Chapter 9 Bankruptcy: Simulation Exercise

Staff Paper

Observations By:
Eric Scorsone, Ph.D.
Nicolette Bateson, CPA
Amanda Wright

Department of Agricultural, Food and Resource Economics

Michigan State University
East Lansing, Michigan 48824

Notice/Disclaimer

This document is provided for research and educational purposes only. It is not intended to provide legal or financial advice or counsel and should not be construed as such to any of its readers. If legal or financial advice is needed, the appropriate licensed professional should be contacted. The content of this paper is introductory and written to familiarize the reader with issues surrounding municipal bankruptcy. Where clarification is needed, it may be useful to consult the original sources cited in the text. The case source data has been altered for the purpose of exploring Chapter 9 planning considerations. Accordingly, the data does not represent the actual financial condition or projections of any one particular city.

Table of Contents

Executive Summary

Cities facing a financial emergency from chronic fiscal stress need to understand Chapter 9 municipal bankruptcy. While not a cure for fiscal stress, Chapter 9 is a tool that a municipality may use to reset its financial course when all other methods fail. Several lessons learned through a simulation exercise using live case data prove beneficial to those charged with municipal fiscal health. From a legal perspective, the exercise revealed a need to address common misconceptions about Chapter 9. From a financial perspective, strategically planning to avoid a bankruptcy increases transparency while working through a checklist of alternatives. If those alternatives fail, the city is in a reasoned position to seek Chapter 9 relief.

Author Note

Amanda Wright is a J.D. candidate at Michigan State University (MSU) College of Law. She is a graduate assistant in the MSU Department of Agricultural, Food, and Resource Economics.

Nicolette Bateson is a certified public accountant in Michigan with more than 20 years of municipal finance and management experience. She serves as a visiting specialist at MSU researching municipal fiscal stress as well as providing educational programs for local government officials and their constituencies.

Eric Scorsone is a faculty member in the MSU Department of Agricultural, Food and Resource Economics and is an MSU Extension Specialist. Eric's experience as an economist includes planning, budget and policy analysis for both state and local government. He is a nationally recognized expert on municipal distress policies and strategies.

Direct correspondence regarding this publication to:

Dr. Eric Scorsone,
MSU Extension State and Local Government Program,
Department of Agricultural, Food and Resource Economics
90 Agriculture Hall
446 W. Circle Drive
Michigan State University
East Lansing, MI
48824-1039 USA

email: scorsone@msu.edu

Produced by ANR Communications. 12/6/2012.

Introduction

To better understand Chapter 9 municipal bankruptcy, Michigan State University conducted a simulation exercise based on historical data from a U.S. city. We present the lessons learned in this paper. In Part 1, we discuss legal considerations garnered from the simulation. That discussion presumes some basic understanding of Chapter 9. In Part 2, we identify financial analysis and planning strategies for the financially distressed city. In preparing the simulation exercise, it became evident that planning for, or preferably attempting to avert, Chapter 9 should begin without delay. The related financial analysis brings clarity to the magnitude of the fiscal hurdles and prepares stakeholders who bear the greatest risk. Appendix A to this paper presents a user-friendly explanation of Chapter 9. Appendix B provides example financial analysis and commentary for cities facing chronic fiscal stress.

Part 1: What Is Chapter 9? What Are the Legal Considerations?

Chapter 9 is basically a structured negotiation process in which a municipality proposes a plan of adjustment that its creditors vote on. If the plan meets the requirements of the bankruptcy code, the bankruptcy judge approves it. The plan of adjustment is essentially nothing more than a new contract between the debtor and its creditors.

Examining Chapter 9

Cash is Crucial: The pivotal factor in identifying Chapter 9 eligibility is a persistent cash flow shortage. Symptoms include lack of sufficient cash inflows, limited or nonexistent access to borrowing, and implementation of significant cost and service reductions.

Reducing and Planning for the Costs of Filing a Chapter 9: Since Chapter 9 can be a costly procedure, understanding how to reduce the costs associated with a Chapter 9 filing is critical.

Planning and Preparing for a Chapter 9: A municipality needs to plan properly to successfully file for a Chapter 9 bankruptcy. This involves examining the entire process to gain an understanding of it.

Managing a Municipality Throughout a Chapter 9 Proceeding: Municipalities should consider developing an advanced plan of financial management in case they need to file Chapter 9. A municipality should understand how to manage its finances during the Chapter 9 proceeding.

How Chapter 9 Differs From the Powers Granted by State-Appointed Authorities

Distinguishing Chapter 9 From Powers Granted to State-Appointed Authorities: Many states have enacted legislation that provides for state-appointed authorities to guide cities toward fiscal stability. Examples include the emergency financial control board in the New York State Financial Emergency Act, Pennsylvania's Intergovernmental Cooperation Authority, and the emergency financial manager in Michigan's Local Government Fiscal Responsibility Act. While the powers granted in these statutes vary, in general, they fall short of the financial restructuring tools available in Chapter 9. Understanding the differences between Chapter 9 and each state's laws is critical to planning purposes.

The Automatic Stay: Chapter 9 allows a municipality to utilize the automatic stay, protecting it from creditor claims or litigation, and giving it a "breathing spell" while it adjusts its debt. In contrast, while adjusting debt under a state authority, a municipality will need to pay its bills, and may face litigation if it is unable to pay its creditors in a timely manner.

The Advantages of One Forum for All Claims: Chapter 9 offers the advantage of having all parties and all claims in one forum before a single judge.

The procedure brings all parties to the negotiation stage and prevents certain parties from "holding out for more." When municipalities negotiate with their creditors outside of a Chapter 9, they face the risk that multiple groups of creditors will continue to demand or hold out for a better deal.

The Aid of an Expert in Bankruptcy and Fiscal Reorganization: Chapter 9 offers the advantage of utilizing a bankruptcy judge. The bankruptcy judge who presides over a Chapter 9 proceeding, while not necessarily experienced in Chapter 9, will be experienced in fiscal issues and debt reorganization. The judge can often act as a mediator and exert pressure on creditors to make concessions.

The Elimination of Constitutional and Other Challenges to Rejection of Contracts: Debt adjustment under a state-appointed authority will likely subject the municipality to litigation as creditors contest the state appointee's authority to take certain actions. Negotiations outside of a Chapter 9 proceeding often lead to creditors filing lawsuits, which diverts time, money and energy away from the real issues while the municipality continues to try to provide services to its citizens. Under Chapter 9, a municipality has the clear authority to modify, assume or reject executory contracts, and these actions will not be subject to constitutional challenges outside of the bankruptcy proceeding while adjustment takes place.

Why Preparatory Work Is Needed Before Filing a Chapter 9 Petition

Eligibility Requirements

a. Be a Municipality.
b. Be Authorized by State Law.
c. Be Insolvent.

(We describe a municipality as "insolvent" when it has a cash flow shortage or will run out of cash within the next fiscal year. The municipality is generally not paying its debts as they become due or will be unable to pay its debts as they become due.)

d. Desire to Effect a Plan of Adjustment, AND *either*

(i) Obtained an agreement with the majority of creditors, or
(ii) Negotiated in good faith, but failed to obtain an agreement, or
(iii) Found negotiations impracticable.

These eligibility requirements make it critical for a municipality to engage in certain preparation actions before filing a Chapter 9 petition as the eligibility requirements are a critical threshold issue of a Chapter 9 case.

In light of these eligibility requirements, we recommend a municipality that may be forced to file for bankruptcy engage in a meticulous review of certain pre-filing requirements before filing, which include, but are not limited to, the following:

- Do we have state authorization?
- Do we have a draft plan of adjustment that we believe will allow us to continue to provide services to our citizens, and return us to and sustain financial solvency?
- Is our draft plan of adjustment supported by at least one class of our creditors and will the state support this plan?
- Have we attempted to negotiate with creditors about a meaningful plan of adjustment, or are negotiations impracticable?
- Have we kept meaningful records of our negotiations with creditors to prove we have negotiated in good faith?
- Do we have a financial management plan to put to use while our Chapter 9 case is pending?
- Have we budgeted for the administrative costs of a Chapter 9 bankruptcy?

Because the eligibility requirements are so important to the filing of a successful case, and careful pre-planning can reduce the cost and time spent on litigating these requirements, ideally, a municipal official or representative would be responsible for documenting and keeping accurate and complete records of these considerations.

A municipality that may be forced to file Chapter 9 bankruptcy must begin to draft a plan of adjustment. Key to the success of the plan of adjustment is the focus on at least five-year planning. The plan is usually implemented over a period of about five years, and it must maintain – not merely attain – financial solvency.

Important Note: While tax increases and asset sales are viable fiscal strategies, these actions are not required as a prerequisite to obtaining access to a Chapter 9 proceeding.

Policy Considerations

Transparency & Honesty: An important policy consideration – and perhaps a point of contention – is the extent of a municipality's transparency with its creditors and with its residents about the reality of filing a Chapter 9. Experts generally agree that a municipality should provide accurate financial information to its creditors.[1] Additionally, recall that one of the requirements to enter bankruptcy is good faith negotiations surrounding a plan of adjustment that could be executed under a Chapter 9. Without transparency as to the fact that Chapter 9 is the alternative to unsuccessful negotiations, a municipality could potentially fail the good faith negotiations test and be denied access to a Chapter 9. Lastly, many municipalities have successfully utilized the "threat" of a Chapter 9 proceeding to bring creditors to the negotiation table and force them to make concessions. Ultimately, the extent of a municipality's transparency about a potential filing is a key point of consideration. Ideally, all municipal officials and representatives should be aware of the reality of filing a Chapter 9 as it applies to their municipality and should agree on the level of transparency to the public and to creditors alike.

Public Relations & Press: A municipality that files a Chapter 9 will receive a lot of attention from the media. The municipality's representatives and officials must be knowledgeable about the proceeding and prepared to answer challenging questions from the public and the media. Lastly, because the public is very familiar with a Chapter 11 proceeding, municipal representatives and officials should be well versed on the key distinctions between these two proceedings to answer frequently asked questions knowledgably. For example, municipalities should be prepared to formulate accurate and consistent answers for questions, which include, but are not limited to:

- Why did the municipality file for Chapter 9 protection? And how is bankruptcy going to help?
- How are vendors impacted by the bankruptcy filing?
- How will the bankruptcy case affect my municipality's ability to provide services to me as a taxpayer and resident?
- What has the municipality done to increase revenues or to avoid bankruptcy?
- Will the municipality be forced to liquidate all its assets?
- Was the municipality forced to file for bankruptcy by its creditors?
- Who does our municipality owe money to?
- What will happen post-bankruptcy? How will this affect our municipality's ability to attract new businesses?
- I am a retiree, why am I a creditor of the municipality? How will I receive notice of how my rights are affected?
- How will pensions be affected?
- How long will the municipality be in bankruptcy?
- Who can I contact for more information?

Loss of Power: A disadvantage of a Chapter 9 proceeding is the lack of control of the outcome from a political standpoint. For example, outside of a Chapter 9, some states retain control over the appointed authority. However, once in bankruptcy, some political power to control at least the outcome is ceded to the bankruptcy judge.

Secured Versus Unsecured Creditors

Special Revenue Versus General Obligations: Generally, a municipality has two types of bonds under a Chapter 9 bankruptcy: general obligation bonds and special revenue bonds. The municipality issues general obligation bonds secured by its full faith and credit. Special revenue bonds are treated differently because these obligations are secured by some specific pledge of revenue, usually the profit retained from the operation of a special project such as a toll road. Under Chapter 9, this kind of debt is not subject to the automatic stay and is not able to be impaired. However, nothing in the bankruptcy code compels a municipality to continue running a special project, and

[1] Knox, John and Levinson, Mark, Avoiding and Using Chapter 9 in Times of Fiscal Stress. 2009.

creditors (i.e., special revenue bondholders) are only entitled to payments from profit less the operating expenses of the special project. Therefore, sometimes this secured debt becomes unsecured, and special revenue bondholders have an incentive to compromise and voluntarily agree to adjustment of their debts.

Managing a Municipality Throughout a Chapter 9 Proceeding

Decide Which Vendors and Which Bills Need to Be Paid: A municipality that enters bankruptcy manages its funds much like any other business that declares bankruptcy. The municipality must decide which vendors to pay and which not to pay. A municipality must plan and adopt a budget under a Chapter 9 proceeding because the bankruptcy judge will not instruct vendors to continue to provide services, will not give the municipality money and will not take control over the municipality's day-to-day operations. A municipality must decide which services it can live with and which services it cannot live without. Vendors and suppliers might also require some proof the municipality will pay any missed payments during the Chapter 9 proceeding if the entity continues to provide services or supplies to the municipality. A municipality should consider that its payroll expenses are likely one of its largest expenses. It can immediately stop paying retiree health care due to the automatic stay, which will free up some cash as the municipality budgets to provide services throughout a pending Chapter 9 case.

Budgeting for Litigation Expenses: Filing a Chapter 9 bankruptcy is costly. Professional fees and other services from two recent bankruptcy cases in other states accumulated to amounts exceeding $3.5 and $10 million dollars. A municipality considering bankruptcy must budget for the administrative costs of the procedure. For the bankruptcy judge to approve the plan, the municipality must show it will pay all administrative costs of the proceeding.

Part 2: Financial Considerations

A long-term financial strategy remains important for any municipality for numerous reasons. Municipalities must weather changes in the economy, provide desirable services, invest in infrastructure and operate within revenue constraints. For the local government in financial distress, the need for a long-term financial strategy becomes a pivotal process. Municipalities should design such a strategy to avert the need for a Chapter 9 bankruptcy. When other efforts cannot overcome unsustainable commitments, then Chapter 9 becomes a tool to reset the municipality's financial course.

Quantifying the Scope of the Problem

Understanding the depth of unsustainable commitments is essential to determining a corresponding financial strategy. This section of the report provides a road map to quantify the scope of the problem through a series of analyses to evaluate cash solvency. The data are based on a case study city where the analyses were subjected to a bankruptcy simulation exercise. We present key concepts below with reference to explanatory exhibits in Appendix B. Depending on the city and its fiscal stressors, additional types of analyses will be necessary. This section identifies proposed metrics that go beyond the information found in audited financial statements. Use the metrics as a starting point to identify the existence of a severe cash and service-level solvency problem.

Evaluating Cash Solvency

Five-Year Financial Plan: No meaningful discussion of solvency can begin without a long-term view of the entity's cash flow (Exhibit B1). This should be the first step in identifying the scope of the potential insolvency.

Cash Flow by Fund: Most municipalities utilize a pooled cash fund, which is an effective cash management tool. However, the individual fund cash balances may be overlooked, even when a cash deficit exists. Municipalities need cash flow analyses by fund (Exhibits B2 and B3) to monitor solvency conditions to a) avoid masking insolvency, b) avoid placing an overreliance on internal fund borrowing, and c) assure that municipalities use financial resources for their intended purposes.

Managing Risk: Municipalities should prepare a cash flow analysis for each fund. While the emphasis on the general fund is obvious, municipalities must also analyze other funds essential to the public's health, safety and welfare, such as enterprise utility funds.

Identifying the Options

List of Creditors: Even though the city leaders know who the creditors are, the management team should assemble a list of creditors in a format used in a bankruptcy proceeding to identify the parties at risk and quantify their exposure (Exhibit B4). This information shapes strategy in addressing chronic fiscal stress as well as educating stakeholders.

What-If Analysis (Plan of Adjustment): After the municipality develops the initial five-year plan (Exhibit B1), it should adjust the plan for realistic revenue enhancements and cost reductions. As the municipality explores additional alternatives, it updates the plan and various versions become what-if scenarios. If a structural cash deficit is projected to continue, and other reasonable options are unlikely, the city reviews the creditors list (Exhibit B4) to identify potential creditor adjustments to work into the plan. This step in the analysis moves the five-year plan into the development of a proposed plan of adjustment (Exhibit B5). Municipalities in financial emergencies should begin this process as part of developing a strategic plan to address the crisis. This process provides an important reality check on the depth of the structural budget problem.

Developing Objectives: Whether it is a five-year plan for restructuring or a proposed bankruptcy plan of adjustment, the municipality (and its stakeholders and residents) should identify feasible objectives. In developing this case study, the authors offered the following objectives for this process: 1) restructure liabilities to provide an acceptable level of services within the available resources; 2) exit the bankruptcy process with a financial plan and controls to mitigate overextending the municipality's financial obligations again in the future; and 3) seek a plan that is responsibly committed to funding the adjusted obligations.

Understanding Labor Costs

Pension Warning Signs: The actuarial report can reveal concerns about a municipality's fiscal condition and solvency that go beyond the footnote disclosures in the audited financial statements. Exhibit B6 shows key data related to pension funding; Exhibit B7 shows annual cost data. Warning signs include a) low funded percentages, b) "reserve" for employee contributions and current retiree obligations exceeding available assets, c) market value of assets being materially less than actuarial value of assets, d) rapidly increasing contribution rates, e) negative net cash flow on an annual basis (i.e., retiree payouts exceed employer contributions), f) number of retirees significantly exceeding actives indicating maturity of plan, and g) rapid decrease in active payroll (signaling changes that will affect the funding assumptions). While individually these conditions may have reasonable explanations, in total, these factors depict a vulnerable pension system that will further strain resources to be sustainable.

OPEB Sustainability: State and local governments increasingly target the OPEB (other postemployment benefits) liability for retiree healthcare as a source of cost restructuring. Developing a strategy to address these costs means understanding a) the amount of liability related to current employees versus retirees, b) the extent to which the group is pre-Medicare versus Medicare eligible, c) which employee groups are leaders and/or carry critical mass to negotiate a change, d) the number of actives to retirees, e) how to communicate the scope of the problem to stakeholders and f) the financial impact of OPEB on governmental versus enterprise funds. Exhibits B8 through B12 provide sample analysis for each of these issues.

Staff Reductions Versus Budget Reductions: Decreased staffing levels often do not equate to a corresponding decrease in personnel expenditures. The combined effect of vested legacy benefits and direct reimbursement for unemployment negates some of the budgetary impact of workforce reductions. While decreasing staffing levels reduces the budget, the number of eliminated positions needed to bring about significant budgetary change becomes more unrealistic to continue providing services. Exhibits B13 and B14 explain this relationship.

Providing Services

Service Providers: Often fiscally troubled cities that encounter a decrease in population and resulting workforce reductions do not experience a decrease in workload. For example, the city in fiscal crisis is often nationally noted for having a higher violent crime rate in the United States for cities within its population category. Police response times, case closure and crime prevention are a source of frustration for city residents and property owners. Other city services, even if funded by federal grants, have suffered due to personnel reductions.

Infrastructure and Capital Reinvestment: A realistic financial plan should quantify and address capital needs. The simulation city does not have an inventory of infrastructure needs.

Service Level Solvency: Simply focusing on the numbers will not address the long-term health of the municipality, dependent on attracting and retaining residents and businesses. Chapter 9 is only a tool to address a one-time financial restructuring. The challenge is crafting a comprehensive plan for true long-term sustainability. That task goes beyond the administration to include constituents, intergovernmental players and the private sector.

Managing the Fiscal Problem

Earlier recommendations to address the financial crisis include identifying stakeholders, developing a communications plan, documenting negotiation efforts, and budgeting resources to evaluate and potentially pursue Chapter 9. Other recommendations from the simulation event include the following:

Seek alternative revenues sources and cost reductions to demonstrate effort to avert bankruptcy (i.e., income tax, Headlee override and benefit changes).

Use an actuary to cost out OPEB and pension benefit changes in advance to gauge effectiveness of cost control efforts.

Understand the potentially severe implications of ignoring the problem. Public officials may face sanctions if a municipality is forced to pursue bankruptcy to avoid breaching contracts, missing debt service payments or failing to provide required levels of service as a result of cash deficits.[2]

Developing Metrics

In preparing the simulation case study, the authors identified some metrics that appeared to be effective in conveying the severity of the case study city's potential insolvency. They include:

Percent of General Fund Budgeted for Actual Current Retiree Premiums: The simulation city needs $9M out of the $57M general fund budget to pay that fund's share of current retiree premiums (equivalent to 16 percent).

Market Value of Assets as a Percent of Reserve Needed for Current Retirees Benefits and Employee Contributions: In the simulation city, this approximates 54 percent ($850M reserves needed divided by $460M assets) identifying the pension underfunding for existing retirees.

Number of Months that the Fund is in a Cash Deficit: In the simulation case, the city's general fund is estimated to have been in a cash deficit position for at least 24 to 30 months or longer. Proving this issue is pivotal to acceptance of the Chapter 9 filing.

[2] Id.

Conclusion

Municipalities can learn two overriding lessons from this simulation. First, many common misconceptions exist about Chapter 9's role in municipal financial restructuring. Second, strategic financial planning efforts are essential to addressing financial stress to avert, or alternatively be prepared for, Chapter 9.

Preventing a structural fiscal crisis hinges on quantifying fiscal realities on a multiple-year basis in advance. Further education on the legal and financial considerations would benefit public officials charged with managing fiscally stressed municipalities.

APPENDIX A:
Educational Handout

Chapter 9: Municipal Bankruptcy

Chapter 11 Versus Chapter 9: The Basic Distinctions

Chapter 9 differs from Chapter 11 in many ways. Many of these differences stem from the requirements of the 10th Amendment and state sovereignty.[1] First, the filing of a Chapter 9 petition must be voluntary. Many people, being familiar with Chapter 11, might think that if their state authorizes municipalities to file a Chapter 9 bankruptcy, that a city's creditors will force it into bankruptcy; this is simply not allowed under Chapter 9. The voluntary requirement is unlike a Chapter 11 case in which three or more creditors may force a debtor into bankruptcy.

Next, the ability of any party, other than the debtor, to propose a plan of adjustment is nonexistent; only the debtor may propose a plan of adjustment in a Chapter 9 proceeding. While the plan of adjustment must be voted on by the creditors and approved by the court, the municipality will not lose control of its future planning because only the municipality can submit the plan of adjustment to the court for approval.

In general, the court and the judge take a "hands-off" approach and will not interfere with the municipality's use and enjoyment of its property, or otherwise become involved in the municipality's day-to-day operations without consent of the debtor. Residents and municipal personnel alike worry that the judge will order the city to increase taxes or lay off workers. While the judge can help exert influence over the parties to reach a compromise, a judge will generally not order a municipality to do something that affects the municipalities operations because this would interfere with state sovereignty.

In addition, the judge who presides over the case is not selected at random as in a Chapter 11. Rather, the chief judge of the Court of Appeals for the Circuit designates the bankruptcy judge from the judges within

[1] Glassman, Paul R. A Practical Guide To Chapter 9 Municipal Bankruptcy. 2011 WL 5053642 (ASPATORE) at 3.

Points of Interest:

- Chapter 9 has several distinguishing features from a Chapter 11 bankruptcy.
- Only about 600 Chapter 9 cases have ever been filed.
- Chapter 9 offers the advantage of having all creditors and issues before one judge.
- The eligibility requirements of a Chapter 9 case are highly contested in litigation.
- Preparing for a Chapter 9 case in advance can save litigation time and costs.

Use this handout only for educational and research purposes to aid in a bankruptcy simulation. It is not meant to be legal advice. If you need legal advice, contact a licensed attorney.

Contents

The City of Vallejo, California, filed for a Chapter 9 bankruptcy in 2008 and spent two years litigating eligibility requirements.

the circuit. A Chapter 9 bankruptcy offers the opportunity for an appointment of a qualified judge with enough time to handle the complex issues that will arise in a Chapter 9 filing.

Finally, a Chapter 9 case has no liquidation provision. A municipality cannot be forced to sell its assets and distribute the profit to its creditors. However, a municipality may choose to sell assets if it wants to. Most people are familiar with a Chapter 11 bankruptcy in which there is a liquidation provision that forces the company or business to sell off all of its assets. Residents worry that if a city or town goes bankrupt, it will be forced to sell the library, city hall or the hospital, if the municipality owns such assets. While selling assets or at least researching their value may be a fiscal strategy the municipality uses, it will not be forced to sell any of its assets.

The Gatekeeper Requirements: Chapter 9 Eligibility

In order to commence a case under Chapter 9, a municipality files a petition with the court. Usually, creditors file objections to the petition, claiming that the municipality does not meet the eligibility requirements. Creditors want to keep a municipality out of bankruptcy because after a municipality gains access to a bankruptcy proceeding, the creditors lose significant control over their claims. The municipality bears the burden of proving that it meets each of the four eligibility requirements listed under 11 USC 109(c)(1)-(4) and at least one of the four requirements listed under 11 USC 109(c)(5). Therefore, eligibility becomes a critical threshold issue in bankruptcy and is essential to a successful filing.

Since often creditors will vehemently contest eligibility, knowledge of the eligibility requirements and careful pre-planning can minimize litigation time and costs. Additionally, the court leans toward allowing a municipality access to bankruptcy because it gives the municipality a chance to successfully readjust its debts.

For simplicity, we'll categorize the first four requirements as the "Gatekeeper Requirements" because creditors who are trying to keep the municipality out of bankruptcy vehemently contest these requirements. We'll categorize the second four requirements as the "Creditor Negotiation Tests" because nearly all of these requirements have to do with negotiation and only one of them must be met.

The Four Gatekeeper Requirements

As previous stated, the municipality must meet each of the four eligibility, or Gatekeeper Requirements. The four Gatekeeper Requirements are listed under 11 USC 109(c)(1)-(4) of the bankruptcy code. Under these requirements an entity must (1) be a municipality to be eligible for relief under Chapter 9, (2) be authorized by state law to file for Chapter 9 bankruptcy relief, (3) be insolvent, and (4) desire to effect a plan of adjustment. The following section further explains each of these requirements.

Must Be a Municipality and Must Be Specifically Authorized by State Law

An entity must be a municipality to be eligible for relief under Chapter 9. The bankruptcy code defines a "municipality" as a "political subdivision or public agency or instrumentality of a State."[2] To decide if an entity is a municipality, one court used a three-part test looking at (1) whether the entity has traditional government attributes or engages in traditional government functions, (2) if so, whether there is state control, and (3) whether or not the state categorizes the entity as a municipality.[3] Generally, a political subdivision typically includes such entities as cities, counties, townships or towns, while public agencies are "state-sponsored or controlled" authorities or entities that raise revenues through taxes.[4]

A municipality must be also be authorized by state law to file for Chapter 9 bankruptcy relief. The authorizing statute must be explicit, written and exact, plain and "direct with well-defined limits, so that nothing is left to inference or implication."[5] Courts will no longer find "general authorization" to file for Chapter 9 bankruptcy by inference from the general powers that a municipality possesses.[6] For example, authorization will not be found in states that generally allow municipalities to sue or be sued, to control finances or to be debtors.[7]

Must Be Insolvent

The municipality must be insolvent.[8] The legal test for insolvency under Chapter 9 is not a traditional balance sheet test. Some municipalities may find this problematic including those that may not run out of money immediately but face extreme financial hardship and high legacy costs not yet realized.[9] However, a municipality need not wait until it runs out of money to file a Chapter 9 proceeding, but must demonstrate that in the

The city of Bridgeport, Connecticut, was found to not be insolvent and was denied Chapter 9 relief.

2 A municipality means "a political subdivision or public agency or instrumentality of the state." 11 U.S.C.A. § 101(40).

3 *In re Las Vegas Monorail Co.*, 429 B.R. 770 (Bankr. D. Nev. 2010) (Requirement of municipality not established).

4 *In re County of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995); Glassman, Paul R. A Practical Guide To Chapter 9 Municipal Bankruptcy. 2011 WL 5053642 (ASPATORE), 4; Foster, Seena Eligibility for Chapter 9 Bankruptcy Relief, Applicable to Municipalities, Pursuant to 11 U.S.C.A. § 109(c). 57 A.L.R. Fed. 2d 121 (Originally published in 2011).

5 *In Re Timberon Water and Sanitation Dist.*, 2008 WL 5170581 (Bankr. D. N.M. 2008); County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995); See also, Glassman, Paul R. A Practical Guide To Chapter 9 Municipal Bankruptcy. 2011 WL 5053642 (ASPATORE) (Explaining the holdings in these two cases); Foster, Seena Eligibility for Chapter 9 Bankruptcy Relief, Applicable to Municipalities, Pursuant to 11 U.S.C.A. § 109(c). 57 A.L.R. Fed. 2d 121 (Originally published in 2011).

6 *County of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995) (Finding that the municipalities authorization to be a debtor is not sufficient to meet the authorization requirement for chapter 9); See also, Foster, Seena (2011) (Quoting *Alleghany-Highlands Economic Development Authority, In re*, 270 B.R. 647 (Bankr. W.D. Va. 2001), explaining that a court will not find general authorization to be a debtor); See also, Benvenuttia. Peter J. State Law Authorization For A Chapter 9 Filing, 2011 WL 5053632 (ASPATORE), 3 (Explaining the difference between generally authorized and specifically authorized).

7 Id.

8 11 U.S.C.A. § 109(c)(3).

9 See Glassman, Paul R. (2011) (Explaining that "A municipality with burdensome long-term obligations must also make the requisite showing of cash flow insolvency in the short term.").

near future it will run out of money and will be unable to pay its debts as they become due.[10]

We can say a municipality is insolvent when it is (1) generally not paying debts as they become due unless such debts are the subject of a bona fide dispute or (2) unable to pay its debts as they become due.[11] The test for insolvency involves a prospective cash flow test beginning from the date the municipality files the petition. The prospective analysis will look no further than the current or upcoming fiscal year.

Must Desire to Effect a Plan of Adjustment

The municipality must desire to effect a plan of adjustment.[12] This requirement assures that the purpose of Chapter 9 is being realized. Courts have generally held that there is no bright-line rule or specific test to prove when a municipality meets this requirement.[13]

Usually, a filed statement or oath indicating intent to effect a plan of adjustment, combined with evidence of efforts made toward negotiating and drafting a plan, would satisfy the court that the municipality met the requirement.[14] The municipality may use direct or circumstantial evidence to fulfill this requirement. Best practice indicates that a municipality should file a draft plan of adjustment with the petition for relief, or file one as close to the filing of the petition as possible.

In the Bankruptcy Code, Chapter 9 is 11 pages total including annotations.

Creditor Negotiation Tests

As previous stated, the municipality must meet at least one of the four Creditor Negotiation tests. The four tests are listed under 11 USC 109(c)(5) of the bankruptcy code. The tests require that the municipality show that (1) it has reached an agreement with the majority of its creditors to file for bankruptcy, (2) it has negotiated in good faith with its creditors but failed to reach an agreement, (3) negotiations are impractical, or (4) it believes a creditor may attempt to obtain an avoidable preference.[15] The following section further explains each of these tests.

Obtained an Agreement of Creditors or Negotiated in Good Faith with Creditors

The municipality must show it has reached an agreement with the majority of its creditors to file for bankruptcy. Prior to filing the petition, a municipality could obtain the agreement of creditors holding at least a majority of the claims of each class that the municipality intends to

[10] Foster, Seena (2011) (Explaining the court in *City of Bridgeport*, *In re*, 129 B.R. 332 (Bankr. D. Conn. 1991) was "in agreement with the proposition that a city should not have to wait until it runs out of money in order to qualify for bankruptcy protection.").
[11] 11 U.S.C.A 101 $ (32)(C).
[12] 11 U.S.C.A. $ 109(c)(4).
[13] Foster, Seena (2001) (Explaining the holdings in *New York City Off-Track Betting Corp.*, *In re*, 427 B.R. 256 (Bankr. S.D. N.Y. 2010) and *City of Vallejo*, 408 B.R. 280, 57 A.L.R. Fed. 2d 637 (B.A.P. 9th Cir. 2009)).
[14] Foster, Seena (2011) ("A filed statement indicating an intent to effect a plan of reorganization, said the court, combined with efforts made towards negotiating the drafting plan, is sufficient to fulfill this requirement.")
[15] 11 USC 109(c)(5).

impair.[16] Municipalities may find this a difficult option because, as discussed earlier, creditors usually want to keep a debtor out of bankruptcy for fear of losing control of their claims. A small municipality with few creditors may be able to obtain an agreement of the majority of its creditors to enter bankruptcy and pass the Creditor Negotiation test using this first option.

Additionally, the municipality could attempt to negotiate in good faith but fail to reach an agreement and also meet the negotiation requirement.[17] This requirement ensures that municipalities choose bankruptcy as a last resort. Good faith negotiations alone will not meet this requirement unless they revolve around negotiating the terms of a plan the municipality could achieve under Chapter 9.[18] This requires actual negotiation of a plan that addresses all of the municipality's liabilities and the methods they would use to adjust them.[19]

During negotiations, municipalities must be transparent with creditors, making it clear that unsuccessful negotiations may result in Chapter 9 bankruptcy. In at least one case, the court has held that negotiations presented on a "take it or leave it basis," or with an unwillingness to compromise, will not meet the negotiated-in-good-faith requirement.[20]

Showed Negotiations Are Impractical

Alternatively, a municipality may argue that negotiation with its creditors is impracticable. The court defined impracticable negotiations as those causing extreme and unreasonable difficulty. For example, a debtor may have a large number of creditors. Municipalities might also apply this test when taking time to negotiate before filing for Chapter 9 would put its assets at risk or cause it to be unable to provide services. The municipality's need to act quickly to avoid public harm may make negotiations impracticable.[21] This is a "fact sensitive inquiry and will depend on each debtor's unique circumstances."[22]

Believes a Creditor May Attempt to Obtain an Avoidable Preference

The municipality may believe a creditor may attempt to obtain an avoidable preference. Rarely used to prove Chapter 9 eligibility, this final alternative has never been successfully utilized. At least one bankruptcy judge

Chapter 9 has been infrequently used so it's not a well-understood area of law.

[16] 11 U.S.C.A § 109(c)(5)(a).
[17] 11 U.S.C.A § 109(c)(5)(b).
[18] Foster, Seena (2011) (Explaining the holding in *Sullivan County Regional Refuse Disposal Dist.*, *In re*, 165 B.R. 60 (Bankr. D. N.H. 1994)).
[19] Id.
[20] *In re Ellicott School Bldg. Authority*, 150 B.R. 261, 266 (Bankr. D. Colo. 1992) (Holding that "the Authority presented the plan as a "take it or leave it" proposal, and expressed unwillingness to compromise. For these reasons, it appears to the Court that no true good faith negotiations took place.").
[21] *In re Valley Health System*, 383 B.R. 156, 163 (Bankr. C.D. Cal. 2008)3 ("Negotiations may also be impracticable when a municipality must act to preserve its assets and a delay in filing to negotiate with creditors risks a significant loss of those assets."); See, Foster (2011) (Explaining the holding in *New York City Off-Track Betting Corp.*, *In re*, 427 B.R. 256 (Bankr. S.D. N.Y. 2010)).
[22] Id.

The plan of adjustment is essentially nothing more than a contract between the debtor and its creditors.

has questioned the requirement's wording.[23] Some believe the wording may be flawed. The code does not make it clear that a transfer by a municipality is actually avoidable under Section 547 because a Chapter 7 liquidation procedure is unavailable in a Chapter 9 proceeding.

What Is the Plan of Adjustment?

The plan of adjustment is essentially nothing more than a contract between the debtor and its creditors, which defines how the debt is to be adjusted and how the debtor will be structured post-bankruptcy. In fact, one can think of the entire Chapter 9 proceeding as a structured negotiation that leads to a new agreement between all the parties, voted on by the creditors and confirmed by the court.

The plan must include provisions for assumption, rejection, or assignment of executor contracts and unexpired leases, it should separate creditor claims into different classes, and it must be voted on.

The bankruptcy code states the confirmation requirements as follows: "The court shall confirm the plan if—

1. The plan complies with the provisions of this title made applicable by sections 103(e) and 901 of this title;
2. The plan complies with the provisions of this chapter;
3. All amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable;
4. The debtor is not prohibited by law from taking any action necessary to carry out the plan;
5. Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date of the plan each holder of a claim of a kind specified in section 507(a)(1) of this title will receive on account of such claim cash equal to the allowed amount of such claim;
6. Any regulatory or electoral approval necessary under applicable non-bankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval; and
7. The plan is in the best interests of creditors and is feasible."[24]

Compliance With the Applicable Provisions of the Code

Compliance with the applicable provisions of the code generally means classifying the claims, and that the plan designates classes of claims as impaired and unimpaired. It also requires the same treatment for each claim of a particular class, unless the holder of a particular claim agrees

[23] Klein, Christopher. U.S. Bankruptcy Judge, Eastern District of California. Eligibility Litigation in Chapter 9 Municipality Cases Under U.S. Bankruptcy Code. Published in The Ugly Truth: Municipal Restructuring and Bankruptcy. Presented by: The American Bar Association. (2012).

[24] 11 U.S.C. § 943(b).

to less favorable treatment. The plan must also provide adequate means for its implementation and examples of methods to do so.

The municipality must make proper disclosure. The municipality must propose the plan in good faith and not by any means forbidden by law it. It must receive regulatory approval for any rate changes.

Each class of the claims that is impaired must accept the plan, unless no classes are impaired under the plan. If utilizing the Cram Down provision, minimum acceptance must be met. This means that at least one class of impaired claims must accept the plan.

The "Cram Down" Provision

In a Chapter 9 proceeding, getting the majority of creditors in every class of creditors to vote in favor of the plan is difficult. For this reason, the court utilizes the "cram down provision." This provision allows the court to confirm the plan if at least one impaired class has accepted the plan, the plan complies with all other requirements of the code, and the plan does not discriminate unfairly and is fair and equitable with respect to each class of impaired creditors that has not accepted the plan.[25] To "not discriminate unfairly" means that creditors with the same legal rights receive equal treatment. "Fair and equitable" usually means that a plan must at a minimum satisfy all other requirements.[26]

If a municipality anticipates using the cram down provision, it should have at least one class of creditors who supports the proposed plan of adjustment pre-bankruptcy. The plan still must treat similarly situated creditors the same, and thus, an entity cannot gerrymander one class of creditors for the sole purpose of gaining their approval. If very similar classes of creditors are classified separately, an objection will likely be filed.

Advanced planning will allow a municipality to think strategically about how it treats varying classes and how it arranges its creditors into classes. Advanced planning will likely lead to more effective use of the cram down provision.

Court Approval

If either the majority of the creditors accept the plan or the majority do not approve so the court utilizes the cram down provision and the plan of adjustment meets the remaining requirements in the code, then the court will approve the plan if it meets the best interest of the creditors test and the plan is feasible.

Courts have interpreted the best interest of the creditors test to mean that the plan must be better than other alternatives available to the

Lack of proper planning can waste time and money. The municipality should go into bankruptcy with a class of creditors supporting the plan of adjustment. If it does not have the support of at least one class, the process will be longer and more expensive.

[25] United States Courts. Municipal Bankruptcy, Chapter 9. http://www.uscourts.govfederalcourts/bankruptcy/bankruptcybasics/Chapter9.aspx. (Last Accessed July 3, 2012). 24. *Id;* See 6 COLLIER ON BANKRUPTCY $ 943.03[7] (15th ed. rev. 2005).

[26] Id.

"Failure to Prepare is to Prepare to Fail."

– John Robert Wooden

creditors.[27] "Generally speaking, the alternative to Chapter 9 is dismissal of the case, allowing every creditor to fend for itself."[28] However, the municipality must not devote all its resources to the repayment of its creditors.[29] Instead, courts require an outcome that is better for the creditors than having the case dismissed.[30]

The debtor generally must show it can meet its obligations under the plan and still maintain its operations at a satisfactory level.[31] When referring to a city or town, the term "operations" generally means the entity's ability to provide services to its citizens. The requirements of this test generally require the court to simply review whether the evidence the debtor submitted proves that it can perform its obligations under the plan.

Commonly Cited Advantages and Disadvantages of a Chapter 9 Proceeding

Advantages

The major advantage of a Chapter 9 proceeding is that it forces all the creditors to come together all before one judge in the same proceeding. Though, in some cases, it may be possible to negotiate a similar plan of adjustment outside of a Chapter 9 proceeding, the process prevents creditors from holding out for more. Additionally, negotiations outside of a Chapter 9 proceeding often lead to lawsuits being filed, which diverts time, money and energy away from the real issues while the municipality is still trying to provide basic services to its citizens. Conversely, during a Chapter 9 proceeding, a debtor can take advantage of the automatic stay and still maintain substantial control over its day-to-day operations. Entities whose main form of debt lies in burdensome collective bargaining agreements may find Chapter 9 especially useful. The standard for adjusting these agreements is of a lower threshold than a Chapter 11 restructuring.

Disadvantages

A major disadvantage of a Chapter 9 proceeding is the lack of control of the outcome from a political standpoint. For example, in states with laws that provide for local government financial control boards, receivers or managers, the powers of these parties are set aside during the Chapter 9 process. In most cases, however, they have been instrumental in Chapter

[27] See United States Courts. Municipal Bankruptcy, Chapter 9. http://www.uscourts.gov federal-courts/bankruptcy/bankruptcybasics/Chapter9.aspx. (Last Accessed July 3, 2012) (Citing, 6 COLLIER ON BANKRUPTCY § 943.03[7] (15th ed. rev. 2005)).

[28] Id. (Again Citing, 6 COLLIER ON BANKRUPTCY § 943.03[7] (15th ed. rev. 2005)).

[29] Id. (Stating: An interpretation of the " best interests of creditors" test to require that the municipality devote all resources available to the repayment of creditors would appear to exceed the standard.)

[30] Id. (Stating: "The courts generally apply the test to require a reasonable effort by the municipal debtor that is a better alternative for its creditors than dismissal of the case.")

[31] See Glassman, Paul R. (2011) 2011 WL 5053642 (ASPATORE), 15 ("This means that there must be a reasonable prospect that the debtor will be able to perform under the plan.")

9 negotiations. However, once in bankruptcy, some political power to control at least the outcome is ceded to the bankruptcy judge.

Additionally, debtors who file a Chapter 9 worry about the credit market response, and surrounding cities worry about "contagion," or the bankruptcy affecting their ability to borrow. Entities will also likely face stigma and negative media attention. Another potential disadvantage of Chapter 9 is the unknown. In some states, no city has ever filed a Chapter 9 petition, and therefore, results in a lack of controlling case law and little predictability. Even in states such as California, which has seen many recent filings, the case law is sparse, and many questions still need to be answered. Lastly, bankruptcy can be expensive and consume human resources.

Fortunately, proper planning, pre-negotiations and transparency with a municipality's creditors can avoid at least some of these negative effects.

"What is the goal of the municipal bankruptcy laws? Although cities are legally classified as municipal corporations, the purposes of federal municipal bankruptcy laws resemble individual bankruptcy more than corporate bankruptcy: municipal bankruptcy is based on the idea of the fresh start rather than the efficient reconfiguration of assets. The theory of Chapter 9 is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual: it will sap initiative and depress money generating activity. The debt-ridden individual will cease to work if all the gains go to the creditor; the taxpayers of a city will cease to pay taxes if rates are too high and the citizens get none of the benefit. In both contexts, bankruptcy is premised on the idea that the debtor will become more productive if freed from the burden of debt, but the law presumes that the debtor will survive bankruptcy in essentially the same form that it went in."

– Michael W. McConnell and Randal C. Picker. "When cities go broke: A conceptual introduction to municipal bankruptcy," 60 U. Chi. L. Rev. 425, 469-70 (1993).

MICHIGAN STATE UNIVERSITY | Extension

MSU is an affirmative-action, equal-opportunity employer, committed to achieving excellence through a diverse workforce and inclusive culture that encourages all people to reach their full potential. Michigan State University Extension programs and materials are open to all without regard to race, color, national origin, gender, gender identity, religion, age, height, weight, disability, political beliefs, sexual orientation, marital status, family status or veteran status. Issued in furtherance of MSU Extension work, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Thomas G. Coon, Director, MSU Extension, East Lansing, MI 48824. This information is for educational purposes only. Reference to commercial products or trade names does not imply endorsement by MSU Extension or bias against those not mentioned.

Produced by ANR Communications. 12/6/2012.

APPENDIX B:
Process for Analyzing Solvency

Exhibit B1: Five-Year Financial Plan

City Simulation
General Fund Cash Flow
Five-Year Plan Using FY 2013 as Base Year
FYE June 30, 2013

Assumptions: Revenues are stable; expenditures increase at 2%/year.

	Approved FY 2013 Budget	Base Year FY 2013 Budget	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Cash Balance (4)	$ (12,968,383)	$ (12,968,383)	$ (12,968,383)	$ (14,118,729)	$ (16,442,428)	$ (19,962,948)	$ (24,704,223)
Revenues (Cash Inflows)							
Property Tax	5,720,000						
Income Tax	14,950,000						
Special Assessments	2,855,000						
State Revenue Sharing	13,140,585						
Charges for Services	11,958,695						
Other	8,893,026						
	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306
Expenditures (Cash Outflows) (5)							
Governance (1)	3,195,942	3,195,942	3,259,861	3,325,058	3,391,559	3,459,390	3,528,578
Public Safety							
District Court	5,358,479						
Police	21,026,009						
Fire	10,916,429						
E-911	3,314,413						
	40,615,330	40,615,330	41,427,637	42,256,189	43,101,313	43,963,339	44,842,606
Infrastructure							
Major & Local Streetlights	2,850,000	2,850,000	2,907,000	2,965,140	3,024,443	3,084,932	3,146,630
Parks & Golf	546,841	546,841	557,778	568,933	580,312	591,918	603,757
Development (2)	1,085,639	1,085,639	1,107,352	1,129,499	1,152,089	1,175,131	1,198,633
Community & Economic Development	1,890,694	1,890,694	1,928,508	1,967,078	2,006,420	2,046,548	2,087,479
Finance & Administration (3)	7,171,109	7,171,109	7,314,531	7,460,822	7,610,038	7,762,239	7,917,484
General Government	161,751	161,751	164,986	168,286	171,651	175,084	178,586
OPEB Paygo (5)	above	-	-	-	-	-	-
OPEB ARC Funding > Paygo	none	-	-	-	-	-	-
Total Expenditures	57,517,306	57,517,306	58,667,652	59,841,005	61,037,825	62,258,582	63,503,753
Ending Cash Balance	$ (12,968,383)	$ (12,968,383)	$ (14,118,729)	$ (16,442,428)	$ (19,962,948)	$ (24,704,223)	$ (30,690,671)

(1) Governance includes mayor, council, city clerk, administrator and Human Relations departments.
(2) Includes Building Inspection and Planning departments.
(3) Includes Accounting & Budgeting, Assessing, Budget Stabilization Fund, Capital Improvements/Debt Service, Facilities, Human Resources, Purchasing & Stockrooms, Risk, Treasury & Collections departments.
(4) Interfund borrowing less cash.
(5) Above categories include $9,024,248 of paygo for current retirees allocated among all departments.

This five-year financial cash flow plan utilizes the approved FY 2013 General Fund budget as the base year with OPEB on a paygo (i.e., pay-as-you-go) method. Assumptions are a) stable level of revenues and b) expenditures increasing at 2 percent per year. When preparing a five-year plan for decision making, the assumptions would be significantly refined. In this case, for example, the revenue assumptions are likely optimistic. Despite the potential optimism, this example five-year plan readily highlights the depth of the structural budget deficit: a cash deficit of $12.9 million, which grows to $30.6 million within five years. Without a five-year plan as a starting point for addressing solvency, the tendency is to revert to a one-year incremental approach, which masks the scope of the problem.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B2: Cash Flow by Fund (General Fund)

City Simulation
General Fund Cash Flow (Paygo for OPEB)
FYE June 30, 2013

	BALANCED FY 2013 Budget	Monthly Cash Flow Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
Beginning Cash Balance	$ (12,968,383)	$ (12,968,383)	$ (12,416,322)	$ (11,192,184)	$ (13,607,698)	$ (12,871,030)	$ (14,107,412)	$ (13,345,972)	$ (14,789,618)	$ (13,809,153)	$ (16,203,495)	$ (15,622,299)	$ (15,889,600)
Revenues (Cash Inflows)													
Property Tax	5,720,000	2,506,377	403,254	117,874	663,818	161,302	136,486	266,768	266,768	223,341	223,341	-	750,673
Income Tax	14,950,000	1,125,269	1,553,943	996,667	1,500,358	1,264,588	1,296,738	1,939,749	1,028,817	1,468,208	943,082	760,896	1,071,685
Special Assessments	2,855,000	1,250,998	201,274	58,834	331,329	80,510	68,124	133,151	133,151	111,475	111,475	-	374,681
State Revenue Sharing	13,140,585	-	2,190,098	-	2,190,098	-	2,190,098	-	2,190,098	-	2,190,098	-	2,190,098
Charges for Services	11,958,695	923,451	923,451	923,451	923,451	923,451	923,451	923,451	923,451	923,451	923,451	438,639	2,285,542
Other	8,893,026	686,720	686,720	686,720	686,720	686,720	686,720	686,720	686,720	686,720	686,720	326,192	1,699,632
	57,517,306	6,492,816	5,958,740	2,783,546	6,295,774	3,116,571	5,301,617	3,949,839	5,229,005	3,413,195	5,078,167	1,525,728	8,372,310
Expenditures (Cash Outflows)													
Governance (1)	3,195,942	330,097	263,078	288,885	308,891	241,871	252,274	299,688	236,070	322,695	249,874	99,629	302,889
Public Safety													
District Court	5,358,479	553,458	441,089	484,360	517,902	405,534	422,976	502,473	395,806	541,047	418,951	167,044	507,840
Police	21,026,009	2,171,700	1,730,779	1,900,567	2,032,185	1,591,264	1,659,706	1,971,641	1,553,095	2,123,002	1,643,911	655,459	1,992,700
Fire	10,916,429	1,127,518	898,598	986,750	1,055,084	826,164	861,697	1,023,650	806,347	1,102,235	853,497	340,306	1,034,584
E-911	3,314,413	342,334	272,830	299,594	320,341	250,837	261,626	310,798	244,820	334,657	259,136	103,323	314,117
	40,615,330	4,195,011	3,343,296	3,671,270	3,925,513	3,073,799	3,206,005	3,808,561	3,000,068	4,100,941	3,175,496	1,266,130	3,849,240
Infrastructure													
Major & Local Streetlights	2,850,000	294,366	234,601	257,615	275,455	215,690	224,967	267,249	210,516	287,765	222,826	88,845	270,103
Parks & Golf	546,841	56,481	45,014	49,430	52,853	41,385	43,165	51,278	40,393	55,215	42,755	17,047	51,826
Development (2)	1,085,639	112,132	89,366	98,132	104,928	82,162	85,696	101,802	80,191	109,617	84,880	33,843	102,889
Community & Economic Development	1,890,694	195,283	155,635	170,902	182,737	143,089	149,244	177,293	139,657	190,904	147,823	58,940	179,187
Finance & Administration (3)	7,171,109	740,678	590,298	648,205	693,095	542,715	566,057	672,446	529,697	724,069	560,671	223,550	679,628
General Government	161,751	16,707	13,315	14,621	15,633	12,241	12,768	15,168	11,948	16,332	12,646	5,042	15,330
Total Expenditures	57,517,306	5,940,755	4,734,601	5,199,060	5,559,106	4,352,953	4,540,177	5,393,485	4,248,540	5,807,538	4,496,971	1,793,028	5,451,092
Ending Cash Balance	$ (12,968,383)	$ (12,416,322)	$ (11,192,184)	$ (13,607,698)	$ (12,871,030)	$ (14,107,412)	$ (13,345,972)	$ (14,789,618)	$ (13,809,153)	$ (16,203,495)	$ (15,622,299)	$ (15,889,600)	$ (12,968,382)

(1) Governance includes mayor, council, city clerk, administrator and Human Relations departments.
(2) Includes Building Inspection and Planning departments.
(3) Includes Accounting & Budgeting, Assessing, Budget Stabilization Fund, Capital Improvements/Debt Service, Facilities, Human resources, Purchasing & Stockrooms, Risk, Treasury & Collections departments
(4) Interfund borrowing less cash.

This monthly General Fund Cash Flow is also based on the approved FY 2013 budget, which limits funding for OPEB to paygo. The cash flow demonstrates that the city is indebted to the pooled cash fund of $12.9 million at the beginning of the year, which decreases to $11.1 million in August and peaks at $16.2 million in March. This analysis highlights the ongoing cash insolvency throughout the fiscal year (rather than being an exception at year end). Presenting a cash flow analysis retrospectively to the date of initial cash deficit aids in explaining that this condition is not an anomaly; in fact, it is a reality that has not been remedied despite efforts to reduce expenditures and increase revenues.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B3: Cash Flow by Fund (Water and Sewer Funds)

City Water and Sewer Funds (Combined)
Cash Flow (Paygo for OPEB)
FYE June 30, 2013

	Approved	Monthly Cash Flow											
	2013 Budget	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
Operating Revenues	$ 81,734,552	$ 6,955,019	$ 9,534,826	$ 9,465,102	$ 7,652,265	$ 6,867,864	$ 6,623,828	$ 6,920,157	$ 7,129,331	$ 6,153,188	$ 6,257,774	$ 1,237,610	$ 6,937,588
Other Revenues	455,867	37,989	37,989	37,989	37,989	37,989	37,989	37,989	37,989	37,989	37,989	37,989	37,989
Cash inflows	82,190,419	6,993,008	9,572,815	9,503,091	7,690,253	6,905,853	6,661,817	6,958,146	7,167,320	6,191,177	6,295,763	1,275,599	6,975,577
Water Purchased	24,031,417	2,015,057	2,292,260	2,665,419	2,270,937	2,111,012	2,025,718	2,111,012	2,111,012	2,111,012	2,111,012	255,880	1,951,087
Personnel Costs	28,546,350	2,410,620	2,437,208	2,375,170	2,268,819	2,366,307	3,323,465	2,330,857	2,197,918	2,135,880	2,144,743	2,215,643	2,339,719
Operating Expenses	7,259,290	613,017	619,778	604,002	576,957	601,748	845,152	592,733	558,927	543,151	545,405	563,434	594,987
Administrative Expenses	14,140,047	1,194,068	1,207,238	1,176,508	1,123,829	1,172,118	1,646,233	1,154,558	1,088,709	1,057,979	1,062,369	1,097,489	1,158,948
Capital Outlay	2,401,583	200,132	200,132	200,132	200,132	200,132	200,132	200,132	200,132	200,132	200,132	200,132	200,132
Interest Expense	644,314	58,986	14,747	136,123	107,764	1,134	1,134	20,418	1,134	181,497	119,107	1,134	1,134
Transfers to Other Funds	2,990,000	249,167	249,167	249,167	249,167	249,167	249,167	249,167	249,167	249,167	249,167	249,167	249,167
Cash outflows	80,013,001	6,741,046	7,020,529	7,406,520	6,797,604	6,701,618	8,291,002	6,658,877	6,406,999	6,478,818	6,431,934	4,582,880	6,495,174
Change in Cash	2,177,418	251,962	2,552,286	2,096,571	892,650	204,235	(1,629,185)	299,269	760,321	(287,641)	(136,171)	(3,307,281)	480,404
Cash (unrestricted) - beginnin	228,967	228,967	480,929	3,033,215	5,129,786	6,022,435	6,226,670	4,597,486	4,896,755	5,657,075	5,369,434	5,233,263	1,925,982
Cash (unrestricted) - ending	$ 2,406,385	$ 480,929	$ 3,033,215	$ 5,129,786	$ 6,022,435	$ 6,226,670	$ 4,597,486	$ 4,896,755	$ 5,657,075	$ 5,369,434	$ 5,233,263	$ 1,925,982	$ 2,406,386

The Combined Water and Sewer Funds' cash flow analysis above is also based on the approved FY 2013 budget and utilizes paygo for OPEB. In addition to the comments noted with the General Fund Cash Flow, the above analysis highlights two further points. First, despite significant rate increases of 12.5 percent for water and 45 percent for sewer effective July 1, 2012, the funds' cash position improves modestly from less than 1 percent of revenues at June 30, 2012, to 2.9 percent by June 2013. This may be contrary to the impressions that stakeholders would have without this type of analysis based on the level of rate increases in current years. Second, the cash balances continue to decline in February through the end of the fiscal year. This pattern is consistent with the general fund. Although this paper emphasizes the need for cash flow by fund, an entity-wide cash flow analysis is also critical to managing the pooled cash funds.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B4: Creditors List

City Simulation*
Creditors List
Summary Recap of Classifications

Classification	Amount of Claim		Percent of Total	Revenue Pledge?
Secured				
Long-term Debt				
State Fiscal Stabilization Bonds	$ 8,000,000		0.7%	SSR
State Infrastructure Bank Street Construction Loan	2,037,079		0.2%	SSR
State Bond Authority				
Drinking Water Revolving Fund Revenue Bonds	28,015,336		2.5%	SSR, Water Fund
General Obligation				
Capital Improvement Bonds (DDA)	9,735,000	$ 47,787,415	0.9%	SSR, Tax Increments
Partially Secured				
Capital leases		286,104	0.0%	Equipment
Section 108 loans (City is a pass-thru entity)		11,829,000	1.1%	Future CDBG funds
Unsecured				
Vendors		8,097,793	0.7%	
Retirees - OPEB		558,119,793	49.9%	
Employees				
Accrued sick and vacation pay	6,914,029			
OPEB	229,576,090			
Unfunded Pension (UAAL)	249,796,000	486,286,119	43.4%	
General Liability Claims		5,768,000	0.5%	
Deposits		1,078,821	0.1%	
Total Amount Owed to Creditors		$ 1,119,253,045	100.0%	

*Excludes one enterprise fund not subject to City's budgetary or financial control
CDBG = Community Development Block Grant
SSR = State Shared Revenue

Whether in bankruptcy or not, the city in a financial emergency must identify the options for seeking debt relief. A creditor list, as shown above, identifies whether each creditor has secured or unsecured debt and whether revenue sources have been pledged to repay that debt. Outside of bankruptcy, the existence of security or a revenue pledge does not preclude the city from asking for debt relief. The categorization of debt becomes critical to what unilateral modifications the bankruptcy court will allow.

This city's secured debt (highlighted in blue) and partially secured debt (highlighted in red) totals 5.4 percent of the city's outstanding liabilities. The largest category of unsecured creditors (highlighted in green) is retirees (49.9 percent) followed by obligations to current employees (total of 43.4 percent). Based on how the law applies to the city's pension underfunding, exposure could shift from active employees to retirees. In total, employee-benefit-related obligations equates to 93.3 percent of amounts owed to creditors. Vendors represent less than 1 percent of the total.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B5: What-If Analysis (Plan of Adjustment)

Assumptions: Revenues are stable;
expenditures increase at 2%/year;
80% reduction in OPEB overall;
begin prefunding at 25% FY 2015 and 2016
increasing to 50% FY 2017 and 2018.

City Simulation
General Fund Cash Flow Five-Year Plan Based on Proposed Plan of Adjustment
FYE June 30, 2013

	Approved FY 2013 Budget	Base Year FY 2013 Budget	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Beginning Cash Balance (4)	$ (12,968,383)	$ (12,968,383)	$ (12,968,383)	$ (6,754,943)	$ (2,557,687)	$ 573,168	$ 1,586,187
Revenues (Cash Inflows)							
Property Tax	5,720,000						
Income Tax	14,950,000						
Special Assessments	2,855,000						
State Revenue Sharing	13,140,585						
Charges for Services	11,958,695						
Other	8,893,026						
	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306	57,517,306
Expenditures (Cash Outflows) (5)							
Governance (1)	3,195,942	3,195,942	3,259,861	3,325,058	3,391,559	3,459,390	3,528,578
Public Safety							
District Court	5,358,479						
Police	21,026,009						
Fire	10,916,429						
E-911	3,314,413						
	40,615,330	40,615,330	41,427,637	42,256,189	43,101,313	43,963,339	44,842,606
Infrastructure							
Major & Local Streetlights	2,850,000	2,850,000	2,907,000	2,965,140	3,024,443	3,084,932	3,146,630
Parks & Golf	546,841	546,841	557,778	568,933	580,312	591,918	603,757
Development (2)	1,085,639	1,085,639	1,107,352	1,129,499	1,152,089	1,175,131	1,198,633
Community & Economic Development	1,890,694	1,890,694	1,928,508	1,967,078	2,006,420	2,046,548	2,087,479
Finance & Administration (3)	7,171,109	7,171,109	7,314,531	7,460,822	7,610,038	7,762,239	7,917,484
General Government	161,751	161,751	164,986	168,286	171,651	175,084	178,586
OPEB Paygo (5) Reduction	above	above	(7,363,786)	(7,511,062)	(7,661,283)	(7,814,509)	(7,970,799)
OPEB ARC Funding > Paygo	-	-	-	990,107	1,009,909	2,060,214	2,101,419
Total Expenditures	57,517,306	57,517,306	51,303,866	53,320,050	54,386,451	56,504,287	57,634,373
Ending Cash Balance	$ (12,968,383)	$ (12,968,383)	$ (6,754,943)	$ (2,557,687)	$ 573,168	$ 1,586,187	$ 1,469,120

(1) Governance includes Mayor, Council, City Clerk, Administrator, and Human Relations departments.
(2) Includes Building Inspection and Planning departments.
(3) Includes Accounting & Budgeting, Assessing, Budget Stabilization Fund, Capital Improvements/Debt Service, Facilities, Human Resources, Purchasing & Stockrooms, Risk, Treasury & Collections departments.
(4) Interfund borrowing less cash.
(5) Includes $9,024,248 of paygo for current retirees allocated among all departments.

A proposed plan of adjustment, illustrated above, begins with the example five-year plan shown in Exhibit B1 that yielded an increasing cash deficit ($12.9 million to $30.7 million within five years) despite budgetary adjustments. Continuing operations under that scenario is not a viable option.

The sample plan of adjustment above is based on experience garnered from other cities that have entered bankruptcy as a result of unsustainable labor costs. Most notably that includes the cities of Vallejo, California, and Prichard, Alabama. In Vallejo, the Chapter 9 bankruptcy resulted in a reduction of OPEB benefits by 80 percent to existing retirees. In Prichard, the city filed for bankruptcy twice due to unsustainable pension obligations, ongoing economic decline and a lack of accountability in adhering to the plan.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B5: What-If Analysis (Plan of Adjustment) Continued

The general fund's base year budget (FY 2013) includes OPEB on a paygo basis of $9 million. The additional amount needed to prefund OPEB for general fund services is $19.4 million. The illustrative proposed plan of adjustment reduces OPEB by 80 percent for FY 2014 as highlighted in red. In addition, this plan requires the city to begin prefunding the remaining OPEB ("ARC > paygo") at 25 percent in FY 2015 and 2016 and increasing it further in FY 2017 and 2018.

Despite the proposed OPEB reduction of 80 percent, the general fund cash balance does not return to a positive status until FY 2016 assuming that the OPEB plan change for existing retirees is effectuated by July 1, 2013. The limited options to address the remaining shortfall of $6.7 million include vendors, capital leases, general obligation bonds and unfunded pension benefits.

While unimaginable that the city and related stakeholders would be faced with a bankruptcy plan of adjustment, the proposed plan meets the three objectives noted earlier:

a. Restructures liabilities to provide an acceptable level of services within resources available

b. Exits the bankruptcy process with a financial plan and controls to mitigate overextending the city's financial obligations in the future

c. Develops a plan that is responsibly committed to addressing the adjusted obligations (Municipalities accomplish this by designing a five-year plan that establishes prefunding OPEB.)

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B6: Summary of Pension Plan Funding Data

City Simulation
City Employees Retirement System*
Summary of Pension Plan Funding Data from
Actuarial Valuation as of June 30, 2010
Report Dated March 14, 2012

Membership	General	Police	Fire	Other	System-wide
Funded Status as of June 30, 2010					
(in thousands)					
Actuarial Accrued Liability	$ 285,714	$ 175,160	$ 126,666	$ 247,512	$ 835,052
Funding Value of Assets	131,841	132,783	72,549	230,042	567,215
Unfunded Actuarial Accrued Liability	153,873	42,377	54,117	17,470	267,837
Percent Funded	46.1%	75.8%	57.3%	92.9%	67.9%
Plan Reserves as of June 30, 2010					
Reserve for Employee Contributions	$ 19,575	$ 17,238	$ 10,611	$ 48,869	$ 96,293
Reserve for Retired Benefit Payments	282,704	161,668	118,170	191,205	753,747
Reserve for Employer Contributions	(170,436)	(46,123)	(56,233)	(10,032)	(282,824)
Total Funding (Actuarial) Value of Assets	131,843	132,783	72,548	230,042	567,216
Market Value of Assets as of June 30, 2010					$ 460,444
Actuarial Value as a % of Market Value					123.2%
Projected Net Cash Flow for FYEJune 30, 2012					
(in millions)					
(A) Contributions (based on 2009 valuation)	$ 7.3	$ 2.3	$ 2.9	$ 3.7	$ 16.2
(B) Benefit Payments & Refunds	24.1	13.7	10.3	18.2	66.3
(C) Net Cash Flow (A minus B)	$ (16.8)	$ (11.4)	$ (7.4)	$ (14.5)	$ (50.1)
(D) Assets (at market value)	$ 111.2	$ 119.0	$ 64.0	$ 212.7	$ 506.9
(E) Ratio (C divided by D)	-15%	-10%	-12%	-7%	-10%
Active Members to Retirees & Beneficiaries	0.3	0.3	0.4	0.7	0.5

assets allocated to reserves (rounding difference)

* In 2004, seven of nine "Other" employee unions and exempt employees voted to move to Municipal Employee Retirement System from the City System.

Overall, the city's pension plan is 68 percent funded with an unfunded liability of $267 million.

The city has negative cash flow in its pension system of 10 percent. This is a significant concern due to the super mature status of the plan as evidenced by a ratio of .5 employees for each retiree. As noted in the city's most recent actuarial (June 30, 2010), the funding value of assets to market values is 123.2 percent. Despite some potential for improvement in market value, further losses may require the city to increase contributions to achieve an assumed long-term real rate of return of 4.25 percent. Stated another way, ongoing negative cash flow negates the benefits of prefunding. Plan assets are used to pay current benefits rather than invest in suitable assets for the future.

An early retirement window would worsen the negative pension plan cash flow situation because benefits payments would immediately increase.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B7: Summary of Pension Plan Annual Cost Data

City Simulation
City Employees Retirement System*
Summary of Pension Plan Annual Cost Data from
Actuarial Valuation as of June 30, 2010
Report Dated March 14, 2012

Membership	General	Police	Fire	Other	System-wide
Net Employer Contribution Rate					
(as a % of payroll)					
2013 (estimated)	68.00%	46.00%	60.00%	20.00%	n/a
2012	59.98%	36.04%	51.42%	12.23%	n/a
2011	43.35%	22.96%	39.17%	10.72%	n/a
Rate increase from 2011 to 2013	*24.65%*	*23.04%*	*20.83%*	*9.28%*	
Member Payroll (fiscal year basis; in thousands)					
2010					$ 68,968
2009					$ 89,636
2008					$ 89,636
Census Data (as of June 30, 2009)					
(Note: Actuarial report does not provide employee or retiree census data. Amounts obtained from FY 2011 Audited Financial Statements.)					
Active Plan Members					1,676
Inactive, vested members					233
Retirees and Beneficiaries					2,820

* In 2004, seven of nine "Other" employee unions and exempt employees voted to move to Municipal Employee Retirement System from the City System.

The General Employee Division is the largest category of liability. The city's contribution rate, as a percent of active employee payroll is 68 percent for FY 2013, up from 60 percent for FY 2012 and 43 percent for FY 2011. The city's contribution rate for FY 2013, as a percent of active employee payroll, for the Fire Division is 60 percent. The Police Division is 46 percent.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B8: OPEB by Category

City Simulation
Postemployment Benefit Plans Other Than Pensions
Summary Data from Actuarial Valuation for FY 2007
Report Dated December 7, 2007

Unfunded Accrued Actuarial Liability (0% Pre-funded) by Category

Category	Future Retirees	Current Retirees	Citywide	
Pre-Medicare	$ 108,029,457	$ 177,818,720	$ 285,848,177	36%
Post-Medicare	121,546,633	380,301,073	501,847,706	64%
Total	$ 229,576,090	$ 558,119,793	$ 787,695,883	
	29%	71%		100%

The city's unfunded accrued actuarial liability was calculated to be $787 million at June 30, 2007. The plan is zero percent funded. A revised actuarial is currently being prepared. The majority of the liability (71 percent) is attributable to those already retired (highlighted in yellow). A large class of creditors are unrepresented (labor unions do not represent retirees), and negotiating with 1,800 or more individuals is not practical.

In addition, identifying potential benefit redesign and/or reduction options depends on whether retirees are Medicare eligible (64 percent) or pre-Medicare eligible (36 percent) as highlighted in blue. In attempting to prevent a Chapter 9 filing, it would not be unusual for an association of retirees to organize for negotiating with the city. Presuming that benefit adjustments would entail premium cost-sharing, the retirees become consumers who may entertain lower cost plan options not previously discussed.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B9: OPEB by Group

City Simulation
Postemployment Benefit Plans Other Than Pensions
Summary Data from Actuarial Valuation for FY 2007
Report Dated December 7, 2007

Unfunded Accrued Actuarial Liability (UAAL) by Group

	General A & B	General C	General D	Fire	Police 1	Police 2	Police 3	Other	Citywide
Active	$ 87,327,923	$ 3,477,294	$ 8,590,588	$ 52,952,956	$ 44,001,750	$ 6,316,786	$ 26,908,793	$ -	$ 229,576,090
Retiree	$ 262,697,395	$ 6,376,698	$ 41,940,925	$ 109,301,004	$ 79,397,699	$ 15,543,989	$ 42,734,024	$ 128,059	$ 558,119,793
Total	$ 350,025,318	$ 9,853,992	$ 50,531,513	$ 162,253,960	$ 123,399,449	$ 21,860,775	$ 69,642,817	$ 128,059	$ 787,695,883
As a %	44%	1%	6%	21%	16%	3%	9%	0%	100%

Annual Required Contribution (ARC) by Group

Group	General A & B	General C	General D	Fire	Police 1	Police 2	Police 3	Other	Citywide
ARC	$ 24,897,980	$ 1,073,240	$ 3,626,431	$ 12,670,390	$ 10,413,548	$ 1,464,996	$ 4,998,827	$ 7,632	$ 59,153,044
As a %	42%	2%	6%	21%	18%	2%	8%	0%	100%

Participant Data

	General A	General B	General C	General D	Fire	Police 1	Police 2	Police 3	Other	Citywide
Actives	410	77	34	18	156	183	15	60	32	985
Retired	570	287	36	58	331	261	38	102	97	1,780
Deferred, Vested	28	14	-	4	3	3	-	-	4	56
Total	1,008	378	70	80	490	447	53	162	133	2,821
	36%	13%	2%	3%	17%	16%	2%	6%	5%	100%

Exhibit B9 highlights the number of benefit groups and related benefit concerns that the city has to address in addition to nonunion employees and retirees. In determining where to address the largest area for general fund cost containment, the pink highlights note that the Fire Division (21 percent) and Police 1 Division (16 percent) are individually less than General A & B Division (44 percent). The latter unit's employees also work in activities accounted for in the enterprise and special revenue funds. As a city evaluates the sustainability of the OPEB commitment, it must a) note where there are commonalties and differences among benefit levels in contract iterations over the years and b) recognize that cost containment must be evaluated in terms of the impact on general fund versus other types of funds. Modifications to benefits for those presently or previously associated with General Divisions will not impact the general fund in the same ratio as police and fire, which are primarily accounted for in the general fund. For example, 42 percent of the ARC (highlighted in yellow) is related to General A & B Division associated employees and retirees where police and fire combined equal 39 percent.

As in the pension system, the number of retirees greatly exceeds the number of actives. There are 1,836 retired and deferred retirees to 985 actives (highlighted in blue) for a ratio of 0.5 actives for each retiree. That number may worsen with the next actuarial due to the number of retirements occurring since 2007.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B10: Comparison of OPEB for Previously Proposed External Comparables

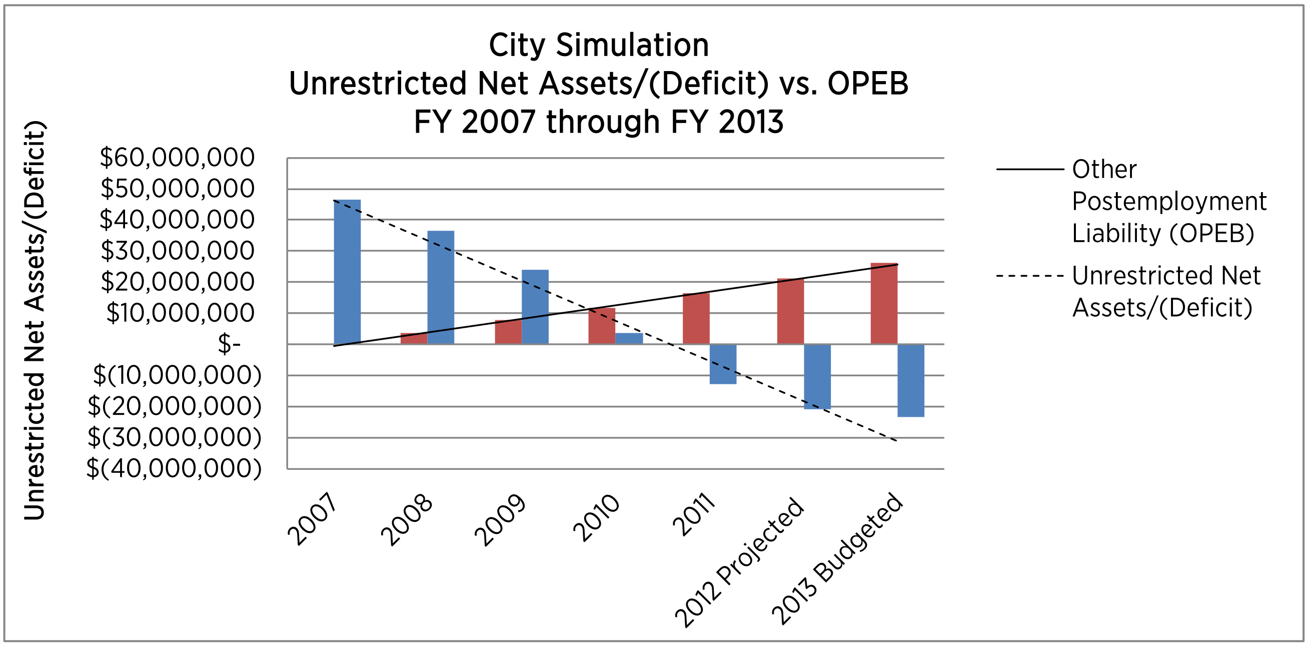
City Simulation
Comparison of Previously Proposed External Comparables -
Funding Status for Other Postemployment Benefits (OPEB)
As of June 30, 2010

Community	2010 Population	Unfunded (Overfunded) AAL	Funded Ratio	Unfunded Liability per Capita
City A	38,401	$ 10,764,000	55%	$ 280
City B	96,942	79,977,000	42%	825
City C	52,347	52,473,521	3%	1,002
City D	129,699	143,360,804	11%	1,105
City E	33,534	37,673,933	1%	1,123
City F	188,040	222,684,549	0%	1,184
City G	113,934	169,637,000	30%	1,489
City H	71,739	137,378,993	20%	1,915
City I	84,094	181,861,454	0%	2,163
City J	134,056	295,473,638	9%	2,204
City K	114,297	376,458,000	10%	3,294
City L	59,515	196,649,058	15%	3,304
City M	51,508	214,780,192	1%	4,170
City N	102,434	774,606,738	0%	7,562
Mean				$ 2,259

The extent of a city's unsustainable OPEB liability becomes evident when compared with other cities. Using cities proposed as comparable by the simulation city and one of its bargaining units in a previous labor arbitration matter, the OPEB liabilities were compared on a per capita basis. Exhibit B10, Comparison of OPEB for Previously Proposed External Comparables, provides perspective when we compare one city's OPEB liability to others. In this case, four out of fourteen cities exceed the mean of $2,259 with one as high as $7,562 per capita.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B11: Enterprise Fund Unrestricted Net Assets (Deficit) vs. OPEB Trend



While we discussed the cash flow concerns of the water and sewer system funds with Exhibit B3, it is important to note the impact of the unfunded OPEB liability on the enterprise funds' combined Statement of Net Assets. As shown in Exhibit B11, there has been a deficit in unrestricted net assets since FY 2011. Despite a double-digit rate increase, the deficit will not be eliminated. The Water and Sewer Funds' proportionate share of the unfunded OPEB liability is eroding its financial position.

Because these are enterprise funds, accounting rules require the incremental unfunded liability for each year to be recognized on the Statement of Net Assets.

Exhibit B12: Key Data for Unrestricted Net Assets (Deficit) vs. OPEB Data

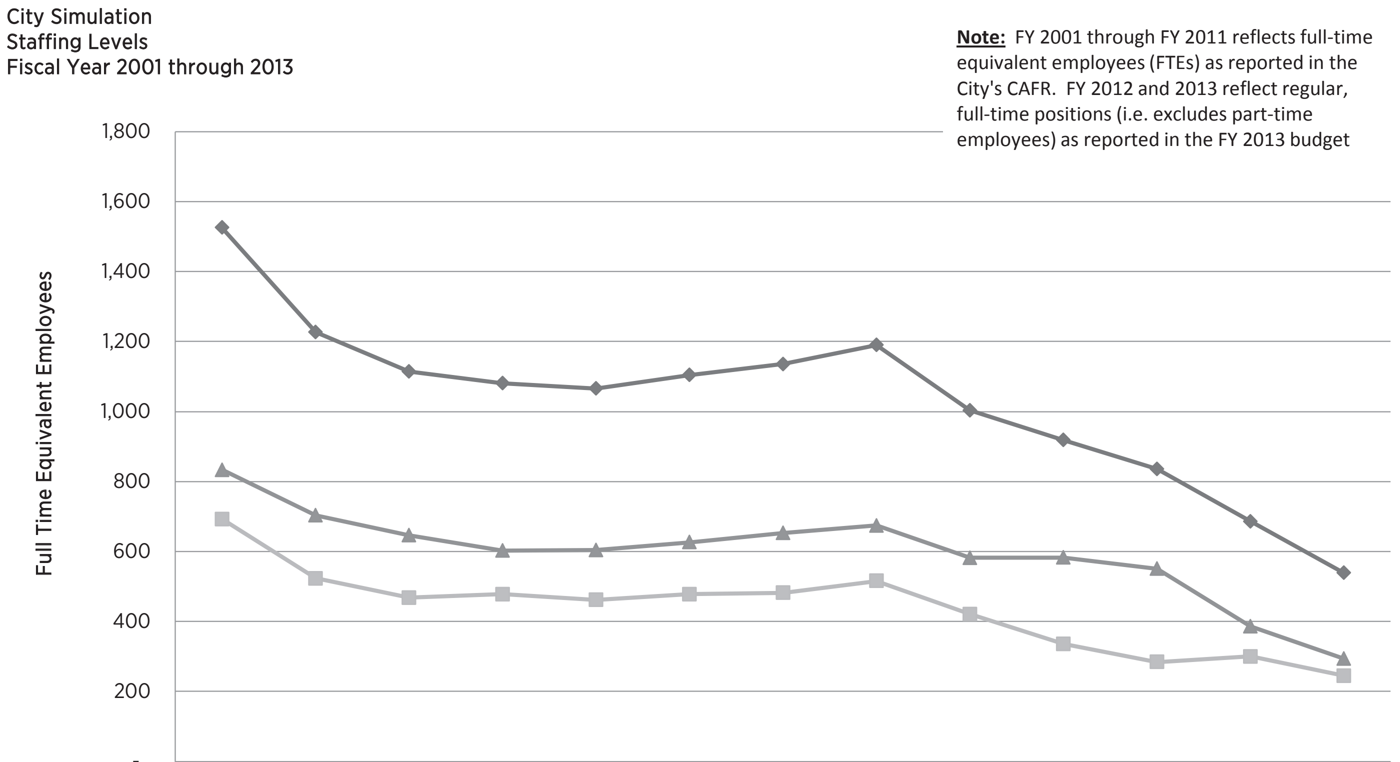
City Simulation
Water and Sewer Funds
Unrestricted Net Assets/(Deficit) vs. OPEB
FY 2007 through FY 2013

	2007	2008	2009	2010	2011	2012 Projected	2013 Budgeted
Other Postemployment Liability	$ -	$ 3,601,451	$ 7,850,265	$ 11,762,762	$ 16,449,351	$ 21,199,351	$ 26,199,351
Unrestricted Net Assets/(Deficit)	$ 46,399,453	$ 36,482,487	$ 24,023,067	$ 3,531,765	$ (12,866,614)	$ (20,884,122)	$ (23,379,690)

As shown in Exhibit B12, the unfunded OPEB liability is projected to be $26 million at the end of FY 2013. Unless the city begins prefunding OPEB, this liability will continue to grow resulting in a projected deficit of $23 million at the end of FY 2013. It is plausible that this relationship will continue unless the city funds OPEB or reduces the liability.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B13: Staffing Levels



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 Regular, Full-time	2013 Regular, Full-time
Public Safety	693	523	468	478	462	478	482	516	421	336	285	300	245
Other	833	704	646	603	604	627	653	674	582	583	551	386	294
Total	1,526	1,227	1,114	1,081	1,066	1,105	1,135	1,190	1,003	919	835	686	539

As with most cities, this city's single largest category of expenditures is personnel costs. To offset the pressure of revenue losses, the city has significantly reduced personnel. Exhibit B13 provides the staffing levels over the past decade and subsequent year budget. By the end of the previous fiscal year, the city had reduced its personnel by 45 percent from over a decade ago. Going forward, the FY 2013 budget reduces the workforce even further to 539 full-time regular employees.

Despite the significant staff reductions of 460 employees, or 37.5 percent, from the beginning of fiscal year 2003 to the end of fiscal year 2010, there was not an equivalent decrease in personnel expenditures. In fact, the dollar amount of wages and benefits continued to increase. Review of city documents revealed that total wages and benefits went from $79.6 million in 2003 to $93.2 million in 2010, an increase of $13.6 million or 17.1 percent. A significant portion of this increase is due to pension and healthcare costs.

Note: Financial amounts are for the purposes of the simulation only.

Exhibit B14: Per Employee Cost

City Simulation
Wages and Benefits on a Per Employee Basis
Fiscal Year 2003 through 2010

Fiscal Year	2003	2004	2005	2006	2007	2008	2009	2010
Annual wages (including overtime)*	$ 45	$ 44	$ 43	$ 47	$ 52	$ 58	$ 49	$ 46
Direct Cost of Fringe Benefits for Active Employees*	20.8	18.8	19.5	23.2	26.2	27.6	28.9	26.6
Total Wages and Benefits*	$ 66	$ 63	$ 62	$ 70	$ 78	$ 85	$ 78	$ 73
Average # of Employees During the Fiscal year	1,114	1,097	1,073	1,085	1,120	1,163	1,096	885
Average Wages and Benefits per Employee	$ 59,379	$ 57,608	$ 57,966	$ 64,778	$ 69,468	$ 73,502	$ 71,117	$ 82,355
Retiree Healthcare - Current premiums*	13.5	15.8	16.4	16.2	18.6	19.2	19.5	20.3
Per Employee Basis With Current Retiree Premiums (pay as you go)	$ 71,476	$ 71,987	$ 73,292	$ 79,670	$ 86,054	$ 90,010	$ 88,933	$ 105,324
OPEB ARC for Unfunded Liability*						40.9	35.7	37.0
Per Employee Basis All Costs						$ 125,210	$ 121,512	$ 147,102

* Expense levels shown in millions

Notes
(1) Includes all employees, both those with full benefits and those with minimum benefits required by law.
(2) Includes contribution for both normal cost and unfunded actuarial accrued liability for the defined benefit pension system.
Also includes other fringe benefits for active employees such as healthcare, worker compensation, FICA, unemployment, and life insurance.
(3) Represents annual required contribution (ARC) for other postemployment benefits (OPEB) (i.e. retiree healthcare). Data available as of FY 2008.
(4) Amounts obtained from City Finance Department.

Exhibit B14, above, demonstrates the impact of current retiree healthcare costs and the OPEB liability on a "per employee" costing unit basis. The FY 2010 average direct cost rate per employee was $82,355. Adding in the cost of current retiree healthcare premiums, that rate increases to $105,324. Finally, adding the actuarially determined annual contribution, the per employee basis increases to $147,102.

The purpose of analysis as shown in the last two exhibits is 1) for local officials to better understand the personnel costs for decision-making purposes and 2) to explain the impact of fringe benefits versus wages to stakeholders.