



## Next Up: Illinois Municipal Bankruptcy?

### Description

At its recent annual conference the Illinois Municipal League, a century old adviser and advocate for local government, took the unprecedented step of sponsoring an in-depth session on a volatile topic: hometown bankruptcies.

The September 18th session, entitled “Finance: Lessons from Detroit and Pension Cases,” couldn’t have been timelier. Many of Illinois’ municipal leaders are warily eyeing Motown’s bankruptcy proceeding while questioning whether their financially desperate and cash-crunched cities, the same fate, a Rescuing Illinois investigation finds.



At the very least, these leaders are now, more than ever before, openly

questioning if bankruptcy is a viable option to reorganize or slash their growing financial obligations, including public pensions for retirees and current workers.

Technically, Illinois municipalities can’t file for bankruptcy, although a pair of small downstate towns actually did, but they flew far under the radar and went through the process virtually undetected.

Still, efforts are emerging to formally sanction bankruptcy, and among the most outspoken proponents is the mayor of Rockford, the state’s third largest city and one of its most debt-ridden.

If you don’t see the video above, [click here and watch it on WTTW](#).

I’m a big advocate of giving municipalities the same tools that have helped the private sector bounce back and reset,” says Mayor Larry Morrissey, who moderated the Illinois Municipal League (IML) panel. “If it’s good enough for Chrysler and GM to restructure and become profitable again

it should be good enough for municipalities.â?•

## DETROIT IS NOT ALONE

The City of Detroit is probably the best-known example of a municipal bankruptcy, but distressed local governments in California and Alabama have also recently sought relief through Chapter 9 of the U.S. Bankruptcy Code.

Chapter 9, which in key ways differs from personal or corporate bankruptcy, enables municipalities, schools, park districts and other taxpayer-supported agencies to seek protection from creditors while restructuring debt, reworking contracts and perhaps even altering or reducing bond payments and employee pension benefits.

There have been approximately 660 Chapter 9 filings nationwide since 1937, mainly in small municipalities and taxing districts, says Chicago attorney James Spiotto, a municipal bankruptcy expert and managing director of financial consulting firm Chapman Strategic Advisors LLC.

Reasons for filing vary but often include troubled public development projects, unanticipated hefty legal judgments against a taxpayer-backed entity, or massive pension and bond debt payments that leave a municipality cash-strapped and unable to cover operating costs of employee salaries, vendor payments and other expenses.

U.S. bankruptcy law requires government entities to obtain specific authorization from the state to file for Chapter 9, but thereâ??s no provision in Illinois to grant that authority to local governments, so technically filings arenâ??t permitted.

## CASH-STRAPPED, WORRIED

Increasingly, though, local government officials statewide are discussing bankruptcy as a way to reorganize their troubled finances.

Mounting pension obligations and other debt, coupled with flat or declining tax revenues, are forcing local governments to slash services, increase fees and taxes and even borrow to make ends meet.

In a months-long investigation, released in August, the Better Government Association closely reviewed the finances of 217 police and fire pension funds in suburban Cook County.

The taxpayer-supported systems, with collective assets of nearly \$5 billion, are intended to provide public safety workers and their families with stable retirement incomes.

But the collective unfunded liability of those pension funds is \$3.3 billion, BGA Rescuing Illinois research determined. Moreover, dozens of the funds are in immediate financial peril.

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*Money in dozens of Chicago-area police and fire pension funds is drying up â?? which should be a big worry not only for current and future retirees, but taxpayers, a BGA Rescuing Illinois investigation*

discovers.

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Municipal leaders have told the BGA they're looking to state lawmakers to reform the local police and fire pension systems, easing their financial burden, but a legislative fix doesn't appear imminent.

Meanwhile, the debts keep mounting.

Morrissey says Rockford isn't in danger of falling into bankruptcy anytime soon. But if the city's pension obligations and other debts aren't brought under control it could cause problems down the road.

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Rockford's unfunded pension and post-employment benefit liabilities increased 15 percent to \$217.4 million in 2013, from \$188.8 million in 2008, even as the city's pension contributions increased, records show.

The same story is playing out across Cook County, where municipal fire and police pension debt is spiking, even as governments dump more cash into the systems, leaving less to spend on parks, roads and other important assets.

"If [Chapter 9] was available now I can think of several towns that would do it right now," says municipal attorney Burt Odelson. "Municipalities are having a terrible time paying the bills."

## **STEALTH BANKRUPTCY**

A pair of downstate towns successfully reorganized in the last decade, even though the municipalities didn't receive the required authorization from the state.

The Chapter 9 cases probably proceeded, bankruptcy experts tell the BGA, because no one challenged the filing petitions.

The towns are small with relatively limited assets and debts, so major financial reorganizations weren't necessary.

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In the first case, the Village of Brooklyn, a town of 750 people across the Mississippi River from St. Louis, filed in 2003, in part to help restructure payments related to lawsuits alleging police misconduct and financial mismanagement.

In the wake of an embezzlement scheme, the town, in a cost-cutting move, dropped its insurance coverage, leaving it unable to afford the mounting legal costs, according to court filings.

Two years later, in 2005, the nearby Village of Alorton, population 1,960, filed for bankruptcy, around the time a police-shooting victim obtained a \$978,000 judgment against one of the town's officers. The victim was one of Alorton's largest creditors, court filings show.

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“I’ll be honest, I just got away with it,” says Belleville attorney Stephen Clark, who filed Chapter 9 petitions on behalf of both towns. “Everybody either didn’t know [about the authorization requirement] or they knew and felt it was better to approve the plan.”

The Village of Washington Park, another Clark client, wasn’t as fortunate.

A federal judge dismissed the town’s bankruptcy petition in 2010 because state officials didn’t authorize the move. Washington Park also filed in 2004 but later withdrew, Clark says.

“We continue to go further and further in debt each year,” says Washington Park Village Attorney Eric Evans, who also represents the Village of Brooklyn. “We cut everything we can cut. Sooner or later we’re going to [have] bankruptcy without a bankruptcy.”

## **BACKING BANKRUPTCY OPTION**

Legislation surfaced last year that would’ve given financially distressed municipalities in Illinois a clearer path to Chapter 9. But the bill, introduced by State Sen. Kimberly Lightford (D-Maywood) and backed by the IML, didn’t win much support and was never called to a vote.

Lightford says there are no plans to reintroduce the bill and it’s unclear if the IML or other municipal advocates and leaders will get behind a similar proposal.

That’s not to suggest interest is waning, Morrissey and others say. Instead, it speaks to how contentious the issue has become.

In Illinois, public employee pensions are guaranteed by the state constitution. But in the Detroit and Stockton, California bankruptcy cases, federal judges have ruled that pension benefits can be adjusted, the same as other debts, despite a constitutional guarantee.

## **THE OPPOSITION**

Those rulings haven’t gone unnoticed in Illinois.

“Yeah, we’re very concerned,” says Pat Devaney, president of the Associated Fire Fighters of Illinois, a Springfield-based labor union. “For a community to declare themselves a deadbeat [would be devastating].”

James McNamee, the president of the Illinois Public Pension Fund Association, put it more bluntly: “We’re talking about people’s retirement! You can’t screw around with that.”

Even though bankruptcy has been useful for some U.S. towns, the Democratic state lawmakers who control the General Assembly are unlikely to give their blessing for fear of upsetting powerful labor unions, Morrissey and others say.

And it’s uncertain where Republican governor-elect Bruce Rauner stands on the issue, although he has vowed to shake up Springfield and deal with the public pension crisis.

But even Republican lawmakers acknowledge they have concerns about triggering a wave of filings and the harmful effect it could have on the state's reputation.

"I'd rather see [pension] reforms take place rather than bankruptcy," says state Sen. Dave Syverson (R-Rockford).

Nationwide, only a dozen states specifically allow filings, while California, Michigan, and nine others require legislative or gubernatorial approval. Illinois is not in that group, though it does have programs for financially distressed municipalities.

If certain qualifications are met, local governments can obtain state assistance through the Financially Distressed City Law and the Illinois Government Financial Planning and Supervision Act. The programs offer financial oversight and management, and perhaps even revenue from a loan or bond sale.

While the assistance may be beneficial, experts tell the BGA that the seldom-used programs are not nearly as comprehensive as Chapter 9.

A key part of the bankruptcy process includes the creation of a recovery plan that focuses on economic development—outlining steps to create jobs, attract new businesses, raise revenue and restructure debt.

"It's a process to become sustainable," says bankruptcy attorney Spiotto, though he cautions Chapter 9 can be "time consuming, expensive and not pretty."

But it's unavoidable in some cases, and with so many Illinois towns struggling, the bankruptcy chatter is unlikely to quiet down.

"If people were in a position of confidence we probably wouldn't be discussing it," says IML legislative director Joe McCoy. "But there's not a lot of confidence right now."