Y3. AD 9/8: 2 B22

For U[illegible] Only

A Commission Report

Bankruptcies, Defaults, And Other Local Government Financial Emergencies

LIBRARY
ADVISORY ... MENTAL
GIFT
RECD MAY 28 2003

Advisory Commission on Intergovernmental Relations

Washington, DC 20575 • March 1985

A-99

U of NT Libraries 76203

A Commission Report

Bankruptcies, Defaults, And Other Local Government Financial Emergencies

Advisory Commission on Intergovernmental Relations

Washington, DC 20575 • March 1985

PREFACE

In 1973 the Advisory Commission on Intergovernmental Relations published a report, *City Financial Emergencies.* That report discussed the circumstances that define a financial emergency—bankruptcies, defaults, or a failure to meet other financial obligations. It also traced the history and incidence of such emergencies through 1970, reviewed appropriate roles of state and federal governments in relieving the emergencies, and examined the finances of 30 large U.S. cities for symptoms of impending emergencies. This report updates the earlier work by examining new occurrences of emergencies, especially those resulting in bankruptcy and default, and reviews how new developments in state laws and the federal bankruptcy code have helped resolve emergencies. It also looks at what has happened to the finances of the 30 cities since they were examined in the earlier report.

The single most important finding of this report must be underscored—a searching review finds no evidence that local governments generally are experiencing increased financial emergencies, or that they are likely to do so in the future. Neither the 1973 report nor this one consider the underlying economic, social, or political factors that have caused central city-suburban fiscal emergencies. Although these issues are important, they are not directly related to the reasons why some governments experience financial emergencies, while others do not.

In addition to the governments specifically mentioned in this report as experiencing financial emergencies, a number of other governments were suggested by various sources as having serious problems. Because it was impossible to examine the facts about each suggested government emergency, and because it would be unfair to mention a government's name without a careful review of the facts, not all governments reported to the staff as experiencing various forms of financial crisis are included in this report.

Much of the bankruptcy and default activity occurred in special districts, single-purpose agencies, or on debt issued by governments for "private" purposes. This report, like the 1973 one, is primarily concerned with general-purpose governments—those that provide a broad range of essential services. However, to provide as comprehensive a view as possible, information about the extent and nature of bankruptcies and defaults in entities other than general-purpose governments is included.

Robert B. Hawkins, Jr.
Chairman

ACKNOWLEDGMENTS

This report was prepared under the overall direction of Philip M. Dearborn, a consultant to the Commission. Susannah E. Calkins and Michael W. Lawson of the Commission staff aided in all parts of the research and had primary responsibility for writing *Chapters 3* and *2* respectively. W. Bartley Hildreth contributed information assistance for the description of the Ohio experience in *Chapter 4*. Members of the Commission staff contributed helpful suggestions and assistance.

Ruthamae Phillips and Arlene Preston were especially helpful. They typed numerous drafts, arranged meetings, and coordinated the paperwork with great efficiency and patience.

The preparation of this report was made possible by a grant from the Department of Housing and Urban Development. The encouragement of John Ross to undertake this project and his support throughout the work are very much appreciated. The Ford Foundation, which generously financed the 1973 report, also provided financial assistance for this report. Ford's Louis Winnick has had a continuing interest in this subject and his encouragement and support are gratefully acknowledged.

In the course of performing the research a great many individuals and organizations provided information, assistance, and suggestions. The Commission thanks all who helped and especially the following people: Freda Ackerman, Wayne Anderson, Georgette Asherman, Robert Aten, Thomas Atwell, Hilda Beck, Michael Bell, Joyce Benjamin, Comer Coppie, David Bradley, Richard Croker, Robert Ebel, M. S. Farrell-Donaldson, Sylvan Feldstein, Charles Gentry, Clifford Goldman, Joseph M. Green, Andrew Haswell, Cornelius Healy, James Heckbert, George Hempel, Maxie Higgason, Carrol Kilgore, Clifford Kirsch, William McCarthy, Deborah Matz, Gerald Miller, Charles Mohan, Judith Napier, Robert Odell, Kimberly Osgood, David Peebles, John Petersen, George Peterson, Walter Phillips, John Rhodes, Charles Roaches, George Roberts, Michael Roser, Lillian Rymarowicz, Arthur Schloss, Thomas Sharp, Edward Shoemaker, Richard Speer, James Spiotto, Douglas Veith, Francis Viscount, Barbara Weiss, Berton Wills, Don L. Wyatt, and Jack Zackin.

Full responsibility for the content and accuracy of the report rests, of course, with the Commission and its staff.

S. Kenneth Howard
Executive Director

John Shannon
Assistant Director

CONTENTS

Chapter 1 **Developments Since the 1973 Financial Emergencies Report** 1
Scope of this Study 1
A Classification of Financial Emergencies 2
History of Emergencies 2
1972-83 Highlights 3
New Developments 3
Deficit Funding Bonds 3
Sale of Assets 4
Judgments 4
Investment Losses 5
Findings 5
Strengthening Financial Management 5
Short-Term Borrowing 5
Federal Bankruptcy Reforms 6
Emergencies Caused by Judgment Awards 6
Local Use of Deficit Funding Bonds 6
Chapter 2 **Financial Emergencies: Bankruptcies** 7
General Municipal Bankruptcy Provisions 7
The Recent Occurrence of Municipal Bankruptcies 8
General-Purpose Governments 8
Bay St. Louis, MS 8
Wapanucka, Ok 10
South Tucson, AZ 11
School Districts 11
San Jose School District 11
Special Districts 12
Bankruptcies Associated with Real Estate Developments 12
Bankruptcies in Other Special Districts 14
Other Governmental Entities 15
The Management Institute 15
The Jersey City Medical Center 15
Pulaski Memorial Hospital 16
Summary 16
Chapter 3 **Financial Emergencies: Defaults** 19
Default Occurrences, 1972-83 19
Government-Purpose General Obligation Defaults 20
Government-Purpose Revenue Bond Defaults 20
Private-Purpose Tax Exempt Obligations Defaults 20
A Comparison of Defaults with the Earlier Period 22
Problems in Preparing a Default List 22
Compilation of the List 22

Classification of Defaults 23
A Closer Look at Some Default Cases 23
Parlier, CA 23
New York, NY 24
Cleveland, OH 24
Saco, ME 25
Cleveland Board of Education 26
Summary 26
Chapter 4 **State Actions** 29
The Ohio Experience 30
The 1979 Ohio Law 30
Its Use 30
Summary of Tests Used 31
Evaluation of Ohio Experience 31
Preliminary Findings 32
The New York Laws 33
The Use of Deficit Funding Bonds 33
Severe Financial Emergencies in New York City and Yonkers 33
Evaluation of New York Experience 34
Chapter 5 **The U.S. Bankruptcy Act, Chapter 9** 37
The 1976 and 1978 Changes 38
Application of the Bankruptcy Law after 1976 38
Defining Insolvency 39
Labor Contracts 40
The Ability of the Bankruptcy Court to Supercede State Tax and Debt Limits 41
Chapter 6 **The Financial Health of Major U.S. Cities, 1971-82** 43
Determining Fiscal Health 44
Results of General Fund Operations 44
Revenue and Expenditure Growth Rates 45
Balance Sheet Condition 46
Liquidity 47
Short-Term Debt 48
Property Tax Collections 49
Locally Administered Retirement Systems 49
Conclusions 52
Appendix A **Selected Major Cities' General Fund Excess or Deficiency of Revenues Compared to Expenditures, as a Percent of Expenditures** 54
Appendix B **Selected Major Cities' General Fund Fiscal Condition, Balance or (Deficit) as a Percent of Total Revenues** 55

Figures and Tables

Figure 1 **Cases Filed and Accepted under Chapter 9 of the Federal Bankruptcy Laws, 1972-84** 9
Table 1 **Number of Local Government Defaults, 1972-83** 20
Table 2 **Reasons for Ohio Local Governments Fiscal Emergencies** 31
Table 3 **New York Local Governments Issuing Deficit Funding Bonds, 1973-83** ... 33
Table 4 **Selected Major Cities in Which General Fund Expenditures Exceeded Revenues by More Than 5%** 45
Table 5 **Selected Major Cities in Which General Fund Expenditures Exceeded Revenues for Two Consecutive Years with the Second Year Larger** 45
Table 6 **A Comparison of Selected Major Cities' Total General Fund Revenues to Expenditures** 46
Table 7 **Selected Major Cities' General Fund Average Annual Rates of Revenue** . 46
Table 8 **Selected Major Cities with General Fund Accumulated Deficits, as a Percent of General Fund Revenues** 47
Table 9 **Five Cities with Lowest Liquidity, as a Percent of General Fund Expenditures, 1976 and 1982** 48
Table 10 **30 Selected Major Cities' Total Fund Cash and Investments, as a Percent of General Fund Expenditures** 48
Table 11 **30 Selected Major Cities' Current Property Tax Collections as a Percent of Current Levy** 49
Table 12 **30 Selected Major City Retirement Systems: Annual Benefit and Withdrawal Payments, as a Percent of Annual Receipts** 50
Table 13 **30 Selected Major City Retirement Systems: Benefit and Withdrawal Payments, as a Percent of Assets** 51
Table 14 **Selected Major Cities' Payments to Local Retirement Systems** 52

Chapter 1

DEVELOPMENTS SINCE THE 1973 FINANCIAL EMERGENCIES REPORT

The New York City note default in 1975 created apprehension that a rash of municipal defaults and financial emergencies could be imminent. The default by Cleveland on its notes in December 1978, and the Washington Public Power Supply System (WPPSS) default in 1983, added to this perception. Questions were raised about whether the country was in the midst of another series of government financial emergencies or whether New York, Cleveland, and WPPSS were merely isolated occurrences.

A searching review by the Advisory Commission on Intergovernmental Relations (ACIR) finds no evidence that local governments generally are experiencing increased financial emergencies, or that they are likely to do so in the future. In the 1972 to 1983 period, only three instances of general-purpose government bankruptcy filings, and one long-term general obligation bond default were found. Government defaults on general obligation notes, while large in dollar amount because they involved New York and Cleveland, were also a rare occurrence over this period. Defaults on revenue bonds and notes issued to finance government activities, such as water supply systems or low-income housing, occurred more often, but most of these, except for WPPSS, involved small special-purpose issues. While a variety of financial emergencies not involving bankruptcies or defaults occurred, most of them were successfully alleviated by actions of the governments themselves, or by state intervention. In short, the 1972 to 1983 period was not characterized by unusual numbers of government financial emergencies.

SCOPE OF THIS STUDY

The balance of this chapter sets forth a classification of financial emergencies, research highlights, the devel-

opment of some new and unexpected problems, and the study findings. *Chapter 2* examines the municipal bankruptcies that were filed under federal law during this period. *Chapter 3* analyses municipal defaults. *Chapters 4* and 5 look at how well state and federal laws responded to the emergencies occurring since 1972. The final chapter reviews the 10-year financial experience of the 30 largest cities first examined in the 1973 report, and considers the likelihood of future large-city financial emergencies.

A CLASSIFICATION OF FINANCIAL EMERGENCIES

Before examining in more detail the findings in this report, it is helpful to classify events into the types of financial emergencies that can occur to local governments. Financial emergencies generally fall into one of the following categories:

Bankruptcy—This classification applies only to instances for which there has been a formal filing of a bankruptcy petition under Chapter 9 of the *Federal Bankruptcy Act*. To file a bankruptcy petition the government must declare itself insolvent. A bankruptcy filing may or may not involve a default. For purposes of examining bankruptcies, they can generally be divided into two categories—those involving a general-purpose local government, and those relating to special districts or special-purpose agencies.

Default, General-Obligation Bonds—Failure to pay interest or principal when due on long-term debt for which the government has pledged its full faith and credit.

Default, General-Obligation Notes—Failure to pay interest or principal when due on short-term debt for which the government has pledged its full faith and credit.

Default, Government-Purpose Revenue Bonds or Notes—Failure to pay interest or principal when due on long-term or short-term debt for which the government has pledged the revenues of a government facility or facilities. This classification includes defaults on special district and special assessment bonds, when issued for government purposes.

Default, Private-Purpose Revenue Bonds or Notes—Failure to pay interest or principal when due on long-term or short-term debt for which the issuing government makes no payment commitment, and which is solely secured by revenues from a nongovernmental entity.

Failure to Meet Other Obligations and State Declared Emergencies—This classification includes cases in which governments have met principal and interest payments on their debt, but have failed to meet payrolls, pay vendors, pay retirement fund obligations, or failed to meet other significant financial obligations. In most instances, these emergencies are evidenced by state actions declaring the governments in a financial emergency.

In addition to classifying emergencies by type, it is also helpful to classify them by severity. Such a classification is particularly important in the case of so-called "technical defaults." These defaults sometimes occur because of failure to meet a legal requirement, such as filing a report. Other types of technical defaults consist of inability to make timely payments because of administrative failure, i.e., delay in check issuance or failure to get legislative approval of actions.

Some technical defaults reflect legal requirements that were not met or maintained, yet cause little or no damage to creditors. These defaults include situations in which interest and principal are paid from a reserve fund set up to assure timely payments; a noteholder voluntarily extends a note maturity date; the default lasts only a few days; or the government holds the debt in its treasury investment account and fails to pay itself. Generally, when these situations are found they are classified as defaults, but noted as technical in nature. In many instances, such technical defaults are not publicly reported and thus go unnoticed.

Determining the number and types of financial emergencies that have occurred can be done with varying degrees of accuracy. Bankruptcy filings are a recorded event and a list of such filings can be obtained from the Administrative Office of the United States Court. However, even bankruptcies can present a problem because it is possible that quasi-governmental entities created solely to issue private-purpose bonds may use the municipal bankruptcy process. In these cases, the bankruptcy may actually be caused by a private corporate failure that has little relationship to the activities of a typical governmental entity, except that in order to make the debt tax exempt, it was issued in the name of a government.

Defaults are not recorded on any national basis. In some instances they are purposely not publicized by either the government or the creditors. Therefore, a complete list of defaults is almost impossible to compile. Equally difficult to determine are failures of governments to meet nonsecurity obligations such as payroll commitments.

HISTORY OF EMERGENCIES

Historically, emergencies have tended to come in clusters. In retrospect, however, there has usually been a clearly apparent reason for their occurrence. In the 1870s approximately one-fourth of the indebtedness of major local governments was in default, primarily as a

result of carpetbagging governments and railroad-aid bonds. The depression of 1893 caused another cluster of defaults, with private-purpose improvement bonds especially vulnerable. Again in the depression years of 1933 to 1935, defaults soared to a peak of 3,251 in 1935.

During the economically prosperous and untroubled years from 1945 through 1972, there were only a limited number of defaults, mostly small in amounts. The major defaults during this period were three revenue bond issues: the Chesapeake Bay Bridge and Tunnel, the West Virginia Turnpike, and the Calumet Skyway. [For a more detailed discussion of the number and causes of defaults prior to 1970, see *City Financial Emergencies*, pp. 9-17.]

1972-83 HIGHLIGHTS

Over the more than ten years since the 1973 report was issued, a number of developments have occurred. New York City had the financial emergency that was implicitly predicted in the 1973 report. Cleveland also had a financial emergency. Several other major cities had serious problems, but overcame them before they became financial emergencies. Several smaller cities also had a variety of financial emergencies and close calls.

Some of the developments were anticipated in the 1973 report, such as the emergencies in New York City and other jurisdictions caused by heavy reliance on short-term operating loans. But some of the developments were not expected, such as the emergencies caused by court judgments; the growing use of deficit-funding bonds to avert emergencies; and the sale of assets to realize funds needed to alleviate emergencies. Other developments have not yet caused financial emergencies, but clearly have the potential for doing so. For example, several local governments have experienced significant financial losses through imprudent investments of idle cash or retirement funds. Other losses resulted because some security dealers handling government funds have gone bankrupt.

There were, of course, several notable defaults including New York City and Cleveland, but these defaults were cured with no loss of principal. Most of the other default activity after 1973 centered on revenue bonds, and especially private-purpose bonds; those issued by small special-purpose districts; and those issued for purposes that are marginally governmental: for example, hospitals, nursing homes and housing projects. The largest and most notable among the revenue bond defaults was the Washington Public Power Supply System.

Since 1973 some states, such as Ohio and New York, have taken significant actions to prevent or correct local government financial emergencies. In others, state oversight of local government finances remains minimal or nonexistent.

The national government overhauled the municipal bankruptcy code in 1976 and 1978. There have been several bankruptcies filed under the new law. Some of the bankruptcy law changes paralleled ACIR's 1973 recommendations, but others did not. The federal government intervened directly to help New York City overcome its financial emergency. It also added local government auditing requirements to the General Revenue Sharing law, thereby contributing to a significant improvement in local financial management.

The 1973 finding that under funded, locally administered, retirement systems posed a threat to the financial health of local governments increased public awareness of the problem and a series of studies of retirement systems ensued. There has been a substantial increase in the funding of major city retirement systems and some improvement in their financial condition (see *Chapter 6*). No financial emergencies since 1973 have been found to be directly traceable to retirement system problems.

The finances of the 30 large cities showed relatively strong financial health in 1982, compared to earlier years. Several cities experienced especially serious budget imbalances and fund deficits in the mid and late 1970s, but all of them successfully overcame their problems. These jurisdictions cut costs and increased revenues, thereby bringing their budgets back into balance.

NEW DEVELOPMENTS

The 1973 ACIR report touched only briefly on the use of deficit funding bonds, the sale of assets to resolve a financial emergency, and on emergencies caused by court judgments and investment losses. Therefore, a brief discussion of each of these new developments is appropriate.

Deficit Funding Bonds

One of the most significant new developments in treating financial emergencies has been the use of deficit funding bonds. This device was pioneered by those who converted New York City's huge operating deficit to long-term debt.

According to the *Annual Report of the Comptroller, 1975-76* (p. 6), New York City had an accumulated deficit of $5.1 billion on June 30, 1975, and the comptroller estimated an additional operating deficit of $1 billion for fiscal 1976. However, by June 30, 1976, despite a $1.2 billion operating deficit for the year, the city had reduced its accumulated deficit to $2.6 billion. This reduction in accumulated deficit occurred because the Municipal Assistance Corporation, acting on the city's behalf, issued $2.4 billion of long-term bonds and used the proceeds to eliminate an equivalent amount of current short-term operating debt of the city. By June 30, 1981, the amount of long-term debt issued to eliminate accumulated operating deficits had increased to $4.5

billion. The city operating deficit had been entirely eliminated by September 30, 1981.

The City of Detroit at the end of its 1981 fiscal year had an accumulated general fund deficit of $115.7 million. During fiscal 1982, the city sold $113 million of "fiscal stabilization bonds" with the net proceeds going into the general fund to eliminate the operating deficit. As a result, Detroit finished 1982 with a $3.2 million operating surplus although its long-term debt had been increased by $113 million.

In addition to these two major cities, Yonkers and other smaller governments in the State of New York used long-term debt to finance operating deficits (see *Chapter 3*). Using long-term debt to fund an operating deficit was also proposed in Washington, DC, in 1981, but the proposal did not get necessary Congressional approval. Although no specific search was made for other uses or attempted uses of bonds for this purpose, deficit funding bonds are becoming more common.

Eliminating accumulated operating deficits by issuing long-term bonds gives the government a clean budget slate for future operations by removing an operating deficit from the balance sheet and providing an infusion of operating cash from the bond proceeds. The bond issue permits the current deficit to be paid in the form of debt service over an extended period of time, reducing its impact on the budget in any single year. On the negative side, however, it increases the government's total long-term debt service requirements and may thereby reduce the amount that can be raised for future capital needs.

Historically, it has been considered unwise for local governments to use long-term debt to pay operating costs. New York's successful use of this technique to stabilize its finances may have removed some of the concerns. However, it should be recognized that in New York this technique was just part of a total plan that included strict state supervision by a financial control board to insure future balanced budgets.

Sale of Assets

In private-sector bankruptcy actions it is customary to liquidate the assets of the entity and to use the proceeds to pay creditors. There is no provision in the municipal bankruptcy law for liquidating assets because the law recognizes that local governments must continue to provide basic services. In short, local governments cannot be liquidated out of business.[1]

In recent years there have been several examples of local governments selling off some assets to satisfy creditors, even though not required to do so by law. In both the South Tucson and San Jose bankruptcy cases, settlement of creditor claims was reached in part by voluntary sale of government property. In Cleveland, the threat of a financial emergency in the early 1970s was averted by selling the city's sewer system to a county authority and using $9.6 million of the proceeds to eliminate an accumulated deficit.

The sale of assets to avert or mitigate financial emergencies may be an attractive alternative when the problem is caused by a one-time expenditure demand, such as a court judgment, natural disaster, or similar event. The sale of assets to satisfy a deficiency caused by an operating deficit, unless accompanied by stringent controls to prevent recurrence of the budget imbalance, could result in merely deferring an emergency.

Judgments

A sudden unplanned large expenditure demand creates a problem for any local government but for a small government (or one that is already in weak financial condition) it may cause a financial emergency. Judgments against a government as a result of court actions or arbitration decisions can create such sudden expenditure demands. When a government incurs a large judgment, the payment is often made from funds realized by the sale of bonds, but in some states bond sales to pay judgments are not legally permitted. In other instances the judgment may be so large, or the government so financially weak, that bonds cannot be sold.

Three financial emergencies reviewed in this report (South Tucson, Wapanucka, and Bay St. Louis) were directly caused by judgments, and were significant enough to cause the governments to file for bankruptcy. A fourth (San Jose School District) was caused indirectly by an arbitration judgment; ultimately, the district also filed for bankruptcy.

Despite the relatively few instances of emergencies caused by judgments thus far, there may be more in the future because the liability of local governments to tort judgments, such as those experienced by South Tucson and Bay St. Louis, has recently been broadened by the courts and legislatures in many states.

In addition, two new forms of exposure to judgments from antitrust proceedings and civil rights actions have become significant. In the 1982 decision *Community Communications Co. v. City of Boulder* the Supreme Court exposed local governments to large antitrust judgments for a variety of activities common to most local governments. This development is so recent that there has not been time for major judgments to work their way through the appeals process. Therefore, there are no current examples of emergencies caused by such judgments. Unless Congress or the states mitigate the antitrust exposure of local governments, future financial problems resulting from these actions appear inevitable.

Civil rights judgments against governments for discrimination have not generally resulted in large financial judgments. However, Bridgeport, CN, recently settled a discrimination suit first filed in 1975 by issuing

$6 million in bonds. While discrimination judgments may generally be of a magnitude that can be handled by local governments, there may be governments unable to cope financially with such awards.

If judgments do create more financial emergencies in the future, state governments may need to consider several alternatives to eliminate or mitigate the exposure. An obvious alternative would be to limit the size of judgments permitted against local governments. A cap on judgments would present several problems because the permissable amount of the judgments would have to be scaled to the size of the government, and it would hardly seem fair to determine how much a plaintiff is awarded on the basis of government size. A better alternative may be to require all local governments to carry insurance or to establish a state insurance pool for local governments, especially for the smaller units.

Investment Losses

Local governments have been urged in recent years to make greater use of nontax revenue sources. This pressure, together with high interest rates, has caused many governments to develop aggressive cash investment programs. Local government cash generally results from bond sales in anticipation of beginning capital projects, tax payments in advance of expenditures, and fund surpluses. Most governments invest the cash in U.S. Treasury securities or bank certificates of deposit that are fully collateralized or guaranteed, and most localities invest the funds for very short periods in order to maintain their liquidity.

There have been some recent bad experiences by governments that pursued more aggressive investment policies. These include: investments in repurchase agreements from investment brokers who subsequently went bankrupt; investments in long-term bonds that did not provide sufficient liquidity; and other types of unsecured or illiquid investments. When these situations develop, they often involve very large amounts of money, the loss of which could result in a financial emergency. For example, the City of San Jose, CA, recently lost $60 million because of illiquid investments. Only because of the generally strong financial condition of the city was it able to handle this loss without an emergency. Marion County, OR, lost $20 million in 1980 as a result of bad investments. To overcome this problem the county temporarily had to lay off a third of its workforce.

Preventing emergencies caused by unwise investment policies requires strict laws covering local government investments of inactive cash, and careful adherence to those laws. A local government must time its investments so that funds will be available when needed; it should invest only in U.S. Treasury securities, certificates of deposit with full collateral or insurance protection, and other similar conservative investments.[2]

FINDINGS

A review of the cases of financial emergencies in local governments occurring over the 1972-83 period, generally confirms the findings in the 1973 ACIR report that financial management problems are the principal cause of emergencies, and that state actions are the most appropriate means of preventing and treating them. As a consequence, it is not surprising that the first two findings essentially repeat the findings on the same subject in the earlier report. Although considerable progress has been made by various state and local governments, the importance of the findings for all states and local governments is such that they deserve to be reiterated. The remaining three findings are concerned with new issues that were not directly covered in the 1973 ACIR report.

Strengthening Financial Management

The principal cause of financial emergencies in the 1972-83 period continued to be unsound financial management. In the affected local governments, bad budgeting and accounting practices, coupled with unaudited financial reports, resulted in unbalanced budgets, accumulated fund deficits, and ultimately, led to losses of liquidity and financial emergencies.

It should be noted that the federal General Revenue Sharing law requires independent audits of recipient governments' finances. However, states still need to require that their local governments conform to generally accepted accounting principles, and states need to provide effective monitoring and supervision. The Ohio monitoring and supervision law closely conforms to the 1973 ACIR recommendations.

Short-Term Borrowing

The use of short-term loans was a precipitating factor in both the New York and Cleveland financial emergencies, as well as others during the 1972-83 period. Short-term loans generally involve large amounts of money relative to the size of a government's budget, and usually the full amount borrowed must be paid back at one time. If the government does not have a sufficiently large amount of cash available to make the payment, the loan will not be repaid and the government will default.

Until recently, most governments have created short-term loans in the form of notes in anticipation of taxes, other revenues, or bond issues. However, various new types of loans, such as commercial paper, are now being used. These new types of financing, because they involve large amounts coming due on a short-term basis, have the potential to create the same problems that traditional notes have caused in the past.

In the 1973 report, the Commission recommended that short-term borrowing, both for operating and cap-

ital purposes, be strictly limited and regulated by the states. Such regulation remains an important safeguard against potential emergencies resulting from short-term borrowing.

Federal Bankruptcy Reforms

The number of general-purpose governments using the federal municipal bankruptcy law did not increase substantially in the 1972-83 period, even after a 1976 amendment allowed municipalities to file bankruptcy petitions without the approval of creditors—an amendment recommended in the 1973 ACIR report.

The small number of bankruptcy filings appears to confirm the Commission's prior conclusion that the federal municipal bankruptcy law is needed only in instances in which state remedies are clearly inadequate. However, the filings of the three general-purpose governments and one school district in the 1972-83 period indicate that these governments do not appear to have exhausted all the state remedies available to them. Questions can also be raised about whether the governments were truly insolvent or were merely using the federal bankruptcy proceedings as a convenient way to delay meeting their obligations.

Emergencies Caused by Judgment Awards

Court judgments and arbitration awards (torts, anti-trust, and discrimination judgments), especially for large amounts against small governments, can create financial emergencies. The actual numbers of emergencies resulting from this cause have been few, but the trend toward a broadening of local government liabilities and exposures to lawsuits appears likely to cause more emergencies in the future.

Local Use of Deficit Funding Bonds

Financing operating deficits by issuing long-term bonds or by selling government assets such as land can have an adverse effect on a jurisdiction's long-term financial health, unless the actions are done as part of an overall state-supervised plan to resolve the government's financial problems. In several instances in the 1972-83 period, long-term bonds were used to refinance and thereby stretch out operating deficits. If deficit funding bonds are used to offset continued unbalanced budgets, they may reduce a government's ability to incur long-term debt to finance capital facilities.

FOOTNOTES

[1]There has been one exception to this rule. In the bankruptcy of a governmental "instrumentality" in California, the entity did liquidate its assets. See *Chapter 2*, p. 15, which discusses the bankruptcy of the Management Institute located in Alameda County, CA.

[2]See Government Finance Officers Association, Committee on Cash Management, *Model Investment Legislation for State and Local Governments*, June 1984.

Chapter 2

FINANCIAL EMERGENCIES: BANKRUPTCIES

This chapter opens with a brief overview of the general provisions of federal bankruptcy law pertaining to municipal governments.[1] The balance of the chapter examines the incidence of municipal bankruptcies occurring between 1973 and 1983. The individual circumstances of the bankruptcies of general-purpose governments is discussed first, followed by the description of the bankruptcies involving a school district, utility districts, and other governmental entities.

GENERAL MUNICIPAL BANKRUPTCY PROVISIONS

Article VI, Section 8 of the *U.S. Constitution* grants Congress the general power to "establish uniform laws on the subject of bankruptcies throughout the United States." This power pertaining to bankruptcy is embodied in Title 11 of the *U.S. Code*. All requirements and procedures for filing municipal bankruptcy specifically are addressed in Chapter 9 of the *U.S. Bankruptcy Code*.

In a strict sense, the term "bankruptcy" is a misnomer when it is used in conjunction with municipal governments. Because municipal governments provide services that are essential to the general welfare of communities, it is generally neither desirable nor feasible for governments to simply cease operations and liquidate their assets like private sector bankruptcies.[2] Instead, municipal bankruptcy should be more appropriately viewed as a means by which the financial obligations of a municipality are *restructured* to allow a realistic and orderly repayment of debts incurred. A major consideration in this reorganization process is the continuation of essential governmental services with the minimal amount of loss or inconvenience to individual creditors.

A second significant aspect of municipal bankruptcy law involves a major principle of American federalism. U.S. bankruptcy law, as it concerns municipalities, must balance the sovereignty of states over their municipal governments with the individual rights of creditors. As will be seen in the following discussion of municipal bankruptcies, the principle of federalism is particularly relevant when federal bankruptcy courts are confronted with state laws regarding tax or debt limitations imposed on local governments or the abrogation of public sector labor contracts. Thus, the power of the federal courts must be tempered with a respect for the fact that state governments, rather than the federal government, have ultimate authority over local governments. As a consequence, any action that a federal bankruptcy court might demand of a municipality must recognize the state constitutional and statutory constraints affecting the particular municipality.

There are four major requirements that must be satisfied in order to qualify for relief under Chapter 9. The petitioner:

1) must be deemed a municipality (as broadly defined in the Chapter 9 provisions);
2) must be permitted by state law to file;
3) must be insolvent or unable to meet debts as they mature and;
4) must desire to effect a plan of adjustment of its debts.[3]

Only after meeting these requirements can a government file for bankruptcy.

THE RECENT OCCURRENCE OF MUNICIPAL BANKRUPTCIES

Compared to the prior 12-year period, the number of Chapter 9 bankruptcy petitions filed from January 1972 through June 1984 increased approximately twofold to 21 cases;[4] during the period 1960-71, ten cases were filed.[5] However, the number of general-purpose government cases remained essentially constant during those two periods—four and three, respectively. The increase in the number of cases filed under Chapter 9 can be accounted for by the greater number of special districts and other "government instrumentalities"[6] that filed for protection under the federal bankruptcy laws.

It is unclear whether the increase in the number of bankruptcies is significant. In 1976 and 1978, the federal laws were revised, making it easier for municipalities to file for bankruptcy. One change is particularly noteworthy. This change permits a municipality to file a bankruptcy petition without the approval of its creditors. With this revision in the law, municipalities are better able to protect themselves from the rash of lawsuits that could occur if it were known that such governments were unable to meet their financial obligations. The provision is directly relevant to at least six of the bankruptcy cases discussed below. Because of this change, the apparent increase in the number of municipal bankruptcies does not necessarily indicate that local governments are less fiscally sound than they were in the earlier period.

GENERAL-PURPOSE GOVERNMENTS

Initially, it might seem that the paucity of bankruptcy filings by general-purpose governments would provide an insufficient amount of information with which to explore the issues related to municipal bankruptcy and the causes of such bankruptcies. Yet, even in the limited number of general-purpose bankruptcies actually filed, federalism and other issues were raised. In addition, court judgments emerged as a cause of municipal bankruptcies. The three general-purpose government bankruptcies that occurred between 1973 and 1983 are examined below to illustrate the issues involved and to show how court judgments can propel governments into financial emergency situations.

Bay St. Louis, MS

In August 1975, a federal district court issued a $375,000 judgment against the City of Bay St. Louis as a result of a New Orleans youth diving off a pier under construction and breaking his neck. The judgment was awarded in federal court because the plaintiff was a resident of Louisiana who was claiming damages in Mississippi. It was upheld through various appeals and became final in May 1977.

During the appeal process the plaintiff attempted to garnish the city's bank accounts for payment of the judgment, but these attempts were stayed pending completion of appeals. After a final appeal decision in May 1977, followed by several months of unsuccessful negotiations for payment of the judgment, the city feared another attempt to garnish its bank accounts. The total budget of the city for all purposes in 1978 was only $728,294. Thus, the city claimed that a freezing of city bank accounts and demand for immediate cash payment of the $375,000 judgment would have a "disruptive and catastrophic effect on the affairs of the City of Bay St. Louis." The city was also concerned that the plaintiff might try to get a court order directing the city to raise the money to pay the judgment.

Under the threat of either garnishment of its bank accounts, or a court order to pay, the city filed for bankruptcy under Chapter 9 of the *Federal Bankruptcy Act* on August 30, 1977. The only creditor listed on the petition was the judgment claim for $375,000.

In its plan for adjustment of debts, the city noted that it had no liability insurance, it had no surplus funds to pay the judgment, it was levying its legal limit of proper-

Figure 1

Cases Filed and Accepted* under Chapter 9 of the Federal Bankruptcy Laws, 1972-84

Year Filed	Name of Debtor	Court District	Docket Number
General-Purpose Governments			
1977	Bay St. Louis, MO (city)	Southern Mississippi	7700352
1982	Wapanucka, OK (town)	East Oklahoma	8200231
1983	South Tucson, AZ (city)	Arizona	8300866
School Districts			
1983	San Jose School District, CA	Northern California	8302387
Utility Districts			
1973	Lake Apopka Natural Gas District of Orange and Lake Counties, FL	Central Florida	7300294
1976	Roxborough Park Metropolitan Water and Sanitation District, CO	Colorado	7601797
1976	Woodmoor at Breckinridge Water and Sanitation District, CO	Colorado	7602137
1976	Morrison Creek Metropolitan Water District, CO	Colorado	7604001
1981	North and South Shenango Joint Municipal Authority, PA	Western Pennsylvania	8100408
1982	Pleasant View Utility District of Cheatham County, TN	Middle Tennessee	8201139
1982	Sanitary and Improvement District #5 of Cass County, NE	Nebraska	8201671
1983	Sanitary & Improvement District #42 of Sarpy County, NE	Nebraska	8300956
1983	Sanitary & Improvement District #4 of Lancaster County, NE	Nebraska	8301438
1984	Whitley County Water District, KY	Eastern Kentucky	8400089
1984	Sanitary & Improvement District #63 of Sarpy County, NE	Nebraska	8401263
Other Governmental Entities			
1981	The Management Institute, Alameda County, CA	Northern California	8102265
1983	Jersey City Medical Center, NJ	New Jersey	8300829
1984	Pulaski Memorial Hospital, Waynesville, MO	Missouri	8400082

*Two additional districts initially filed but were thrown out of Chapter 9 because they were not deemed to be governmental entities: American Milling Research and Development (Docket Number 7400129) and Fort Cobb Irrigation District (Docket Number 7600679).

ty taxes, and if forced to pay the judgment out of current revenues, it would "cease to function as a municipality." The plan asked the court to reduce the judgment and to order a tax levy to pay the reduced amount, based on an assumption that the courts could order it to levy a tax in excess of its legal limit.

The plaintiff did not approve the plan and challenged the bankruptcy filing as not being made in good faith and not complying with the requirements of Chapter 9. He claimed specifically that the city was not insolvent and was filing the petition for purposes of delay. The plaintiff also claimed that the city was not authorized by the laws of Mississippi to file a bankruptcy petition and had not received any state approval to file.

After filing the bankruptcy petition the city asked the bankruptcy court to reduce the judgment because it was excessive and unfair to the city's taxpayers. Thus, after exhausting all of its usual appeal rights in federal courts, it made a further appeal to the federal bankruptcy court. The bankruptcy court declined to consider the request to change the judgment. On March 23, 1978, the court ordered the city to make a concerted effort to attempt to borrow the amount needed to pay the judgment. To help the city the court indicated that it would consider approving city certificates of indebtedness, as authorized by Chapter 9 of the bankruptcy law. Such certificates have a prior lien on city revenues. The city found that a local bank would loan the money, but only if a state court validated the loan. The state's bond counsel advised the city that he did not believe such a validation would be possible without an amendment to state laws.

Because of the unfavorable state ruling on borrowing money for the judgment, the city suggested that the court order a 5-mill levy above the city's tax limit to raise about $70,000 per year, and that this amount be paid annually until the $375,000 award was paid. The plaintiff objected to the revised plan and alleged that the bankruptcy court could authorize the borrowing of money, without the need for an amendment of state laws. The court agreed with the plaintiff and ordered the city to borrow $450,000 by the issuance of certificates of indebtedness to pay the judgment, interest, and legal fees. The court stated that if the city did not borrow the money within 30 days, the bankruptcy petition would be dismissed on the finding that the plan submitted by the city did not meet the requirements of Chapter 9 and should not be confirmed. The city appealed this order without success.

The city did not borrow the money as directed by the court because it could not meet the legal conditions imposed by the banks. As a result, the bankruptcy petition was dismissed on December 4, 1978.

In early 1979 the city got approval of the state legislature to borrow money to pay the judgment, and to amortize the debt by imposing a 0.5% additional sales tax. This action successfully resolved the problem.

A financial emergency was officially declared in Wapanucka on June 28, 1982, with the filing of a bankruptcy petition under the federal bankruptcy law. The emergency was caused by a $112,527 judgment against the town.

Wapanucka, OK

A description of the series of events that occurred prior to Wapanucka's bankruptcy explains how the judgment occurred. Briefly, an oil truck went off a highway and landed in the lake which provided the town's water supply. The oil from the truck made the water from the lake permanently unusable. To replace the water supply, the town planned to obtain an artesian well located on private property about two miles outside of town. A loan of $210,730 was obtained from the Farmers Home Administration to provide the necessary piping and to rehabilitate the distribution system. Through its right of eminent domain, the town then sought to acquire the well. Based on an appraisal, $5,000 of the available loan money was reserved for this purpose, pending a court determination of the actual condemnation award. When the court awarded a $112,000 judgment instead of the $5,000 reserved, the town had an insufficient sum of money with which to pay the judgment and the bankruptcy proceeding ensued.

Like several other bankruptcies, the Wapanucka bankruptcy had no direct relationship to expenditures exceeding revenues. The town of 472 people, mostly ranchers and pensioners, had a 1983 general operating budget of approximately $48,000, long-term debt of $210,730, and no significant financial problems prior to the judgment.

The judgment created a problem because under Oklahoma law, judgments are to be paid from property taxes levied over three years. The law invokes the state constitution which requires that tax levies be used for payment of judgments. The law does not consider the effects of such levies on either the local budget, or on the taxpayer's tax burden.

Under the threat of a three-year tax levy to pay the judgment, the attorney for the town claimed it "would be totally insolvent if it has to pay that bill ($112,000)." He alleged that the additional property tax payments would have amounted to over $500 per owner and "many people would have been put out of their homes for inability to pay."

The bankruptcy petition was filed by the town to stop the three-year tax levies that were demanded by the holders of the judgments and to get approval by the bankruptcy judge for paying a reduced amount. An unstated purpose of the filing was probably also to delay proceedings on the judgment, so that a related lawsuit (involving the oil truck) could be settled.

The time gained by filing bankruptcy and thus stopping action on the judgment permitted the town to successfully complete its lawsuit for damages against the

owners of the oil truck. A $500,000 settlement provided money for the city to pay the $112,000 condemnation judgment, legal fees, and other debt incurred in connection with the incident. As a consequence, the bankruptcy proceedings were dismissed in September 1983, and the town no longer had a financial emergency.

South Tucson, AZ

The financial emergency in South Tucson was directly caused by a $3.6 million tort liability judgment against the city in October 1980. The judgment resulted from an incident in which a South Tucson police officer shot and severely crippled a Tucson officer while engaged in a joint raid. It was upheld through all state court appeals. The $3.6 million award exceeded the city's 1981 general fund expenditures and occurred at a time when the city was already close to a financial emergency as a result of a large accumulated operating deficit totaling $264,000, an amount equal to 7.7% of its $3.4 million budget. General fund expenditures exceeded revenues by $117,000 in 1981 alone. From the time of the judgment until August 1983, the city refused to pay the judgment because it claimed a financial inability to do so based on its serious financial problems and the size of the judgment relative to its budget. During fiscal years 1981, 1982, and 1983 the city brought its operating budget into balance, and as a result, the city went from a general fund imbalance of $117,000 in 1981 to an excess of revenues over spending of $258,000 in 1983. The budget turnaround enabled the city to eliminate the 1981 fund deficit and end 1983 with a $61,000 surplus. However, even with this improvement in city finances, the 1983 budget surplus was still not sufficient to pay even the interest on the judgment and the city continued to claim it was financially unable to pay the judgment.

The key question regarding payment of the award became not whether the city had funds immediately available, which it obviously did not, but whether it could reasonably raise them in the future by new or increased taxes or by budget reductions. In the summer of 1983, a state court, in a mandamus action filed by the holder of the judgment, was about to decide whether the city could raise the money to pay the award. The court action, if successful, would have required the city to levy additional taxes, or use other means to to pay the judgment over a reasonable future period.

With a hearing scheduled for September 13, 1983, the city filed a federal bankruptcy petition on August 25, 1983. This action stayed proceedings in the state court and shifted the problem of determining the city's ability to pay the judgment to the federal bankruptcy court. The city then filed a bankruptcy plan on December 23, 1983, with a proposal to pay a reduced judgment over 25 years. The bankruptcy judge found deficiencies in the plan, including the proposal to pay over 25 years, and the failure to pay a lump sum at the beginning of the period.

Instead of acting on the plan, the judge decided to let the state court proceed with its determination of whether the city could pay. A state court hearing on the city's ability to pay was then rescheduled for February 21, 1984. However, just prior to the hearing, a settlement was reached for the payment of about $3 million of the judgment. The city raised the money through a combination of transfer of city-owned land to the plaintiff and a bond issue. As a result, all lawsuits, including the bankruptcy case, were dismissed.

The question of whether South Tucson was insolvent at the time it filed for bankruptcy rests on whether it was impossible for the city, on some reasonable basis, to meet its responsibility to pay the judgment. An Arizona appeals court judge suggested that "mere financial hardship is insufficient as a defense, but a complete want of funds and inability to raise them is a defense to mandamus." Although neither the state nor federal court ever decided whether South Tucson was insolvent, the city was successful in using bankruptcy proceedings to delay a state court action, and eventually to gain a reduction in its judgment.

SCHOOL DISTRICTS

The bankruptcy of the only school district to file in the period is important because it involves the largest government to file, and because it raises some important issues regarding the bankruptcy law.

San Jose School District

San Jose School District filed a Chapter 9 bankruptcy petition on June 30, 1983, and declared itself insolvent. The San Jose bankruptcy case presents a situation in which state laws may have forced the district into bankruptcy. The district, as a result of the Proposition 13 tax limitation, depends almost completely on state aid for financing its budget, and state aid levels are dependent on annual appropriations by the state legislature. In addition, the district is required by state law to have a balanced budget to receive the state aid. In its bankruptcy petition, the district claimed it was impossible to balance either the 1983 or 1984 budgets. These anticipated budget imbalances directly stemmed from employee collective bargaining agreements negotiated in 1982. At the time that the agreements were signed, it was anticipated that the forthcoming state aid would provide sufficient funds to fulfill those agreements. However, when school aid appropriations for 1983 and 1984 were finally determined by the state, San Jose's appropriations were insufficient to meet its collective bargaining agreements.

If it did not meet the state requirement of a balanced budget, the district feared it would lose all its state aid

and therefore be forced to shut down completely. Thus, the district was left with a contract for pay raises, inadequate state aid to meet its requirements, and a state mandate to balance its budget. To make this even more a Catch-22 situation, the district could not raise its tax rates because of state tax lids.

On the expenditure side, the school district alleged that it had already made major cost reductions and that more were not feasible, especially in view of unions' refusals to negotiate layoffs. Whether the district could make additional reductions remained in dispute, but its expenditures were severely constrained in the 1981 to 1983 period. The added costs of the pay raises in fiscal 1983 would have required an approximate 5% budget reduction in other expenses, and another 5% reduction in fiscal 1984.

As a result of its financial problems, the district refused to give the pay raises required in the contract for 1983. Prior to the end of the fiscal year, however, an arbitrator ruled against San Jose and ordered payment of $3.5 million in raises. As a result, the district ended fiscal year 1983 with expenditures exceeding revenues and a general fund deficit. The general fund had cash on hand of $1.4 million and owed trade creditors $0.5 million, plus the $3.5 million owed for retroactive salary awards. The district's claim of insolvency rested on its 1983 payables exceeding its year-end cash, and its inability to raise sufficient funds in 1984 to fund a budget that included additional pay increases required under the collective bargaining agreement. The district asked the bankruptcy court to allow it to reject its labor contracts covering fiscal years 1982, 1983, and 1984, thereby eliminating its 1983 deficit, and enabling it to balance its 1984 budget.

The bankruptcy judge made two key rulings after the initial bankruptcy filing. The first was that the 1983 deficit and the unbalanced 1984 budget constituted insolvency. The second ruling declared that to maintain basic school operations it was necessary to set aside the pay raise provisions of the collective bargaining agreement for 1983 and 1984. In making these decisions the judge said, "My reason for all this is basically and simply the imminent collapse of this whole school system. It just isn't going to get any money out of the state or the amounts that are necessary from the state in order to operate, unless these contracts are rejected."

Both the labor associations and the district appealed various portions of the judge's initial rulings. Nevertheless, a bankruptcy plan to pay the debts existing on June 30, 1983, was filed by the district on February 7, 1984. It proposed to divide the claims into five classes consisting of: $10,000 of secured claims to be paid in full; $100,000 of small claims to be paid in full; bond holders to be paid in full; $3.1 million of employee retroactive pay increases for 1983 to be paid in full; $480,000 of unsecured general claims from 1983 to be paid in full; and $8.0 million in 1984 claims, mainly resulting from the rejected labor agreements, to be paid only to the extent that there are excess revenues available in the 1984 budget.

The sources of funds to pay the claims are $2.7 million of excess revenues now determined after final audit to be available from fiscal 1983; a special tax levy for bond debt service only; $984,000 from sale of excess property and $800,000 estimated to be available from excess revenues in the 1984 budget.

If the bankruptcy plan is approved, it will result in the employees covered by the labor contracts receiving their full 1983 pay award, but not receiving the full amount due them in fiscal 1984. The disclosure statement accompanying the plan cites two key reasons for the district's failure to meet its full 1984 salary obligations. First, the district claims that,

> An important factor in considering a plan involving municipalities is the hardship on the public if there is a reduction in essential services. In California public education is just such an essential service... Given its constitutional obligation, a school district has a duty to take any fiscal action necessary to continue to provide education.

Second, under the equal protection provision of the *California Constitution*, the school district claims it must not only provide education, but do so on equal terms to the education provided in other school districts in the state.

Thus, the San Jose School District claimed an undue reduction in levels of service is sufficient basis for a bankruptcy court to reduce its legal obligations to meet its contractual obligations to its employees and no longer claimed actual inability to balance its budget.[7]

SPECIAL DISTRICTS

Of the 21 municipal bankruptcy petitions filed in the last 12 years, 14 were classified as special districts—and all but one were water and/or sanitation districts. Ten of these special districts were associated with real estate developments where much of the planned construction and other improvements did not occur. The underlying revenue bases of the special districts created to serve these developments were insufficient to meet the financial obligations of the districts. As a result, the districts were forced into bankruptcy. Two additional special districts not associated with real estate developments sought protection under Chapter 9 as a direct result of inadequate revenue bases; their bankruptcies were primarily caused by problems between the districts and their respective private-sector contractors.

Bankruptcies Associated with Real Estate Developments

Ten special districts filing for protection under Chap-

ter 9 were associated with unsuccessful real estate developments. Five of these districts are located in Colorado; they all were associated with the same developer. Although not directly related to the Colorado bankruptcies, a sixth special district in Texas will be discussed in conjunction with the Colorado bankruptcies because it exhibits similar circumstances. The remaining four bankruptcies associated with real estate developments are located in Nebraska.

The bankruptcy of five special districts in Colorado—Woodmoor at Breckenridge Water and Sanitation District, Roxborough Park Metropolitan Water and Sanitation District, Morrison Creek Metropolitan Water District, Steamboat Lake Water District and Steamboat Lake Sanitation District—were caused by the bankruptcy of a single private real estate development corporation—the Woodmoor Corporation. The individual circumstances of each of these cases differs somewhat, but the following brief description of the details of the Morrison Creek bankruptcy is generally indicative of the remaining four cases.

In the early 1970s a private land development corporation called the Woodmoor Corporation acquired 10,000 acres of real estate in Routt County, CO, a county in the northwestern portion of the state. Shortly thereafter, Woodmoor announced a plan for a large-scale recreational development. As initially conceived, this project was to have included the construction of a ski mountain and a large recreational lake. In addition, the development was to be divided into between 2,000 and 3,000 separate lots on which townhouses and condominiums were to be constructed. By the winter of 1973 the ski mountain was in operation but the lake was not. Sixty townhouses were completed and 90 more were nearing completion. The Morrison Creek Metropolitan Water District, which encompassed the same boundaries as the development, was created by the state to provide water and sanitation services to the residents of the development and authorized to levy a property tax to fund these services. The Morrison Creek District then issued about $2.67 million in general obligation bonds and began construction of a water and sewerage system.

In 1974 the development plans of the Woodmoor Corporation—at Morrison Creek and at the other four developments—were thrown into a tailspin by the national recession. Ultimately, the corporation was forced to file for bankruptcy under Chapter 10. Woodmoor discontinued further development and all sales activity stopped. At the time that Woodmoor filed for bankruptcy, Morrison Creek Metropolitan Water District could only service approximately 300 of the 2,000 units of property sold. The large lake and other improvements promised to purchasers were never completed. In many cases, the roads leading to the various properties were never built; thus, many owners did not have access to their properties. Of course, no additional properties could be sold or improved in this environment.

Morrison Creek Metropolitan Water District aggressively sought to secure tax receipts to cover its financial obligations, foremost of which were its debt obligations. Yet, because only modest residential development had occurred, such action proved wholly inadequate. Given the small tax base, the mill rate would have had to have been in excess of 900 mills—a rate considered far too high to levy. With the concurrence of the state, Morrison Creek District filed a Chapter 9 petition in December 1976.

As a result of Morrison Creek's bankruptcy status, the district successfully reorganized its debt structure. Current bondholders were given the option of redeeming their bonds at 25% of face value (33% did so and were paid from what little cash was on hand) or trading in their bonds for "contribution certificates," redeemable at the face value of the original bonds in the year 2000. With a mandated property tax rate of 20 mills, it is anticipated that these certificates will pay face value in the year 2000, although holders of the certificates could be paid in amounts greater than or less than the face amounts depending on the change in value of the properties in the development.

Another case similar to the Colorado bankruptcy cases is that of Grimes County Municipal Utility District #1, located in southeastern Texas. The developer at Grimes, F.T.I, Inc., had constructed horse stables, a golf course, clubhouse, harness racing facilities and had an active lot sales program. Grimes County Municipal Utility District #1 was created to service the development and was authorized to levy a property tax to fund its operations. However, F.T.I., Inc., was found bankrupt in the mid-1970s and the operation of the golf course, stables and harness racing facilities ceased. As a result, construction and development came to a halt. Because of a tax base wholly inadequate to fund the operation of the district, Grimes, like the bankrupt Colorado district, was forced to file for protection under Chapter 9 and a reorganization of the district's debt was undertaken closely paralleling that of the Morrison Creek case.

Four additional municipal bankruptcies during this time period are associated with real estate developments in Nebraska. These involved Sanitary and Improvement Districts #5 of Cass County, #42 and #63 of Sarpy County, and #4 of Lancaster County. Like the bankruptcies discussed above, when the respective developers experienced financial problems, the sanitary and improvement districts were unable to meet their financial obligations and ultimately filed for bankruptcy.

There is a feature unique to the bankruptcy of Sanitary and Improvement District #42 of Sarpy County that is worthy of note—the impact of the state's use of its powers of eminent domain. Shortly after its creation in 1966, the Sanitary and Improvement District #42 contracted for improvements for a sum of $893,574. In the following year, the Nebraska Department of Roads proposed an

extension of a major highway south of Omaha that effectively divided the district in half. The state, then, prevented the City of Bellevue from approving any building permits on the affected land. While other development was occurring in the sanitary district, none could occur on the land affected by the state action. Furthermore, little development occurred in the area bordering this land because it was generally viewed as providing less than desirable sites for residential development.

In 1974, the district refinanced the initial $893,574 debt through the sale of bonds totaling $1,150,000. As provided in the bond indenture, interest payments were to commence in 1974 and payments to retire the bonds were to begin in 1979 and to continue through 1990. However, from 1974 to 1979 the assessed valuation for purposes of taxation grew much less than anticipated. In addition, the board of trustees for the district, which had significant representation from the developer, did not levy taxes sufficient to meet the future bond payments because it would have created an unreasonably high tax rate on the property owners within the district. In any case, the imposed delay in the development and the disruption caused by the proposed highway prevented the growth necessary to support the financial obligations of the district. As a consequence, the district board filed for bankruptcy.

Bankruptcies in Other Special Districts

Like the bankruptcies discussed above, adverse economic circumstances caused two additional special districts to file for bankruptcy though, unlike the bankruptcies discussed above, these districts were not associated with real estate developments.

Lake Apopka Natural Gas District of Orange and Lake County, FL, and Whitley County, KY, Water District were both caught between a stagnant tax base and external circumstances that precluded the raising of utility rates. Lake Apopka, a natural gas district in central Florida, was a major provider of residential natural gas. Three factors led to the district's default on its debt obligations and the resultant bankruptcy petition: (1) a series of unusually warm winters in the early 1970s which lowered the demand for gas, resulting in a lowered revenue stream, (2) a major electricity generating plant that was supposed to have located in the Lake Apopka District ultimately did not locate there, greatly reducing the anticipated revenue base and (3) severe competition from other energy sources precluded any significant rise in natural gas rates.

Improved economic circumstances and patient bondholders allowed Lake Apopka to work its way out of bankruptcy without any reorganization of its debt. Soon after the district filed for bankruptcy in November of 1973, the Arab oil embargo of 1973-74 greatly increased the price of oil—an energy source that was a major competitor to natural gas. This event, along with the return of normal winter weather, provided the boost necessary to return Lake Apopka to fiscal solvency and orderly operations and the bankruptcy case was dismissed from court in September of 1974.

Whitley County Water District, a very small water district built in the 1960s in Appalachian Kentucky, was (and still is) unable to pay off its approximately $1 million principal and interest debt. The case was filed in the spring of 1984 and is still in litigation. The problem was caused by two factors: (1) the cost of providing water to the system exceeded the revenue generated from providing the water and (2) rates could not be raised because the low-income residents of the region could revert to carrying their own water. Although no interest or principal has been paid since the district began operations, only recently did a creditor file suit against the district. It was this action that precipitated the bankruptcy proceedings. The bankruptcy action outcome, including possible reorganization of debts and alteration of the district's financial management structure, is yet to be determined.

Within the 1973-84 period, two utility districts were forced into bankruptcy, in part because of contract problems between the districts and their respective contractors. North and South Shenango Joint Municipal Authority, located in two rural townships in western Pennsylvania, and Pleasant View Utility District of Cheatham County, located west of Nashville in west-central Tennessee, are both water and sewerage districts. In the early 1970s, the North and South Shenango Joint Municipal Authority was created at the behest of the State Department of Environmental Resources. Financing for the project was to come almost exclusively from state and federal (Farmers Home Administration) funds. On the assumption that federal and state funds would be forthcoming, the authority borrowed $4-5 million from Penn Bank to begin construction.

After construction had begun but prior to receiving the state and federal funds, a citizens group became greatly displeased with the quality of workmanship by the authority. The group filed suit in federal court to stop further construction on the grounds that state and federal environmental standards were not being met.

The citizens group won the case and, because the court had determined that environmental standards were not being met, no funds were forthcoming from Washington or Harrisburg. Penn Bank, still owed $4-5 million by the authority, seized the assets of the authority which prevented any further construction or rehabilitation of the system. North and South Shenango Joint Municipal Authority had little alternative but to file a Chapter 9 bankruptcy petition.

After a wholesale change in the authority's board of directors, Penn Bank joined forces with the authority to file suit against Northwest Engineering Company, the contractor for the construction of the system. As the case

currently stands, it is the hope of Penn Bank and the authority that Northwest will either rehabilitate the system or pay off the loan to Penn Bank. In either case, the federal and state funds then should be forthcoming to complete the system.

Contract problems and poor financial planning led to the bankruptcy of Pleasant View Utility District of Cheatham County, TN. Unlike North and South Shenango Joint Municipal Authority, the contract problems did not arise with the construction contractor but rather with its fiscal agent. After realizing the initial bond issue of $560,000 was wholly inadequate to perform the necessary construction, a refinancing was undertaken to raise total indebtedness to $2.2 million. However, owing to the allegedly exorbitant fees charged by the fiscal agent, the district received construction funds of slightly less than $1.2 million, an inadequate amount to construct the facilities.

Poor financial planning on the part of the district's commissioners and its advisors stands out as the second and equally significant factor leading to Pleasant View's bankruptcy. An improperly designed rate structure did not provide enough funds for payment of the principal and interest on the outstanding debt. As a result of poor financial planning, the district was in arrearage for more than a decade in its payment of maturing debt. When a single party who held 50% of the district's debt threatened to file suit against Pleasant View for nonpayment of interest and principal, the district sought protection under Chapter 9.

Ultimately, the case was settled without benefit of any court-approved reorganization. The district was able to recover approximately 50% of the damages sought against its fiscal agent in an out-of-court settlement. In addition, the district's commissioners proposed a reorganization of the debt combined with a significant change in the rate structure and financial management. In an out-of-court agreement with the party holding 50% of the bonds and with the subsequent concurrence all of the remaining bondholders contacted, the proposal was accepted. Holders of matured bonds were to be repaid the principal amount along with accrued interest. The agreement provides for the timely payment of future principal and interest and explicitly stipulates the manner in which such payment can be ensured.

OTHER GOVERNMENTAL ENTITIES

The Management Institute

Three additional governmental entities filed for bankruptcy during this period—the Management Institute, the Jersey City Medical Center and the Pulaski Memorial Hospital. Although none of these entities was a unit of general government or special district, all were able to file for bankruptcy under Chapter 9 because of the special "governmental instrumentality" clause in the federal bankruptcy law.

The Management Institute (TMI) was established by a joint powers agreement established between several municipalities in Alameda County, CA, in the early 1970s. Its purpose was to provide instruction to the employees of local area governments in a broad range of technical and administrative areas. Local governments in Alameda County would contract with TMI to provide instruction in specific areas and TMI, in turn, would hire subcontractors to provide instructional materials and personnel to teach the various classes.

Four factors were identified as being primarily responsible for the financial problems that ultimately led to TMI's bankruptcy: (1) the passage of Proposition 13, (2) changes in the federal *Comprehensive Training and Employment Act* (CETA), (3) a proviso in the original authorization of TMI that limited its activities to the training of public sector employees only and (4) poor management on the part of TMI itself. The passage of Prop 13 in 1978 put pressure on all units of local government in California—including those in Alameda County—to limit or reduce spending (see also the discussion of San Jose School District above). As the restrictive impact of Prop 13 became increasingly apparent to local governments in the late 1970s, employee training such as that provided by TMI was one of the first programs to be curtailed.

Concurrently, the reforms enacted during the reauthorization of CETA in 1978 put additional restrictions on the use of CETA funds received from the federal government. These restrictions greatly reduced, if not entirely eliminated, the employment of individuals eligible for the type of training provided by TMI.[8] Furthermore, the fact that only public sector employees could be trained by TMI, coupled with the greatly reduced funding for training public sector employees, exacerbated an already difficult situation.

Finally, poor management in letting contracts and inadequate financial control over accounts receivable were at least equally responsible for the failure of TMI. In the end, TMI was unable to pay its various subcontractors for preparing materials and services rendered, and was forced into bankruptcy. And, unlike any of the other bankruptcy cases discussed in this study, TMI ceased operations and its assets, cash and remaining accounts receivable were apportioned among its creditors.

The Jersey City Medical Center

The Jersey City Medical Center was a municipal hospital owned and operated by the City of Jersey City. Three factors were responsible for its financial problems and subsequent bankruptcy: (1) the changing demographic composition of the clientele of the center, (2) the revision of a state law so that cities could divest themselves of municipal hospitals[9] and (3) inadequate financial management.

As it was originally conceived, the center was to provide health care for the entire Jersey City community—including the medically indigent. Typically, the center was able to recover the vast majority of its costs through fees and the insurance payments made on behalf of its many patients; the portion of the center's expenses not reimbursed were covered by an annual subsidy provided by the City of Jersey City.

During the 1970s the percentage of indigent patients at the hospital rose along with the cost of providing medical services; as a result, the annual budget deficits mounted. At the same time, the state granted cities the authority to divest themselves of municipally owned-and-operated hospitals and Jersey City did so. While Jersey City and Hudson County continued to subsidize the center after the city divested itself of the hospital, the city no longer had a legal obligation to subsidize the increasing deficits of the hospital. The center's difficulties were accompanied by insufficient rigor in the collection of accounts receivable and poor financial management in general.

In February 1983, the Medical Center filed for protection under Chapter 9 in the reasonable fear that Public Service Electric and Gas, a major creditor which was owed approximately $1.5 million, would attempt to obtain a preference.[10] The state stepped in and passed special legislation to permit the center to increase its charges for certain procedures, thereby permitting the center to raise additional revenue from its fee structure.[11] In addition, the reorganization forced the center to revamp its financial management system to ensure more complete and timely collection of accounts receivable. Although it is still early in the reorganization process, it is expected that these changes, along with the anticipated subsidies from Jersey City and Hudson County, should place the Jersey City Medical Center in a state of financial solvency.

Pulaski Memorial Hospital

The Pulaski Memorial Hospital is a small county hospital located in Waynesville, MO. Several events caused the hospital to file a Chapter 9 bankruptcy petition on January 10, 1984. Numerous vendors to the hospital had lodged complaints with the hospital board regarding the nonpayment of amounts due for services rendered or goods received. Several of these vendors threatened to remove equipment that was leased to the hospital, including critically important life-support equipment. Given that this action would have severely hindered the hospital's ability to care for its patients, the board took drastic action in September 1983, by firing the management of the hospital and replacing it with new management.

The new management quickly discovered that the hospital's internal accounting system was wholly inadequate. No financial statements had been prepared in 1983. In addition to the complaints of the numerous vendors to the hospital, it was discovered that the employee withholding tax payments due the federal and state governments for income and Social Security taxes had not been made over a period of several months—this amount totaled approximately $80,000. In the interim, there was increasing fear that one of several creditors would attempt to obtain a preference. It was this fear that prompted Pulaski Memorial Hospital to seek relief under Chapter 9.

The plan of reorganization was filed with the bankruptcy court in early January 1985. Upon court approval, all small claims ($1,000 or less) will be paid in full within 90 days. The remaining unsecured claims will be paid from current revenues on a pro rata basis. These payments will commence six months after court approval of the plan and will continue until these claims are paid.

SUMMARY

Although the 1972-84 period had considerably more municipal bankruptcies than the prior 12-year period, the increase is more apparent than real. The number of general-purpose bankruptcies remained essentially constant between these two periods. Although the number of special district or "governmental entities" filing for bankruptcy rose, it is not clear whether this rise was an indication of less fiscally sound governments or simply occurred in response to changes in the federal bankruptcy laws.

The cases discussed above reveal that a variety of seemingly disparate factors have led to municipal bankruptcies. However, several recurring themes link many of these bankruptcies together. Those themes are:

Court Action. Tort liability cases where judgments against the governments far exceeded their ability to pay caused two general-purpose governments—Bay St. Louis, MS, and South Tucson, AZ—to file for bankruptcy. Wapanucka, OK, was forced into bankruptcy as a direct result of a condemnation award considerably more than the town had anticipated. The bankruptcy of a fourth government—North and South Shenango Joint Municipal Authority located in western Pennsylvania—was precipitated by the construction of a sewerage system that was deemed by the federal district court to be in violation of federal and state environmental standards. Finally, an arbitration ruling unfavorable to the school district was indirectly responsible for the bankruptcy of the San Jose School District.

Real Estate Developments. Ten municipal bankruptcies in Colorado, Nebraska, and Texas were associated with real estate developers who were forced into private bankruptcy. When the developer in each of these cases filed for bankruptcy, the various special

districts were left with revenue bases inadequate to meet their financial obligations and ultimately filed for bankruptcy under Chapter 9.

Changes in Intergovernmental Fiscal or Structural Relationships. The passage of Proposition 13 in California which, in effect, reduced state funding of local programs, played an integral role in the bankruptcy of two governmental units—the San Jose School District and The Management Institute. In the case of the San Jose School District, the annual state appropriation for fiscal year 1983 was inadequate to allow the district to fulfill its contractual obligation to its employees. The general reduction in state funds to local governments is indirectly responsible for the bankruptcy of The Management Institute. In addition, changes in the provisions of the federal CETA program also were important in leading TMI into bankruptcy. The revision of a law in New Jersey which allowed Jersey City to divest itself of the Jersey City Medical Center helped propel the Center into bankruptcy. Lastly, the State of Nebraska was instrumental in forcing Sanitation and Improvement District #42 of Sarpy County into bankruptcy when it exerted its power of eminent domain in building a highway through the middle of that district.

Poor Financial Management and Inadequate Planning. Although not as clearly defined as the factors noted above, poor financial management combined, at times, with inadequate planning were contributory factors or leading factors in the bankruptcy of several government entities.

In general, the bankruptcies discussed in this chapter can be explained by more than one of the above factors acting in concert with situations unique to each case. Only in the tort judgment cases did a single factor adequately account for the municipal bankruptcy.

FOOTNOTES

[1]See *Chapter 5* of this report for a discussion of recent revisions in municipal bankruptcy law.

[2]There is one exception to this statement. The Management Institute located in Alameda County, CA, liquidated its assets to settle its bankruptcy case. The bankruptcy of The Management Institute is discussed later in this chapter.

[3]*U.S. Code Congressional and Administrative News*, 94th Congress, Second Session, Vol. 2 (Legislative History), 1976, p. 544; 11 U.S.C., SS1O9(c) as enacted by PL 95-598 and as amended by PL 98-353.

[4]During this period American Milling Research and Development, Inc. and Fort Cobb Irrigation District initially attempted to file under Chapter 9. These two cases were not approved under Chapter 9 and, in subsequent action, both were converted to Chapter 11 bankruptcies. For this reason, these cases were not listed in the accompanying table or included in the aggregate Chapter 9 petition count.

[5]ACIR, *City Financial Emergencies* (1973), Table 5-2, p. 83.

[6]11 USC 401, "... the petitioner [i.e., the governmental entity] means agency, instrumentality, or subdivision which has filed a petition under [Chapter 9]..."; see also, 11 USC 404.

[7]In May 1984, the school district reached a settlement with its employees, and the bankruptcy case was dismissed in June 1984.

[8]In order to counter the allegations that CETA funds were being used as a substitute for local funds in the hiring of regular government employees, maximum wage ceilings of $10,000 were instituted in addition to numerous other restrictions.

[9]The state legislature passed a statute in 1972 that divested cities of control over hospitals (historically, any municipality was authorized to create and operate a municipal hospital). In this new statute, control of the hospital was vested in a board of managers.

[10]This fear was seemingly justified in that one year earlier Public Service Electric and Gas filed suit against the center. The medical center was granted a stay by a special state statute. This statute, directed at the Jersey City Medical Center, stated that, in effect, if the State Division of Health determined a municipal hospital to be in a state of financial distress, the governor could dismiss the board of managers and appoint his own board. This action also granted the center an automatic stay of one year against all judgments. This process was followed in the case of the Jersey City Medical Center. The point is also relevant in that the appointment by the governor of the board of managers gave the medical center the "governmental entity" status necessary to qualify it for filing under Chapter 9.

[11]In effect, it will force fee-paying patients and third party payers to bear some of the additional cost of supporting the Center's indigent patients.

Chapter 3

FINANCIAL EMERGENCIES: DEFAULTS

This chapter will examine municipal defaults—cases of financial emergency which involve failure to pay interest or principal on municipal securities, but which do not result in the government filing a bankruptcy petition. Discovering cases of municipal defaults is much more difficult than discovering bankruptcy cases because there is no single source of information. The Advisory Commission on Intergovernmental Relations information on defaults is based on a search for cases in various records and interviews with professionals in the field. The list—particularly that of defaults on private-purpose municipal obligations—is not all inclusive, but it is the best that can be compiled from these sources.

The discussion in this chapter is divided into three parts: a section discussing the number and some of the characteristics of the defaults occurring since the 1973 ACIR report and a comparison of the two periods; a brief description of the way in which the ACIR list was compiled; and a look in more detail at some of the more significant examples of defaults by government entities.

DEFAULT OCCURRENCES, 1972-83

ACIR's search for defaults from 1972 through 1983 found 36 defaults on government-purpose debt and 82 on private-purpose tax-exempt debt (*Table 1*). Defaults occur when the government is unable to pay interest or principal when due. However, five of the government-purpose defaults and three of the private-purpose defaults are classified as technical because the investor suffered only a brief interruption of payment or was paid from a reserve fund; the repayment of the debt itself was never in serious jeopardy.

Table 1
NUMBER OF LOCAL GOVERNMENT DEFAULTS,[1] 1972-83

			Total
TOTAL GOVERNMENT-PURPOSE DEFAULTS			36
General Obligation Defaults		11	
Long-Term Bonds	1		
Notes	10[2]		
Revenue Bond Defaults		25[3]	
TOTAL PRIVATE-PURPOSE DEFAULTS			82[4]

[1]Excludes defaults when issuing government subsequently filed Chapter 9 bankruptcy petition.
[2]One of these defaults was technical.
[3]Four of these defaults were technical.
[4]Incomplete count, see text.

SOURCE: Advisory Commission on Intergovernmental Relations, 1984.

Government-Purpose General Obligation Defaults

Of the 36 government-purpose defaults, 11 were general obligation debts—one bond and ten note defaults. The one bond default involved a total debt of only $110,000. This very small number of defaults on debt for which the governments pledged their full faith and credit evidences the financial strength of most governments over this period. Despite this generally favorable record, two of the general obligation note defaults—New York and Cleveland—were so large that they created an impression that the default problem was worse than it actually was.

In addition, five of the note defaults involved small governments in Maine that failed to pay tax anticipation notes due at the end of their fiscal year. With the exception of Saco, ME, which will be discussed in more detail later, these defaults all were apparently caused by notes that were issued in anticipation of a single installment property tax payment due late in the governments'fiscal year. Instead of reserving money to pay off the notes as the taxes were paid, the governments used the funds for other purposes. As a result, they had insufficient funds on hand at the end of the year to pay the notes.

Government-Purpose Revenue Bond Defaults

There were 25 defaults on government-purpose bonds for which only revenues from a project were pledged to pay interest and principal; four of these were technical defaults. Analysis of these defaults indicates in almost all of the cases the bonds were issued by special districts or statutory authorities rather than units of general-purpose government such as cities and counties.

These defaults on government-purpose revenue obligations were issued to fund a variety of government functions:

- six were for water supply systems and sewers,
- five were for housing (chiefly low-income or housing for the elderly),
- five were for hospitals, and
- three were for utilities other than water and sewers.

Geographically these default cases came from all over the United States. Of the 21 nontechnical cases, Florida and Tennessee each had three, and California, Mississippi and New York each had two. Washington had the only major default, that of the Washington Public Power Supply System (WPPSS). (See box.)

Those cases in which causes of defaults can be identified fall into several general categories: poorly conceived projects which failed to produce revenues at the projected level; cost overruns on construction or operations; and changes in economic conditions or technological developments which rendered projects obsolete or unprofitable. The largest default, the well-known case of the two defaulting projects of the Washington Public Power Supply System, may have occurred because of a combination of all three conditions. Hospitals seem particularly prone to have problems in realizing anticipated revenues, as do low-income and senior citizen housing projects. Several utility district issues defaulted because developers' plans proved too ambitious. There were also a few cases of fraud.

Private-Purpose Tax-Exempt Obligations Defaults

The ACIR list of defaults on private-purpose tax-exempt obligations was compiled as a byproduct of the search for defaults on government-purpose obligations. The list is incomplete and does not include information on small locally placed issues.

The 82 cases of default found on private-purpose obligations include those on issues by state and local governments to finance activities which are not related to government functions, such as bonds issued to finance commercial and industrial facilities. In most cases, the issuing government has little to do with the obligations except to lend the government's immunity from federal taxation so that interest on the obligation is tax exempt. Most private-purpose bonds are issued by industrial development authorities, or other special districts or authorities created for the purpose of encouraging local industrial development. There is usually no responsibility of the sponsoring state or local government in the case of a default on private-purpose bonds.

Because the list of private-purpose defaults is incomplete, extensive discussion or conclusions are not appropriate. However, a few brief generalizations and comments can be made.

For most cases in which information is available, the amount of money involved in the default was relatively small; there are nine cases in which less than $1 million is involved, and about an equal number where the issue involved amounts of between $1 and $2 million. The largest amounts (of those for which information was available) were for large privately owned nursing homes, with amounts ranging up to $50 million.

There is a higher concentration of the defaults in several states: 14 in Oklahoma, ten in Alabama, nine in Tennessee and five in South Carolina. The large number discovered in Oklahoma may be attributed in part to the sources used. A cluster of defaults in Oklahoma was described in an analysis of a sample of defaulting issues based on public documents in Securities and Exchange Commission files:

The eagerness of the participants in an IRB-financed project can create an atmosphere conducive to abuse. An example of this is the Midwestern Oklahoma Development Authority (MODA). The Department of Defense and the Office of Economic Adjustment recommended its formation after the closing of the Burns Flat Air Force Base. MODA issued seven IRBs in the early 1970s that later defaulted. The underwriter and bond lawyer were subsequently sued for fraud. Some of the suits are still in court.[1]

Some cases of default involve companies with industrial development bonds issued in several states. Mansfield Tire and Rubber which went bankrupt in 1980 had almost $10 million in tax-exempt private-purpose debt in four different states. Permaneer Corporation's bankruptcy involved debt issued in Michigan, Missouri, Georgia, and Arkansas. In some of these cases, an issue in one state did not default, despite the bankruptcy of the parent corporation.

WPPSS

In 1957, 17 public utilities in the northwest formed a municipal corporation called the Washington Public Power Supply System (WPPSS). Projections made by WPPSS indicated that existing power supplies would not be adequate to meet future needs of the Pacific northwest, and in the early 1960s, it decided to build five nuclear power plants, financing the construction by the sale of tax-exempt bonds.

As construction slowly progressed, it became apparent that the five projects were encountering serious problems for several reasons. There were major construction cost overruns and costly rebuilding caused by frequent failures of construction to meet standards of the Nuclear Regulatory Commission. Financing was considerably more costly than had been anticipated because of soaring interest rates. In addition, instead of demand increasing for electricity in the Northwest, demand began to decline in response to increased energy costs and economic slowdowns in the area. Despite these problems, WPPSS continued its construction program, and continued to finance its activities by selling tax-exempt bonds, which eventually reached a total of $8.3 billion.

On January 1982, WPPSS decided to try to solve some of its problems by abandoning work on Projects 4 and 5, thereby foregoing any revenues from them. In January 1983, the public utilities participating in WPPSS were required to begin paying out of their own revenues for debt service on the bonds issued to finance the two abandoned projects. Area consumers, faced with sharp increases in their electricity costs, went to court. A series of court decisions, culminating in a ruling by the Washington State Supreme Court held that the state's public and municipal utilities had no legal authority to enter into a contract with WPPSS to pay their 70% share of the debt for the abandoned Projects 4 and 5. As a result, WPPS found itself unable to meet its obligations and on August 18, 1983, it defaulted on $2.25 billion in bonds for Projects 4 and 5.

The financial future is unclear for defaulting Projects 4 and 5 and even for WPPSS itself. The system has said that it will not go into bankruptcy. At the same time, dozens of cases of securities fraud have been filed in federal courts against those involved in the sale of WPPSS securities on the grounds that the sales continued long after the serious problems of the system were clearly apparent to Wall Street.

A securities fraud trial is scheduled to begin in September 1985. How WPPSS, its sponsoring utilities, its contractors, investment banking firms, and investors will share the responsibility and ultimately resolve the largest municipal bond default in history remains uncertain.

For a detailed description of the WPPSS default see the reprint of a four-part series of *Weekly Bond Buyer* articles: Howard Gleckman, WPPSS: *From Dream to Default*, January 1984, 37 pp.

A Comparison of Defaults with the Earlier Period

Although figures on the dollar volume of the defaults could not be obtained on a similar basis to those presented in the 1973 report, a few generalizations can be made from inspection of the data. The 1972-83 cases divide into two segments: three are defaults involving very large amounts (New York City, Cleveland, and WPPSS), and the rest are relatively small in dollar magnitude. (One technical default, the Cleveland School System, was also major.) It is likely that if dollar figures were available for 1972-83, the dollar volume of defaults in that period would exceed the dollar volume of any comparable period since World War II. But this is the result of the large dollar defaults by New York City, Cleveland and WPPSS. Without these defaults, the dollar volume would be quite small.

The government-purpose defaults and bankruptcies, added together, total 57 (21 bankruptcies and 36 defaults) between 1972-83 compared to the 294 recorded defaults between 1960 and 1969. This 1972-83 number appears low in view of the tremendous increase in municipal debt and municipal obligations over the past ten years. The total dollar volume outstanding of local government debt increased from $121 billion in 1972[2] to $252 billion in 1982,[3] and the dollar volume of municipal bonds issued increased from $18 billion in 1972 to $87 billion in 1982.[4] However, the number of issues did not show a comparable increase. (According to *Bond Buyer* figures, there were 8,420 issues in 1972 and 9,095 in 1982.)[5]

While it is possible that even the extensive and strenuous ACIR search efforts missed a substantial number of cases occurring between 1972 and 1983, particularly private placements, it is unlikely that these could bring the total anywhere near the number found in the earlier period. It is thus apparent that the actual number of defaults over the 1972-83 period was relatively few and, *exclusive of a few major defaults*, represented a small amount of investors' money.

PROBLEMS IN PREPARING A DEFAULT LIST

Compilation of the List

To prepare a list of defaults a variety of sources were canvassed. In contrast to bankruptcies which are all recorded in federal court records, no single source of default information exists. While attention has focused on a few spectacular defaults, such as New York City, Cleveland, and the Washington Public Power Supply System (WPPSS), there has been little national attention given to smaller defaults.

The information on defaults in the 1972-83 period was primarily derived from a search of the *Daily Bond Buyer* for each year from mid-1973 through December 31, 1983, by the ACIR staff.[6]

The completed list should contain all significant general obligation defaults on bonds and notes. Such defaults, even if small or temporary, are usually reported in the financial press or known about in the financial community. In addition, for the same reasons, most government-purpose revenue bond defaults of any significant size or duration have probably been found. However, some smaller government-purpose revenue issues that were locally placed may have defaulted without public notice.

Several instances of defaults on Farmers Home Administration loans to local governments were discovered in the course of the ACIR survey, and it is likely that there are more. However, the Farmers Home Administration has informed us that their loans are too numerous and records too voluminous to make a search for other defaults feasible.

In contrast to government-purpose bonds, it is apparent that the list of private-purpose bonds that defaulted is incomplete. Because private-purpose defaults do not relate directly to government finances, no effort was made to compile a complete list of these defaults, and it was compiled only as a byproduct of efforts to collect a default list for government-purpose obligations.

In addition, the characteristics of the private-purpose defaults on the list are biased by the sources containing information on the specific cases. A substantial number of cases were obtained from the Securities and Exchange Commission (SEC) materials compiled in 1978 to support SEC's request to Congress for additional powers to regulate municipal securities. Cases on this list were limited to those which had been investigated by the SEC. Another SEC study done in 1984 to study the question of whether yields on defaulted issues tended to be higher than those on bonds which have not defaulted also—because of its topic—concentrated on bonds in which defaults were related to incomplete disclosure. Our other major source of information on private-purpose defaults was a list the Federal Deposit Insurance Corporation (FDIC) compiled of bank-holdings of defaulted IRBs in the period between 1973 to 1983.

The difficulties of compiling a complete list of defaults on private-purpose obligations are even greater than those of compiling public-purpose default lists because many private-purpose issues tend to be small in size, and the obligations are frequently placed locally. Before the *Tax Equity and Fiscal Responsibility Act* (TEFRA) requirement that bonds be registered and that notice of their issuance be filed with the U.S. Treasury, there was no central source of information on bonds issued. Even the most widely discussed studies of municipal bonds[7] relied on estimates of the total volume issued, and contained no information on the number of bonds in default. Most small private-purpose bonds are

not rated by bond rating agencies, so information about issues from rating agencies is limited to large issues. Although information on the number of new issues will now be available from the Treasury Department lists, there are still no central sources of information on defaults.

Classification of Defaults

In attempting to classify defaults, separating government-purpose issues from private-purpose issues presented some problems. Among the rules of thumb applied was a general presumption that all hospital bonds, except those that were clearly identified as private-for-profit hospitals, should be classified as government-purpose. When there was a tangled situation in which a government service (such as port facilities or low-income housing) was provided by a private organization or a special authority, the government-purpose classification was used.

Assigning defaults to a specific time period was also difficult. Ideally, cases were dated according to the date of the initial default. In many instances, however, the available information did not provide the date of the initial default. If it appeared that the initial default probably occurred after the period covered by the 1973 study, the case was included on the current list. In those cases in which the initial default probably occurred prior to the 1973 study, but the issue continued to be in default, the case was not included. However, some cases may be omitted or counted twice because the 1973 report contained only a count and not a listing of the individual defaults.

It was also impossible to get the exact amounts of debt in default. Some reports of default contained only the amount of missed interest or principal payment, while others gave the original amount of the issue, or the amount still outstanding. In some instances no dollar amounts were mentioned. As a practical matter, there is no uniform measure of the exact amount of a default, although some such as New York City are obviously large, while others are quite small.

A CLOSER LOOK AT SOME DEFAULT CASES

Because defaults are relatively rare for government obligations, several of the more significant defaults were explored in more detail to determine their cause and how the problem was resolved. Those selected include Parlier, CA, because it was the only general obligation bond default, and because it also defaulted on other obligations; New York and Cleveland because of the magnitude and significance of their defaults; Saco, ME, because it shows the impact of a citizen-initiated tax limitation on a city which is already having budget problems; and the Cleveland Board of Education because of the role of the federal courts.

Parlier, CA

Between 1973-83, there was only one default on a general obligation bond—the City of Parlier, CA. Parlier's default was triggered by several years of fiscal problems, eventually leading to missed debt and interest payments at the end of 1982. Its history is strongly reminiscent of some of the city financial emergencies which occurred in the 1930 era.

Parlier, a small city (population of 2,902 in 1980) in central California near Fresno, found itself in a severe financial emergency when an independent auditor reported on December 15, 1982, that the city owed $819,089 and had about $2,000 cash on hand to pay bills. Its total revenue from all sources was only $781,000 in fiscal 1982—less than it owed at the end of the year. The unpaid obligations included: a delinquent $175,000 bank loan; $12,000 in debt service past due to the Farmers Home Administration; $6,000 in debt service past due on general obligation bonds; $16,300 in past due payments to its pension plans; $250,000 due to general creditors; and various amounts due to restricted state funds. In short, the city had defaulted on $110,000 of general obligation bonds, on a $175,000 bank loan, and a $483,000 federal loan, failed to pay pension contributions and was generally out of cash. The independent auditor reported, "There is no money. There are no reserves."

The reasons for this financial emergency appear fairly conventional. The several years prior to default had been characterized by a series of unbalanced budgets in which expenditures exceeded revenues by large amounts. For example, in fiscal 1982, total spending exceeded total revenues by $294,000 or an amount equal to about 36% of total revenues. This imbalance in the general fund was financed by using cash from restricted revenues. The budgets for 1979, 1980, and 1981 had also been out of balance. A financial emergency in October 1981 was averted only because the city was able to borrow $175,000 from a local bank, using city-owned land as collateral.

On November 9, 1982, the city administrator, who had been hired the previous summer to resolve the city's problems, declared in a letter to the mayor and city council: "It is my conclusion that a state of financial emergency exists, and this emergency can be remedied only by the implementation of extraordinary measures." He pointed out that suppliers to the city were canceling the city's credit privileges and that the city had insufficient cash to meet current payrolls. To resolve this problem, the city administrator recommended that he be authorized to file for bankruptcy under Chapter 9, an action which would freeze past debts and give the city time to develop an "acceptable financial strategy." He also recommended disbanding the police department and letting the county sheriff assume policing responsibilities in order to produce sufficient savings to balance

the 1983 budget and stabilize cash flow.

Because the city was not being immediately threatened by creditor lawsuits, the city council held off on authorizing bankruptcy but did approve the immediate disbanding of the police department. A decision was also made to sell some excess city property to raise money to repay the bank loan. The city council also adopted stringent spending ceilings by categories of spending and began to monitor results monthly to insure the budget remained in balance.

By June 30, 1983, as a result of the city's own efforts, all defaults had been cured and all but five creditors paid. The general fund deficit had been reduced to $458,000. Only $88,000 was owed to outside creditors with the rest owed to the city's own restricted funds.

Throughout the Parlier emergency the state played almost no role. The state's sole activity was a demand that the city's use of restricted state aid to finance general fund activities be corrected. Thus, the city experienced a severe financial emergency and overcame it without state or federal help, although it was prepared to use the federal bankruptcy law, if necessary.

New York, NY

The landmark default on notes of the largest city in the country began in April 1975. At that time, the city had insufficient funds to pay the cost of municipal services and to meet upcoming maturities of its indebtedness. The banks refused to renew short-term loans that were maturing or to loan additional cash to the city; only state cash advances were keeping the city afloat. In September 1975, the state passed the Financial Emergency Act and formally placed the city under the control of a state emergency financial control board. On November 15, 1975, the state enacted the Moratorium Act that suspended for three years the right to initiate lawsuits against the city to require payment of short-term obligations. With this law in place, the city deferred payment of its notes. In simple terms, the city defaulted on its short-term notes as they matured.

The causes of the New York emergency were becoming apparent at the time the 1973 ACIR report was published. In fiscal 1971, New York's expenditures exceeded revenues by $656 million, an amount equal to 9.2% of its total revenues. In the prior year the budget imbalance had been equal to 7.3% of its revenues. Symptomatic of its budget balancing and deficit problems, the city had $1.6 billion of short-term operating debt outstanding at the end of 1971.

It is difficult to trace the steady deterioration of New York's financial position between 1971 and 1975 because of confusion in its accounting practices, but it is apparent that as the budget imbalances continued, the deficit increased each year, and the short-term borrowing continued to grow. The fiscal year 1975 budget imbalance was probably about $1.2 billion. By fiscal year 1975, the city estimates its accumulated fund deficit had reached $3 billion, and $4.5 billion of short-term loans were outstanding.

The explanation of New York's financial emergency is that city spending for operating purposes exceeded operating revenues over several years. This overspending created an accumulated fund deficit and a cash problem which could only be resolved by increasing amounts of short-term borrowing. When the banks would no longer roll over the ever-growing amount of short term debts, New York had no funds to meet its obligations as they came due.

The solution to the financial emergency was based primarily on a plan to return the city to balanced budgets under the supervision of a state emergency financial control board. Several measures were utilized to provide cash while the solution was being worked out. These included: cash advances from New York State; establishing the Municipal Assistance Corporation to issue securities on behalf of the city; the providing of cash loans by city pension funds; and finally, federal seasonal loans and guarantees of city loans. Most of the short-term notes of the city were converted to long-term serial bonds by the Municipal Assistance Corporation. This permitted the city to eliminate its accumulated operating deficit by paying manageable principal and interest installments on bonds over an extended time period. The solutions have generally worked and the city now has a balanced budget.

While the New York financial emergency was important because of the city's size and its national implications for credit markets, it was, in essence, a fairly simple and classic case. Bad accounting and budgeting practices permitted the city to spend more than its revenues by substantial amounts over several years, until its accumulated deficit became so large that it was unable to raise cash to meet its obligations as they came due.

Cleveland, OH

This city was cited in the 1973 ACIR report as a city that had come close to a financial emergency in 1971. Nine years later on January 4, 1980, an actual financial emergency in the city government was declared by the state auditor under a state law that empowered him to make such determination. The financial emergency consisted of a default on $15 million of bond anticipation notes that had matured over a year earlier on December 15, 1978, and overdue accounts payable on December 31, 1979, in excess of $36 million. In addition, the city had a general fund deficit of $35 million on a generally accepted accounting principle basis; on a cash basis of accounting, its actual cash was $32 million less than its book balances.

Like New York City, Cleveland reached its financial emergency because its general fund expenditures ex-

ceeded revenues in the years prior to the emergency. Because the city's accounting was not in accordance with generally accepted accounting principles, the exact amounts of these imbalances are unclear. (Here, too, it resembled New York City which also had accounting problems). Cleveland's unaudited imbalance for 1978 is reported as $17 million and for 1979 as $7 million. Imbalances in these years caused a cash shortage in the general fund and required using cash from restricted funds to meet obligations as they came due.

An examination made by an independent accounting firm on June 30, 1978, indicated that approximately $52 million of cash from capital funds and from other restricted sources had been used to meet general operating obligations. Most of the money used for operating purposes came from the sale of bond anticipation notes. These notes were issued with the expectation that the proceeds would be used for capital improvements and that bonds would be issued prior to the time the bond anticipation notes matured.

The accounting firm found that city financial records were in disarray, that the city apparently was experiencing severe operating budget imbalances, and that these imbalances were requiring the use of capital and other restricted cash for general operating purposes. As a direct result of these findings, the city's national bond ratings were reduced and suspended. These actions, in turn, made the sale of bonds to repay the bond anticipation notes impossible and when the local banks refused to renew the notes, a default ensued.

The official declaration by the Ohio state auditor of a financial emergency on January 4, 1980, permitted the city to borrow $15 million from the state to pay overdue debts for supplies and other obligations incurred in routine operations. This loan from the state was repaid later in the year from income tax collections. The note default was cured in November 1980, by issuing $36.2 million in bonds to eight Cleveland banks. As a result of revenues from an increase in the city's income tax, the city's general fund revenues exceeded expenditures in 1980 by $17.5 million, and by $6.1 million in 1981. However, in 1982 the city again experienced an imbalance of $1.1 million. Nevertheless by December 31, 1982, the accumulated general fund deficit had been reduced to $24.6 million.

Under a plan required by the state financial emergency law, the city expected to balance its budgets in 1983 and 1984 and to eliminate the accumulated general fund deficit by 1989. With these results, it hopes to end the formal financial emergency.

The financial emergency in Cleveland exhibits an interesting intergovernmental dimension that involves the federal Office of Revenue Sharing. The General Revenue Sharing law required the city to have a comprehensive financial audit by 1979 in order to continue receiving revenue sharing funds. Such an audit was not considered feasible by city officials because of its bad accounting practices. In March 1978, the city filed an application for a waiver of the audit requirements until 1980. The waiver, which was subsequently granted, included a requirement for a city plan to meet the audit requirements by 1980. The Office of Revenue Sharing also required monthly or quarterly reports of progress towards meeting the audit requirements as a condition of the waiver. Thus, the federal revenue sharing audit provisions helped motivate the city to improve its financial management both before and after the financial emergency. Had the requirement for auditing been in effect earlier, it is likely that it would have revealed Cleveland's problem before the city defaulted and became an emergency.

Saco, ME

Within little more than a year of each other, three local governments in Maine defaulted on tax anticipation notes. Saco had the most serious financial emergency—employees' pay was delayed in addition to the default on tax anticipation notes—and it was the only city in Maine in which a voter-imposed tax limitation contributed to the city's financial difficulties.

On December 31, 1979, Saco failed to pay a $2.1 million tax anticipation note that was due because the city had only about $1.6 million in cash in its bank account. Although the city still might have averted default by issuing a $540,000 bond anticipation note that a Boston bank had agreed to buy, the mayor refused to sign the note because he felt it would be improper to use proceeds from a bond anticipation note to pay a tax anticipation note.

After Saco defaulted, the holders of the tax anticipation notes obtained a court order attaching the city's $1.6 million bank account, leaving no money to meet payrolls or other obligations. The city's property taxes, its principal revenue source, were not due until fall. Under normal circumstances the city would have sold 1980 tax anticipation notes to provide cash for its 1980 operations, but with the 1979 notes in default, no buyers could be found. The city had no cash and no way to raise any—it was in a financial emergency.

The lack of cash forced Saco to keep the schools closed until January 9 after the Christmas vacation, and employees went unpaid for several days. On January 8, a bank agreed to loan the city $200,000 to meet payrolls and the emergency was temporarily relieved.

On January 23, the state approved legislation authorizing the city to put its 1980 tax collections as they were received in a special escrow account restricted to repaying tax anticipation notes. With this provision for assuring payment, local banks agreed to loan the city $2.2 million in tax anticipation notes and $540,000 in bond anticipation notes. The proceeds from these notes provided cash to cure the 1979 default and meet 1980 operating obligations. As a condition of the note sale, the

banks required the city to draw the money only as needed, thus giving the banks an opportunity to monitor and control city spending during the year.

The 1979 default was caused by several factors. The city started the year with a deficit of about $379,000 resulting from prior unbalanced budgets. In January 1979, the voters of the city enacted a $3 million limit on local property taxes with a 2% annual increase allowed for inflation. The effect of the tax limit was to reduce expected revenues for 1979 by about $600,000, and thus add to the city's problem in balancing its budget. In early June—five months after the start of the fiscal year—the city finally adopted a budget that was in apparent balance. The budget provided reductions in most departments and required a layoff of nearly 20% of the school teachers and custodians.

Because the city's property taxes to finance the year starting January 1, 1979, were not due until September, the city borrowed $2.1 million in January in anticipation of the tax payments. With a $3 million tax levy, it was expected there would be ample revenues to repay the notes by their due date of December 31, 1979.

Unfortunately, the city encountered problems keeping its expenditures within the $3 million budget set by the tax limitation. In addition, the city completed a sewer project which it had expected to finance by the sale of bonds, but it found itself unable to sell the bonds in 1979 because of the uncertainty about the condition of the city's finances. Instead of setting aside sufficient tax revenues from the September tax collections to cover the tax anticipation notes, the city used these revenues to cover the budget deficit and the unfinanced sewer project costs. As a result, there was insufficient cash on December 31 to pay the notes.

The principal cause of the Saco financial emergency was the usual problem of not balancing its budgets, but in this case the problem was aggravated by a tax limitation approved after the budget year had actually started. Contributing to the problem was bad cash flow caused by a single property tax payment date late in the fiscal year, construction expenditures made prior to selling the necessary bonds, and failure to segregate the tax revenues needed to pay tax anticipation notes.

Since the emergency, several of these problems have been corrected. The city now requires property tax payments in two installments so it gets cash earlier in the year and, as required by the new state law, it segregates tax revenues to keep them available to pay tax anticipation notes.

Cleveland Board of Education

The default of the Cleveland Board of Education on tax anticipation notes was really only technical because a federal court ordered the bank holding the notes to extend them beyond the due date. However, the school system did not have sufficient money on hand to pay the notes when due and it would have defaulted on payment.

The school system's problems occurred during the period when it was under the control of a federal court because of a desegregation lawsuit. Its problem had no direct relationship to those of the City of Cleveland because each has separate taxing authority. The school system issued tax anticipation notes in 1977 to fund its current operations. Because its budget was not balanced, the school board planned to close the schools for part of the year to the extent necessary to balance its budget and provide the money needed to pay the notes. However, the federal court refused to permit such closing, thereby placing the school district in a default position when the tax anticipation notes came due. The court then ordered the banks to renew the district's short-term debt.

SUMMARY

The ACIR search for defaults occurring between 1972 and 1983 found 36 defaults on government-purpose debt. One of these was a default on a long-term general obligation; ten were defaults on general obligation notes; and the remaining 25 were defaults on government-purpose revenue bonds. Compared to the 294 defaults recorded between 1960 and 1969, the number of recent defaults is very low.

However, in terms of dollar volume the defaults occurring in the 1972-83 period may exceed that of earlier periods because of three defaults involving very large amounts—New York City, Cleveland, and the Washington Public Power Supply System (WPPSS). The WPPSS default on $2.25 billion came close to the total indebtedness of all defaulting state and local units ($2.85 billion) during the Depression period 1929-37.[8] Except for the three major government-purpose defaults, the dollar amounts involved in all the government-purpose defaults were quite small.

Case studies reviewing the causes of default in four cities—New York, Cleveland, Parlier (CA), and Saco (ME) show a common thread in both large and small cities with default eventually occurring as a result of a series of years of unbalanced budgets and snowballing deficits. In most cases the seriousness of the city's financial situation was masked by poor accounting.

FOOTNOTES

[1]Asherman, Georgette, *Industrial Revenue Bonds and The Disclosure Exemption*, [unpublished working paper], May 1984, p. 5.

[2]ACIR, *Significant Features of Fiscal Federalism, 1982-83 Edition*, M-132, December 1981, p. 74.

[3]ACIR, *Significant Features of Fiscal Federalism, 1982-83 Edition*, M-137, January 1984, p. 131.

[4]U.S. General Accounting Office, *Trends and Changes in the Municipal Bond Market*, GAO-PAD 83-46, September 12,

1983. Both figures include municipal bonds issued by state governments.

[5] *The Bond Buyer Statistical Supplement for 1983*, p. 5.

[6] The *Daily Bond Buyers* for this period were made available by Government Finance Research Center in Washington. Copies prior to mid-1973 were not readily available in Washington. Information was also obtained from lists of defaults prepared by the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, and an insurer of of municipal bonds. In addition, three New York bond rating firms and several investment banking firms brought default occurrences to our attention. A telephone survey of all state auditors and controllers was conducted for both defaults and other types of financial emergencies. The information from all sources was collated and cross-referenced to arrive at a single list of defaults.

[7] See, for example, the Congressional Budget Office, *Small Issue Industrial Revenue Bonds*, revised September 1981.

[8] Hempel, George, *The Postwar Quality of State and Local Debt*, New York, National Bureau of Economic Research, 1971.

Chapter 4

STATE ACTIONS

The 1973 ACIR report concluded that states should play a key role in providing assistance to local governments faced with financial emergencies. To facilitate such assistance, the report listed recommended guidelines to be used to determine when intervention was required and recommended a series of state actions that might be taken after an emergency was declared.

The four guidelines for determining a financial emergency were:

1) default in payment of principal or interest on debt;
2) failure for a specified time period to make payments to the state or other governments of required tax withholdings, pension contributions, or other mandated payments;
3) failure for a specified time period to pay salaries or pension benefits; and
4) a floating debt of accounts payable or other current obligations which, net of funds available, exceeds 10% of the total prior year's appropriation.

The 1973 report's recommended state action consisted, in essence, of state receivership with a variety of powers to regulate and control the local government's finances. Two key powers among the 13 specific ones enumerated were: (1) to require a plan for regaining solvency; and (2) to provide a temporary state cash loan or to guarantee a loan from private sources to enable the government to meet its immediate needs.

Two states, New York and Ohio, enacted laws that were patterned after the report's recommendations and each has had experience with actual financial emergencies. The experiences of these two states provide a good basis for evaluating the 1973 recommendations of the Commission. The Ohio law most closely follows the recommendations and has been involved in ten in-

stances from November 1979 (the date of its enactment) through October 1983. Because the Ohio law so closely parallels the original ACIR recommendations, and because it has been used extensively, a detailed examination of the Ohio experience provides a good basis for evaluating the effectiveness of state intervention.

THE OHIO EXPERIENCE

The 1979 Ohio Law

The Ohio law was enacted in direct response to the Cleveland bond anticipation note default in December 1978 and the city's continued deteriorating financial condition in 1979. Cleveland had accounts payable that reached $36 million by December 1979 and a cash deficit in the general fund of $32 million. As a result, there was concern that without state intervention the city would be unable to continue providing basic services. Under the *Ohio Constitution*, it was necessary to pass a law of general application to all municipalities and not solely applicable to Cleveland. Thus, a new comprehensive statute, "Local Fiscal Emergencies," was adopted. Ironically, the first city to use the law was Niles and not Cleveland.

This new law set out in detail the conditions constituting a fiscal emergency. While these conditions were tailored to fit the unique Ohio local government budgeting and accounting characteristics, they can be summarized as follows:

1) the existence of a default on a debt obligation for more than 30 days,
2) failure to pay employees within 30 days of when such payment is due unless two-thirds of the employees have agreed to a delay of up to 90 days,
3) (A technical measure unique to Ohio, based on a need to reallocate tax levies, within the constitutional tax limitation, from other local governments to the municipality.),
4) Accounts payable that are delinquent by more than 30 days in either the general fund or all funds that, after deducting cash available to pay them, exceed one-twelfth of the prior year's general fund or all funds revenues,
5) a condition in which the total deficit for a combination of funds, less balances in any other funds that can be transferrred to reduce such deficits, exceeds one-twelfth of the prior year's revenues of those funds that are in deficit, and
6) A condition in which uncommitted cash and investments in the general cash accounts of the government are less than the book balances of the funds by an amount greater than one-twelfth of the total cash received in those funds in the prior years.

The law provides that the state auditor shall determine whether a local government meets any one of the six conditions for a financial emergency. If the auditor so determines, a fiscal emergency is declared and a financial planning and supervision commission is established.

Its Use

This section provides information on the ten Ohio local governments that have been declared to have a fiscal emergency, the date of the emergency declaration, and the basis for such determination.

Niles—January 1980 (population 23,088). The city failed to meet test 5 in that at the end of its 1978 calendar year, it had funds with net deficits of $1,045,071, an amount equal to 41% of the receipts in those funds for the year and a deficit clearly in excess of the one-twelfth permitted under the fiscal emergency law. Niles was the first government examined under the new law and the auditor did not consider it necessary to determine whether the city failed other tests. However, it is likely that the city would also have failed at least tests 4 and 6.

Cleveland—January 1980 (population 573,822). Cleveland failed test 1 by virtue of the default of bond anticipation notes in December 1978. Only the failure of test 1 was used for purposes of declaring the emergency. However, the city also failed test 4, with $36.5 million of overdue accounts payable on December 31, 1979; test 5, with $35.2 million of fund deficits on December 31, 1979; and test 6, with fund book balances that exceeded cash by $32 million on December 31, 1979.

Norwood—March 1980 (population 26,240). Norwood failed test 5 because it had a total net deficit of $1,906,515 on December 31, 1979, or an amount equal to 19% of the receipts of those funds during the year and in excess of the one-twelfth allowed. The city also failed test 6, with actual cash of $816,475 equal to only 30% of the fund book balances of $2,749,536.

Plymouth—May 1980 (estimated population 2,000). Plymouth failed test 1 by dint of its default on a Farmers Home Administration note of $56,383 due January 1, 1980, and on a bank loan of $10,200 due April 10, 1980. The village failed test 5 as a result of net fund deficits of $97,522, equal to 15% of total fund receipts of $656,534. And it failed test 6, with actual cash of $159,867, compared to fund book balances of $297,923. The cash difference of $138,056 was equal to 19% of total 1979 receipts and in excess of the test in the law.

Ashtabula—September 1980 (estimated population 23,800). Ashtabula failed only test 5 and that by a relatively small margin. On December 31, 1979, the city had funds with net deficits of $753,862, or an amount equal to 15% of its 1979 funds' receipts, thus exceeding the one-twelfth allowed.

Freeport—September 1980 (population 525). This tiny village had net overdue general fund accounts payable of $4,004 on December 31, 1979, compared to total 1979 general fund receipts of $18,888. It thus failed test 4. However, because of its very small size, it was considered uneconomical to establish a state financial planning and supervision commission. Instead, the state auditor worked directly with local officials after the emergency was declared.

Ironton—December 1980 (population 14,290). Ironton failed test 5 with net fund deficits of $457,331, an amount equal to 14% of total 1979 receipts in the deficit funds. It failed test 6 with actual cash of only $34,151, compared to fund balances of $548,105. Moreover, the $34,151 cash on hand understates the problem because the city had short-term bond anticipation notes outstanding of $3.4 million on December 31, 1979. Thus, that jurisdiction could have been faced with a much more serious cash problem, if it could not issue bonds to repay the notes or renew the notes when they came due in December 1980. In fact, the city was briefly in default on $2 million of these notes on December 15, 1980, until the bank agreed to renew them; Ironton also defaulted on $966,000 payable to another bank. This latter bank did not renew the notes but it did not officially declare them in default either. The note defaults occurred after the state auditor's review and thus did not technically constitute a failure of test 1.

The city also did not meet its December 1980, payroll until six weeks after it was due, but at the time of the auditor's review it was not 30 days past due and, therefore, its delay in meeting the payroll did not constitute a legal failure to meet test 2.

Lincoln Heights—December 1981 (population 5,300). The city failed test 4 with overdue general fund accounts payable of $46,875, an amount equal to 9% of 1980 receipts and slightly in excess of the one-twelfth allowed. The city failed test 5 with net fund deficits of $66,901 or a little under 10% of combined deficit funds' receipts of $700,731 for 1980.

East Liverpool—February 1982 (population 16,687). East Liverpool failed test 4, with net overdue payables in its general fund on December 31, 1981, of $293,002, an amount equal to 16% of its 1981 general fund receipts. The city did not officially fail the test 6 cash measure because the law does not require notes outstanding to be deducted from cash. However, on December 31, 1981, the city had total cash of $224,324, with notes of $308,022. The difference is a negative net cash balance of $83,698, compared to book balances of $256,593 and, on this basis, would have constituted a failure to meet test 6.

Manchester—August 1983 (estimated population 2,300). Manchester failed test 4 with overdue net payables on December 31, 1982, in both the general fund and all funds that were equal to 13% and 14% of the respective 1982 receipts. It failed test 5 with net fund deficits of $48,000 or 27% of total deficit funds receipts.

Summary of Tests Used

The results of the applications of the fiscal emergency tests to the ten local governments declared to have financial emergencies shows that test 5, the measure of fund deficits relative to receipts was failed by eight of the ten governments (see *Table 2*). In contrast, no governments failed the technical test 3. Only one government (Ironton) failed to meet its payroll for 30 days (test 2) and that failure occurred after the government had already been declared in a fiscal emergency.

Table 2

REASONS FOR OHIO LOCAL GOVERNMENT FISCAL EMERGENCIES

	Tests Failed					
City	**1**	**2**	**3**	**4**	**5**	**6**
Niles				X[1]	X	X[1]
Cleveland	X			X[1]	X[1]	X[1]
Norwood					X	X
Plymouth	X				X	X
Ashtabula					X	
Freeport				X		
Ironton	X[1]	X[1]			X	X
Lincoln Heights				X	X	
East Liverpool				X		X[1]
Manchester				X	X	
Tests Used	**3**	**1**	**0**	**6**	**8**	**6**

[1]Did not officially fail the tests as determined by state auditor, but probably did unofficially.

Evaluation of Ohio Experience

The Ohio law can be evaluated by considering whether it properly detected financial emergencies before they caused serious adverse consequences to the government and its citizens and whether the corrective measures resulting from the state action were successful.

The correct timing of the declaration of a financial emergency is important for two reasons. If the emergency is declared too soon, it may unnecessarily involve the state in local finances, and actually delay or impede local resolution of the problem. On the other hand, if the declaration is delayed too long, a default, missed payroll or other serious consequence can occur.

The Ohio law provides two basic safeguards against premature determination of an emergency. First, unless there has been a default or failure to pay employees, the

city has four months after the end of a year in which it fails one of the other tests to take "steps to remove such condition" [R.C. 118.03(B)]. If the auditor finds such steps have been taken, the declaration is postponed until at least four months have elapsed from the end of the fiscal year. After the four-month period, the auditor must then determine that conditions existing at the end of the prior year have not been corrected. The local government is thus given an opportunity to correct its own problems.

The second safeguard against premature declaration of emergency is the right of the mayor to appeal a declaration to the court of appeals and request an expedited hearing. However, this appeal is only on the question of whether the auditor has properly applied the tests, and not whether there is a need for a declaration of financial emergency based on other considerations, such as the ability of the government to solve its own problems.

Of the ten cities that have been declared to have a financial emergency, only Ashtabula contested the declaration. In March 1980, the auditor notified the city of his intention to declare an emergency. The city requested and received a four-month postponement to allow time to correct its problems. However, the city actions were not sufficient and the auditor did declare an emergency in September 1980.

No financial emergency city asked the court of appeals to review the auditor's decision. That none of the cities, except Ashtabula, seems to have objected to state action does not necessarily mean the emergency declaration was timely. It may merely mean the cities could not dispute the fact that they failed one of the tests. However, it would seem likely that the governments would want to avoid the stigma and loss of local control from an emergency by trying to correct the problem within the four-month period allowed. Since only one government tried to do so, and it failed, it probably indicates that the tests were correctly finding significant financial problems that did not lend themselves to immediate solution by local officials acting on a voluntary basis.

The question of whether the declaration of emergency is too delayed to prevent serious consequences is difficult to answer because of conditions that already existed at the time the law was enacted. Cleveland had already defaulted; it was too late for the law to have an effect there. Similarly, Plymouth's default in January 1980, occurred too soon after the law was passed for state intervention to have a beneficial impact.

Ironton, declared as an emergency in December 1980, both defaulted on notes and failed to meet its payroll after the emergency had been declared. In this case it appears that the declaration may have been delayed too long. However, had the law been in effect before November 1979, it might have caused an emergency to be declared earlier in Ironton because the city's finances were in general disarray during 1979.

Preliminary Findings

Determining whether the law is effective in correcting financial emergencies requires a longer testing period than four years but some results are apparent in the ten cases that have occurred. Of the ten governments with an emergency, Niles, Plymouth, and Norwood (three of the governments that were declared in emergency in 1980) were found by the state auditor to be free of emergency conditions in 1983. The remaining seven, including four with emergencies declared in 1980, have improved their finances, but had not removed the emergency conditions by the end of 1983. Cleveland, for example, redeemed its defaulted notes and improved its cash position but it still had a deficit at the end of 1982.

For most cities, the principal condition that keeps them in a financial emergency is the fund deficits. The fund deficits were caused by unbalanced budgets and can generally only be eliminated by budgets that contain an excess of revenues over spending. Thus, it is necessary for the governments not only to cure the problems that caused the unbalanced budgets but also to devise a way to provide excess revenues. The Ohio law's requirements that the city have a plan to accomplish this and the provisions for monitoring compliance with the government's plan should eventually correct the emergency conditions. However, external economic events may cause complications. Cleveland has had problems keeping its budget in balance because of the recent national recession, and, as a consequence, had to revise and extend its plan for recovery.

The law's provision allowing the state to buy a municipality's notes to provide cash assistance was used only for Cleveland. In this case it appears to have worked as planned. Cleveland borrowed $15 million from the state in 1980 to pay overdue accounts payable and provide working capital. This loan was repaid on time later in the year when the city's cash flow improved. While it is not clear what Cleveland would have done if it had not been able to borrow from the state, it does appear that the loan eased some of the city's immediate problems and provided relief for creditors.

The Ohio law generally seems to have been successful based on its experience to date. It has revealed financial emergencies in timely fashion, and has had some success in providing a basis for correcting the emergencies.

One question raised by the Ohio experience is why there has been such a relatively large number of financial emergencies in this one state. It does not appear that the law either caused the emergencies or found ones that would not have otherwise existed. Rather, it appears that local governments in Ohio have had an unusual proclivity for financial emergencies.

Two characteristics of Ohio local governments may account for this problem. All of the ten emergency cities were characterized as having accounting problems, and they did not report results in accordance with generally

accepted accounting principles, thus confirming a conclusion of the 1973 report that bad financial management is a major cause of financial emergencies. Even the tests in the state law are generally geared to the cash accounting basis generally employed by Ohio municipalities. These accounting problems in Ohio now appear in process of correction and in future emergencies the role of bad accounting may diminish.

The second factor contributing to Ohio emergencies appears to have been the difficulty the governments experienced in increasing revenues due to a strict property tax limitation and little growth in the property tax base. In addition, heavy dependence on local income taxes means reduced revenues from this revenue source in times of economic downturn. In short, the unbalanced budgets in the Ohio local governments with emergencies appear to be the result of revenue sluggishness rather than overspending.

THE NEW YORK LAWS

Unlike Ohio, New York has not passed a law of general application for financial emergencies but instead responds by enacting special legislation when it determines an emergency exists or is about to occur. New York has used two variations of legislation depending on the severity of the problem. The first type of legislation has been used fairly frequently in less severe cases. The second form has been used only for New York City and Yonkers.

The Use of Deficit Funding Bonds

In the less severe cases, when local governments experience accumulated deficits that threaten their liquidity and may lead to financial emergencies, the state authorizes issuing bonds to fund the deficit and to restore the government's cash position. To provide security to bond purchasers, the legislation requires establishment of a special debt service fund, to be held in trust by a bank, which directly receives property tax revenues sufficient to pay the debt service.

In addition, a general law requires the state comptroller to monitor the annual budgets of those governments which have been authorized to issue deficit funding bonds. In these cases, the comptroller examines the revenue and expenditure estimates in the budget and makes recommendations to the government. This review requirement continues for as long as the deficit bonds are outstanding. However, the comptroller has no explicit power to change the local budget or to compel actions by the local government.

From 1972 to 1982 this form of special legislation was used for 16 municipalities and 12 school districts. (See *Table 3*.) One city, Peekskill, was authorized to fund its deficit twice—in 1981 and again in 1983.

It was not feasible to examine the circumstances of each government using deficit funding bonds, but the large utilization of this technique suggests that some New York local governments may be accepting deficit funding bonds as almost a routine financing device. Thus, it becomes relatively easy to spend more, or tax less, incur deficits, and then issue bonds to fund the deficit because the sale of the bonds requires only a simple legislative act, a segregated debt service fund, and minimal budget review by the state comptroller.

Table 3

NEW YORK LOCAL GOVERNMENTS ISSUING DEFICIT FUNDING BONDS, 1973-83

Year	MUNICIPALITIES[1]	Amount Of Bonds	Length of Bond Maturity (years)
1975	Long Beach	$750,000	10
	Port Chester	550,000	5
1976	Yorktown	879,000	10
1977	Charleston	77,000	9
	Keeseville	193,000	10
	Monticello	361,633	10
1978	Evans	757,502	5
1980	Putnam Valley	475,437	5
	Greenport	207,885	10
1981	Montgomery County	1,649,733	6
	Peekskill	530,000	10
	Huntington	964,700	5
1982	Seneca County	1,300,000	2
	Schenectady	900,000	5
	Utica	1,353,760	5
1983	Peekskill	4,000,000	10
	Altamont	500,000	10
	SCHOOL DISTRICTS[2]		
1974	Wyandarch	750,000	10
1975	Deer Park	2,215,000	10
	Salmon River	325,000	10
1976	Roosevelt	2,383,000	10
1978	Altmar-Parish-Williamstown	160,000	5
	Bradford	89,000	5
	Lisbon	100,000	5
1979	Marcellus	364,500	5
1980	Middle County	645,000	5
1981	Fabins-Pompey	176,000	5
	Lyme	38,000	5
	Perth	120,000	5

[1] In 1973, 1974, and 1979, municipalities issued no deficit funding bonds.
[2] In 1973 and 1977, school districts issued no deficit funding bonds.

Severe Financial Emergencies in New York City and Yonkers

This simple approach to curing mild financial emergencies after they occur has worked in most New York

situations, but the state experienced problems in New York City and Yonkers for which it had to enact stronger measures. In both instances, special legislation was passed approving the issuance of bonds to fund large accumulated deficits, with a requirement that earmarked revenues flow directly into a segregated debt service fund. However, unlike New York State's experience with other financial emergencies of lesser magnitude, the simple form of legislation was not sufficient to induce investors to buy the bonds in these two instances.

NEW YORK CITY

The additional actions required in New York City included creating a state emergency financial control board in September 1975. This board was given many of the powers recommended by the ACIR in its 1973 report, including: requiring the city to develop a plan to balance its budget; approval power over most city contracts, including those with labor unions; and other powers to require adequate financial reporting and adherence to the approved plan to balance the budget. Although the mayor and city comptroller were members of the control board, state officials were effectively in charge of the board's activities.

Prior to creating the control board, the state also created a separate agency (Municipal Assistance Corporation, usually called MAC or "Big Mac") to issue bonds for the city and to oversee a separate debt-service fund. However, even with the control board overseeing the city's finances the MAC was not able to issue sufficient bonds to fund $2.4 billion in maturing notes. Thus, despite the best efforts of the state, a default could not be averted, and there was discussion of bankruptcy under Chapter 9 of the *Federal Bankruptcy Act*. Bankruptcy was averted by federal direct short-term loans approved by Congress in November 1975. While the immediate financial emergency was eliminated by the state actions and the federal loan guarantee, the city was still faced with a badly imbalanced operating budget.

The plan the city submitted to the control board provided for corrective actions that would cause revenues to exceed expenditures by 1978. The city followed the plan and revenues exceeded expenditures by $32 million in 1978. Although this balance was achieved on a "financial plan basis" as required by the control board, the budget was unbalanced by $712 million on a generally accepted accounting principle basis, mainly because the city continued to use capital funds for operating purposes. Based on city plans and under continued supervision of the control board, the city achieved a fully balanced budget in 1981 and continued to do so in 1982 and 1983. It now appears that the control board's powers may sunset as early as 1986. Although the state was obviously late in determining that the city had a financial emergency requiring supervision, the state actions have since been effective.

YONKERS

The Yonker's situation was also so serious that it required creation of an emergency financial control board to oversee the city's finances. The state legislation creating this board was approved in October 1975, about a month after the New York board was approved, and the board's structure and powers were similar to that of New York's. However, several features were different. The Yonker's legislation specifically authorized a 1% increase in the city's sales tax, and it froze all city government wage and salary levels for fiscal 1976, later extended to fiscal 1977 as well. However, the Yonker's control board had less direct control over the city's revenues and contracts than the New York City board had, and thus had trouble enforcing compliance with financial plans.

As was the case with New York City, the control board was not sufficient to restore investor confidence and permit bond sales. To achieve this end, additional legislation was passed in July 1976, empowering the state comptroller as "fiscal agent" to approve city budgets, control a special segregated debt service account with earmarked revenues, segregate bond proceeds, and approve of note issues. This legislation, in effect, transferred the supervisory powers from the control board to the state comptroller, although the control board remained in existence until December 31, 1978. The fiscal agent's powers will remain in effect until the bonds issued to pay the deficit are retired.

Although the combined control board and fiscal agent legislation were adequate to get Yonkers back into the bond markets, the city's continued problems in balancing its budget, as evidenced by the need for state loans to balance its budget in 1979 and later years, raise doubts about the effectiveness of the state actions. These doubts were confirmed by the reimposition of a state control board in May 1984. It appears that the state comptroller, or fiscal agent, does not exercise political or institutional power comparable to that of the control board in New York City, and has thus been unable to impose sufficiently strict financial budget discipline on Yonkers to solve its financial problems.

Evaluation of New York Experience

New York State has chosen a flexible approach to local government emergencies. The state determines the existence of an emergency by special legislation and tailors the legislation to address the particular emergency. Both the determination of an emergency and the solutions are made in a political environment. In Ohio local governments know in advance the conditions that will trigger an emergency declaration and the state actions that will ensue, while in New York local governments cannot be sure when or how the state will act.

In the instances of smaller local governments with serious deficit problems, the New York system seems to have been effective in averting more serious problems. However, a state monitoring law such as that of Ohio would have triggered action several years sooner in New York City and Yonkers, when the problems were at a stage that might have been more manageable.

The ease with which the smaller governments have been able to issue bonds to fund deficits may actually be fostering some budget laxness. Perhaps, more stringent state measures to prevent situations in which deficit bonds are required or more direct state controls after bonds are issued would encourage tighter budget control by local officials. In the two instances of significant financial emergency, the state had to make several attempts before it found a combination of actions that would work. In the case of New York City, this problem in finding solutions is not surprising because of their size and complexity. However, in Yonkers, it appears that the trial and error approach delayed solutions and may have resulted in a solution that only temporarily relieved the emergency.

It seems apparent that in both New York City and Yonkers, as well as probably the less severe cases, a monitoring law with criteria for determining when a financial emergency exists would have reduced the severity of the problems encountered. It is less clear that a uniform statutory procedure for dealing with the emergencies would have been more successful in solving the problems. It may be that in complex cases such as New York City and Yonkers, special legislative action would have been necessary in any event.

Chapter 5

THE U.S. BANKRUPTCY ACT, CHAPTER 9

INTRODUCTION

The 1973 report concluded that it was appropriate to use the *Federal Bankruptcy Act* in two instances. First, when there is inadequate response to a local fiscal emergency by the state and second, when it is necessary to stretch out the debt payment schedule of the local government. However, the 1973 report suggested that the bankruptcy law should "by its very existence encourage solutions short of bankruptcy proceedings."

The earlier ACIR report also noted that the term bankruptcy was inappropriate in terms of local governments because they do not liquidate their assets to satisfy creditors and they do not go out of business.[1] Instead, the federal act provides a basis for the government, with agreement from most of its creditors, to reorganize and adjust its finances under the supervision of a federal judge. To make the federal law more usable for this purpose, the 1973 report suggested several changes. The three principal changes recommended were: to clarify the definition of creditor; to permit a municipality to file a petition without approval of its creditors, but only after the parties have seriously tried to gain approval of a plan and the state had been a party to such efforts; and to provide for continued supervision of the affected government after a plan is approved, preferably with the court designating a state agency to do such supervision. A number of other less important technical changes, such as providing separate official forms for municipal filings, were also recommended.

These recommendations were presented to the U.S. Commission on Bankruptcy Laws, which was then reviewing the entire bankruptcy code. Because of the very limited use of Chapter 9, in 1973 there was little interest expressed in changing the municipal provisions.

THE 1976 AND 1978 CHANGES

The New York City financial emergency in 1975 caused new awareness of the need to make the federal bankruptcy provisions in Chapter 9 more practical and accessible for local governments. Congress found an "impracticability of existing federal bankruptcy remedies for use by municipalities" and that this situation "increases the likelihood of their default and will aggravate the adverse effects." The principal concern of Congress was the adverse effect of a New York City default on national credit markets. For these reasons, Congress considered and enacted major changes to Chapter 9 in 1976 and later incorporated these, with a few additional changes, in its total overhaul of the bankruptcy code in 1978.

The principal issue that needed to be addressed by Congress in 1976 was how to allow governments to file bankruptcy petitions without approval of creditors. Provision for such filings was one of the recommended changes in the 1973 ACIR report. Under the law prior to 1976, a local government could file a bankruptcy petition only if it had reached agreement on a financial reorganization plan with creditors holding 51% in amount of the debt affected by the plan. This provision presented two problems for use of the bankruptcy code by large governments such as New York. First, it is extremely difficult, if not impossible, to define and locate all of the affected creditors who could number in the hundreds of thousands. Second, even if they could all be located, it is extremely difficult to negotiate agreement on a plan prior to filing a petition with 51% of the creditors approving.

To resolve these problems, the 1976 amendments permitted such filings, without approval of any creditors, provided the government had negotiated in good faith with its creditors and been unable to get approval of 51%; had determined negotiation was impracticable; or had a reasonable fear that a creditor would attempt to obtain preference for a claim while negotiations were taking place.

Two other key changes were made in the law as a result of Congressional concern over the New York financial emergency. First, the filing stays commencement or continuation of all proceedings by creditors to enforce claims and, in effect, transfers those actions that are in state or other federal courts to the federal bankruptcy court. However, it specifically permits the government to continue its routine operations, including incurring and discharging new debts after the filing. Second, the amendments gives the government the ability to reject executive contracts, including probably labor contracts.

Also, in an attempt to aid New York in what was considered its most critical problem at the time, the 1976 amendments permit issuing certificates of indebtedness to provide cash for necessary operating expenses. The law does not provide any assurance as to marketability of such certificates. However, the priority given to these certificates over all other claims makes them attractive to investors.

The 1976 amendments are also significant because the authors of these changes took great pains not to tamper with state and local governmental rights. The law did not change the requirement for state approval of local government filings either by general law or by specific approval prior to filing a petition. Filing a petition does not limit or impair the power of a state to control the exercise of local powers, except that the state may not adjust the local government's debts without complete concurrence of all creditors. This latter exception is in recognition of the power reserved to the federal government under the bankruptcy provision of the *U.S. Constitution*. Filing a petition also does not interfere with the local government's control and use of its revenues and property.

The House Committee Report on the 1978 act summarized the posture of the federal bankruptcy laws relative to state and local laws. It reported that the 1978 amendments take "greater care to insure that there is no interference in the political or governmental functions of a municipality that is proceeding under Chapter 9, or of the state in its power to control its municipalities."[2] And the report goes on to conclude that, "The Supreme Court and the Court of Appeals have made it very clear that the jurisdiction of the court is strictly limited to disapproving or to approving and carrying out a proposed composition."[3]

APPLICATION OF THE BANKRUPTCY LAW AFTER 1976

Ironically, New York City never used the law that had been revised specifically for its use. However, through 1983 three general-purpose local governments and one school district filed bankruptcy petitions under the new law. The three petitions of general-purpose governments—Bay St. Louis, MS; Wapanucka, OK; and South Tucson, AZ—all claimed insolvency because of an inability to pay financial judgments against the government arising from court decisions. The bankruptcy in San Jose School District resulted from a claimed insolvency because of inability to pay an arbitrator's retroactive pay award that was about to be enforced by a state court (see *Chapter 2*).

Each of these petitions raises questions about the interpretation of insolvency. There is also the related question—when should the federal law supersede alternatives under state laws? In addition, these filings raise several questions that are not clearly answerable by reading the federal bankruptcy law. In the absence of creditor approval, can there be a discharge or reduction of the amount of local government debt? What happens if the government and creditors cannot agree on a plan?

Can collective bargaining agreements be rejected in their entirety or in part? There have also been a number of procedural and technical issues raised, some similar to those for which recommendations were made in the 1973 report, such as the form of petition, the manner of filing it, and providing notice to creditors. In view of the different interpretation in the four petitions that have been filed, the definition of creditor also appears to remain somewhat nebulous.

Defining Insolvency

The principal unresolved question remains how to define insolvency for purposes of permitting the use of the federal bankruptcy code. The law itself states that the petitioning government must show that "it is insolvent or unable to meet its debts as they mature and desires to effect a plan to adjust its debts." Only in the San Jose case has the court directly addressed this issue. In this case, the court found that because "the district was unable to meet its debts as they matured for the 1982-83 school year, was unable to balance its budget for the 1983-84 school year, and was thus unable to meet its debts as they matured in the 1983-84 school year," it was insolvent for purposes of filing a bankruptcy petition.

The San Jose financial facts are somewhat difficult to determine, but several characteristics of the San Jose problem make it appear similar to the budget problems that annually face local governments across the country. The imbalance in the school district's budget for fiscal 1983, including payment of the labor award, would have been $3.5 million or about 4% of total spending. Most governments consider that a 4% difference between revenues and expenditures is not an extraordinary event, given the estimating problems inherent on both the revenue and expenditure sides of budgets and the possibility of unexpected adverse events occurring after a budget is adopted. Also, most governments are able to adjust their budgets to close a 4% gap during the year, or if not able to do it in the year in which it happens, at least to be able to overcome the gap by adjusting the following year's budget to provide a compensating surplus.

The anticipated fiscal 1984 budget imbalance in San Jose that was used as a second basis for declaring insolvency also raises doubts about the definition of insolvency. At the time of filing, the school board still had over a year to make adjustments in both the revenue and expenditure sides of the 1984 budget. In addition, it had time to appeal to the state for additional aid to overcome its 1984 problems. Therefore, the claim of an unbalanced budget for 1984 seems somewhat premature.

The factor that distinguishes the San Jose budget situation from that of countless other local governments is the unusual working of state laws that inhibit a typical solution to the problem. Under the Proposition 13 tax limitation of the *California Constitution*, the district is severely limited in its ability to raise additional revenues. State laws require that budgets be balanced and that schools remain open a minimum number of days. Failure to comply with either of these laws, as the city said would occur, raised a possibility of state action to withhold all 1984 state support for San Jose schools. The bankruptcy judge agreed that state aid might be withheld. In his ruling that the district was insolvent he said, "My reason for all this is basically and simply the imminent collapse of this whole school system."

Thus, despite the lack of clearly demonstrated financial inadequacy at the time of filing, the court concluded that the actions of state laws in relation to the city's finances would, in the future, cause the school district to become totally insolvent. The judge summarized his view of what constitutes insolvency within the meaning of the bankruptcy act as follows:

> . . . if you can pay all your bills today, but everyone knows that you can't pay them tomorrow, then you would be eligible.

In the South Tucson and Bay St. Louis bankruptcies the question of insolvency hinged on their ability to borrow money to pay judgments that were obviously beyond their ability to pay from current budgets. In each instance, the cities did eventually borrow money to pay the judgments, but only after attempting to get the bankruptcy court to reduce the amount of the judgment. In effect, the bankruptcy court was used as a final appeal body for reduction of the award after all other appeals were exhausted.

The Bay St. Louis judge rejected the city's efforts. The city's subsequent ability to borrow sufficient funds to pay the judgment, together with the judge's finding of solvency, suggests that Bay St. Louis was not insolvent and should not have been permitted to use Chapter 9 for delay purposes.

The South Tucson case is less clear because there was a negotiated settlement prior to a final court decision. While the judge initially found the city insolvent, its ability to raise $3 million for the eventual settlement casts doubt on its true insolvency. It suggests that the city's desire to delay payment, rather than its inability to pay, was the principal cause of the filing.

The Wapanucka case raised a more fundamental insolvency issue because it raised the question of whether the taxpayers had sufficient means to permit the city to pay the judgment. While the attorney for the local government argued that the tax burden required to pay the judgment would be impossible for the residents to handle, there was little evidence presented to support such contention and the court never ruled on the insolvency issue. In this case the insolvency test would have been reduced to a question of when tax burdens are so economically oppressive that they are impractical to levy.

All four bankruptcy cases illustrate the ease with which the insolvency issue can be sidestepped. Because there are no clear guidelines in the law for determining

insolvency, it is possible to file a bankruptcy petition on only a government's own claim of insolvency. Filing a petition provides an immediate stay of other court actions and may delay the government's need to make hard decisions about raising taxes, borrowing money or reducing its budget. If a purpose of the bankruptcy provision is to provide a government time to work out its problems, then the present law may be satisfactory. However, if the purpose of the law is to provide a final resort only for governments in dire financial straits, then the law needs a better definition of insolvency and a procedure that requires proof of insolvency prior to implementation of other provisions of the act.

Labor Contracts

The amended Chapter 9 now provides that a municipality, after filing a bankruptcy petition, can reject executory contracts. Although labor contracts are not specifically mentioned in the law, collective bargaining agreements are probably included. In providing for rejection of labor contracts, Chapter 9 raises questions about standards for rejection and about wages and working conditions after rejection.

The law does not provide any standards for determining when a labor contract rejection by the municipality is justified and, therefore, should be approved by the bankruptcy judge. In the case of corporate bankruptcies the standards are relatively simple. If the financial burden of the contract is so onerous that the firm cannot continue in business, then rejection is justified to preserve the company and the jobs of the employees. This same standard cannot be applied to a municipality because the government cannot cease operation, and therefore, all the employees cannot lose their jobs. It is, of course, possible that some employees will lose their jobs, but the need to reduce employment in government is a relatively common occurrence.

A general standard for municipalities could be that the labor contract is so burdensome that a balanced budget for the government will be impossible. Therefore, without corrective action, a successful plan for reorganizing the government's debts under the bankruptcy law could not be implemented. However, this type of approach leads the bankruptcy courts into weighing conflicting claims on the budget, such as whether rejecting the labor contract is preferable to increasing tax rates or reducing service levels. While it is easy to talk in general terms about how a budget balancing standard might work,[4] it may be very difficult to apply in specific situations.

In the only case involving municipal rejection of a labor contract, the San Jose School District argued that it had taken all of the cost cutting measures possible to reduce its budget, short of rejecting its labor contracts. The judge did not get deeply into the workings of the school budget, and instead, simply concluded, "If the contracts are not rejected the district will be unable to submit a balanced budget." In the case of a school district, unlike a general-purpose local government, the judge concluded that the resulting loss of state aid could shut down operations and result in the loss of all jobs.

In rejecting the contract, the judge seems to have relied heavily on an equality of sacrifice doctrine—that students, nonunion employees, and vendors had all been adversely affected by budget reductions; it was reasonable, therefore, to require union employees to accept pay reductions.

The federal bankruptcy law also fails to provide guidance on pay and working conditions once the contracts are rejected. Can the local government unilaterally set new pay and other benefit levels? Do state collective bargaining laws apply or does the bankruptcy court judge determine pay and benefit levels? In the San Jose case the school district asked for the right to go back to the salary levels set forth in the prior contract and also asked to be permitted to negotiate new salary levels with the unions.

In an unusual solution, the judge, in effect, set the employment conditions himself. He provided that the pay levels in the first year of the contract would continue but the raises for the second two years would be rejected. He additionally ruled that other nonfinancial provisions of the contract would continue in effect. He also made it clear that he expects the school district and the unions to negotiate new contracts prior to submitting the reorganization plan. These actions seem to violate the Congressional intention that the court not interfere with the political and governmental functions of the government.

Both the school district and the unions initially appealed the decision. The school district argued that the judge did not go far enough, that he should have allowed the raises for all three years to be rejected. The unions contend that the "nonfinancial" aspects in the agreement should also have been set aside because they represented concessions by the union in return for the higher compensation included in the contract.[5]

The question of what happens after rejection of a labor contract also raises difficult questions about the status of state laws. The state may have provisions dealing with the termination of labor contracts or the specific collective bargaining procedures to be followed in negotiating a new contract. Chapter 9 provides that the power of a state to control a municipality in the exercise of its governmental powers is not to be impaired by bankruptcy. Although this issue was not directly addressed in the San Jose case, it remains a potential problem that needs to be addressed.

Another unanswered question is whether members of a union can strike the local government to protest the rejection of the labor contract or to protest the pay and working conditions that are substituted for those in the rejected contract. Under federal law, the bankruptcy

court would not be able to prohibit a strike and, in the San Jose case, the judge specifically recognized the right of the unions to strike. Under many state laws, however, strikes are prohibited. It is also unclear whether the action of a federal bankruptcy court in recognizing the right of unions to strike would supersede a state prohibition on strikes.

In regard to labor contracts, it is apparent from both the way Chapter 9 is written, and the way the bankruptcy act has been applied in the San Jose case, that a clarification is needed. Such clarification should specify whether the provision on rejecting executory contracts includes labor contracts. If it does, then better standards for rejecting such contracts should be provided. And finally, the procedure after rejection and the relationship of state labor laws to such rejections should be made clear.

The Ability of the Bankruptcy Court to Supercede State Tax and Debt Limits

The 1976 amendments permit the court to authorize a government to issue certificates of indebtedness, and thereby imply that the court has power independent of state laws to authorize debt and, by further implication, to levy taxes sufficient to pay the debt service. In Bay St. Louis the city alleged that the court could order it to levy taxes in excess of state tax limitations and thus provide funds to pay the judgment without damaging its budget. The court itself ruled that it could order borrowing through certificates of indebtedness regardless of state law. However, the state bond counsel issued an opinion that the city could not borrow without state authorization. Instead of testing the bankruptcy court's ability to issue such order, the city solved the problem by going to the state legislature for permission to issue bonds and levy additional taxes.

In the other three cases certificates of indebtedness were not discussed as a solution. In the San Jose case, there apparently has been no attempt to have the bankruptcy court order a tax levy beyond the state constitutional limitation.

Thus the potentially powerful tool of certificates of indebtedness for resolving bankruptcy cases, especially in cases requiring payment of large judgments, remains untested and unclear as to its applicability.

FOOTNOTES

[1]One exception to this rule is the bankruptcy of The Management Institute located in Alameda County, CA. As a "governmental instrumentality," its case is much different. For a discussion of this case, see *Chapter 2*.

[2]U.S. House of Representatives, Committee on the Judiciary, Report No, 95-595 on the *Bankruptcy Reform Act of 1978* (PL 95-598), September 8, 1977, p. 263.

[3]*Ibid*., p. 264.

[4]For example, "Executing Contracts and Municipal Bankruptcy," *Yale Law Journal* 85, 1976, p. 965, suggests, "Unless a city can reject its labor contracts, lack of funds may force cutbacks in police, fire, sanitation, and welfare services, imposing hardships on many citizens."

[5]This contention is supported by *ibid*., note, p. 959, that suggests, "a municipality desiring to reject a collective bargaining agreement must reject the entire contract and do so explicitly. The city cannot retain the advantageous features of a contract and cast off the rest."

Chapter 6

THE FINANCIAL HEALTH OF MAJOR U.S. CITIES, 1971-82

This chapter updates and expands the examination of major city financial health first published in the 1973 report by the Advisory Commission on Intergovernmental Relations. Later, reports on the same subject were published by the First Boston Corporation in 1977 and 1978, and by the Urban Institute in 1979. The work contained in this chapter uses much of the information developed for these earlier reports.

The original purpose of the 1973 examination was to determine whether any major cities were showing indicators of financial emergencies. However, as information for subsequent years has become available, it is now possible to review financial trends for the cities over the 1971 to 1982 period. Because of the large amount of information that results from such an examination, the results for individual cities will generally be presented in this report for only four years; 1971, the original year examined;[1] 1976, a year about mid-point in the period; and 1981 and 1982, because they are the two most recent years for which complete information is available.

The information used in this report is from the official published financial reports of each city, unless otherwise noted. In the earlier years many of the cities were not audited and did not conform to accounting principles. All the cities were audited in 1982 by independent public accountants or government auditors and most of the reports are in conformity with generally accepted accounting principles. This improvement probably occurred for several reasons: the federal General Revenue Sharing audit requirement; investor concerns after New York's default; and, perhaps, the recommendations made in the 1973 ACIR report. As a result of the changes in accounting and reporting during the period, adjustments and revisions in the reported information for individual cities have been necessary. In some instances

information for some years was simply not available for some cities. To the extent possible, the information has been made comparable from year to year for each city and from city to city.

DETERMINING FISCAL HEALTH

Determining the financial health of cities is perilous for several reasons. First, a reliable and internally consistent set of information is difficult to obtain. Although the Bureau of the Census collects a considerable amount of data on city expenditures, revenues and debt, such information is not of assistance in evaluating cities on the basis of their financial condition or results of operation; the Census does not report revenues, expenditures and debt on a generally accepted accounting basis. Therefore, it is necessary to use published financial information from cities themselves, but the information that can be obtained from even well prepared financial reports is limited. For example, reports often do not show the total amount of federal or state aid received separately from other revenues, the amount of expenditures financed by borrowing or changes in revenues caused by increases in taxes and fees. Without more detailed information, some desirable analyses that would help judge financial health cannot be made.

A second problem in considering financial health is the lack of accepted meassures of what is normal. Each city's financial fortunes may reasonably vary from year to year depending on the complex interactions of many separate revenue and spending actions. This can create misleading indicators. For example, although most cities like to have operating revenues slightly in excess of expenditures, minor imbalances often occur and are not generally evidence of a problem. Some cities, such as Baltimore, may even be required to budget an imbalance, so as to use up surplus funds from prior years. The 1973 report identified symptoms of extreme ill health but, while these criteria remain valid as indicators of pathological conditions, they do not establish measures of normal health. For example, unrestricted reserves are a component of good health but how large should they be? How large must an imbalance be to be abnormal? How fast should expenditures reasonably increase and how large a lag in the rate of revenue growth is acceptable? Because these and other questions have no absolute answers, they force us to compare this year's performance against historical performance and against the typical results in other cities instead of against accepted standards.

A third difficulty in looking at fiscal health is the tendency to base judgments on dollar amounts or percentages of change without considering the important service and political dimensions of city finances. For example, during the period 1971 to 1982, several major cities recovered from what appeared to be serious problems by taking politically courageous actions to raise taxes and reduce spending. In other instances, apparently sound cities deteriorated rapidly because of tax cuts, new programs enacted without consideration of the long-term costs, budgets balanced with windfall revenues, or state and federal financial mandates that had adverse effects on cities.

Taking into account these limitations, this chapter will review the relevant information that is available about the financial health of major cities through the end of their 1982 fiscal years. This review examines individual cities and compares the performance of these major cities in the aggregate to prior years. These comparisons will show which cities are doing comparatively well and which cities are experiencing problems. In addition, the report provides a generalized outlook of trends in city finances.

RESULTS OF GENERAL FUND OPERATIONS

In examining city finances, one of the most important considerations is whether revenues in the general fund[2] exceed expenditures for the fiscal year, or stated more simply, was the budget in balance? Historical experience, as well as common sense, indicates that many financial problems first start with an unbalanced budget. However, it should be noted that cities routinely experience occasional bad years in which spending exceeds revenues, with the difference made up from excess revenues accumulated in prior years or by excess revenues in the following year. All of the 30 cities, except Indianapolis and Minneapolis, had a negative imbalance in at least one of the four years 1971, 1976, 1981 and 1982 (see *Appendix A*).

The 1973 report concluded that negative budget imbalances were important only if they were significantly large in one year or persisted over two years and got larger in the second year. An imbalance equal to 5% of total revenues was considered significant for one year. Using the 5% measure, four cities in 1971 had imbalances exceeding 5% of their budgets (see *Table 4*). By 1976, the number had grown to six, but in 1981, only Detroit exceeded 5% (5.6%). By 1982, again only two cities, Milwaukee and Cincinnati, exceeded a 5% imbalance, but neither exceeded 6%.

Three cities had two consecutive years of imbalances with a larger imbalance in the second year in 1982, and in both instances the imbalance was small (see *Table 5*). This contrasts with five cities in 1976 and three in 1971 that had this condition.

It is significant that New York, Cleveland, and Buffalo failed both tests in 1971 and all three had serious financial problems in later years. Philadelphia, Milwaukee, Boston, and New Orleans appear on both lists in 1976. Both Philadelphia and Boston later experienced serious financial problems that required massive tax increases to avert financial emergencies. Milwaukee, and to a less-

Table 4

Selected Major Cities in Which General Fund Expenditures Exceeded Revenues by More Than 5%

City		Percent
	1971	
New York		−9.2%
Philadelphia		−10.2
Cleveland		−16.1
Buffalo		−7.3
	1976	
New York		−9.3
Philadelphia		−8.7
Milwaukee		−6.1
Boston		−9.0
New Orleans		−5.7
Cincinnati		−7.7
	1981	
Detroit		−5.6
	1982	
Cincinnati		−5.5

Table 5

Selected Major Cities in Which General Fund Expenditures Exceeded Revenues for Two Consecutive Years With The Second Year Larger

City	Percent by Which Expenditures Exceed Revenues	
	1970	**1971**
New York	−7.3%	−9.2%
Cleveland	−0.6	−16.1
Buffalo	−2.4	−7.3
	1975	**1976**
Philadelphia	−4.1	−8.7
Milwaukee	−2.9	−6.1
San Francisco	−0.1	−2.7
Boston	−0.6	−9.0
New Orleans	−0.6	−5.7
	1981	**1982**
New Orleans	−0.1	−2.6
Cincinnati	−2.8	−5.2
Denver	−2.1	−2.8

er extent New Orleans, had strong reserves in 1976 and they apparently were able to use these reserves to provide time to work out their problems.

Overall, the individual city results of general fund operations from 1971 to 1982 shows cities in their weakest financial condition in 1976 and their strongest condition in 1981 and 1982. Of perhaps greatest significance, is the small numbers of individual cities showing unfavorable results for 1981-82 as measured either by size or persistency of imbalances.

A composite view of how well all cities excluding New York did over the 1971 to 1982 period shows that in 1971, 16 cities had imbalances, and the spending for all cities exceeded revenues by $23 million or 0.5% of total expenditures (see *Table 6*). In the three following years results improved dramatically, with only eight imbalances in 1973 and total *excess* revenues equal to 3.5% of spending.

However, 1975 and 1976 saw a recurrence of problema, both in the number of cities with negative imbalances and the total amount. After another three good years, including 1977 when only six cities had imbalances, the problem of imbalances recurred in 1980. Proportionally, the largest number of cities (19) had the greatest imbalance of any year examined. But this bad year was again followed by good years in 1981 and 1982.

REVENUE AND EXPENDITURE GROWTH RATES

These annual changes in budgetary performance are directly related to the annual revenue and expenditure growth rates. Ideally, revenues and expenditures should grow at about the same rates to insure balanced budgets. However, only in rare instances are the rates of growth exactly the same. Variances in growth rates may result from government decisions to change tax rates or spending levels, or may occur as a result of changes in national or local economic conditions.

Over the period 1972-83, the average annual growth in general fund revenues for the major cities has ranged from a high of 11.5% in 1977 to a low of 6.4% in 1982 (see *Table 7*). The average annual expenditure growth rates followed a somewhat similar pattern, ranging from a high of 13.1% in 1975 to a low of 7.1% in 1982.

However, in several years the difference in revenue and expenditure growth rates was quite large. In 1972, 1977, and 1981, revenue growth was very strong and expenditures grew at rates more than 2 percentage points lower. A possible reason for the 1972 revenue growth was the start of the federal General Revenue Sharing program. Similarly, 1977 was the year in which cities first received federal anti-recession fiscal aid. A different situation occurred in 1975 and 1980, when expenditures grew at above average rates, and were more than 2 percentage points in excess of revenue growth. The budget imbalances in the 1975-76 and 1980

Table 6

A Comparison of Selected Major Cities' Total General Fund[1] Revenues to Expenditures

Year	Number of Cities Included	Number in Which Expenditures Exceeded Revenues	Total all Cities' Excess or (Deficiency) of Revenues (in millions)	Percent of Total Expenditures
1971[2]	29	16	$(23.1)	(0.5)%
1972	28	12	16.1	0.3
1973	27	8	175.1	3.5
1974	28	9	156.1	2.9
1975	29	16	(28.4)	(0.4)
1976	29	13	(154.2)	(2.2)
1977	29	6	230.6	3.1
1978	29	12	73.6	1.0
1979	28	9	98.8	1.2
1980	27	19	(188.7)	(2.2)
1981	29	10	212.6	1.5
1982	28	11	169.0	1.2

[1]Except New York City in all years; and except for some other cities for some years in which information was not available.
[2]ACIR, *City Financial Emergencies*, A-42, 1973, p. 50. Figures include some 1970 results in cases where 1971 data were not available.

Table 7

Selected Major Cities' General Fund[1] Average Annual Rates of Revenue and Expenditure Increase
(unweighted)

Year	Average Annual Rate of Revenue Increase	Average Annual Rate of Expenditure Increase	Comparison of Revenue Increase to Expenditure Increase
1972	11.3%	9.2%	+2.1
1973	9.8	8.2	+1.6
1974	8.3	8.6	−0.3
1975	10.4	13.1	−2.7
1976	8.0	8.5	−0.5
1977	11.5	7.7	+3.8
1978	8.8	9.6	−0.8
1979	8.4	9.3	−0.9
1980	9.1	11.2	−2.1
1981	10.4	7.7	+2.7
1982	6.4	7.1	−0.7

[1]Includes New York. Does not include some cities in some years in which comparable information was not available.

periods were obviously a result of these differences in growth rates.

BALANCE SHEET CONDITION

Another way to gauge a government's fiscal health is to analyze the amount of unused resources, or fund balance, carried forward each year from prior years' operations. Fund balances give both a cumulative view of past budgetary performance and a measure of reserves available for future years' operating costs. Financial condition measures are determined by examining end of the year balance sheets. These measures contrast with the results of operation measures that focus on comparing revenues and expenditures for an entire year.

One measure of financial condition looks at the availability of unrestricted resources in the general fund at the end of the fiscal year. This amount is derived by comparing current assets with current liabilities. If the assets exceed the liabilities, the fund is in a balance or surplus condition. If the liabilities exceed the assets, the fund is in a deficit condition. Sometimes even though there is a balance or surplus, a portion of it is restricted or reserved for some future purpose. In that case, only the unrestricted amount is considered available.

Most cities maintain general fund surpluses as an insurance to protect their budgets from unexpected ad-

verse events, such as recessions. When a city's general fund is in deficit, it indicates there has been an inability to balance budgets in prior years, and it means a weakened ability to cope with future problems. If general fund deficits become large, they may also cause problems in cash availability.

Because not all cities have balance sheets prepared in accordance with generally accepted accounting principles, it is necessary to restructure some balance sheets on a pro forma basis.[3] Therefore, especially in 1971 and 1976, the resulting balances or deficits do not always exactly agree with the balances or deficits reported by the cities.

In each of the years 1971, 1976, and 1982, seven cities had a deficit financial condition (see *Table 8*). In 1981, eight cities were in a deficit situation.

Only Chicago and New York had a deficit in each of the four years, and New York's deficit in 1981 and 1982 is very small. The Chicago deficit occurs because of an unusual situation in which property taxes are collected by state law in the year following the year they are budgeted and spent. Eleven of the 30 cities had a deficit in at least one of the four years (see *Appendix B*).

In 1982, only two cities, Chicago and Cleveland, had deficits that exceeded 5% of revenues. This experience compares with four cities in 1981, six cities in 1976, and four cities in 1971 with such a condition.

Table 8

Selected Major Cities With General Fund Accumulated Deficits, As a Percent Of General Fund Revenues

City	Percent
1971	
New York	9.2%
Chicago	47.5
Philadelphia	6.1
Detroit	3.7
Cleveland	16.6
St. Louis	2.9
New Orleans	1.2
1976	
New York	31.1%
Chicago	24.8
Philadelphia	10.2
Detroit	5.6
San Antonio	3.9
Boston	10.7
Buffalo	15.0
1981	
New York	0.5%
Chicago	10.5
Detroit	16.2
Cleveland	7.4
Boston	7.5
St. Louis	0.7
Columbus	0.2
Buffalo	0.3
1982	
New York	0.2%
Chicago	10.6
Cleveland	11.8
Boston	4.7
St. Louis	1.5
Columbus	1.0
Buffalo	2.6

LIQUIDITY

Another way of looking at financial condition is to measure the government's overall cash position. This measure includes money restricted in its use, as well as general fund cash. It is derived by adding together all cash and investments easily convertible to cash (except retirement fund investments) and deducting any short-term loans outstanding. The resulting measure of overall liquidity is important because historically cities have only experienced financial emergencies when all of their cash, regardless of restrictions, has run out. This situation was dramatically illustrated by New York, when it not only used up all its cash, but also exhausted its ability to borrow any additional money.

Overall liquidity ideally should be compared to some measure of demand for public services, perhaps to the overall level of spending in order to measure the relative strength of each city. However, total spending for each city is not a practical measure because of differences in accounting and reporting between cities and between years, and because of irregular levels of annual capital spending. Therefore, liquidity in this report is related to total general fund spending. Because general fund spending is lower than total spending, this comparison will make liquidity appear greater than it would be if compared to total spending. For cities, such as Atlanta, Denver, and Seattle, with large amounts of cash in restricted funds, the resulting ratio is much higher.

Nevertheless, those cities that have negative or low liquidity measured against general fund spending do illustrate a potential for cash problems. The 1982 balance sheets show all cities with positive cash positions (see *Table 9*). This favorable experience contrasts with 1976, when two cities, New York and Chicago, had negative liquidity. The 1973 report did not contain this measure, so information for 1971 is not available.

By comparing the five cities with the lowest liquidity in 1976 (see *Table 10*) to the five lowest in 1982, it is apparent that city finances, measured by liquidity, were much stronger in 1982 than they were in 1976. In 1976,

the range was only from -8.1% in New York to 11.7% in Buffalo. In contrast, the range in 1982 is from 11.7% in Chicago to 27.0% in Detroit.

Further confirming the trend to improved liquidity is the increase in the average liquidity for all cities from 74.6% in 1976 to 89.8% in 1982, and the fact that 19 cities increased and only ten decreased their liquidity between the two years (*Table 10*—information for Houston was not available on a comparable basis).

SHORT-TERM DEBT

Another test of financial condition is whether cities have short-term debt outstanding at the end of the fiscal year. While short-term notes are often used by cities to meet seasonal cash flow needs or for other purposes, such loans create an element of risk. This risk occurs because notes usually require payment of a large amount of cash on a specific date, generally within a year of their issuance. If, for any reason, the government does not have available that amount of cash, and cannot renew or extend the note, it faces default. The importance of short-term debt as a potential trigger for financial emergencies is illustrated by the fact that both the New York and Cleveland emergencies were caused by an inability to pay short-term notes when they matured.

In the original 1973 ACIR report, the concern over issuance of short-term notes was limited to those whose proceeds were used for operating purposes. Operating loans, particularly when outstanding at the end of the year, were considered a basic sign of trouble because they indicated the accumulated operating deficit was creating liquidity problems. Notes issued in anticipation of bond sales were excluded because, historically, they had not created many problems and it was assumed

Table 9

Five Cities With Lowest Liquidity, As a Percent of General Fund Expenditures, 1976 and 1982

City	Percent
1976	
New York	−8.1%
Chicago	−4.0
Boston	0.8
Philadelphia	6.6
Buffalo	11.7
1982	
Chicago	11.7%
Los Angeles	11.8
New York	12.8
Boston	18.1
Detroit	27.0

Table 10

30 Selected Major Cities' Total Fund Cash and Investments, As a Percent of General Fund Expenditures

City	Total Fund Cash and Investments As a Percent of General Fund Expenditures 1976	1982
New York	−8.1%	12.8%
Chicago	−4.0	11.7
Los Angeles	19.6	11.8
Philadelphia	6.6	39.9
Detroit	34.7	27.0
Houston	76.5	NA
Baltimore	49.4	45.3
Dallas	125.0	96.5
Cleveland	72.9	54.5
Indiana	53.3	53.2
Milwaukee	104.4	94.1
San Francisco	27.7	108.8
San Diego	71.5	109.6
San Antonio	102.2	107.2
Boston	0.8	18.1
Memphis	53.4	71.8
St. Louis	54.2	55.0
New Orleans	55.2	92.2
Phoenix	60.2	115.9
Columbus	42.2	102.8
Seattle	244.3	257.3
Jackson	78.9	94.9
Pittsburgh	54.0	66.8
Denver	91.9	184.6
Kansas City	147.1	104.3
Atlanta	168.4	280.3
Buffalo	11.7	31.2
Cincinnati	144.7	108.3
Nashville	136.6	83.6
Minneapolis	85.4	165.9
Unweighted Average	74.6%	89.8%
Number Under 25%	5	4

NA = not available.

Table 11

30 Selected Major Cities' Current Property Tax Collections, As a Percent of Current Levy

City	Property Tax Collections As a Percent of Current Levy 1970	1982	Change
New York	95.0%	92.9%	−2.1
Chicago	84.7	93.4	+8.7
Los Angeles	NA	NA	NA
Philadelphia	95.6	94.0	−1.6
Detroit	97.8	NA	NA
Houston	89.0	91.7	+2.7
Baltimore	97.6	98.6	+1.0
Dallas	98.5	NA	NA
Cleveland	96.6[1]	96.4	−0.2
Indianapolis	95.5	97.9	+2.4
Milwaukee	99.6	98.1	−1.5
San Francisco	98.4	96.2	−2.2
San Diego	98.2	93.5	−4.7
San Antonio	90.6	97.3	+6.7
Boston	99.0	NA	NA
Memphis	97.3	95.4	−1.9
St. Louis	NA	NA	NA
New Orleans	99.9[2]	93.9	−6.0
Phoenix	98.3	104.3	+6.0
Columbus	95.8	95.8	0
Seattle	96.9	97.1	+0.2
Jacksonville	97.2	97.7	+0.5
Pittsburgh	94.0	92.6	−1.4
Denver	99.4	98.9	−0.5
Kansas City	97.6	96.5	−1.1
Atlanta	94.1	94.0	−0.1
Buffalo	96.8	93.6	−3.2
Cincinnati	97.5	96.9	−0.6
Nashville	96.0	96.8	+.8
Minneapolis	97.4	96.1	−1.3
Average	96.0%	96.0%	
Number Below 90%	2	0	
Number Above 96%	15	14	

NA = not available.
[1]1971 data.
[2]1972 data.

that their issuance had no relation to a government's overall financial condition. However, Cleveland defaulted on bond anticipation notes. Part of the New York notes that were not paid on time were also bond anticipation notes. Thus, while bond anticipation notes do not indicate financial problems in the same way that loans for operations do, they nevertheless present inherent and perhaps greater risks for the government!

In 1971, four cities, New York, Chicago, Detroit, and Buffalo, had operating loans outstanding at the end of their fiscal years.[4] By 1982, only Chicago had such operating loans outstanding. Moreover the $136.2 million of Chicago notes outstanding in 1982 was almost the same amount as the $136.4 million in 1971, but the notes as a percent of a much larger total budget dropped to 12.8% in 1982 compared to 34.4% in 1971. The need for Chicago to issue notes is caused by the state law that provides for property tax payments in the year following expenditure by the city. Three cities, Buffalo, Cincinnati, and Minneapolis, had bond anticipation notes outstanding at the end of 1982.

PROPERTY TAX COLLECTIONS

The 1973 ACIR report concluded that a low or falling rate of current property tax collections as a percent of current levy indicated potential financial problems. The report examined property tax collections in 1970 compared to collections made five years earlier in 1965.

A comparison of the 1982 collection rates with the 1970 rates shows the average collection rate for all cities is unchanged at 96.0% (see *Table 11*). However, of the 24 cities for which comparable information is available in both periods, nine improved their collection rates, and 15 had a lower percentages in 1982. All cities in 1982 had collections more than 90% of their levies, in contrast to 1970 when Chicago and Houston collected less.

Overall, the changes in collection rates from 1970 to 1982 are probably not significant. Many of the individual city changes are very minor (seven are less than 1 percentage point), and the others may be due to changes in tax administration, payment dates, or reporting practices rather than to changes in the quality of the tax base.

LOCALLY ADMINISTERED RETIREMENT SYSTEMS

In the 1973 report, "underfunded, locally administered, retirement systems" were found to pose an emerging threat to the financial health of local governments. The Commission recommended state regulation of local systems, the consolidation of local systems into state systems, or that states require substantial funding of such systems. The report also pointed to the serious lack of information about local retirement systems.

In 1979 the Advisory Commission on Intergovernmental Relations followed up on its concern with prob-

Table 12

30 Selected Major City Retirement Systems: Annual Benefit and Withdrawal Payments, As a Percent of Annual Receipts

City	Annual Benefit and Withdrawal Payments As a Percent of Annual Receipts 1970-71	1981-82	Percentage Point Change
New York	47.5%	47.6%	+0.1%
Chicago	52.7	45.6	-7.1
Los Angeles	43.7	46.8	+3.1
Philadelphia	66.4	57.2	-9.2
Detroit	48.0	35.7	-12.3
Houston	26.3	19.9	-6.4
Baltimore	50.3	47.5	-2.8
Dallas	23.0	45.6	+22.6
Cleveland		(No Local Systems)	
Indianapolis	102.0	97.1	-4.9
Milwaukee	26.5	21.0	-5.5
San Francisco	40.9	49.9	+9.0
San Diego	37.7	39.8	+2.1
San Antonio	33.3	36.1	+2.8
Boston	74.3	85.9	+11.6
Memphis	38.4	28.7	-9.7
St. Louis	36.4	29.1	-7.3
New Orleans	75.3	67.4	-7.9
Phoenix	16.3	26.8	+10.5
Columbus		(No Local Systems)	
Seattle	60.1	61.0	+0.9
Jacksonville	84.8	46.5	-38.3
Pittsburgh	95.0	98.1	+3.1
Denver	55.4	19.7	-35.7
Kansas City	23.1	26.1	+3.0
Atlanta	59.6	52.6	-7.0
Buffalo		(No Local Systems)	
Cincinnati	35.1	33.2	-1.9
Nashville	66.6	39.7	-26.9
Minneapolis	55.4	39.4	-16.0
Average of 27 Cities	50.9%	46.1%	-4.8%
National Average	49.4%	43.6%	-5.8%

SOURCE: U.S. Bureau of the Census, *1982 Census of Governments: Employee-Retirement Systems of State and Local Governments,* Table 9, 1983. For 1970-71 data, see U.S Bureau of the Census, *Finances of Employee-Retirement Systems of State and Local Governments in 1970-71,* Table 3, 1972.

lems of state and local pension systems by considering a staff study of their intergovernmental aspects and making a series of recommendations. It reaffirmed its support of state regulation and/or state consolidation of state and local retirement systems. The Commission also recommended improved reporting and disclosure of retirement system information to state-local pension commissions and to the public in general.[5]

Since 1973, many states have taken legislative actions to improve their supervision of local systems, or to consolidate them into state systems. Because of the New York default, there has also been an increased awareness of the need for cities to issue audited financial reports that provide better information about the status of local pension funds.

However, despite the improvement in financial reporting, it is still difficult to get comparable actuarial information about the funding of local retirement systems. Not only are different assumptions used for critically important variables in the different cities, such as inflation and rate of return on investments, but the actuarial calculations themselves are not uniform.

In the 1973 report, two measures based on Bureau of the Census information about local systems were used instead of actuarial information. The first measure was the net amount of payments from the local systems for benefits and withdrawals, shown as a percentage of receipts. The higher that this percentage of payments and withdrawals is to receipts, the less receipts there will be left to accumulate in the funds for future benefit payments. In 1971, benefit and withdrawal payments averaged just over half of all pension fund receipts in the 27 major city retirement funds. By 1982 this situation had improved—the percentage had dropped to about 46% (see *Table 12*).

Over the same period, 16 of the

27 cities improved their performance by this measure. These include Philadelphia, improved by dropping from 66% to 57%, New Orleans from 75% to 67%, and Nashville from 67% to 40%. The cities substantially increasing their payments as a percent of receipts were generally those with low percentages in 1971, such as Dallas, up from 23% to 46%, Phoenix, up from 16% to 27%, and San Francisco, up from 41% to 50%. An exception to the general trend is Boston whose payments increased from a high 74% to 86% of receipts. Two cities in 1982, Indianapolis and Pittsburgh, continued to pay out virtually all of their receipts on a pay-as-you-go basis.

The second measure of retirement system funding used in the 1973 report was benefit and withdrawal payments from the local fund as a percentage of the total assets of the fund. By relating payments to fund size, it is possible to make an evaluation of how well the system has been funded in past years.

This measure shows that several cities made very substantial improvements in their funding (see *Table* 13). For example, payments as a percent of the fund improved from 33% in 1971 to 16% in Philadelphia; from 30% to 15% in Jacksonville; from 19% to 4% in Denver; from 30% to 20% in Atlanta; and from 26% to 13% in Nashville. Only Boston, among those cities with a 1971 percentage over 10%, increased its percent in 1982 (from 17.0% to 27.5%).

The average funding performance for all cities improved from 1971 to 1982. When Indianapolis and Pittsburgh, which maintain no appreciable funds are excluded, the benefit and withdrawal payments in 1982 equalled slightly more than 10% of total assets, down from just over 12% in 1971. This means that the 1982 assets of these funds would be sufficient to meet benefit and withdrawal needs at the 1982 level for almost ten years,

Table 13

30 Selected Major City Retirement Systems: Benefit and Withdrawal Payments, As a Percent of Assets

City	Benefit and Withdarawal Payments As a Percent of Assets 1970-71	1981-82	Percentage Point Change
New York	7.8%	8.4%	+0.6%
Chicago	8.4	9.2	+0.8
Los Angeles	9.7	10.4	+0.7
Philadelphia	33.1	15.9	−17.2
Detroit	9.2	9.0	−0.2
Houston	5.7	5.0	−0.7
Baltimore	5.7	5.9	+0.2
Dallas	4.6	8.6	+4.0
Cleveland	(No Local Systems)		
Indianapolis	100.0+	100.0+	0
Milwaukee	3.2	3.9	+0.7
San Francisco	7.3	9.2	+1.9
San Diego	7.7	6.9	−0.8
San Antonio	8.2	12.5	+4.3
Boston	17.0	27.5	+10.5
Memphis	6.1	6.2	+0.1
St. Louis	5.9	5.2	−0.7
New Orleans	31.9	22.0	−9.9
Phoenix	2.7	4.7	+2.0
Columbus	(No Local Systems)		
Seattle	9.8	15.8	+6.0
Jacksonville	29.8	15.0	−14.8
Pittsburgh	100.0+	100.0+	0
Denver	18.8	4.1	−14.7
Kansas City	5.0	4.7	−0.3
Atlanta	29.7	19.7	−10.0
Buffalo	(No Local Systems)		
Cincinnati	4.3	5.5	+1.2
Nashville	25.8	13.2	−12.6
Minneapolis	12.4	10.7	−1.7
Average of 27 Cities	18.7%	17.0%	−1.7
Average of 25 Cities (excluding Indianapolis and Pittsburgh)	12.2%	10.4%	−1.8
National Average	9.3%	9.2%	−0.1%

SOURCE: U.S. Bureau of the Census, *1982 Census of Governments: Employee-Retirement Systems of State and Local Governments*, Table 9, 1983. For 1970-71 data, see U.S. Bureau of the Census, *Finances of Employee-Retirement Systems of State and Local Governments in 1970-71*, Table 3, 1972.

Table 14

Selected Major Cities' Payments to Local Retirement Systems
(in thousands of dollars)

City	1971-72	1981-82	Percent Change
New York	$463,823	$2,006,426	432.6%
Chicago	38,267	132,976	347.5
Los Angeles	105,593	367,683	348.2
Philadelphia	42,818	130,464	304.7
Detroit	90,383	276,500	305.9
Houston	8,037	49,937	621.3
Baltimore	15,825	24,797	156.7
Dallas	9,017	31,217	346.2
Cleveland	(No Local Systems)		
Indianapolis	4,883	13,182	270.0
Milwaukee	10,366	31,862	307.4
San Francisco	49,421	142,910	289.2
San Diego	8,003	27,823	347.7
San Antonio	1,916	8,002	417.6
Boston	22,013	81,772	371.5
Memphis	9,546	30,909	323.8
St. Louis	9,267	29,240	315.5
New Orleans	7,913	21,316	269.4
Phoenix	2,391	8,028	335.8
Columbus	(No Local Systems)		
Seattle	8,879	25,852	291.2
Jacksonville	3,579	29,259	817.5
Pittsburgh	3,515	10,457	297.5
Denver	NA	NA	NA
Kansas City	4,733	12,469	263.4
Atlanta	7,199	33,356	463.3
Buffalo	(No Local Systems)		
Cincinnati	6,197	20,248	326.7
Nashville	5,647	13,947	247.0
Minneapolis	13,830	39,198	283.4

NA = not available.

SOURCE: U.S Bureau of the Census, *1982 Census of Governments: Employee-Retirement Systems of State and Local Governments*, Table 9, 1983; for 1971-72, see U.S. Bureau of the Census, *1972 Census of Governments: Employee-Retirement Systems of State and Local Governments*, Table 8, 1973.

even if there were no additional receipts into the funds.

In general, with the exception of Boston and the pay-as-you-go cities of Indianapolis and Pittsburgh, both measures of retirement system financing show major cities improved their retirement financing. This is not surprising in view of the increase in city contributions for retirement costs in 1982 compared to 1972. Over this period, all the cities, except Baltimore, more than doubled their payments and 17 cities more than tripled their payments (see *Table 14*). Five cities, New York, Houston, San Antonio, Jacksonville, and Atlanta, increased their payments by an amount more than four times greater than their 1972 payments.

This study of city financial emergencies does not undertake further research into the problems of local pension systems for two reasons. The present ACIR investigations did not turn up any examples of financial emergencies in which pension funding was the cause of the emergency, or in which the financial emergency had a serious adverse impact upon an existing pension system. Secondly, there have been many investigations into the problems of state and local retirements systems during the decade since the first ACIR report on financial emergencies. Among the most important studies are the 1978 report of the House of Representatives Pension Task Force on Public Employee Retirement Systems,[6] and the major study prepared for the Housing and Urban Development Department by the Urban Institute.[7] This study included 20 supplementary working papers exploring specific issues relating to public pensions.

CONCLUSIONS

Among the 30 large cities, none in 1982 were showing a pattern of indicators that would suggest a financial emergency was likely to occur.

The 1973 report found that the quality of financial management was a key determinant in keeping cities out of financial emergencies. The experience of the major cities over the 1971 to 1982 period seems to support that conclusion. Many of the cities experienced one, or several years of serious budget imbalances, fund deficits, or lack of liquidity. However, by virtue of strong management action to bring their budgets back into balance, they overcame their problems. In the cases of New York and Cleveland, the management actions were taken only after the state intervened. In the other instances, the cities themselves recognized their problems and initiated the appropriate action.

Part of the current financial health of these cities is undoubtedly due to the improved accounting, reporting, and auditing that has occurred since 1971. Because of these improvements, the indications of financial problems are much more timely and obvious and the pressures to improve financial management are, therefore, harder for officials to avoid. Financial emergencies may still be caused by unexpected occurrences, but the likelihood of emergencies in large cities caused by persistent budget imbalances or other types of financial mismanagement seems diminished.

FOOTNOTES

[1]Some information from 1969 and 1970 fiscal years was used for comparisons, and in some instances, was substituted for 1971 information when it was not available. For simplicity, all of the information used from the original report will be referred to as 1971.

[2]The primary operating fund that contains all unrestricted revenues of the government. Although it is usually called the general fund, in a few instances, it has other designations.

[3]The pro forma basis used is the one developed for the 1973 reports. Assets were limited to cash, investments, and amounts due from other governments or funds. Liabilities include accounts payable, amounts due to other funds and governments, and encumberances. In some cases other minor additions or deductions were made, and in some cases information was not available to include all of the assets or liabilities.

[4]Memphis had an operating loan that was less than 0.5% of its budget.

[5]Advisory Commission on Intergovernmental Relations, *State and Local Pension Systems: Federal Regulatory Issues*, A-71, Washington, DC, 1980.

[6]U.S. House of Representatives, Committee on Education, *Pension Task Force on Public Employee Retirement Systems*, 95th Congress, 2nd Sess., March 15, 1978.

[7]The Urban Institute, *The Future of State and Local Pensions: Final Report*, Washington, DC, 1981.

Appendix A

Selected Major Cities' General Fund Excess or Deficiency of Revenues Compared to Expenditures, As a Percent of Expenditures

	1971[1]	1976	1981	1982
New York	−9.2%	−9.3%	0.9%	0.3%
Chicago	3.5	5.3	0.2	−2.4
Los Angeles	−1.9	2.1	0.7	2.5
Philadelphia	−10.2	−8.7	3.7	−3.1
Detroit	3.8	−3.1	−5.6	1.8
Houston	−3.3	1.4	7.1	NA
Baltimore	−2.2	−4.1	1.1	−1.2
Dallas	−1.0	3.9	1.1	3.4
Cleveland	−16.1	0.1	2.8	−4.7
Indianapolis	0.2	5.3	6.4	4.5
Milwaukee	8.6	−6.1	4.3	−5.6
San Francisco	2.6	−2.7	10.6	8.3
San Diego	3.2	6.2	4.6	−4.2
San Antonio	−0.8	−4.4	6.2	3.4
Boston	−1.0	−9.0	3.0	5.6
Memphis	4.2	−1.6	−0.7	2.5
St. Louis	−3.7	1.4	−2.9	−2.5
New Orleans	0	−5.7	−0.1	−2.6
Phoenix	−1.5	2.3	−2.1	2.0
Columbus	2.0	−0.2	−3.8	−1.1
Seattle	2.8	−3.1	−1.9	2.1
Jacksonville	−4.3	3.9	2.1	1.1
Pittsburgh	5.6	−3.8	6.3	6.4
Denver	4.8	3.8	−2.1	−2.8
Kansas City	−2.2	2.3	2.4	1.7
Atlanta	−3.4	2.1	−2.5	3.7
Buffalo	−7.3	0.3	2.6	6.6
Cincinnati	−0.9	−7.7	−2.8	−5.2
Nashville	5.9	4.2	3.3	−0.1
Minneapolis	2.6	0.4	2.4	1.0
Number of Deficiencies	16	14	10	12
Combined Deficit (−) or Surplus (in millions of dollars)	−$679.3	−$1,322.5	$340.4	$210.2
Excluding New York	−$23.1	−$154.2	$212.6	$169.0
Weighted Average	−5.6%	−6.8%	1.2%	0.7%
Excluding New York	−0.5%	−2.2%	1.5%	1.2%

NA = not available.

[1] From the 1973 ACIR report. Figures include some 1970 results in cases where 1971 data were not available.

Appendix B

Selected Major Cities' General Fiscal Condition, Balance or (Deficit)[1] As a Percent of Total Revenues

	1971	1976	1981	1982
New York	−9.2%	−31.1%	−0.5%	−0.2%
Chicago	−47.5	−24.8	−10.5	−10.6
Los Angeles	NA	NA	3.1	5.6
Philadelphia	−6.1	−10.2	4.4	1.7
Detroit	−3.7	−5.6	−16.2	0.4
Houston	10.8	7.4	15.5	NA
Baltimore	2.4	8.1	2.7	1.4
Dallas	4.3	6.7	6.9	7.0
Cleveland	−16.6	0.2	−7.4	−11.8
Indianapolis	4.5	2.7	3.8	6.0
Milwaukee	12.3	21.8	18.6	12.2
San Francisco	15.8	9.5	23.5	27.0
San Diego	7.3	8.3	8.6	6.1
San Antonio	5.7	−3.9	10.0	12.9
Boston	13.4	−10.7	−7.5	−4.7
Memphis	6.7	2.7	5.0	6.3
St. Louis	−2.9	1.2	0.7	−1.5
New Orleans	−1.2	4.5	8.4	5.4
Phoenix	4.4	3.0	0.1	2.4
Columbus	3.3	3.4	−0.2	−1.0
Seattle	22.9	1.3	6.3	8.7
Jacksonville	26.3	11.9	11.4	11.3
Pittsburgh	7.9	5.6	1.1	5.4
Denver	8.2	6.4	5.1	3.0
Kansas City	1.2	4.5	9.6	9.5
Atlanta	17.3	25.0	17.5	17.4
Buffalo	2.1	−15.0	−0.3	−2.6
Cincinnati	0.9	2.7	10.6	6.2
Nashville	6.3	16.9	6.3	5.8
Minneapolis	12.9	6.6	15.7	16.8
Unweighted Average	3.8%	2.0%	5.0%	5.0%
Number of Deficits	7	7	8	7

[1] Because of deficiencies in financial reporting, especially in 1971 and 1976, many balances or deficits are not in accordance with generally accepted accounting principles. Pro-forma adjustments were made to reported balances and deficits in some cases to make them more compatible with accepted accounting principles. For 1981 and 1982 balances, the undesignated fund balance was generally used, but in some cities it was referred to as unrestricted.

★U.S. GOVERNMENT PRINTING OFFICE 1985 526-186/30267

Advisory Commission on Intergovernmental Relations

April 1984

Private Citizens
James S. Dwight, Jr., Washington, DC
Robert B. Hawkins, Jr., **Chairman,** Sacramento, CA
Kathleen Teague, Washington, DC

Members of the United States Senate
David Durenberger, Minnesota
William V. Roth, Delaware
James R. Sasser, Tennessee

Members of the U.S. House of Representatives
Barney Frank, Massachusetts
Robert S. Walker, Pennsylvania
Theodore S. Weiss, New York

Officers of the Executive Branch, Federal Government
Lee L. Verstandig, Assistant to the President for Intergovernmental Affairs
Samuel R. Pierce, Jr., Secretary of the Department of Housing and Urban Development
Vacancy

Governors
Lamar Alexander, **Vice Chairman,** Tennessee
Bruce E. Babbitt, Arizona
Scott M. Matheson, Utah
Richard L. Thornburgh, Pennsylvania

Mayors
Ferd Harrison, Scotland Neck, North Carolina
James Inhofe, Tulsa, Oklahoma
Joseph P. Riley, Jr., Charleston, S.C.
Vacancy

State Legislators
Ross O. Doyen, President, Kansas State Senate
David E. Nething, Majority Leader, North Dakota State Senate
William F. Passannante, Speaker Pro Tem, New York State Assembly

Elected County Officials
Gilbert Barrett, Chairman of the Board, Dougherty County, Georgia
William J. Murphy, County Executive, Rensselaer County, New York
Sandra Smoley, Board of Supervisors, Sacramento County, California

what is acir?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, State and local government and the public.

Of the 26 Commission members, nine represent the Federal government, 14 represent State and local governments and three represent the general public. Twenty members are appointed by the President. He names three private citizens and three Federal executive officials directly and selects four governors, three State legislators, four mayors and three elected county officials from slates nominated, respectively, by the National Governors' Conference, the Council of State Governments, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The other six are Members of Congress—three Senators appointed by the President of the Senate and three Representatives appointed by the Speaker of the House. Commission members serve two-year terms and may be reappointed. The Commission names an Executive Director who heads the small professional staff.

After selecting specific intergovernmental issues for investigation, ACIR follows a multi-step procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts and interested groups. The Commission then debates each issue and formulates its policy positions. Commission findings and recommendations are published and draft bills and executive orders are developed to assist in implementing ACIR policies.

UNT LIBRARIES DENTON TX 76203