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VIEWPOINTS: Cities generally have alternatives to bankruptcy

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Last year's bankruptcy filing by the City of Vallejo and the prospect of bankruptcies of several other Bay Area cities has been a wake-up call for municipalities across the state.

California's cities are dealing with reduced revenue, generally caused by a reduction in local tax dollars collected. At the same time, the Legislature has elected to close the State's huge budget gap by taking about $2 billion from local governments. On top of all this, many cities and counties face increased expenses due to rising health care costs and pension obligations.

As with any business enterprise in a time of economic distress, the sooner leaders of California's cities, counties and special districts acknowledge looming financial shortcomings and work to address the fundamental problems, the higher the likelihood that bankruptcy can be avoided. And, while Vallejo will probably not be the only California city that ends up filing bankruptcy in the face of these dire economic times, municipalities can, and should, take pro-active steps to avoid being forced into insolvency.

In the private sector, bankruptcy can be avoided when an enterprise is able to sufficiently grow its revenue, reduce its expenses or achieve some combination of the two. The concept is the same in the public sector, although for a municipality this can be a particularly difficult task.

First, localities cannot create new revenue streams with the same agility as private businesses. Second, many municipal expenses are non-discretionary, which means a relatively small portion of their budgets have to account for a disproportionately large portion of cuts. Despite these difficulties, the municipality that can successfully implement a strategy of cutting costs while implementing new revenue measures

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places itself in a good position to avoid bankruptcy.

The significant increase in foreclosure rates and related reduction in real estate values will severely reduce local property tax collections. Additionally, public employee pension funds have not been immune to the declines in the stock market. And, as a result of complex agreements between cities and municipal employee unions, these losses in fund value will result in the requirement that local governments increase contributions into retirement funds at a time that revenues are on the decline. Changes in accounting standards to reflect other post-retirement costs will further darken the picture, creating a financial "perfect storm" for governments across the state.

As cities and counties increasingly struggle with the realities of budgeting with less when it is becoming more and more expensive to run local governments, there are a number of steps that leaders can take to reduce the impact on local residents. First and foremost, elected officials need to work with labor unions to reach compromises to restructure long-term collective bargaining agreements, ideally without loss of jobs or services.

Local officials also have opportunities on the revenue and liability management side that can help address the coming crisis. Depending on the nature of a city's or county's bonded indebtedness, local governments may be able to restructure certain long term financial obligations. This could be effectuated by refinancing existing debt or funding future pension requirements with pension obligation bonds.

Alternately, governments can look for existing revenue streams or municipal assets that might be leveraged to support new bonds to fund infrastructure needs and/or create resources for ongoing operations. For example, California cities could follow the Chicago's lead by contracting private sector companies to monetize municipal assets, such as parking system or toll projects.

Each of these alternatives, as well as myriad of other potential fixes, can help cities and counties try to avoid bankruptcy. However, there is also the possibility that competing interests become so inflexible that officials will be forced to take extreme measures to break the stalemate. This is where bankruptcies will occur: Not because decision-makers are predisposed to filing for bankruptcy protection, but because dire financial circumstances leave no alternative. If negotiations among each of the various interests fail, then only bankruptcy will bring all constituencies together to achieve a resolution for the benefit of the public.

Many well-known companies have successfully restructured through bankruptcy, though, including United Airlines, PG&E and, most recently General Motors. In the mid-1990s, Orange County became the largest municipal bankruptcy in U.S. history, and the county emerged from bankruptcy with revived fiscal health. In many situations, bankruptcy has been the vehicle through which a financially crippled entity was brought back to fitness.

It is crucial that decision makers not lose sight of their role as stewards of the public interest. In doing so, they should ensure that all options remain on the table as they pilot their local governments through these uncertain times.