Chapter 9: Looming Municipal Financial Crisis?[1]

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For the past several years, there have been predictions that Chapter 9 would become increasingly common. June 30th marks the fiscal year end for many states and municipalities, including in Kentucky. While there have been more filed chapter 9 cases in the last several years than in past eras, there has certainly not been the onslaught that some envisioned or predicted.

Meredith Whitney, an analyst who foresaw the mortgage crisis, caused a firestorm in May 2011 when she predicted looming municipal bond defaults and restructurings including possible chapter 9 filings and municipal bond capital markets turmoil.[2] She is not the only analyst to recommend moving investments out of the municipal bond market.

In her article, Ms. Whitney presented some sobering statistics. States have racked up over $1.8 trillion in taxpayer supported obligations. Much of the debt arises from underfunding pension and other post-employment benefits ("OPEB") of government employees. Municipal budgets often are passed with budgeted shortfalls. Additionally, federal stimulus dollars used by states to subsidize expenses during the economic downturn will begin to expire. States have grown more and more dependent on federal subsidies and grant dollars, with some states relying on them for almost thirty percent (30%) of their annual budgets. States employ fifteen percent (15%) of the United States workforce. Finally, fixed expenses including debt service obligations and actuarially required minimum pension funding have grown tremendously in the percentage of total dollars these items take out of the annual budget. Some of the debt remains "off balance sheet" and there is an overall lack of transparency and inability to easily see the total picture.

The underfunded and unfunded budgetary issues, on all levels, from the smallest of municipalities to counties to states, is indeed a looming major political issue. The growing need for infrastructure repairs and past- due maintenance is a major cost item that officials do not like to address. One gripe of voters is that elected officials, once in office, will not address the foreseeable long-term problems and the tough issues.

Municipalities and their elected officials are increasingly squeezed on making too few dollars go around for too many different needs. At some point, the ability to continue to defer tough choices ends. The ongoing flat or declining revenues combined with the increasing costs of providing the basic services, is enough on its own, much less extraordinary capital improvements, such as the Jefferson County Alabama sewer system issues as one example.

Professionals experienced in the bankruptcy process are used to taking the necessary steps to get all constituents to the table, in efforts to reach consensus where all can share the pain and share the "haircut," rather than piecemeal issues one at a time, or try to deal with only one group such as bondholders or unions. While it may be true that there are not yet more filed Chapter 9 cases, Chapter 9 must increasingly be explored and considered as these political issues are forced to be addressed. If you would like more information about Chapter 9 options and analysis, please contact Laura Day DelCotto or any of the other attorneys at DelCotto Law Group at (859) 231-5800 or visit our website, www.dlgfirm.com.

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[2] Meredith Whitney, "The Hidden State Financial Crisis" Wall Street Journal, May 18, 2011.