012, Central Falls, Rhode Island receiver Judge Robert Flanders noted to George Mason graduate students that pensions are “not an essential” service—they do not respond when, in an emergency, a resident dials 9-1-1. Judge Flanders made clear that the only way he had been able to determine a path out of Chapter 9 for that city was to reduce pension payments. But now the legal challenge in California, and another on East Providence and North Providence in Rhode Island, pose two hurdles to addressing severe fiscal distress: 1) Will this be an issue determined by the courts—and, if so, how will state versus federal authority be resolved?, and 2) Will this not impose enormous costs—both in terms of time and badly needed resources on the city in severe fiscal distress to await the very lengthy and costly litigation that could span years to reach resolution? The Calpers litigation would have threatened the city’s ability to provide essential services and force it into default.

There is much at stake: according to Moody’s, as much as 10 percent of California cities have declared fiscal distress, so while in Rhode Island Central Falls’ receiver made clear that pensions were not an “essential service,” the decision of what is essential in California is rendered more difficult: an adverse decision for CalPERS, after all, could have severe implications for all state and local California pensioners—current and future.<sup>42</sup> There are no easy choices here: San Bernardino owes CalPERS about \$2.8 million annually; the city currently collects about \$29.5 million in property taxes and \$16.3 million in sales and use taxes. Judge Jury has urged the city to devise an “end game” plan.

#### **IV. State and Local Options to Local Fiscal Emergencies**

##### ***Local Options in the Face of Emergencies***

The Government Financial Officers Association has put together a map of the process for recovering from financial distress. The first step toward recovery is “recognizing that there is a problem.” GFOA acknowledges that there are immediate stabilization actions – “generic treatments” – that local officials can take to balance the budget, thereby buying time for a longer-term solution to the problem. Examples can include hiring freezes, delaying capital projects, implementing new fees for service, and being more aggressive about collecting revenues.

As evidenced by the diagram below, the road to recovery is complicated. Local options for addressing distress depend on the state laws and practices that govern their actions, which will be the subject of the next section.



that there was “something wrong with the state,” some states have introduced legal mechanisms that in many instances were designed to provide an alternative path to Chapter 9 bankruptcy filing.

According to Chicago attorney James E. Spiotto, a municipal finance legal expert, 23 states have laws which allow them either to supervise local government debt or to assist local governments with debt restructurings in the face of a fiscal emergency.<sup>48</sup> (Appendix A lists these states and those that authorize Chapter 9.) When they are used, these laws and programs are frequently termed “state takeovers” by observers. While in some instances, the state does take over financial control from a local government, the exact arrangements are more nuanced and vary from state to state.

*What can the laws do:* Intervention laws vary in terms of the authority that the state has to step in to a local government’s finances. Based on the authorities that the state has (i.e., the authority to *require* a locality to make changes in local finances, versus the ability to *recommend* or *advise* a change) and on the nature of the local government’s participation (i.e., whether or not intervention is voluntary), the state government’s role can generally be depicted on a continuum from a “hands-on”/strong intervention to a more “hands-off”/weaker intervention.<sup>49</sup> It is important to note that most research makes clear that a strong intervention in local fiscal affairs is not universally “desirable,” despite the mounting challenges facing local governments.

On the strong end of the spectrum are interventions that result in a body – such as Rhode Island’s receiver or the emergency financial manager as defined by Michigan’s now-defunct Public Act 4 -- that supplants the local elected officials’ authority over the budget and sometimes over daily operations (e.g., cutting pay for employees). A less stringent form of intervention comes in the form of a financial control board, coordinator or a citizens’ commission – all bodies which have the authority to improve budget conditions and assist with debt restructuring, usually via a plan that local government officials must develop and commit to, but generally do not take over the general operations of the municipality. For example, the Florida Bond Financial Emergencies Act can – should the governor deem a fiscal emergency – result in the creation of a financial control board that has advisory authority.<sup>50</sup> Research has further distinguished between states that can assist with immediate actions to return a locality to immediate financial integrity versus those that can balance a budget, and those which have the ability to advise/recommend versus those that have the ability to implement changes.<sup>51</sup> For examples, Idaho allows for a state entity to step in to readjust the debt of an insolvent drainage, highway or irrigation district, and in New Hampshire, state officials may assist local governments facing a state-declared emergency with issuing bonds, sometimes guaranteed by the state. Both of these states allow for extraordinary means to provide emergency funds or assistance with immediate obligations in order to restore financial integrity. In contrast, Rhode Island’s Fiscal Stability Act allows for either a budget commission or a receiver to take operational control of government – including the authority both to increase fees and to cut pay or consolidate services. Another way to view these laws is on a spectrum from those which have the ability to advise/recommend versus those that have the ability to implement changes.<sup>52</sup> California’s Debt And Investment Advisory Commission can make recommendations for sound policies regarding local debt and investments, and can provide technical assistance in the face of an emergency. Pennsylvania’s Act 47 coordinators can develop plans for recovery, to which local officials must agree. In contrast, Michigan’s intervention laws – both Public Act 4 which was repealed last fall and Public Act 72 (the earlier financial manager law) allowed state-appointed managers to implement governmental changes.

Then there are states which can provide technical assistance to localities in issuing and refinancing debt (such as the Oregon Municipal Debt Advisory Commission or the California Debt and Investment

Advisory Commission), but do not have specific authority to intervene in local emergencies. And finally on the more hands-off end of the spectrum are states such as Minnesota or Iowa which have programs in place to provide financial assistance or emergency loans to local governments facing the threat of default or missed payments, with more limited conditions. It is important to point out that these interventions are not mutually exclusive – so that states may have two or more laws allowing them to address local government distress. For example, Florida has both a local government technical assistance act as well as a financial emergencies act which allows for the governor to declare an emergency and approve a recovery plan for a distressed locality.<sup>53</sup>

For illustration purposes, the diagram below is based on our review of literature in this field and of the 23 state intervention mechanisms. This model is one potential illustration of the authority that states have to respond to or intervene in local fiscal crises. In this model, state responses go from the relatively “hands-off” – offering financial assistance with limited conditions – to totally “hands-on” – seizing operational control from local officials. In practice, state responses are not mutually exclusive within these categories; i.e., states may have two or more laws allowing them to address local government distress. For example, Florida has both a local government technical assistance act as well as a financial emergencies act which allows for the governor to declare an emergency and approve a recovery plan for a distressed locality.<sup>54</sup>

Figure 5: Possible spectrum of state authority to intervene in local crisis. In practice, state responses tend not to be mutually exclusive within these categories.



### **State Interventions as an Alternative to Chapter 9 Bankruptcy**

In some states, these laws were expressly enacted to provide an alternative to Chapter 9 bankruptcy, and its associated costs (both legal and – potentially – to credit ratings). To avoid Chapter 9 filings, Michigan has taken over Detroit Public Schools, the cities of Pontiac, Benton Harbor, Ecorse, Hamtramck, Highland Park, and Flint, and the village of Three Oaks.<sup>55</sup> In New Jersey, municipalities cannot file for bankruptcy without the approval of a financial control board – approval that is not likely to be given anytime soon, according to the state’s local finance director.<sup>56</sup> In some states, a court-imposed period of state oversight or supervision is required as a precursor to Chapter 9 – such as Pennsylvania’s Act 47 or Rhode Island’s Distressed Cities and Towns law.<sup>57</sup>

Given the fiscal conditions facing local governments, intervention laws may well appear in legislatures around the country. In the 2011 legislative session, the Indiana legislature considered a bill that would have allowed a state board to declare a municipality distressed, allowing for a financial take-over, the appointment of a fiscal manager, and authorized the filing of a bankruptcy petition.<sup>58</sup>

Some analysts favor consideration of other state alternatives to Chapter 9, because of apprehensions about the potential use of Chapter 9 by local officials as a “tool” for negotiating with creditors. Some analysts have implied that because it allows for a renegotiation of all obligations owed by a local

government, Chapter 9 might become a tool for local governments to avoid obligations to bondholders, banks, vendors, employees, retired employees, or taxpayer citizens.<sup>59</sup>

*Preventing debt crises:* Aside from Chapter 9 authorization and intervention laws, other state laws are also designed to prevent local fiscal crises. In a true local government crisis, where a locality is facing multiple creditors with a limited coffer, the question of “who gets paid first” or “who takes a hit?” moves to the forefront. Most states have some selection of legal remedies designed to protect bondholders in the event of a local government crisis. Whether holders of general-obligation bonds are protected during bankruptcy depends on the laws of each state. Thirty states have “statutory lien” laws that give holders of general-obligation bonds and certain other muni bonds first dibs on specified revenue and permit payment even during bankruptcy, according to bankruptcy attorney Jim Spiotto. All states subscribe/adhere to some form of the *writ of mandamus*, which forces a local government to perform a ministerial action that it has refused to undertake such as collect taxes in order to make payments to creditors.

All states but Alaska, Florida, and Tennessee have debt limits designed to keep a municipality’s debt load within a certain “manageable” cap.<sup>60</sup> These are most frequently a percentage of the tax base in a county (e.g., California counties may not incur debt in excess of 5 percent of taxable property). Washington, DC, may not increase its total indebtedness above that existing on June 11, 1878. The North Carolina Local Government Commission will not approve a local government bond issuance if the entity’s fund balance is below 8 percent.<sup>61</sup> North Carolina is the only state in the union which sells bonds on behalf of its local governments.<sup>62</sup> States also have laws on their books designed to protect the interests of bondholders and ensure that local governments do not default on debt. For example, all states authorize the use of refunding bonds to refinance outstanding debt.<sup>63</sup>

Another area in which states can assist local governments with financial obligations is through public employee pensions. Many states have consolidated pension funds in order to maximize investment assets across government employers, as well as to reduce the administrative costs, investment risk, and other burdens to individual governments. States with many local governments tend to have more locally-administered plans. Pennsylvania has 3,200 pension plans.<sup>64</sup> Some states offer financial subsidies in order to assist local governments with making plan contributions. And states can force local governments to adhere to sound fiscal principals. The State of Illinois enacted historic pension reform in 2010, requiring local police and fire pensions to be 90 percent funded by 2040—up from as low as 30 percent for some localities (more on this topic later in the paper).<sup>65</sup>

It is important to note that these laws exist within the larger structure of a state’s fiscal architecture. States also have other ways of helping distressed localities, including subsidizing the cost of delivering services and equalizing funding in education in order to assist poorer communities. Many of these methods will help a locality under stress to avoid coming to a “crisis” point – with the distinction being between long-term distress and a short-term crisis – looming default, bankruptcy, liquidity crisis, or other immediate threat to financial stability. There is a vast body of literature on these topics, and while they are important considerations to explore as we move into the case study phase of our study, they are beyond the scope of this literature review.

*How do states get in the way?* In some instances, rather than intervening in a local government’s finances, state laws or actions may actually be an obstacle to restoring financial integrity. For example, researchers have identified the multiple ways that states may interfere with localities’ ability to raise revenues. One study says that maybe as many as two-thirds of the states have laws that restrict a local

government's ability to raise cash, and that these restraints belie the idea that general obligation bonds are backed by an unlimited ability to tax.<sup>66</sup>

Moffett, Oklahoma, filed for Chapter 9 bankruptcy in 2007 after a state law prohibited the town from issuing speeding tickets on a four-mile stretch of state road that traversed the town. The revenue from these tickets accounted for 70 percent of the town's budget, and though the loss of this revenue was crippling, local mismanagement was also a factor as the mayor had not disclosed \$200,000 debt for purchases of computers, a car, and other equipment. This example also shows that especially for smaller municipalities, where budgets are extremely tight, bankruptcies do not always involve large amounts of debt.<sup>67</sup>

In the case of Jefferson County, Alabama, the federal bankruptcy judge, Thomas Bennett, was very direct:

**Chapter 9, Jefferson County.** Last December, Federal Bankruptcy Judge Thomas Bennett denied the city of Birmingham the ability to sue bankrupt Jefferson County over maintaining a hospital for the indigent.

<sup>68</sup>Judge Bennett repeatedly blamed the state of Alabama for precipitating the county's bankruptcy filing in November 2011. Birmingham Mayor William Bell and the City had asked the bankruptcy court to allow a lawsuit to be filed in state court to stop the County Commission from closing inpatient and emergency-room care at the county-owned Cooper Green Mercy Hospital for the indigent. (Birmingham is the county seat.) Judge Bennett had ordered an automatic stay, which goes into effect when a bankruptcy case is filed, preventing new and existing lawsuits from going forward. Judge Bennett wrote that there is no legal requirement for the county to have a hospital, and that it is only required to pay the cost of indigent care that is not fully reimbursed by other governmental programs or third-party payers. His 41-page opinion also focused heavily on what drove the county to file the country's largest municipal bankruptcy with \$4.1 billion in debt, mostly related to its sewer system: "Contrary to what many have written and what others have assumed was the sole impetus for Jefferson County's bankruptcy filing — its sewer system indebtedness — a major cause was actually beyond the county's control...The initiating act was the Alabama Legislature's elimination of a...tax that had been in place for a number of years and working as designed." Judge Bennett provided a concise discourse on how Alabama state courts struck down the county's occupational tax, which was a major source of revenue for the general fund, and that the Legislature failed to enact a replacement tax. Alabama counties

"All those who attribute Jefferson County's bankruptcy case and Cooper Green's plight only to conduct and actions by the county are ill-informed...The state of Alabama and its legislators are a significant, precipitating cause. Both before and after filing its Chapter 9 case, the county's revenue-seeking activities with Alabama have been to no avail."

do not have home rule, so lawmakers must approve nearly all taxes that are imposed: "The loss of this unencumbered revenue source was rooted in the inability of the state of Alabama and its Legislature to properly enact a statute...All those who attribute Jefferson County's bankruptcy case and Cooper Green's plight only to conduct and actions by the county are ill-informed...The state of Alabama and its legislators are a significant, precipitating cause. Both before and after filing its Chapter 9 case, the county's revenue-seeking activities with Alabama have been to no avail." In addition to losing the job tax, the county's cash-flow problems were worsened because of routine deficits at Cooper Green

hospital that ranged from \$40 million in fiscal 2012 to \$10 million in a year in 2011 and other recent years even though the hospital benefitted from \$40 million a year from a designated sales tax. The hospital also had hundreds of employees to service an average of 40 inpatients a day. While halting some major services at the indigent-care hospital has been highly controversial, Judge Bennett pointed out that it is “surrounded by a massive health-care infrastructure operated by numerous other medical providers, including the largest in Alabama, the University of Alabama at Birmingham.” (Jefferson County is currently transitioning Cooper Green Mercy Hospital into a sustainable, 21st century health-care model, the county said in a rare press release announcing Judge Bennett’s ruling.) The county-run hospital will open an urgent care center on Jan. 1, and will continue to operate primary and subspecialty care clinics. The county also is entering agreements with local hospitals to provide other types of care for the poor.<sup>69</sup>

Indeed, the timeline of the hardships and efforts which the County weathered is indicative of how one state acted to make municipal fiscal distress that much more severe:

Jefferson County Timeline since the commission took office two years ago: <sup>70</sup>	
<b>Nov. 10, 2010:</b>	The five-member Jefferson County Commission is seated.
<b>Dec. 1, 2010:</b>	Circuit Judge Charles Price orders the county to stop imposing its occupational tax immediately. Price rules that the 2009 tax law was unconstitutional because the Legislature did not properly disclose key elements of the bill before the special session that led to its passage.
<b>Jan. 25, 2011:</b>	The commission votes to cut \$31.2 million from the fiscal 2011 budget.
<b>March 16, 2011:</b>	The Alabama Supreme Court affirms Price's ruling and throws out Jefferson County's 2009 occupational tax law and business license fee, which in fiscal 2010 had generated \$74 million, about one-fourth of the county's general fund.
<b>April 12, 2011:</b>	The commission votes to close four satellite courthouses and switches 2,913 hourly workers to a four-day workweek in an effort to cut \$21 million annually from the budget. The 32-hour workweek, effectively a 20 percent pay cut, does not apply to 445 salaried workers.
<b>April 27, 2011:</b>	More than 60 tornadoes carve 1,100 miles of destruction across Alabama, leaving victims in Jefferson County communities such as Pratt City, Concord, Pleasant Grove, North Smithfield, Edgewater and McDonald Chapel.
<b>June 9, 2011:</b>	State Sen. Scott Beason, R-Gardendale, blocks a bill in the Alabama Legislature that would have given the commission the power to raise about \$50 million a year in taxes.
<b>June 16, 2011:</b>	The county's Human Resources Department prepares and begins to hand out 546 layoff notice letters to county employees.
<b>Sept. 13, 2011:</b>	Jefferson County sells 238 licensed beds at the Jefferson Rehabilitation and Health Center to a Tuscaloosa-based company for \$8.3 million, effectively getting out of the nursing home business.



**Sept. 16, 2011:** The commission approves a conceptual settlement agreement with sewer-system creditors that could increase sewer rates as much as 8.2 percent a year for three years and no more than 3.25 percent a year afterward.

**Sept. 27, 2011:** The commission votes without discussion to hire Hoover Mayor Tony Petelos as the county's first professional manager.

**Sept. 28, 2011:** The commission passes a \$638.5 million operating and capital budget that makes major cuts to the Sheriff's Office and to road construction and maintenance, along with many other departments. The budget is 22 percent smaller than the \$817 million spending plan adopted for 2011. The general fund budget, used for daily operations, is \$217 million.

**Nov. 9, 2011:** After deciding that both a final settlement with creditors and a special session of the Alabama Legislature to address the county's problems will not succeed, the commission votes 4-1 to file for Chapter 9 bankruptcy protection.

**Jan. 6, 2012:** The commission wins authority over the county's sewer system in a bankruptcy judge's ruling. Receiver John S. Young no longer has autonomous authority over the sewer system.

**May 22, 2012** - The commission votes to skip a \$15 million non-sewer debt payment and use the money for operating expenses.

**June 12, 2012** -- The commission opens the first of three public sewer hearing before a sparse crowd inside an auditorium at the Birmingham-Jefferson Convention Complex.

**Aug. 14, 2012** -- The commission recesses its weekly meeting after irate supporters of Cooper Green Mercy Hospital halted action before a vote was taken on the hospital's fate.

**Aug. 20, 2012** -- The commission rejects the lease for the Bessemer Courthouse saying the county could no longer afford the payments.

**Sept. 11, 2012** -- The commission votes to establish a "hub and spoke" model of indigent care at Cooper Green Mercy Hospital.

**Sept. 26, 2012** -- The commission restructures a deal with Ambac Assurance Corp. that will keep open the Bessemer Cutoff Courthouse.

**Sept. 26, 2012** - The commission passes a general fund budget of \$205 million, including \$15 million for legal fees, which leaves \$190 million for daily operations.

**Nov. 6, 2012** -- The commission votes unanimously to increase sewer rates for the first time in four years.

## V. State Strategies to Monitor Local Finances

As with Chapter 9 bankruptcy, which requires a locality to prove insolvency rather than the threat of insolvency, many of the state intervention laws described above are specifically designed to take effect in the immediate aftermath of a local crisis, and thus are more *reactive* than *proactive* in nature. And while some states monitor local government finances even through the structure or state body that allows them to intervene in a crisis, nevertheless one national survey found that most states are not aware of local government fiscal crises before they emerge.<sup>71</sup>

There is a wealth of research on this topic of monitoring local conditions. Academic researchers and practitioner groups have identified scores of indicators of financial well-being. The International County Manager Association has published a set of over 30 indicators across six categories, including *revenues, expenditures, earnings, unfunded liabilities, debt structure, condition of capital*.<sup>72</sup> The Government Finance Officers Association has endorsed a “10-point test” to measure fiscal health.<sup>73</sup>

The states have in place a variety of systems to monitor local finances, and research varies in terms of which states those are and what they require from localities. A 1993 survey found that at least 36 states required some financial reporting from various types of local governments, with the responsibility for review of financial data resting with a state agency, the state auditor, or a comptroller.<sup>74</sup> A 2003 study found that although just under half of states reported that the state made an effort to predict local crises, only 10 had formal measures in place to do so.<sup>75</sup> According to a 2005 survey of states, 15 states have indicators to monitor or assess local government financial condition.<sup>76</sup> These progressively smaller numbers of states may not indicate that in fact the number of states monitoring local health has dwindled over time, but may be a reflection of the challenges of asking states to self-report information.

Two of the nation’s largest states, New York and California, have considered legislation that would establish an earlier warning system for local fiscal problems. Beginning with New York City in 1975, the state of New York has intervened in the finances of a handful of local governments facing distress (including Buffalo, Nassau County, and Troy). In most cases, the state has established an independent debt-issuing corporation to help localities access credit markets. And while the state’s 4,000 local governments already submit financial data to the state comptroller’s office, credit ratings agencies have criticized the state’s lack of a cohesive state-wide system for identifying and intervening in fiscal stress. Recently the Comptroller has said he wants to use local data to define stress via nine indicators.<sup>77</sup> In his State of the State address in January, Governor Cuomo said a Financial Restructuring Assistance Program was needed to help New York’s localities deal with financial stress. The experience of financial stress stems from varying causes. The localities need varying advice, he said. A joint task force made up of the comptroller, attorney general, Division of Budget, and private-sector restructuring consultants would run the program. In California, Treasurer Bill Lockyer wants the state to develop a warning system to monitor local government finances and identify cities in fiscal peril.<sup>78</sup>

The Citizens Research Council of Michigan has spoken to at least three challenges in predicting local government fiscal crises: there are very few standards against which local government finances can be measured with confidence; fiscal difficulties emerge gradually and incrementally, making potential difficulties less obvious; and states struggle with a lack of useable dissemination vehicles (such as surveys or audits) and formats to assess financial condition.<sup>79</sup> Additional challenges come in the form of staff: particularly in a time of leaner budgets, states can lack the staff capacity to review the financial documents of hundreds or thousands of localities. The New Jersey Division of Local Government

Services used to scrutinize the budgeted line item of each of the 566 cities and 21 counties within that states until substantial downsizing in the 1990s required it to relax its review; now it examines documents every three years and requires localities to file a report in off years.<sup>80</sup>

An additional factor relates to the institutional relationship between state and local governments. In Colorado, most local budgets are comprised largely of local – rather than state – funds, giving the state less interest in and less of a “right” to keep a close eye on local conditions.<sup>81</sup> And states which have not experienced local fiscal crises might not have a system in place for doing so. In North Carolina, which led the nation in bond defaults in the 1930s, the state plays a very significant role in monitoring local governments and in preventing crises before they emerge.<sup>82 83</sup> From the perspective of the bond ratings agencies, the North Carolina Local Government Commission is a leader in terms of overseeing and supervising local government finances. The state’s emphasis is on being proactive so local officials can work out their problems before the commission is forced to assume control. Other states are more reactive.”<sup>84</sup> The North Carolina Financial Dashboard allows users to his management tool helps provide context by presenting five-year trend data for financial indicators, and permitting comparison against other local governments selected as benchmark peers.<sup>85</sup>

**Divergent Paths: North Carolina and Michigan** The Great Depression hit local government finances hard in North Carolina, which saw more defaults than any other state during the 1930s. As the Citizens Research Council of Michigan noted, in the 1930s, there were similarities to the problems facing Michigan and North Carolina: erosion of the tax base combined with similarities in financing and service delivery responsibilities. In addressing these problems, the states took two different paths: North Carolina strongly centralized both service delivery responsibility and revenue-raising ability, while Michigan opted to leave service responsibilities at the local level while providing state revenues.<sup>86</sup> The Council has argued for increased state oversight of local finances, on the grounds that local budgets are comprised heavily of state dollars. And while Public Act 4, the Emergency Manager Law which gave a state-appointed official tremendous power of local governments, was so unpopular as to be repealed by taxpayers in November 2012, the ratings agencies saw it as a positive.

## VI. Measuring Effectiveness of Intervention Mechanisms

In order to assess the effectiveness of an intervention law, it is necessary to ask the question, “Why do states intervene in local crises?” What end are state officials seeking in establishing laws to step in to assist a struggling municipality? As with the causes of local distress, the reasons for state intervention are varied, and in almost all cases, there is more than one shoe that fits.

- (1) *Interventions provide an alternative path to bankruptcy and default.* The North Carolina Local Government Commission was formed to address the wave of defaults during the 1930s. It is important to note that the LGC was formed in concert with centralization both of service delivery responsibility and of revenue-raising capacity.
- (2) *State intervention can be intended to keep borrowing costs low and protect access to credit.* State officials in Rhode Island were explicit that they were primarily concerned with the state and other local bond ratings in establishing the Distressed Cities and Town Law, which prevented localities from filing for bankruptcy protection or seeking the protection of a judicial receiver without first gaining state assistance. Ratings agencies have criticized states that have experienced local crises and do not have a comprehensive system for addressing them.
- (3) *In some instances, local officials do not have the ability to manage local finances.* In Flint, MI, a governor-appointed review team reported that city officials demonstrated an inability to

“accurately monitor revenue and expenditures throughout a given fiscal year and to amend city budgets accordingly.”<sup>87</sup> The review team recommended the appointment of an emergency financial manager in order to restore stability to the struggling city. A court upheld the governor’s appointment in the face of an appeal by local officials.

- (4) *Interventions are meant to restore fiscal sustainability to a local government.* State actions can be intended to get a locality back to a point at which it can stand on its own two feet. There may exist a moral hazard problem, in which local governments increasingly rely on financial or on technical assistance. In Pennsylvania, 26 localities have entered the state’s Act 47 program, and only six have left. If goal is to return a locality to independence, is there some way this program could be strengthened? In Ohio, the first two years of a fiscal supervisor are paid for by state, after which point a percentage of the supervisor’s salary is paid for by the locality under supervision, a share that grows over time.<sup>88</sup>
- (5) *State attention can encourage/force local governments to do business in a smarter way.* In Massachusetts, the City of Chelsea, which was under the control of a state receiver, is sharing services and entering purchasing agreements with neighbor Boston.<sup>89</sup>

## VII. The Need for Individual Attention

A review of the literature surrounding the causes of local distress and the state policy options for responding to local fiscal distress is informative. However, the 50 unique legal, institutional, and political relationships between state and local governments make it possible to paint with too broad a brush stroke. Just as there are multiple causes of local distress – a pension crisis and a failed bond deal are fundamentally different – there are multiple reasons that states may or may not choose to intervene in a crisis. Thus, in evaluating the effectiveness of state and local actions to address a crisis, a case study approach is needed. This focused analysis allows analysts to contextualize the unique political relationships, service delivery responsibilities, tax and legal structures in place within a given community. Several issues are critical for understanding the experience of municipal governments:

1. How do policy makers define different stages of fiscal emergencies, such as short-term (those relating to cash-flow challenges) and long-term (those related to a growing structural imbalance)? By these definitions, how early can policy makers identify a problem, and what mechanisms at the state or local level would help them see a problem coming? How do policy makers define recovery, both from short-term and long-term fiscal challenges? How long has it taken or will it take for communities to achieve recovery – by these definitions?
2. What was the range of state and local responses to the crisis? How did decision-makers choose these strategies? Did they tailor the responses to the “type” of crisis facing local governments (e.g., internal versus external, as described above)?
3. What is the impact of a fiscal crisis? What are the outcomes of the state and local responses to a crisis? As Central Falls exited bankruptcy this fall after a relatively speedy turnaround period, Governor Chafee announced that the city had its fiscal house in order and that the next phase of state oversight would focus on economic development and on fiscal *operations* – as opposed to fiscal recovery. While retired employees took a sharp cut in their benefits, bondholders emerged unscathed from the crisis. No one has speculated about the impact of 55 percent pension cuts on aging employees with no other source of income—much less how their human needs will be addressed. And beyond the pensions impact, what was and what will be the

impact on other Central Falls residents? The municipality's first Chapter 9 receiver responded that he was uncertain there was a sustainable tax base for the future. What services does Central Falls – a city of 19,000 residents and covering less than one square mile -- provide to its residents, as opposed to those covered by the state or by neighboring jurisdictions? Will the quality of these services decline?

4. What effects have different state strategies had on the states' own fiscal futures? It will be easier to identify the fiscal impact of a crisis and of the responses to a crisis, given the existing literature on fiscal health and fiscal sustainability indicators. What will be more difficult will be to determine what was the impact of the crisis on residents? On public employees? On service delivery, such as schools and public safety? How would you measure how the face of a community has changed? How would you measure how quality of life has changed for residents? These answers will help us address the fundamental question: how does a local government recover from a crisis to once again become a viable community?

We will address these critical issues through case studies of a set of communities that offer a variety of state and local strategies addressing local fiscal crises:

**San Bernardino, CA:** The City, faced with a \$45 million deficit in its \$128 million budget for 2012-13, and with all of its fund balance and other reserves exhausted, and questions raised at a council meeting in mid-July 2012 about the City's cash flow—particularly relating to the ability to meet its payroll the following month, the City filed for protection under Chapter 9 of the federal bankruptcy code on August 1, 2012. For FY 2012-13, the City suspended payments to CalPERS as well as for its pension obligation bonds and legal claims. The City reduced salary and compensation to employees and deferred payments for accumulated vacation time upon separation of service. U.S. District Court Judge Meredith Jury indicated that she would rule on the City's eligibility to file under Chapter 9 in August 2013.

**Detroit, MI:** Generations of economic and fiscal challenges have contributed to the current crisis in Detroit, with the governor appointing an emergency manager earlier this year, and the city filing on July 18, 2013, for federal municipal bankruptcy protection. As in San Bernardino, a critical issue is a conflict between federal municipal bankruptcy laws and the state constitution, which bars any reduction in public pensions.

**Pittsburgh, PA:** In Pennsylvania, since the 1980s, twenty-six communities have entered the Act 47 program, and six have left. What is the difference between those that have left and those that remain in the program? : In 1950, Pittsburgh was the twelfth largest city in the U.S., with a population of 678,806; in 2012, thanks to industrial job loss and suburbanization, the population was 306,211.<sup>90</sup> Over the decades, as residents left for suburbs and jobs elsewhere, they left behind the infrastructure and public sector workforce of a City built for a much larger and denser population. The City has maintained its role as regional employment center: today the daytime population is over 40 percent higher than the resident population – with the ability to tax commuters and recapture some of their costs to the City a key bone of contention surrounding Pittsburgh's fiscal recovery.

**Chicago, IL:** Given the large unfunded liabilities local police and fire plans currently face, local governments will be forced to increase their annual contributions greatly when the law goes into effect in 2015, in order to meet the target of 90 percent funded by 2040. Chicago city officials have stated that this funding requirement would cause a 60 percent increase in the local property tax levy. Additionally,

state law prohibits local governments from cutting benefits to current retirees – a tool that Central Falls officials found was the only arrow in the quiver that would allow them to balance their budget. So while the state’s reforms are designed to avoid a pension crisis, without the additional flexibility that localities need, the law may have the perverse effect of creating a crisis for many local governments in 2015. East Saint Louis and the Chicago Board of Education are the only two instances in which the IL Financially Distressed Communities Act has been used. Will this program be used for Chicago or will lawmakers there make necessary pension reforms in order to avoid an emergency?

**Providence, RI:** Providence has struggled through the same deindustrialization and hollowing out that has afflicted many cities in the Northeast. The city’s population was 248,674 in 1950, but it had dropped to 179,116 in 1970 – a loss of 28 percent and the steepest decline of any city in the US for the same period. It has hovered around this level ever since. Today, Providence and other Rhode Island cities and towns remain sensitive to economic downturns; 25 percent of Providence residents live in poverty, and the metropolitan area’s unemployment rate, while down from a recessionary peak of 12.5 percent, is still nearly 10 percent (compared to 7.5 percent nationally).

**Baltimore, MA:** Baltimore reached a peak population of 949,708 in 1960; 30% of Maryland’s population resided in the City at that time. By 2010, the population had dropped to 620,961 and the City’s share of the state’s population fell to 11%. Like many Eastern and Midwestern cities, a significant portion of this loss in population is attributable to the decline of its industrial base and suburbanization. Baltimore lost approximately 110,000 jobs between 1990 and 2010—about 24% of all jobs. Seventy percent of these jobs lost were in manufacturing and related industries. There are approximately 16,000 vacant and abandoned properties in the City—about one blighted property for every 40 residents. Median household income 44% lower than that of the state, but crime is 86% higher. Through all of this change, Baltimore still retains its position as the only large city in Maryland and serves as its principal urban hub. Unlike other cities in this report, Baltimore has not been in a fiscal emergency and has a relatively healthy balance sheet.

### Appendix: State Bankruptcy Authorization and Intervention Mechanisms

	<b>Bankruptcy</b>	<b>Intervention or Assistance Mechanism (Receiver, Emergency Manager, Control Board, Commission, or other structure)</b>
AL	X	
AK		
AZ	X	
AR	X	
CA	X (conditional)	X
CO	X (limited)	
CT	X (conditional)	
DE		
DC		X
FL	X (conditional)	X
GA		
HI		
ID	X	X
IL	X (limited)	X
IN		X
IA	X (very limited)	
KS		
KY	X (conditional)	X
LA	X (conditional)	
ME		X
MD		
MA		X
MI	X (conditional)	X
MN	X (limited)	X
MS		
MO	X	
MT	X (limited)	
NE	X	
NV		X
NH		X
NJ	X (conditional)	X
NM		
NY	X (conditional)	X

NC	X (limited)	X
ND		
OH	X (limited)	X
OK	X	
OR	X (limited)	X
PA	X (conditional)	X
RI	limited (only receiver can file)	X
SC	X	
SD		
TN		
TX	X	X
UT		
VT		
VA		
WA	X	
WV		
WI		X
WY		

<sup>1</sup> Christine R. Martell and Adam Greenwade, "Profiles of Local Government Finance," *Oxford Handbook of State and Local Government Finance*, Oxford University Press, 2012. p. 178

<sup>2</sup> Ronald C. Fisher and Andrew Bristle, "State Intergovernmental Grant Programs," *Oxford Handbook of State and Local Finance*, Oxford University Press, 2012.

<sup>3</sup> In 2010, property taxes experienced the first annual decline since the mid-1990s, a trend that continued in 2011 and 2012. Property taxes are 29 percent of local revenues. State aid fell in 2010. The Pew Center on the States, "The Local Squeeze." <http://www.pewstates.org/research/reports/the-local-squeeze-85899388655>. Accessed December 20, 2012.

<sup>4</sup> National League of Cities, "City Fiscal Conditions in 2012," September 2012. <http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/city-fiscal-conditions-research-brief-rpt-sep12.pdf>. Accessed December 20, 2012.

<sup>5</sup> Figures for 1980 and 1989 are from Congressional Budget Office, *Federal Infrastructure Subsidies: Grants or Credits?* (Washington, DC, August 1990) and John E. Petersen, Catherine Holstein, and Barbara Weiss, *The Future of Infrastructure Needs and Financing*, (Washington, DC: Government Finance Research Center of the Government Finance Officers Association, December 1988) pp. II-2. Over the same period, federal grants to state and local governments as a percentage of GDP slipped from 3.25 percent to 2.75 percent. Indeed, federal support actually declined in nominal terms, from nearly \$89 billion in 1980 to \$84 billion just two years later. According to George Mason analysis of US Census Bureau Government Finance Statistics data from the U.S. Census of Governments, in 2007-2008 federal revenue was 19.7 percent of state and local revenues. This share climbed beginning in 2008, an increase attributable both to a decline in state and local taxes and the uptick due to the American Recovery and Reinvestment Act which pumped billions of dollars into state and local governments.



- <sup>6</sup> New York Report of the State Budget Task Force, December 2012. <http://www.statebudgetcrisis.org/wpcms/wp-content/images/NY-Report.pdf>. Accessed January 6, 2013.
- <sup>7</sup> John E. Petersen, Catherine Holstein, and Barbara Weiss, *The Future of Infrastructure Needs and Financing*, (Washington, DC: Government Finance Research Center of the Government Finance Officers Association, December 1988) pp. II-2
- <sup>8</sup> Report of the State Budget Crisis Task Force, p. 75, 2012.
- <sup>9</sup> OMB, Table 12.3, "TOTAL OUTLAYS FOR GRANTS TO STATE AND LOCAL GOVERNMENTS BY FUNCTION, AGENCY, AND PROGRAM: 1940–2013."
- <sup>10</sup> U.S. Census Bureau, Table 438. State and Local Governments--Expenditure for Public Works: 1990 to 2008.
- <sup>11</sup> United States Securities and Exchange Commission, "Report on the Municipal Securities Market," July 31, 2012. <http://www.sec.gov/news/studies/2012/munireport073112.pdf>. Accessed December 20, 2012.
- <sup>12</sup> The Pew Center on the States, "The Local Squeeze." <http://www.pewstates.org/research/reports/the-local-squeeze-85899388655>. Accessed December 20, 2012.
- <sup>13</sup> Lucy Dadayan and Don Boyd, Issue Brief: "The Depth and Length of Cuts in State-Local Employment is Unprecedented," Rockefeller Institute of Government, January 2013. [http://www.rockinst.org/pdf/government\\_finance/2013-01-09-State-Local\\_Government\\_Employment.pdf](http://www.rockinst.org/pdf/government_finance/2013-01-09-State-Local_Government_Employment.pdf) Accessed January 9, 2013.
- <sup>14</sup> Chuck Raasch, "Recession battered cities combine services," USA Today, October 19, 2012.
- <sup>15</sup> Definition of fiscal emergency from Robert Inman, "How to Have a Fiscal Crisis: Lessons from Philadelphia," American Economic Review. Vol. 85, No. 2, May, 1995. <http://www.jstor.org/stable/2117952>. p. 378 of 378 - 385. Academic research on fiscal "crisis," "emergency," and "distress" has been summed up through two commonalities: the inability of a government's revenues to cover its expenditures, and the inability of a government to make payments on time. Abraham Carmeli (2003): "Introduction: Fiscal and Financial Crises of Local Governments, International Journal of Public Administration, 26:13, 1423-1430.
- <sup>16</sup> Advisory Commission on Intergovernmental Relations, "Bankruptcies, Defaults, and Other Local Government Financial Emergencies," 1985. <http://www.library.unt.edu/gpo/acir/Reports/policy/a-99.pdf>. Accessed January 18, 2013.
- <sup>17</sup> Fiscal stress is often but not always a precursor to a fiscal crisis or emergency. Beth Walter Honadle, "The States' Role in U.S. Local government Fiscal Crises: A theoretical Model and Results of a National Survey," International Journal of Public Administration, Vol. 26, No. 13, p 1433 of pp. 1431-1472, 2003.
- <sup>18</sup> "Bankrupt Cities, Municipalities List and Map," *Governing*. <http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html>. Accessed December 20, 2012. Business entity filings are from the United States Courts website. <http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx> Accessed December 20, 2012.
- <sup>19</sup> "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012.
- <sup>20</sup> James Spiotto, Chapman and Cutler.
- <sup>21</sup> "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012.
- <sup>22</sup> Steven Church, "Nebraska, Not California, is King of Municipal Collapse," Bloomberg. July 16, 2012. <http://www.bloomberg.com/news/2012-07-16/nebraska-not-california-is-king-of-municipal-collapse.html>. Accessed December 20, 2012.
- <sup>23</sup> Steven Church, "Nebraska, Not California, is King of Municipal Collapse," Bloomberg. July 16, 2012. <http://www.bloomberg.com/news/2012-07-16/nebraska-not-california-is-king-of-municipal-collapse.html>. Accessed December 20, 2012.
- <sup>24</sup> Glossary, Municipal Securities Rulemaking Board, accessed January 11, 2013.
- <sup>25</sup> State Budgets: Day of Reckoning, CBS News. Originally aired on December 19, 2010. <http://www.cbsnews.com/video/watch?id=7166293n&tag=mncol;lst;3>. Accessed December 20, 2012.
- <sup>26</sup> Statistic on default rate is from firm Municipal Market Advisors, as cited by Kelly Nolan in "On GO Bonds, Investors Advise Caution," Wall Street Journal, May 17, 2012. <http://online.wsj.com/article/SB10001424052702303360504577410230458546046.html#>
- <sup>27</sup> Robert Inman, "How to Have a Fiscal Crisis: Lessons from Philadelphia," American Economic Review. Vol. 85, No. 2, May, 1995. <http://www.jstor.org/stable/2117952>. p. 378 of 378 - 385.
- <sup>28</sup> George Mason University analysis of state debt resolution mechanisms identified in "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012. A state survey from 2003 indicated that while ten states had formal definitions of a local government crisis, fourteen more had working definitions. Beth Walter Honadle, "The States' Role in U.S. Local Government Fiscal Crises: A Theoretical Model and Results of a National Survey," *International Journal of Public Administration*, Vol. 26, No. 13, pp. 1431-1472, 2003.
- <sup>29</sup> Nevada Revised Statute § 354.685. <http://www.leg.state.nv.us/NRS/NRS-354.html#NRS354Sec685>. Accessed December 20, 2012.

<sup>30</sup> Chapman and Cutler LLP describing the Illinois Financially Distressed Cities Law, 65 ILL. Comp. Stat. 5/8-12-1. "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP, p. 117. 2012.

<sup>31</sup> New Jersey Stat. Ann. § 52:27BB-55. [http://lis.njleg.state.nj.us/cgi-bin/om\\_isapi.dll?clientID=54505059&Depth=2&depth=2&expandheadings=on&headingswithhits=on&hitsperheading=on&info base=statutes.nfo&record={15F31}&softpage=Doc\\_Frame\\_PG42](http://lis.njleg.state.nj.us/cgi-bin/om_isapi.dll?clientID=54505059&Depth=2&depth=2&expandheadings=on&headingswithhits=on&hitsperheading=on&info base=statutes.nfo&record={15F31}&softpage=Doc_Frame_PG42). Accessed December 20, 2012.

<sup>32</sup> Charles Coe, "Preventing Local Government Fiscal Crises – Emerging Best Practices," *Public Administration Review*, July/August 2008, 761.

<sup>33</sup> NH Revised Stat. Ann. § 13.1. <http://www.gencourt.state.nh.us/rsa/html/l/13/13-1.htm> Accessed on January 5, 2013.

<sup>34</sup> Charles Coe, "Preventing Local Government Fiscal Crises," *Public Administration Review*, July-August 2008, 761.

<sup>35</sup> OR. Rev. Stat. §§ 203.095, establishing County Public Safety Emergency and Fiscal Control Board.

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<sup>36</sup> Advisory Commission on Intergovernmental Relations, "City Financial Emergencies: An Intergovernmental Dimension," 1973.

<sup>37</sup> Advisory Commission on Intergovernmental Relations, "Bankruptcies, Defaults, and Other Financial Emergencies," 1985.

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<sup>38</sup> James Nash, "California Ski Town Aiming to Rival Vail Faces Upheaval," Bloomberg News.

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<sup>39</sup> Lucy Dadayan, "The Impact of the Great Recession on Local Property Taxes," Nelson A. Rockefeller Institute of Government. July 2012. [http://www.rockinst.org/pdf/government\\_finance/2012-07-16-Recession\\_Local\\_%20Property\\_Tax.pdf](http://www.rockinst.org/pdf/government_finance/2012-07-16-Recession_Local_%20Property_Tax.pdf) Accessed January 21, 2013.

<sup>40</sup> Kyle Whitmire, "Bankruptcy judge sides with Jefferson County in Cooper Green fight, blasts city and state," Al.com, December 19, 2012. [http://blog.al.com/spotnews/2012/12/bankruptcy\\_judge\\_sides\\_with\\_je.html](http://blog.al.com/spotnews/2012/12/bankruptcy_judge_sides_with_je.html) Accessed January 5, 2013.

<sup>41</sup> Phil Willon, *LA Times*, December 21, 2012.

<sup>42</sup> Statistics on California cities in fiscal distress is from ConservativeCommune.com, "Muni Watch: All Signs Point to Doom," Posted on August 21, 2012 By Meep

<sup>43</sup> "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012. Alston and Bird has 14 states: their count also includes California and Florida.

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<sup>44</sup> "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012.

<sup>45</sup> Kentucky Revised Statute Ann. § 66.400. <http://www.lrc.ky.gov/KRS/066-00/400.PDF> Accessed December 20, 2012.

<sup>46</sup> "A Primer on Municipal Bankruptcy," Chapman and Cutler LLP. 2012. [http://www.afgi.org/resources/Bankruptcy\\_Primer.pdf](http://www.afgi.org/resources/Bankruptcy_Primer.pdf) Accessed December 19, 2012.

<sup>47</sup> GA Code Ann. § 36-80-5. Available at <http://law.justia.com/codes/georgia/2010/title-36/provisions/chapter-80/36-80-5/>. Accessed December 20, 2012.

<sup>48</sup> "Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies," Chapman and Cutler LLP. 2012. Mr. Spiotto has identified the current universe of state laws and programs that allow states to supervise local government debt and assist with debt restructuring, described in Chapter IV, Debt Resolution Mechanisms.

<sup>49</sup> Charles Coe, "Preventing Local Government Fiscal Crises – Emerging Best Practices," *Public Administration Review*, July/August 2008, 761. And Jim Spiotto, interview, December 19, 2012.

<sup>50</sup> Florida Revised Statute Sections Sections 218.50-218.504, "Local Governmental Entity, Charter School, Charter Technical Career Center, and District School Board Financial Emergencies Act." <http://www.flsenate.gov/Laws/Statutes/2011/218.50> Accessed December 20, 2012.

<sup>51</sup> Charles Coe, "Preventing Local Government Fiscal Crises – Emerging Best Practices," *Public Administration Review*, July/August 2008, 762.

<sup>52</sup> Charles Coe, "Preventing Local Government Fiscal Crises – Emerging Best Practices," *Public Administration Review*, July/August 2008, 762.

<sup>53</sup> Florida Stat. §§ 218.37 and 163.055 (Local Gov't Financial Technical Assistance Program); Fla. Stat. §§ 218.50 - 218.504 (Local Government Bond Financial Emergencies Act)

<sup>54</sup> Florida Stat. §§ 218.37 and 163.055 (Local Gov't Financial Technical Assistance Program); Fla. Stat. §§ 218.50 - 218.504 (Local Government Bond Financial Emergencies Act)

<sup>55</sup> Eric Scorsone, "Local Government Financial Emergencies and Municipal Bankruptcy," Michigan Senate Fiscal Agency Issue Paper. May 2010. <http://www.senate.michigan.gov/sfa/publications/issues/localgovfin/localgovfin.pdf>

<sup>56</sup> Gerald Seneski, New Jersey Director of Local Government Services, "Local Government in Crisis: Bankruptcy, Default, and Fiscal Emergency (A New Jersey Perspective)," presentation to the Raymond James Conference. October 2012.

[http://raymondjames.com/mk/inst\\_invest\\_forum/pdfs/2012%20NJ%20Dept%20of%20Community%20Affairs%20-%20Division%20of%20Local%20Government%20Services%20Investors%20Conference%20Presentation.pdf](http://raymondjames.com/mk/inst_invest_forum/pdfs/2012%20NJ%20Dept%20of%20Community%20Affairs%20-%20Division%20of%20Local%20Government%20Services%20Investors%20Conference%20Presentation.pdf)

<sup>57</sup> “Municipal Bankruptcies: A Guide for Public Finance Attorneys,” National Association of Bond Lawyers, October 2011.

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<sup>58</sup> Senate Bill 105, Indiana General Assembly, authored by Sen. Charbonneau and sponsored by Rep. Soliday.

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<sup>59</sup> This speculation has appeared in media coverage and think-tank research, such as Erin Montarti, “Chapter 9 Bankruptcy: What it Means for Pennsylvania’s Municipalities,” Allegheny Institute for Public Policy, December 2009.

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<sup>60</sup> “Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies,” Chapman and Cutler LLP. 2012.

<sup>61</sup> Fehr, Stephen. “North Carolina Agency a Lifeline,” Stateline, June 6, 2012.

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<sup>62</sup> Charles Coe, “Preventing Local Government Fiscal Crises – Emerging Best Practices,” *Public Administration Review*, July/August 2008, 761.

<sup>63</sup> “Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies,” Chapman and Cutler LLP. 2012.

<sup>64</sup> Commonwealth of Pennsylvania Public Employee Retirement Commission, Status Report on Local Government Pension Plans, December 2012.

[http://www.portal.state.pa.us/portal/server.pt/community/publications/3194/municipal\\_pension\\_plan\\_report/525535](http://www.portal.state.pa.us/portal/server.pt/community/publications/3194/municipal_pension_plan_report/525535). Accessed January 25, 2013.

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<sup>66</sup> Kelly Nolan, “On GO Bonds, Investors Advise Caution,” Wall Street Journal, May 17, 2012.

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<sup>67</sup> “Oklahoma: Speed Trap Town Goes Bankrupt,” February 3, 2007. <http://www.thenewspaper.com/news/15/1584.asp> Accessed January 5, 2013. Additional detail from “U.S. Municipalities that went bankrupt,” CNBC.

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<sup>68</sup> *In Re: Jefferson County*, Case No. 11-05736-TBB, U.S. Bankruptcy Court of No. Alabama, December 19, 2012.

<sup>69</sup> *In Re: Jefferson County*, Case No. 11-05736-TBB, U.S. Bankruptcy Court of No. Alabama, December 19, 2012.

<sup>70</sup> Barnett Wright, “Jefferson County Timeline,” AL.com, November 13, 2012.

<sup>71</sup> Beth Walter Honadle, “The States’ Role in U.S. Local Government Fiscal Crises: A Theoretical Model and Results of a National Survey,” *International Journal of Public Administration*. Vol. 26, No. 13, pp. 1431-1472, 2003.

<sup>72</sup> John M. Trussel and Patricia A. Patrick, “A Predictive Model of Local Fiscal Distress in Local Governments,” *Journal of Public Budgeting, Accounting, and Financial Management*, Winter 2009. 582. Scott Mackey, “State Programs to Assist Distressed Local Governments,” National Conference of State Legislatures, March 1993.

<sup>73</sup> *Evaluating Financial Condition: A Handbook for Local Government, 4th edition*, International County Manager Association, 2003. Ken Brown, “The Ten-Point Test of Financial Condition: Toward an Easy-to-Use Assessment Tool for Smaller Cities,” *Government Finance Review*, December 1993. <http://gfoa.org/services/dfi/bulletin/BUDGET-Ten-point-test.pdf> Accessed January 6, 2013.

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