EMERGENCY FINANCIAL MANAGEMENT OF CITIES BY THE STATE: A CURE OR SIMPLY “KICKING THE CAN DOWN THE ROAD”?

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I. INTRODUCTION

This paper discusses the less than desirable outcomes of state takeover of municipalities in severe financial distress. Municipalities can fall into differing degrees of financial difficulty frequently for a variety of reasons. Serious financial difficulty threatening collapse and leading to takeover by the state – or even bankruptcy – has been rare.

Assumptions that state takeover – less onerous than bankruptcy – guarantees a “fix” for financially distressed communities would be incorrect. In fact, such takeovers dispense resources but do not fully address the root issues or mechanisms to achieve long-term financial solvency for the community involved: state takeovers are only part of a continuing, repetitive cycle for so many communities.

II. BACKGROUND

Many units of local government throughout the United States are now in varying degrees of financial crisis.² In fact, many anticipate that the number of local units in severe financial distress will increase significantly over the upcoming year.³ The overall economic situation

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strongly suggests a worsening financial climate for local units of government.\textsuperscript{4} The emergency financial management process initiated in Michigan, a type of receivership, currently serves to only worsen the economic climate in the local communities affected by the law. Without more reform from the legislature on the emergency management laws, the economic climate in struggling Michigan cities will continue to weaken.

The following chart depicts the broad areas of the country affected by the most recent recession as well as that of 1980-1982.\textsuperscript{5}

Municipalities in Rhode Island, Pennsylvania and Michigan have already been taken over by state officials as prescribed by respective state laws.\textsuperscript{6} Some municipalities have resorted to bankruptcy, as is the case in Vallejo, California, Central Falls, Rhode Island and, the largest, Jefferson County, Alabama.\textsuperscript{7} Jefferson County “is a place where government finances, and government itself, have simply broken down. The County, which includes the City of Birmingham, is drowning under

\begin{itemize}
  \item 4. \textit{Id.}
  \item 5. \textit{Id.}
  \item 6. \textit{Id.}
  \item 7. \textit{Id.}
\end{itemize}
$4 billion in debt, the legacy of a big sewer project and corrupt financial dealings that sent 17 people to prison.”

Recently, the state capitol of Pennsylvania, Harrisburg, was the 27th city to enter a program provided for under State Act 47 designed to help “develop financial recovery plans.” In a New York Times article concerning a rash of New York State communities in difficulty, it was indicated that:

Suffolk County, one of the largest counties outside New York City, projected a $530 million deficit over a three-year period and declared a financial emergency … Nassau County is already so troubled that a state oversight board seized control of its finances last year … The problems are spreading as municipalities face a toxic mix of stresses that has been brewing for years, including soaring pension, Medicaid and retiree health care costs. And many have exhausted creative accounting maneuvers and one-time spending cuts or revenue raisers to bail themselves out.

Finally, in Michigan, the serious woes of Detroit and other Detroit-area financially distressed communities facing Michigan Public Act 4 are depicted graphically in the Detroit Free Press:

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III. ANALYSIS

Many more municipalities can be anticipated to follow the path of receivership or bankruptcy in the near future as the negative effects of a lagging national economy cascade and intensify economic pressure at the local government level.

It must be further stated that the state laws existing to help communities in financial distress are inadequate for the task. On this

11. Revenue Falls Faster Than City’s Spending, DETROIT NEWS, April 19, 2012.
12. Id.
13. A situation in which a “receiver” is “placed in the custodial responsibility for the property of others, including tangible and intangible assets and rights,” generally as an alternative to bankruptcy. See Ken Philip and Kerin Kaminski, Receivership, A Value-Adding Tool, THE SECURED LENDER, at 30.
14. GREENSTONE & LOONEY, supra note 2, at 11.
15. See Varghese, supra note 8.
point the words of Pennsylvania State Senator Jeffrey E. Piccola, that Harrisburg, the State Capital, “wouldn’t be in its situation if the oversight program [Act 47 in Pennsylvania] was stronger,” are a fitting description of weaknesses in other state legislation as well.16

When state takeover occurs in a financially distressed community, massive expense and service reductions are typically implemented in order to address the financial emergency as quickly and as expeditiously as possible.17 Local units of government lose considerable local control during such situations.18 Greater and more careful study of the broad ranging effect of actions taken during State control of communities should be conducted to ascertain whether real long-term progress is being made under the laws that currently exist.

The expedient steps taken to address the financial situations in distressed communities have numerous unintended negative consequences. Steps being taken to address the financial situation should be more carefully studied before they are implemented. After taking in these severe financial situations, major steps should be retrospectively analyzed to assess the full long-term impact on the community. Analysis would help ensure that steps that are overall detrimental to a community are more cautiously reviewed before being implemented by a state in other similar situations.

Actions taken in municipal financial emergencies by State emergency management powers may further exacerbate future economic, social, and political difficulties. These actions can damage chances for economic recovery and actually increase the likelihood of communities repeating the experience of receivership, a term known as “recycling” in the process. Steps taken in the hurry to financially administer a cure can lead to subsequent bouts with the same disease for the community. To compare, in the middle ages, bleeding was a frequently administered treatment for many health problems; the rush to administer treatment was ahead of the research, and case studies were not readily available. This situation is comparable to the prescribed cure faced by so many communities when the state outlook is to rapidly balance the books without considering the multitude of other factors present.

Acting single-mindedly to address only the current financial crisis, which is similar to a symptom in our analogy, without acting to address the root causes of the crisis can mean future recycling in the process for

16. Id.
17. See Varghese, supra note 8 (discussion of reducing pension benefits); see also Mahler, infra note 17 (cutting large numbers of full time local employees).
18. See Varghese, supra note 8 (quoting Gerald Cross, stating that take-overs were in opposition to “long tradition of local-government sovereignty”).
distressed communities. State receivership laws are inevitably going to be inadequate if they do not stop the all too common and hugely expensive community recycling process. For example, in Michigan, many of the communities currently in receivership are repeating earlier such episodes: Flint, Ecorse, Highland Park, Benton Harbor, and Pontiac are either in the process of or very likely to begin recycling in the near future.

Improving the community’s ability to stand as a financially viable and economically stable municipality, post receivership, will require more than tactics such as balancing the books by selling off community assets. Significant time and monetary investments in the development of both civic capital and capital infrastructure networks, undertaken concurrently with financial reforms, will be required. This acknowledgment and understanding of the importance of building an essential framework to help achieve long-term financial stability is lacking in state receivership legislation. For example, during financial takeover crises, civic leadership is typically displaced, rather than developed.\textsuperscript{19} As Jonathon Mahler states in a New York Times article, in reference to actions of the emergency manager in Benton Harbor, Michigan, to prohibit meetings of the City Council, “Democracy has now officially been suspended in Benton Harbor.”\textsuperscript{20} The very public struggle for control between the Michigan’s governor and the local government of Detroit provides further evidence of the difficulties involved in displacing the power of elected representatives of a financially distressed community.\textsuperscript{21}

Similarly, the capital infrastructure essential for future economic success is not developed during receivership. Usually, many capital assets are simply and quickly divested in order to obtain cash, and no real effort is made to develop the infrastructure of the distressed community, enabling the community to better meet the economic challenges of the future.

Investments in the two key areas of civic and capital infrastructure should be carefully measured and analyzed during the term of receivership, while at the same time requiring the typical financial balance sheet statistics that are always deemed necessary for these

\textsuperscript{19} See Mahler, infra note 17.
situations. The measurement of civic and capital infrastructure investment statistics should be required by state legislation throughout receivership in order to more fully allow evaluation as to whether progress toward the long-term goal of financial success of the community is truly being made.

The difficulties in finding long-term solutions for communities in receivership are aggravated by the conflicting goals of many federal programs which, created decades ago, continue on as though little had changed in the economic situation of the community over that time. For example, many outdated Housing and Urban Development Department (HUD) policies aimed toward the creation of additional affordable housing in distressed communities already possessing a surfeit of vacant housing are counterproductive. The often times hamper the overall financial recovery of a community in receivership by using scarce funding in ways that are at odds with the overall economic condition of the community. HUD policies should be adjusted and refined to allow communities to use funding where more appropriate and to assist in relieving the financial distress of the community in receivership.

Another example is the frequent late or incomplete repayment of HUD redevelopment loans through lax local and federal enforcement, which further aggravates the financial distress of affected communities. According to Detroit city officials, “Nearly all the developers who tapped a special federal loan program to redevelop some of downtown and Midtown Detroit’s most visible buildings are behind or have not made a single payment -- lost revenue the city would direct to other improvement projects.”

There are several improvements to state legislation that are necessary to reduce the chances of communities recycling into receivership, dealing with civic or social capital, elected officials, members of local advisory boards and commissions, and perhaps members of civic groups such as Rotary and Kiwanis. These areas should receive much focus and attention in terms of training and development during receivership. This will assist groups become more prepared to help the community to function prudently and effectively in economic and financial terms after the community exits receivership. Absent such focus, lasting results will

22. See Mahler, supra note 17.
24. Id.
25. Id.
be difficult to achieve and any reforms undertaken will be difficult to institutionalize.

Methods and obligations of the receivership process must be spelled out in state legislation for those communities entering the process as to what those civic capital groups will be required to do in order to prepare to return the city to financial self-governance, and to have a chance to exercise financial authority in a manner which will avoid recycling into receivership again. Establishing obligations and goals in the realm of developing civic capital should be a major focus of the state legislature and contained within the relevant legislation.

Methods and obligations regarding designing and reinvigorating the capital infrastructure of the community must be structured and specified in state laws for communities entering into receivership. This is important in order to provide the ability for the community to face the post-receivership economic future. It should not be sufficient for state receivership agents to sell off capital assets wholesale and then depart with no carefully considered, planned, funded, or implemented capital infrastructure concept in place to allow the community to financially sustain itself following receivership. The ability of the community to further strengthen its economy in the post-receivership period is important. One of the most important ways in which to derive funding for investment in capital infrastructure is for state receivership legislation to emphasize the importance of collecting delinquent utility rates, some of which are as high as 20 percent in distressed communities, instead of just writing them off as uncollectible.\textsuperscript{26}

\section*{IV. Conclusion}

The respective methods and obligations for the state and receivership communities must be specified in receivership legislation with regards to data collection and critical areas to be monitored in both the long and short terms. Specifying these methods and obligations is necessary in addition to the usual financial performance data routinely required and provided in accordance with normal governmental accounting standards because that data fails to present the complete picture of the true financial recovery prospects of a community in receivership.

Much work in the area of monitoring the effects of state actions during receivership is necessary. The absence of data means that states are still directionless when trying to cure the ills of receivership communities. With few precise long-term expectations in place in state

\textsuperscript{26} See Mahler, \textit{supra} note 17.
legislation, receivership will most often translate into an exercise in delaying the inevitable, rather than achieving a lasting cure for the problems facing many communities, and leads again to financial distress and receivership.