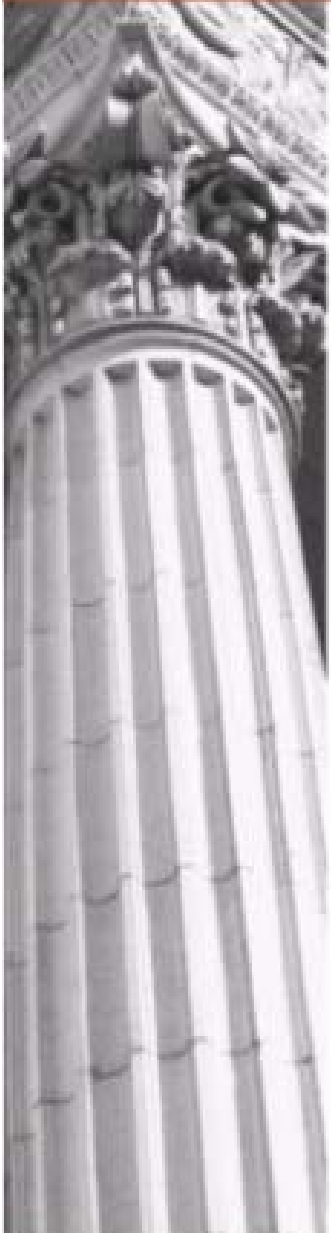




Financial Emergencies in Michigan Local Governments

Citizens Research Council of Michigan
Report 361

The full report is available at www.crcmich.org





Factors in Local Government Fiscal Distress: Revenues

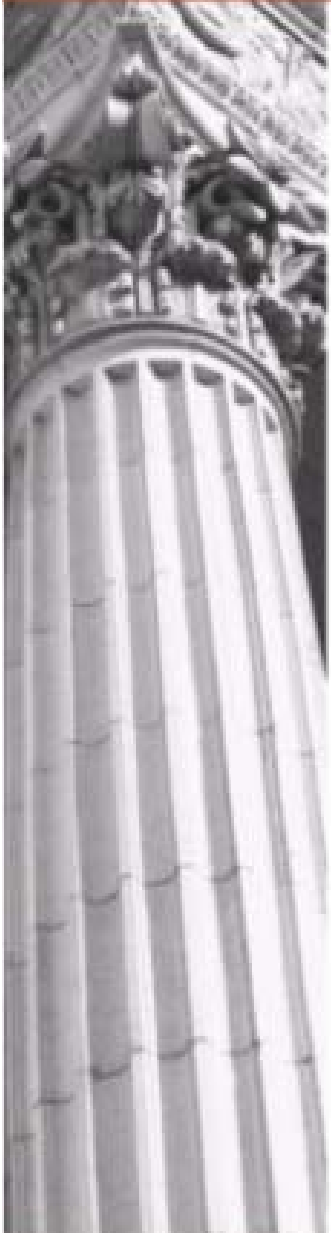
- **Reliance on the property tax (only 22 cities impose an income tax; Detroit also imposes a utility users' excise tax and a casino wagering tax)**
- **Erosion of the property tax base and restrictions on property tax growth (Headlee and Proposal A)**
- **Reduction or elimination of statutory state revenue sharing payments**
- **Exhaustion of fund balances**





Factors in Local Government Fiscal Distress: Spending Pressures

- Negotiated wage and salary increases
- Required pension funding due to declining value of pension fund assets
- Health care costs for active and retired employees
- Prior years deficits
- Required disclosure of the value of other post employment benefits (OPEBs)





Fiscal Options for Local Governments (Good and Bad)

- Use fund balances
- Seek voter approval of new or increased taxes
- Sell unneeded assets
- Defer purchases and maintenance; defer payments
- Lay off employees; negotiate furlough days
- Privatize functions
- Reduce or eliminate services
- Renegotiate contracts to reduce payments
- Consolidate functions with other governments
- Underfund pension obligations
- Accumulate increasing deficits
- Sell deficit elimination bonds





The Language of Fiscal Distress

State and local officials are using strong words (“insolvency,” “bankruptcy,” “receivership”), which may reflect their concern about the fiscal situation, but which are not technically accurate.





Definitions

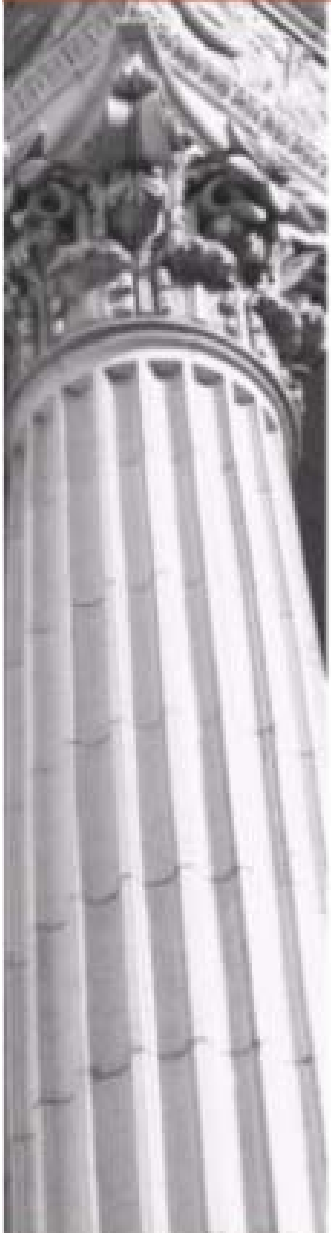
- **Cash Flow Insolvency:** the inability to meet debts when due
- **In Default:** the condition of failing to meet debt obligations, or make debt payments on the required date (generally cured by refinancing or renegotiating the debt)
- **Judgment Levy:** a court ordered property tax imposed by a local government to pay a creditor





Definitions

- **PA 72 of 1990: the Local Government Fiscal Responsibility Act, provides a process for identifying and managing a local government financial emergency**
- **Emergency Financial Manager: EFM, an individual appointed under PA 72 to manage the financial affairs of a local government**





Definitions

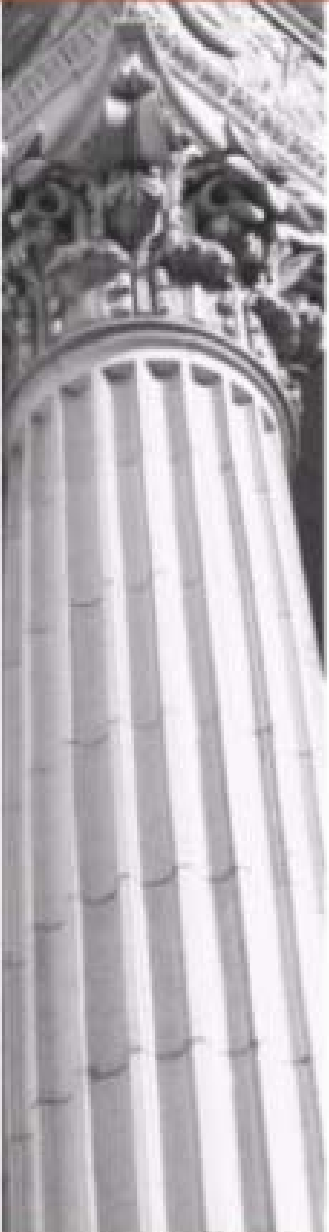
- **Municipal Bankruptcy:** a process available under Chapter 9 of Title 11 of the federal Bankruptcy Code that allows local (not state) governments to reorganize, and includes the authority to abrogate contracts
- **Receivership:** a form of corporate bankruptcy in which the court appoints a receiver to run the company and repay as much of its debt as possible





Relevant State Statutes

- **Uniform Budgeting and Accounting Act**
- **Emergency Municipal Loan Act**
- **Fiscal Stabilization Act**
- **Revised Municipal Finance Act**
- **Local Government Fiscal Responsibility Act**





The Local Government Fiscal Responsibility Act Process

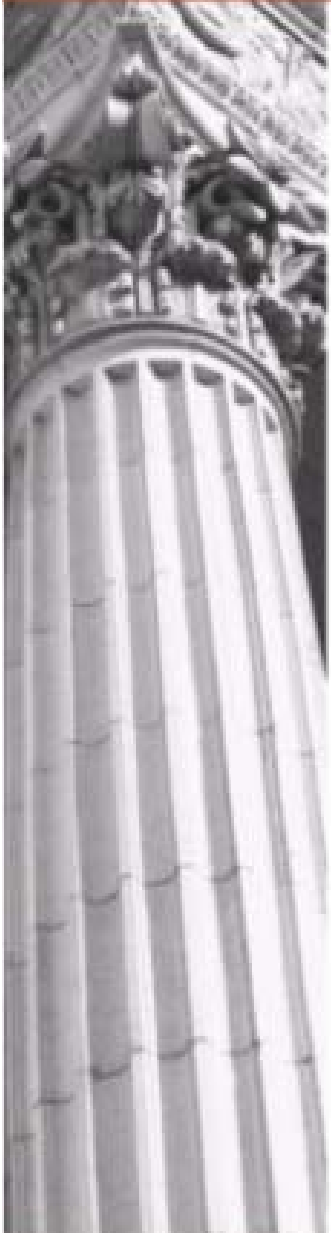
- Preliminary review to determine if a serious financial problem may exist
- Appointment of a Review Team
- Possible Review Team findings
 - No problem
 - Consent agreement
 - Financial emergency
- Assignment to Local Emergency Financial Assistance Loan Board (LEFALB)
- Appointment of an emergency financial manager
- Resolution of the financial emergency and return of local control





Triggers for a Preliminary Review by the State Treasurer

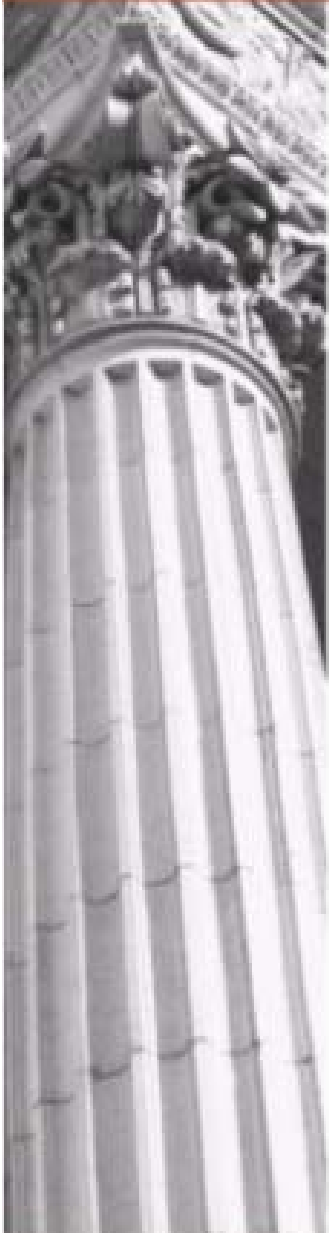
- Request by CAO or local governing body
- Request by a creditor, as defined
- Petition by registered electors, as defined
- Request by pension trustee, actuary, or 10% of pension beneficiaries
- Notification of failure to pay employee wages for 7 days after due date
- Notification of a bond default
- Request from the State Senate or House





Triggers for a Preliminary Review by the State Treasurer

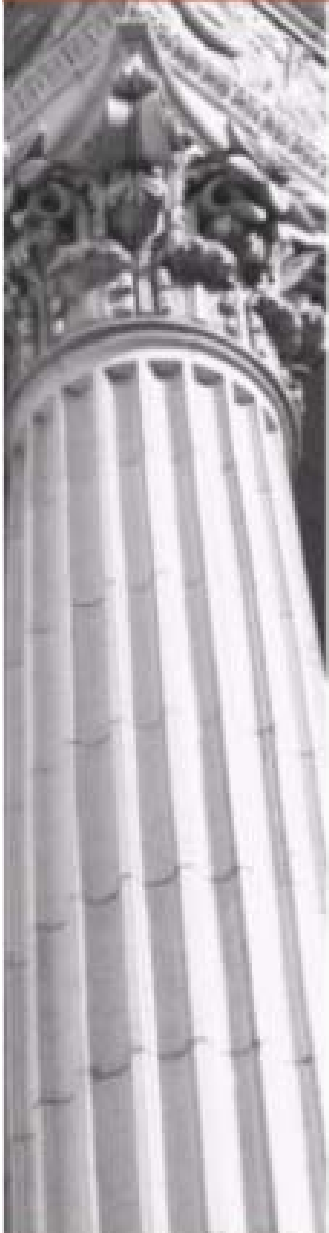
- Violation of orders issued concerning bonds or notes
- Violation of an order issued by LEFALB
- State treasurer reports a violation of the uniform budgeting and accounting act to the AG
- Failure to file a deficit elimination plan
- Failure to file an annual financial report or audit
- Request by another jurisdiction due to failure to distribute taxes collected for that jurisdiction
- Judgment levy was ordered without approval of the governing body





Conditions Indicative of a Serious Financial Problem (State Treasurers' Review)

- Default on bonds or notes, with insufficient funds to pay
- Failure for 30 days to transfer employee withholding taxes, taxes collected for another jurisdiction, or retirement contributions
- Failure for 30 days to pay employee compensation
- Accounts payable in excess of 10% of total annual expenditures
- Failure to eliminate a deficit within 2 years prior to year of review
- Projected deficit greater than 10% of budgeted revenues





Review Team Appointed by the Governor

Team members:

- **State Treasurer**
- **Auditor General**
- **Nominee of the Senate Majority Leader**
- **Nominee of the Speaker of the House**
- **Others with relevant experience**

**The team has 60 days for the review, with
a 30 day extension possible**





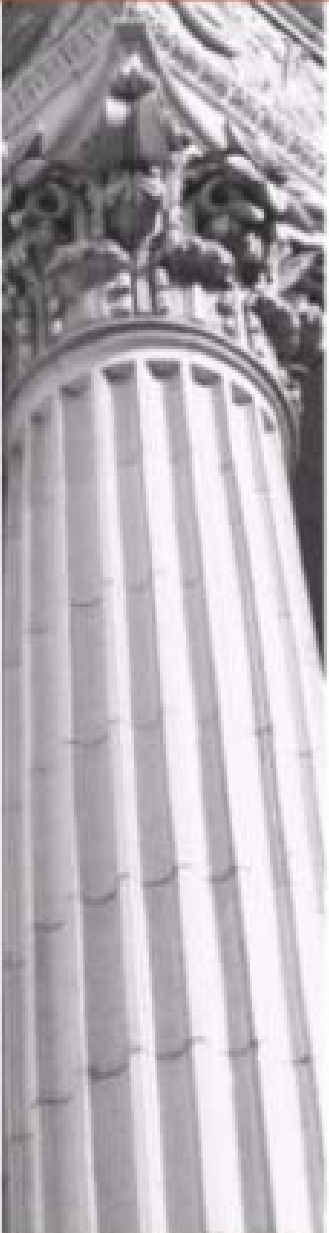
Possible Review Team Findings:

- A serious financial problem does not exist.
- A consent agreement has been negotiated that will resolve the financial problem.
- A financial emergency exists and there is no satisfactory plan to resolve it.

The Governor has 30 days to make a determination.

If an emergency exists, responsibility is assigned to LEFALB.

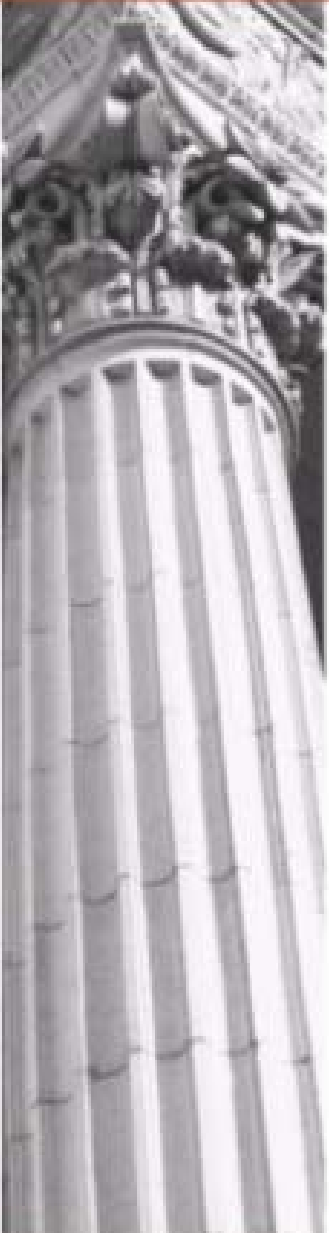
The LEFALB appoints an EFM.

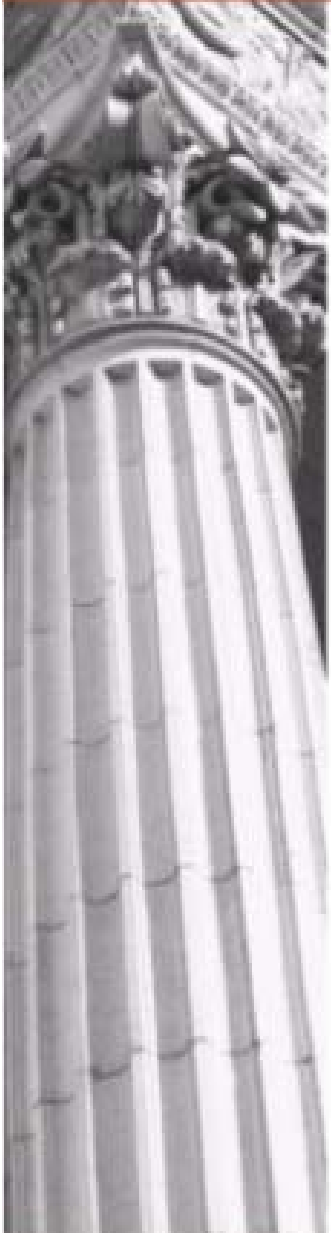




Appeal

- **The local government has 10 days to request a hearing conducted by the Governor or his or her designee.**
- **The local government may appeal to the Circuit Court**





Emergency Financial Manager

- Selected on the basis of competence
- Cannot have been an official or employee of the unit for at least 5 years
- Need not be a resident of the local government
- Entitled to compensation paid by the local unit
- May hire staff and contract for professional expertise, paid by the local unit
- Assumes the financial duties of the executive and legislative body



Emergency Financial Manager

- Has access to all records and reports
- Develops and implements a financial plan (this plan is to be made public, but does not require public approval)
- Exercises budget control
- Represents the local unit in collective bargaining
- Reviews payrolls and other claims before payment
- May consolidate departments, transfer functions, fire non-elected department heads



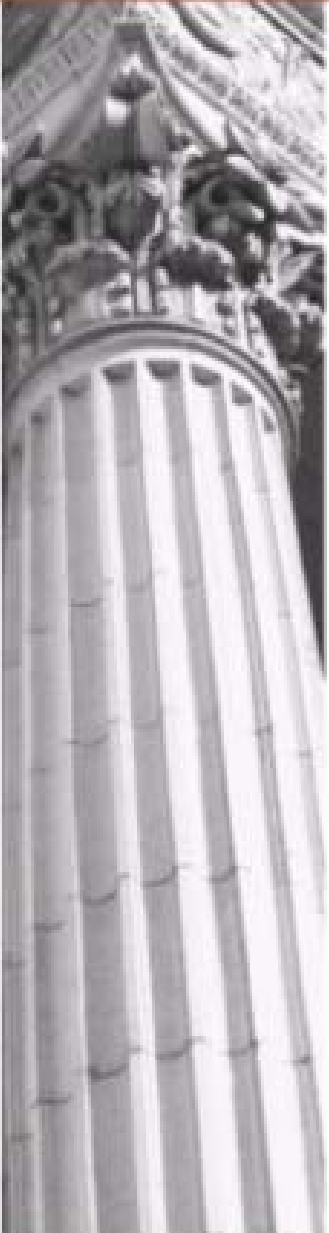
Emergency Financial Manager

- May sell assets if that does not endanger health and welfare
- May apply for an emergency loan from the state
- Must approve any bond sale
- May enter into intergovernmental agreements
- May eliminate the salaries of the executive and governing body
- Identifies and refers criminal conduct contributing to the financial emergency to the AG and prosecuting attorney
- Files semiannual financial reports as required



Emergency Financial Manager

- **May renegotiate, but may not abrogate, contracts including labor contracts**
- **May not raise taxes without the approval of the electors**





The EFM and Municipal Bankruptcy

- If an EFM is unable to resolve the financial emergency, he or she may request approval from the LEFALB to authorize the local government to file under Chapter 9 of Title 11 of the federal Bankruptcy Code.
- LEFALB has 60 days to approve or disapprove the request.
- This is the only way a Michigan local government can file for bankruptcy.
- No Michigan local government has ever filed for bankruptcy.





Municipal Bankruptcy

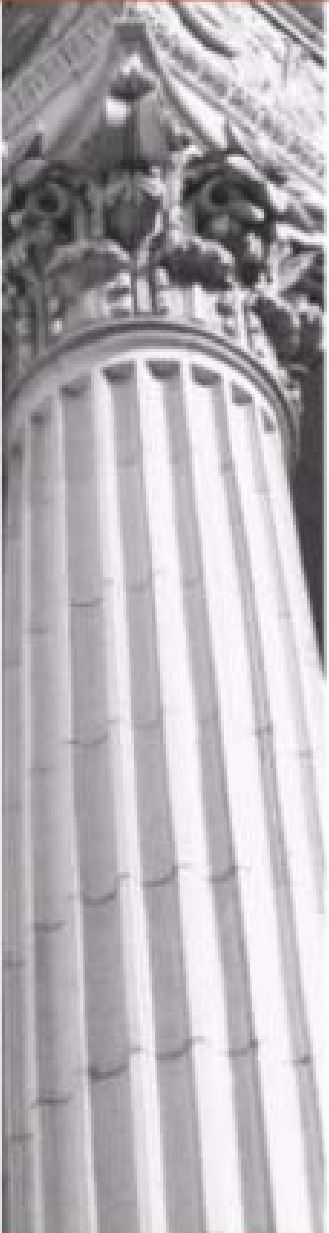
- **Increases risks for all entities associated with local government**
 - **Effect on credit ratings, access to credit markets, cost of future borrowings**
 - **Effect on union negotiations**
 - **Effect on contractual rights and obligations**
- **Expensive, contentious, and time-consuming**





Who Can File for Chapter 9 under Federal Law?

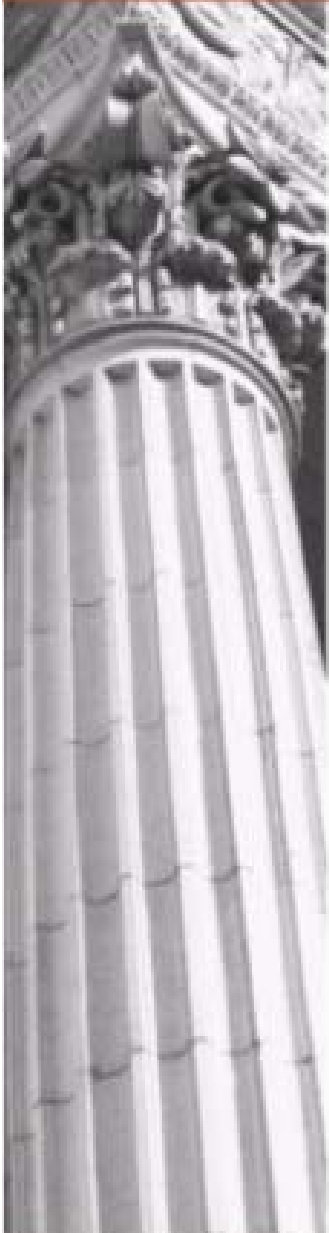
- **Must be a “municipality”-- a political subdivision or public agency or instrumentality of the state (includes MI townships, counties, authorities).**
- **Must have specific authorization from the state.**
- **Must be insolvent on a cash flow basis.**
- **Must file voluntarily.**





Who Can File for Chapter 9 under Federal Law?

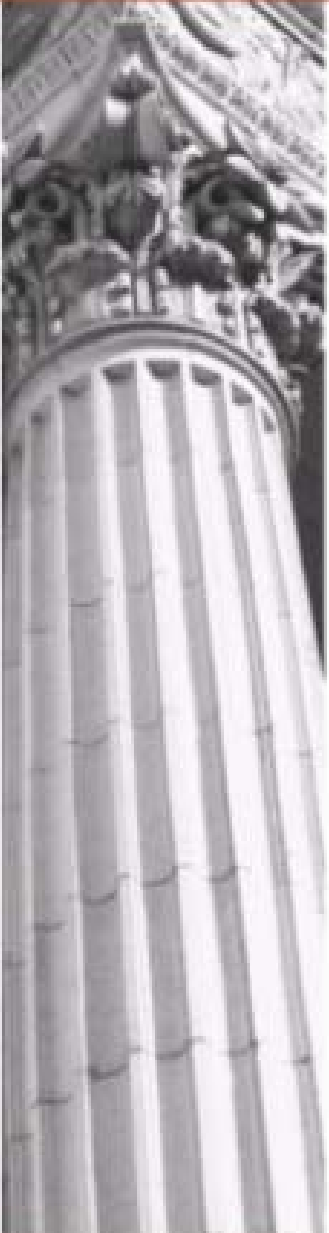
- **Must demonstrate one of the following:**
 - **Obtained approval of creditors holding a majority of the dollar value of claims in each class the debtor intends to impair**
 - **Negotiated in good faith but failed to obtain agreement of creditors holding a majority of the dollar value of claims in each class the debtor intends to impair**
 - **Is unable to negotiate with creditors because such negotiations are impractical**
 - **Reasonably believe that a creditor may attempt a preferential transfer (a payment larger than would be likely under bankruptcy)**





Municipal Bankruptcy

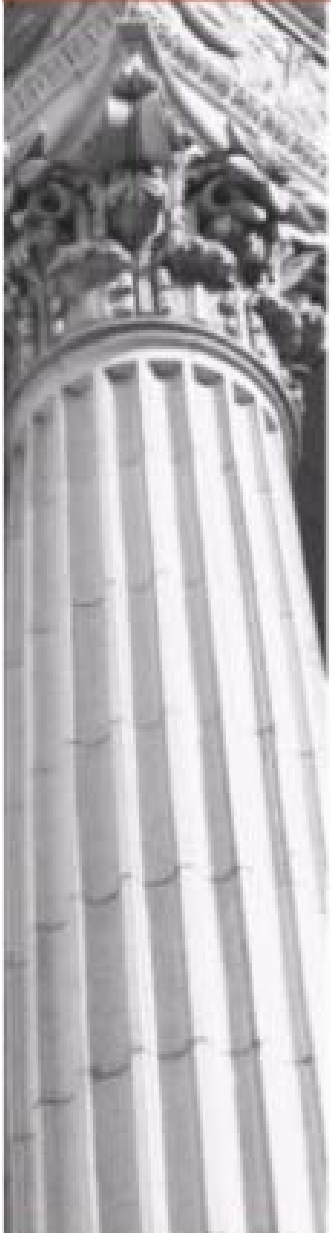
- **The local government does not “go out of business.”**
- **Not forced to sell assets.**
- **Not forced to raise taxes.**
- **No receiver is appointed.**
- **The local government (not the creditors) develops the plan of adjustment, and must obtain court approval of that plan.**





Municipal Bankruptcy

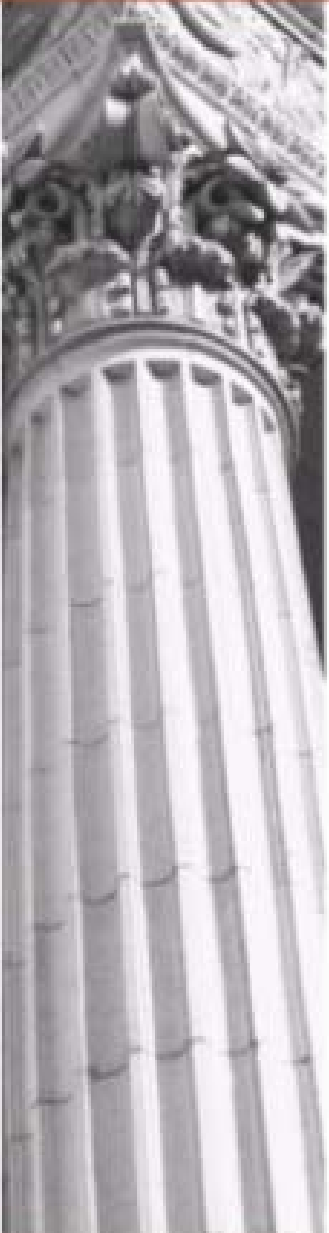
- **Not all classes of creditors have to approve the plan of adjustment (the court has “cram down” authority).**
- **May restructure and reorganize assets and debts, but...**
- **Debt that is guaranteed by a designated revenue stream is protected from reorganization.**
- **May abrogate contracts, including union contracts.**





Municipal Bankruptcy

- **Only Michigan and Pennsylvania both allow municipal bankruptcy and constitutionally guarantee the rights of local government employees to pensions they have earned.**
- **Bankruptcy has not been used to abrogate pension obligations that are guaranteed in state constitutions.**





Municipal Bankruptcy

- **The limited role of the court in municipal bankruptcy:**
 - **Approve the petition**
 - **Confirm the plan of adjustment (even if some classes of creditors object)**
 - **Ensure implementation of the plan of adjustment**





Other Possible Options (Good and Bad)

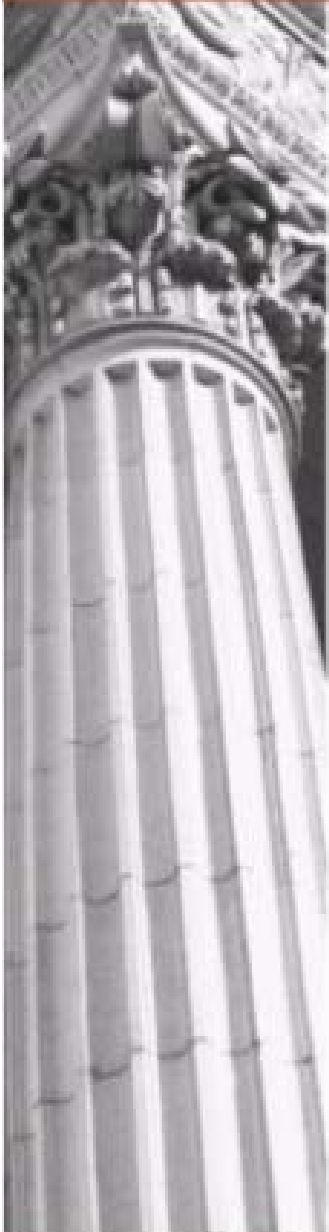
- State or federal bailout
- Amend PA 72
- Require troubled units to file frequent financial reports that necessitate accurate accounting and management information systems
- Advocate for local electors to approve a model charter
- Allow additional local taxing authority (would require local voter approval)
- Local government could enter into consent agreements that include court mandated judgment levies (no voter approval needed)





Other Options (Good and Bad)

- **Governor could remove for misfeasance local officials who violate state finance laws**
- **Dissolve the municipality, transfer existing taxing authority and service responsibility to the county or the state**
- **State could appoint a financial oversight board**
 - **Retain locally elected officials**
 - **Board would analyze and approve budgets**
 - **Board would approve major contracts**
 - **Board would monitor implementation of deficit elimination plan**





Who Should Bear the Burden of Resolving a Local Government Fiscal Problem?

Elected officials of the local government (removal, loss of authority over financial matters)

Employees of the local government (negotiated wage and benefit reductions, furlough days, layoffs)

Creditors of the local government (debt restructuring)

Taxpayers of the local government (tax increases, judgment levies)

Residents of the local government (closing facilities, service reductions)

Taxpayers of the region (sale of assets or transfer of responsibilities to a regional authority)

State government (PA 72 of 1990, appointment of a financial oversight board)

State taxpayers (state bailout)

Federal taxpayers (federal bailout)





Thank You

