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MUNICIPAL BANKRUPTCY

IN PERSPECTIVE

A JOINT REPORT
FROM THE BUREAU OF GOVERNMENTAL RESEARCH
AND THE PUBLIC AFFAIRS RESEARCH COUNCIL OF LOUISIANA

Hurricanes Katrina and Rita, and the failure of the levee system in Katrina's wake, left a swath of devastation unprecedented in modern U.S. history: 200,000 homes badly damaged or destroyed, 18,000 businesses ruined, 422,000 residents displaced and still unable to return home, and critical infrastructure destroyed. In Louisiana, the damage was particularly severe in Cameron, Orleans, Plaquemines, and St. Bernard Parishes.

The widespread destruction and displacement have created fiscal crises for some local governments dependent on sales and property tax revenues. With their tax bases in shambles, they must meet the three-fold challenge of servicing existing debt, providing services, and rebuilding damaged infrastructure. Whether and, if so, how the more severely impacted local government entities will be able to meet the challenge remains to be seen.

Faced with problems of a similar scope, a business would consider all of its options, including filing for bankruptcy. Severely distressed local governments should do the same. However, the bankruptcy option has been removed from the table for local governments by state officials concerned about the stigma of bankruptcy and its potential impact on other governmental entities in the state.

BGR and PAR are not taking a position for or against using the bankruptcy law. Rather the intent of this report is to frame the issue for further discussion and consideration.
The report examines the potential role of bankruptcy as a tool to help restore fiscal stability in those Louisiana local governments hardest hit by the storms. It provides a brief overview of federal and state law on municipal bankruptcy, describes the advantages and disadvantages of the option, and looks at the financial condition of selected governments and their debt positions.

EXECUTIVE SUMMARY

Based on available indicators, it appears that most local governments in Louisiana are not experiencing severe financial distress as a result of Hurricanes Katrina and Rita. However, a number of parishes face tremendous challenges in the short- and long-term. BGR and PAR reviewed selected entities in three of those parishes – Cameron, Orleans and St. Bernard – to determine whether they were likely to need assistance in dealing with their financial issues. The City of New Orleans and the Orleans Parish School Board received more in-depth analysis.

Fortunately, many of the Louisiana local entities affected by the hurricanes have resources or options they can draw upon to avoid resorting to the courts. Some entities outside of New Orleans may require some additional assistance, but this need appears relatively small compared to the magnitude of the fiscal distress in New Orleans.

HARD-HIT PARISHES

Cameron Parish and St. Bernard Parish

Of the local government entities reviewed by BGR and PAR, those in Cameron Parish appear to be the best situated. St. Bernard Parish faces an uncertain future. Although debt levels are not

high, more than 80% of the parish's population has been displaced and most of its housing destroyed.

City Of New Orleans and Orleans Parish School Board

Both the City of New Orleans and the Orleans Parish School Board face severe financial difficulties. Flooding left two or more feet of water in almost two-thirds of housing units. Large swaths of the city remain uninhabited, and only half of the city's pre-Katrina population is expected back by the third anniversary of the storm. The damage and population loss have caused the local economy to contract severely, and the tax base has declined with it.

City of New Orleans. The City's projected 2006 budget reflects a drastic decline in current revenue sources, with tax revenues falling from $260 million originally expected in 2005 to $110 million in 2006. Only 59% of General Fund revenue is expected to come from local taxes. The City is counting on borrowings, including $36 million left of a post-disaster loan from the federal government, to pay operating expenses. To maintain the current level of services, projected to require $369 million, the City would need an additional $147 million. Without this money, the City will not have sufficient funds to pay for unfunded state mandates and for police, fire, and other services. Current cash flow projections show the City running out of funds in May.

While revenues have plummeted, the City's debt load has actually increased. Its outstanding indebtedness totals $964 million, with debt service estimated at $96 million this year. Payments for debt service will exceed property tax collections this year.

The City's projected 2006 budget reflects personnel cuts that eliminated half of the City's work force. It includes no funding for infrastructure – an area with substantial needs before the storm. While outside assistance is available for repairs related directly to the storm, substantial additional capital investment is needed to bring infrastructure up to standard.

The City clearly faces tremendous challenges – debt levels approaching $1 billion, a greatly reduced population to support that debt, and dramatically lower tax revenues. Its ability to survive and rebuild a healthy community will depend on a number of unknowns, including whether its tax base can be restored to its pre-Katrina level in the near future. The City's options for dealing with the crisis are reviewed below.

Orleans Parish School Board. The School Board had chronic financial, infrastructure, and academic problems before Hurricane Katrina. In the fall of 2005, the system was essentially dismantled when the Board of Elementary and Secondary Education (BESE) swept 102 failing schools into a state-run Recovery School District (RSD). This left only 16 schools under the control of the School Board.

The School Board's projected 2005-06 revenues are $235 million, 55% of the pre-Katrina budgeted number. Projected expenses total $223 million. At first glance, the amount of both revenues and expenses appear large for a district with only 14% of its pre-Katrina student

population. However, the School Board has significant fixed and extraordinary costs, including $34 million for debt service and an accrued liability of $68 million owed to the state for unemployment compensation. In addition, it is required by law to transfer to the RSD a fixed amount of local funding for each student attending an RSD school.

Although the budget shows a surplus of $12 million, the picture is not as rosy as it seems for a number of reasons. First, revenues include $40 million of extraordinary grants and borrowings from the federal government to meet operating expenses. Second, the School Board expects to owe the state $68 million for unemployment compensation, of which only $11 million is included in the budget. The amount owed could grow to $120 million. Third, the School Board's debt ($266 million) and other fixed costs, such as retiree health care benefits, were incurred in the context of a much larger system and weigh disproportionately on a smaller student population. Assuming that the School Board has 11,442 students in 2006-07 (half of the student population projected by BESE), existing debt service would be a $3,000 a year per pupil, five times the pre-Katrina amount. If the debt were spread over the student population for both the School Board and the RSD, it would equal $1,500 per pupil, two and a half times the pre-Katrina amount.

The School Board is experiencing serious cash flow problems and would run out of funds this year were it not for Katrina-related federal grants and loans. Like the City, the School Board is facing severe constraints, and the burden of existing obligations could interfere with the School Board's constitutional obligation to provide a minimal level of education.

OPTIONS

Fiscally distressed local governments can turn to a number of options short of default or bankruptcy to put their fiscal house in order. These include: cutting expenditures, raising taxes, postponing payment of obligations, drawing down reserves, renegotiating debt obligations to reduce or defer payments, and borrowing from government entities or commercial lenders.

Some of the solutions available to local governments, such as borrowing, refinancing bonds, or postponing payments on other obligations, would provide temporary relief by increasing costs in the long run. For local governments that are experiencing only a temporary disruption in cash flow, these options can provide the needed cover until their normal revenue streams are restored. In the case of a public entity with longer-term problems, short-term fixes may just delay the day of reckoning or compound the problem.

Other remedies, such as raising taxes or cutting services, may actually hinder the municipality's ability to stabilize itself. This would occur where taxes rise, or services fall, to a level that discourages investment or results in disinvestment. Under those circumstances, the disadvantages of default or bankruptcy must be weighed against the cost of the municipality continuing to meet its obligations. Where the cost to the community's health is too high, bankruptcy becomes an option to consider.

MUNICIPAL BANKRUPTCY

Municipal bankruptcy provides local governments with a means to refinance or reduce debt and to obtain relief from burdensome contracts. It does not wipe the slate clean. It is a relatively rare phenomenon. Fewer than 500 petitions have been filed nationwide, and most have been for small entities such as irrigation districts. BGR and PAR are aware of only one filing in Louisiana, which was made by a hospital district.

A number of factors may contribute to the scarcity of cases:

- The threshold requirements for municipal bankruptcy are high. The entity must be insolvent, and its state must specifically authorize the filing. As explained below, the latter poses a significant hurdle.
- The municipality is required, as a precondition to filing, to engage in negotiations with its creditors or to be excused from such negotiations for reasons specified in the statute. The negotiations may lead to a resolution of the problem outside of court.
- To meet the requirements for court approval of a bankruptcy, municipalities are required to engage in self-help remedies, such as using their borrowing capacity or raising taxes to the extent practical. Thus, municipal bankruptcy cannot be used to avoid politically unpleasant but reasonable actions.
- Municipalities are not exposed to some of the risks that lead other creditors to seek bankruptcy protection. For example, their assets are not subject to seizure.
- Municipalities, like businesses, are concerned about the ramifications of bankruptcy on their ability to borrow and the cost of such borrowings.
- Some of the relief that is theoretically possible, such as abrogating union contracts, may not be achievable as a practical matter, given the requirement for state authorization.
- The process is expensive.

Despite the limitations and possible fall-out from bankruptcy, bankruptcy can help a municipal debtor in critical ways:

- It provides immediate relief by staying the municipality's obligation to make payments on debt other than special revenue bonds.
- It provides a means of obtaining long-term relief, including reduction in debt and other obligations, that will bind a dissenting minority if a majority of creditors consent.

- Bankruptcy can protect a municipality and its residents from untenable levels of taxation by blocking creditor lawsuits seeking to force officials to raise taxes to support debt.

- Because post-filing borrowings to support the entity's operations are given a higher priority than pre-filing borrowings, it can in some cases facilitate borrowing.

In the governmental sector, bankruptcy is considered a remedy of last resort. However, when all other short-term options have been exercised or have failed, it is useful to have access to this process. Municipal bankruptcy is not a perfect solution for a governmental entity's fiscal problems, but it can provide breathing room while other long-term options are pursued. Local governments must continue functioning, and temporary or partial relief from heavy debt service obligations can make a difference.

ADDRESSING THE PROBLEM

The City of New Orleans has attempted to adjust to the changed circumstances by firing 3,000 employees, suspending capital expenditures, raising taxes to pay debt, borrowing from the federal government, and negotiating to restructure its debt. It has also attempted, unsuccessfully to date, to borrow from financial institutions. In late March, the City issued a Request for Proposals for financial and management consultant services to advise the City about how to improve its revenue forecast model, expand revenues, contain spending, and enhance its credit rating.

The Orleans Parish School Board is also pursuing funding options, including borrowing from the federal government and pursuing Hurricane Education Act funds and charter school grants. It has fired almost its entire work force and raised taxes to cover debt service requirements.

Despite steps taken to date, both the City and the School Board are teetering on the edge of a cliff. The School Board is dealing with chronic cash flow problems and would be running a deficit were it not for federal disaster-related grants and loans. It is facing extraordinary expenses as a result of massive lay-offs. The City is one month away from running out of cash, and there is no plan in place for dealing with the cash flow problem.

The School Board has advised the State Bond Commission that it has the funding needed to pay debt service on its long-term obligations. The Board of Liquidation has made provision for paying city debt under its management. But the City's budget projections clearly indicate that the City currently lacks adequate funds both to pay debt service on its other obligations and to provide its current, rather dismal level of services. The School Board's extraordinary expenses and fixed costs could interfere with its ability to provide even a minimal level of education.

While BGR and PAR are cognizant of the importance of local government entities' paying outstanding indebtedness, they submit that debt repayment needs to be considered in the larger context of restoring the community's health and recovery: What conditions are needed to retain and attract residents and businesses? Would the various options for dealing with the entity's debt and other obligations promote or impede the creation of those conditions?

For destroyed communities, recovery depends in part on the government's ability to deliver vital services, such as police, fire, and sanitation, and to cause an attractive environment to rise out of the ashes. In the case of Orleans Parish, it also depends on the continued reform of the school system, and the availability of sufficient resources to elevate the level of public education.

For a devastated community, continuing to shoulder pre-Katrina debt loads and obligations may interfere with its ability to create the conditions needed for recovery. In that context, bankruptcy is a legitimate line of inquiry and should be evaluated. While its limitations and negative implications must be carefully considered, the drag of outsized debt, reduced services, and elevated tax rates on redevelopment should also be analyzed. It becomes a matter of a hard-nosed cost-benefit analysis. As noted at the outset, it is not the purpose of the report to advocate bankruptcy as a solution to local fiscal problems, but simply to examine it as an option.

The state has consistently taken the position that the disadvantages of bankruptcy outweigh any advantages a local public entity might gain. It must now take the next step and provide alternative means of relief. It could begin by tapping into relief funds and programs provided by the federal government for hurricane relief. The state's options for assisting local government entities with their fiscal crises include:

- Providing grants or loans through the Gulf Opportunity Zone tax credit program.
- Allocating Community Development Block Grants to local government expenses.
- Using general fund revenues.
- Picking up the cost of unfunded mandates or other amounts owed the state, such as unemployment compensation.

BGR and PAR call on the state and distressed local governments to embark immediately on a joint effort to assess and address their financial problems and needs. The problems are not going to disappear on their own.

MUNICIPAL BANKRUPTCY LAW

While federal law permits local governments to file for bankruptcy under certain circumstances, municipal bankruptcy is rarely pursued anywhere. Nationwide, fewer than 500 petitions have ever been filed and most of those have been for small entities such as water districts. The last major municipal bankruptcy occurred in 1994 when Orange County, CA, filed for relief.

Default on debt appears to be equally rare. A study by Moody's Investor Services found that only three general-purpose governments rated by Moody's have defaulted on long-term bonds in 30 years.

Municipal bankruptcy is governed by Chapter 9 of the U.S. Bankruptcy Code. Like Chapter 11, which governs reorganizations of publicly and privately owned business organizations, Chapter 9 is designed to provide a financially distressed local government entity with protection from its creditors while it negotiates a plan for adjusting its debt. Reorganization typically involves extending debt maturities, reducing the amount of principal or interest, or refinancing debt with new loans. It is not intended to wipe the slate clean. The goal is to satisfy creditors to the extent feasible under the circumstances, while providing the municipality with the means to continue providing services at some basic level. The Bankruptcy Code does not provide for the liquidation of a municipality's assets and the distribution of the proceeds of those assets.

Creditors cannot force a municipality into bankruptcy. Only the municipality can initiate the proceeding. It does this by filing a voluntary petition under Chapter 9. At the time the debtor files the petition, or at a later time agreed to by the court, the debtor files a plan for the adjustment of its debts and a disclosure statement. After the bankruptcy court approves the disclosure statement as containing adequate information, the disclosure statement and plan are sent to the creditors for a vote. Thereafter, the court holds a hearing at which it evaluates whether the plan meets the confirmation requirements. A plan cannot be confirmed if it does not meet the requirements. It can, however, be amended to address objections or concerns raised by creditors or the judge.

Once the plan is confirmed, the debtor has deposited with a disbursing agent the consideration to be distributed under the plan, and the court has determined that any provision to make future payments is a binding obligation of the debtor, then the debtor's pre-petition obligations are replaced with those contained in the plan. The debtor is discharged from all debts, other than those that are specifically excluded in the plan or confirmation order or debts owed to creditors without notice or actual knowledge of the Chapter 9 proceedings.

ELIGIBILITY REQUIREMENTS

In order to file for Chapter 9 bankruptcy, an entity must meet a number of statutory requirements:

Qualify as a Municipality

The local government entity must be a political subdivision or public agency or instrumentality of a state. The concept includes a parish, municipality, or any other unit of local government, such as school boards and special districts, authorized by law to perform governmental functions.

Obtain State Authorization

While federal law provides the legal framework for municipal bankruptcy, access to the forum is controlled by state law. State authorization is required to avoid running afoul of the Tenth Amendment to the U.S. Constitution, which prohibits the federal government from interfering with the sovereign power of states.

A municipality must be specifically authorized to make a Chapter 9 filing either by statute or by a statutorily designated governmental officer or organization. Louisiana law requires the prior consent of the governor, attorney general, and State Bond Commission. The State Bond Commission is chaired by the state treasurer, and its members include representatives of the governor, lieutenant governor, president of the Senate, speaker of the House, secretary of state, attorney general, commissioner of administration, chairmen of the legislative fiscal committees, and two legislators. The State Bond Commission must also approve any resulting debt adjustment plan. The state treasurer has made a commitment to the rating agencies and bond insurers that he will not vote to allow any municipality in the state to enter into bankruptcy. Obtaining these approvals would obviously be a significant hurdle for any local governmental entity contemplating bankruptcy.

Be Insolvent

Unlike a business organization under Chapter 11, the municipality must be insolvent to file for bankruptcy. That is, it either is not paying its debts or will not be able to pay its debts as they come due. Because municipal assets are not subject to seizure and sale, insolvency of a municipality is not determined simply by examining its current balance sheet. Determination of a municipality's insolvency requires a comprehensive cash flow analysis of factors including multi-year cash flows, available reserves, ability to reduce expenditures or borrow, and legal opportunities to postpone debt payments. The municipality is expected to continue operating and providing at least a minimal level of services.

A municipality's taxing capacity also enters into the analysis of insolvency. Although a municipality need not exercise its taxing authority to the fullest extent possible before a court can deem it insolvent, a failure to consider any reasonable tax increase may lead a court to conclude that the good faith requirement, discussed below, is not met.

In a case involving the bankruptcy filing of Bridgeport, Conn., the court held that the city, which had chronic financial problems, a $16 million annual deficit, and the highest effective tax

rates in the state, was not insolvent because it had not exhausted its borrowing power and, therefore, could not demonstrate that it would run out of funds in the next fiscal year.

Negotiate in Good Faith

The municipality must be seriously interested in developing a workable plan to adjust its debts. In addition, the debtor must have negotiated in good faith with its creditors or been excused from so doing for one of two reasons. These include an inability to negotiate because such negotiations are impracticable, an exception designed to assist large municipalities with large numbers of creditors. The obligation to engage in pre-filing negotiations is not found in the bankruptcy law governing Chapter 11 business filings.

IMPACT ON OPERATIONS

Although the threshold for seeking bankruptcy protection is higher for a municipality than for a business entity filing a Chapter 11 petition, a bankrupt municipality is subject to fewer constraints on operations, and the court's role and powers are far more limited. The bankruptcy court cannot take over the governance of the debtor or appoint a trustee. The court's primary role is limited to determining whether to enter an order for relief after the petition is filed, determining whether to confirm the plan and grant a discharge, and ruling on any matter brought before it related to implementation of the plan.

Nor can the court interfere with the municipality's political or governmental powers or with its properties or revenues, without the municipality's consent. The end result is that the court cannot order reductions in expenditures, increases in taxes, or sales of property. In addition, the municipality can continue to borrow in the ordinary course without bankruptcy court approval, if it is able to do so without affecting the rights of existing creditors. Neither creditors nor courts may control the affairs of the municipality indirectly by proposing a readjustment plan that would effectively determine the municipality's future tax and spending decisions.

During the pendency of a Chapter 9 bankruptcy proceeding, the municipality is not required to pay principal or interest on general obligation bonds. Special revenue bonds are payable to the extent that the special revenues are available after payment of the ongoing operating expenses of the project or system from which the revenues are derived.

PLAN OF ADJUSTMENT

Chapter 9 provides the debtor with a means to refinance or reduce its debt and to obtain relief from burdensome contractual obligations, such as collective bargaining agreements. The content of the plan appears to be largely a matter of negotiation, within broad parameters defined by concepts such as "fair and equitable" and "in the best interest of creditors."

The plan can impair the rights of holders of secured, as well as unsecured, claims or leave unaffected the rights of a particular class of claims. This includes general obligation indebtedness, which has a claim on the full faith and credit of the community, as well as other

types of debt. In addition the municipality can reject executory contracts (including collective bargaining agreements and retiree benefit plans) and unexpired leases, subject to court approval.

The bankruptcy court is required to approve a Chapter 9 bankruptcy plan if all the statutory conditions are met. These include, among others, requirements that:

- The plan complies with applicable provisions of the Bankruptcy Code, including consent provisions.
- The debtor is not prohibited by law from taking any action necessary to carry out the plan.
- All necessary regulatory or electoral approvals have been obtained or obtaining them is a condition of the plan.
- The plan is "in the best interests of creditors and is feasible."

Acceptance by creditors

Under the applicable provisions of the Bankruptcy Code, confirmation is conditioned on acceptance of the plan by each class of creditors whose claims or interests are "impaired" (*i.e.*, the creditor's legal, equitable, or contractual rights would be altered by the plan). Unlike the situation outside the federal bankruptcy process, the accepting vote of a statutory majority will bind dissenting creditors in a class.

"Cramdown" – binding a dissenting class

Alternatively, the court may confirm a plan notwithstanding the plan's rejection by a class if at least one impaired class of creditors has accepted it. This process is sometimes referred to as "cramdown." Cramdown, in essence, forces creditors to go along with a plan that they have not approved. In the case of a cramdown, the court must find that the plan does not discriminate unfairly, and is fair and equitable. When a cramdown occurs, secured creditors must receive at least the value of the property securing their claims. Holders of special revenue bonds are entitled to continue to receive project revenue pledged in support of such bonds. Unless unsecured creditors are paid in full, holders of any subordinated indebtedness cannot receive anything. Absent subordinated general obligations, this test is easily satisfied for unsecured creditors.

Best interest of creditors and feasibility

A plan is feasible if the court believes that the debtor can make the payments required under the plan and still maintain its operations at the level it considers necessary for continued viability of the community. What the best interest test requires in the case of a municipality is more elusive. The test has been interpreted to mean that the plan must be better than other alternatives available to the creditors. In a Chapter 9 case, the alternative would be dismissal of the case, leaving a chaotic situation in which every creditor must fend for itself. The best interest test requires the court to walk a middle line, although it requires that the debtor reduce

debt through reasonable payments over a reasonable period of time. It does not require the debtor to dedicate all its resources to debt repayment.

One issue of some ambiguity is the extent to which the best interest test requires a municipality to raise taxes in order to meet debt obligations. The Supreme Court has held that the fairness of a plan cannot be evaluated without specific findings on a district's ability to repay bonds with tax revenues. In an early irrigation district case, the Ninth Circuit Court of Appeals required a showing that the taxing power was inadequate to raise taxes to pay the debt.

Determining the point to which taxes can be raised is a tricky proposition. At some point, tax increases trigger decreases in the collection rate, causing stagnation or decline in tax revenues. The cycle can become vicious, with each decrease in collections leading to higher tax rates, and each increase in tax rates leading to a greater decrease in collections. The increased rates can also dampen economic activity, further exacerbating the revenue problems that led to the bankruptcy filing in the first place.

Compliance with state law

The municipality's plan cannot require it to take actions that are beyond its power under state law. For example, the municipality, in arranging a debt adjustment, would have to comply with state legal restrictions on its ability to incur or refinance debt.

Regulatory and electoral approvals

A municipality's ability to raise taxes or incur additional debt may be impeded by factors other than the purely pragmatic considerations. For example, the Louisiana Constitution and state law require voter approval for millage increases above specified levels. The bankruptcy filing and confirmation of the plan do not eliminate the need to obtain that approval. Nor do they eliminate the need for approvals by the State Bond Commission or action by the state Legislature, where required.

Advantages and Disadvantages of Bankruptcy

A municipality considering bankruptcy would have to weigh the benefits and disadvantages of the remedy. While there is much in the way of theory, there is little in the way of a track record. In addition, whether generally perceived disadvantages would negatively impact a specific municipality depends on the larger context. The same is true in the case of generally acknowledged advantages. In that regard, it should be noted that the interest of the state and its municipalities do not necessarily coincide.

In this section, we discuss in general terms what bankruptcy might accomplish and what problems it could create. Most of the perceived disadvantages of bankruptcy relate to its impact on a municipality's ability to borrow and the cost to it and other governmental entities in the state. The advantages relate to the potential for debt relief.

What would bankruptcy accomplish?

A threshold issue for any entity contemplating bankruptcy is: What would bankruptcy accomplish?

Modification or Limitation of Obligations. Municipal bankruptcy, unlike a Chapter 7 filing for individuals or business entities, does not provide the debtor with a clean slate. Rather it provides a local government with protection from creditors while it renegotiates its debt. The end result may be a reduction in the amounts of principal and interest owed, temporary relief gained by postponing principal or interest payments to later dates, or relief from burdensome contracts. It should be noted that other factors, such as political pressure from employee organizations or state laws, may make it difficult or impossible to translate these theoretical possibilities into reality.

Ability to coerce recalcitrant creditors. Confirmation of an adjustment plan is predicated on a municipality's good faith negotiation with its creditors. Ideally, the municipality and creditors would reach agreement without resorting to the bankruptcy courts. This may not be possible for a number of reasons, including hold-outs by unwilling creditors. Bankruptcy helps in two ways. First, consent of an impaired class of creditors requires a less than unanimous affirmative vote (i.e., the majority of creditors voting by class, holding two-thirds of the debt in a class). Second, bankruptcy provides a means of forcing the plan on unwilling classes of creditors if certain conditions are met.

Immediate debt service relief. Filing for bankruptcy stays a municipality's obligation to pay debt service on obligations other than revenue bonds and other obligations payable from special revenues.

Stay of actions. Prior to the enactment of the Bankruptcy Code, a creditor's remedy for nonpayment of bonds was a mandamus action against municipal officers to require them to levy sufficient taxes to cure defaults and to maintain current payments on bonds. The filing of a bankruptcy petition blocks such actions, as well as actions against inhabitants of the debtor to enforce a lien arising out of taxes or assessments owed to the debtor. Whether this provides any real protection in the current situation is difficult to say.

Protection from a death spiral of taxes. Louisiana law, like the law in other jurisdictions, requires a municipality to raise taxes to the level necessary to support general obligation indebtedness. A municipality intent on paying its debt could be forced into a situation where the tax rate becomes prohibitively high, impeding the government's ability to deliver services, deterring investment, and even causing disinvestment if residents and businesses relocate to other jurisdictions. Bankruptcy filing prevents mandamus actions to force tax raises, and can lead to a plan that precludes the need for them.

Facilitating borrowings. Bankruptcy could actually increase a municipality's ability to access credit to meet its immediate operating needs, since such borrowings have priority over pre-filing debt.

Problems Associated with Bankruptcy

Impact on the Municipality's Credit Rating. One concern with filing for bankruptcy is that the municipality's credit rating will be withdrawn or downgraded -- eliminating the ability to borrow or increasing the cost. While this is a legitimate concern, the actual impact would depend on the circumstances. The impact of bankruptcy on the credit rating would be less severe in cases where the municipality's financial problems are already reflected in its pre-bankruptcy rating. As a case in point, rating agencies have already reduced the City of New Orleans' bond ratings to junk-bond status as a result of Hurricane Katrina. Moody's changed the debt rating for the City's general obligation bonds from Baa1 to Ba1 and Standard and Poor's reduced its rating from BBB+ to B. The limited tax bonds were rated slightly lower than general obligation bonds both before and after the storm.

There is also a fear that bankruptcy will drag down the municipality's credit rating for years to come, increasing long-term borrowing costs. We have not found any study documenting the long-term impact.

Impact on the Municipality's Ability to Obtain Bond Insurance. Some municipalities, including the City of New Orleans, issue bonds backed by insurance. This lowers the cost of borrowing and improves the credit rating. Bankruptcy would adversely affect, if not eliminate, a municipality's ability to obtain insurance for its debt in the near term. What happens going forward would depend on a number of factors, including the municipality's future credit rating.

Impact on Access to the Credit Markets. Another frequently cited negative is the adverse affect of bankruptcy on a municipality's access to credit markets, both during the bankruptcy proceeding and thereafter. Whether lack of access to the credit markets should be considered a disadvantage when analyzing the bankruptcy option depends on whether the municipality would otherwise have access to the credit markets. The short-term impact would be neutral if the markets are, by virtue of the entity's financial situation, already closed to it.

Future access is a very serious issue for an entity faced with major infrastructure needs. Unfortunately, we did not find any studies documenting whether, and if so for how long, bankrupt entities were excluded from the credit markets over the longer term. Assuming for the moment that bankruptcy does disrupt access in the long-term, the real impact of that fall-out depends on whether the municipality would otherwise have access to the markets. Other factors, such as state legal restrictions on borrowings, could impede borrowings.

Impact on the Credit Rating of Other Government Bodies in the State. State officials have expressed concern that a municipal bankruptcy would hurt the borrowing costs of other municipalities and the state. The rationale appears to be that the credit ratings of the state's municipalities are higher because of an implicit obligation on the part of the state to stand behind its municipalities. If the state allows a municipality to declare bankruptcy, the market's disappointment will be reflected in higher costs for other governmental borrowers in the state.

According to three rating agencies, each governmental borrower is considered on its own terms. Bond ratings are based upon the economic, fiscal, and management conditions within the jurisdiction being rated, not upon the conditions in other jurisdictions. While some players in the bond market might be skittish, it is not clear that the bankruptcy of a hurricane-devastated parish would impact the credit rating or borrowing costs of healthy entities in other parts of the state.

Practical Difficulties. The relief theoretically possible under the Bankruptcy Code may not be possible because of political realities. The consent of the State Bond Commission, the attorney general, and the governor are required for any filing. State officials must approve any bankruptcy plan for a Louisiana municipality. As a practical matter, this creates significant hurdles and could tie the hands of the municipality when dealing with politically powerful constituencies, such as public employees.

Expenses. Generally, bankruptcy reorganization can be an expensive process. However, in a Chapter 9 case, as opposed to a Chapter 11 case, a municipal debtor is not automatically compelled to pay all allowed fees and expenses of professionals for the debtor and any statutory committee. The majority view is that a municipal debtor cannot be compelled to pay professional fees to which it does not consent.

THE FISCAL ADMINISTRATOR PROCESS

A 1990 state law created a rational process for initiating an in-depth investigation of a municipality in fiscal distress. The law requires the legislative auditor, attorney general and state treasurer to review the fiscal stability of political subdivisions. If the three agree there is a reasonable certainty that an entity's revenues are not sufficient to pay current expenditures or meet its debt service, the attorney general must file for court review and appointment of a fiscal administrator. The State Board of Elementary and Secondary Education (BESE) can initiate the process for a fiscally troubled school district by having the superintendent of education notify the three-person review group. The court is required to appoint an administrator if it is reasonably certain that the municipality is insolvent.

The fiscal administrator has a number of duties. He must investigate the financial affairs of the entity with particular attention to its bonded indebtedness. He must file a written report including an estimate of revenues and expenditures for the current and following year; an amended budget or proposed new comprehensive budget; an estimate of the financial aid or new revenues needed; and, a recommendation as to whether the entity should be allowed to file a petition for bankruptcy.

The governing authority of the municipality is required to adopt the administrator's proposed budget. The court may order the adoption of the budget if the municipality fails to adopt it. The fiscal administrator is required to monitor revenues and expenditures under the adopted budget.

The appointment of a fiscal administrator for a home rule entity without its consent presents serious issues under the home rule provisions of the Louisiana Constitution. As a practical matter, however, any political subdivision seeking the state's permission to file for bankruptcy would have to agree to whatever investigation and preliminary remedial steps the state stipulates. In any case, a municipality considering bankruptcy should have already done the work required of an appointed fiscal administrator.

OTHER OPTIONS FOR FISCAL RELIEF

A local governmental entity could simply default on an obligation without filing bankruptcy. However, that action is likely to be more damaging to the issuer's long-term credit prospects than a bankruptcy filing.

Local governments have a variety of options, short of going into default or filing bankruptcy, which they may pursue in minimizing or temporarily eliminating the immediate costs of meeting their various debt obligations. These include:

- Cutting operating and maintenance costs
- Increasing taxes or other revenues
- Postponing payments on obligations
- Drawing down general fund and reserve account balances
- Inter-fund borrowing
- Refunding debt to extend maturity dates or reduce current debt service requirements
- Borrowing from government entities or commercial lenders to temporarily meet existing debt service requirements

Some of the proposed solutions, such as refunding bonds or postponing payments on other obligations such as debt, would provide temporary relief by increasing costs in the long run. For example, postponing payment of court-ordered judgments against the local government will continue to run up the interest to be paid. Refunding bonds to reduce up-front debt service or extend maturities is likely to increase borrowing costs, particularly considering the issuer's reduced circumstances. For local governments that are experiencing only a temporary disruption in cash flow, these options may provide the needed cover until their normal revenue streams are restored.

For a public entity whose tax base has been severely eroded, making full use of the available options still may not free up enough revenue to support a minimal level of services. In such a case, the state or federal government could step in and provide temporary assistance through grants. In the absence of such assistance, a municipality might be faced with real choice of either defaulting on its obligations or seeking bankruptcy protection.

To date, the federal government has provided extensive disaster relief and cleanup funding to local governments through the Federal Emergency Management Agency (FEMA). It has also made short-term Community Disaster Loan (CDL) disbursements to many of the affected

entities in amounts up to 25% of pre-disaster budgets. It has not provided any direct funding for paying debt service on existing obligations. It has, however, facilitated debt restructurings by waiving a one-time limit on bond refinancing for local governments in the Gulf Opportunity Zone. The waiver would allow the refinancing of up to $4.5 billion of local government debt in Louisiana. Many local entities have recently refunded debt to take advantage of lower interest rates. This new authority allows them to again refinance to obtain longer maturities or otherwise lower current debt service costs.

In addition, the federal government has authorized the state to issue up to $200 million of tax-free bonds to help local governments in the Gulf Opportunity Zone meet their debt obligations. The proceeds of the bonds can be loaned or granted to the local government. To qualify, the state would have to provide a cash match equal to the amount of bonds issued. It must repay the bonds in two years.

In the special legislative session following the hurricanes, prior to congressional action on the Gulf Opportunity Zone legislation, the Governor proposed legislation authorizing the state to borrow up to $1.5 billion using a line of credit to aid local governments, businesses, and the state government. The state treasurer, among others, proposed issuing state bonds and selling the remaining 40% of the state's tobacco settlement revenue stream to provide funding to assist local governments in making debt service payments. Using the tobacco money would have required a constitutional amendment to change the dedication of those funds. The legislature took no action on the proposals in that session.

In the special session of 2006, the legislature passed a bill to enable the state to take advantage of the tax-free bond program under the Gulf Opportunity Zone legislation. The state match can be provided through a direct appropriation or through a state debt issuance. However, the administration's proposed budget, as presented on March 6, did not include a funding match for tax credit bonds. The administration maintains that any decision regarding the size of a tax credit bond program should be held in abeyance until the state has more complete information on the extent of the local governments' financial problems. The Blanco administration has indicated that it is leaning toward loans.

The administration is considering several sources for the state's matching funds, in addition to securitizing the remaining tobacco settlement revenues. The options involve various methods to reduce state debt service in order to free money to provide the match.

Preliminary and incomplete responses to a treasury department survey indicate that interest in participating in this program is strong among entities in Orleans Parish. Reporting entities outside of Orleans Parish for the most part did not indicate significant problems in meeting their debt service, however not all entities have reported yet.

EVALUATING FISCAL DISTRESS

A threshold issue in a bankruptcy proceeding is whether an entity satisfies the insolvency requirement. To identify local governments in severe distress, we examined a number of

factors, including parish sales tax changes, changes in parish-wide property tax assessments, population changes, and the results of a survey of local entities by the state's treasury department. A number of these are parish-wide measures that may obscure significant

problems in specific smaller entities. Data analyzed for sub-parish entities was generally limited to those receiving CDL distributions.

The following analysis is very general and is limited by a paucity of underlying data. A more accurate determination of the level of fiscal distress in the hurricane-impacted areas would require data that is not currently available.

COMMUNITY DISASTER LOANS

One indicator of potential fiscal distress is whether an entity applied and received approval for a federal Community Disaster Loan (CDL). To qualify, an entity must have experienced at least a 5% loss in operating revenues. Entities in 10 parishes received allocations. Appendix A lists by parish the 58 entities approved for CDLs, the amounts allocated (prior to redistribution of the extra $72 million held back), and how much cash the entities had drawn as of mid-March.

SALES TAX COLLECTIONS

Local general governments, school boards and some other local entities depend heavily on sales tax revenues. A large portion of the local government bonded indebtedness is backed by specific sales tax dedications. Appendix B presents data on monthly sales tax collections from August to December 2005 collected by the Army Corps of Engineers and compared with the same months for the prior year. Data for the hard-hit parishes of Plaquemines and St. Bernard were not available. Cameron Parish does not have local sales taxes.

Most of the local governments included in the Corps' report sustained at least a slight decline in collections in August that became much more pronounced in September. However, by October most of them experienced a phenomenal rebound in collections. Among these parishes, only Jefferson and Jefferson Davis parishes still had decreases in October, but both made gains in November. By December, the increase in parish five-month totals compared to the prior year ranged from 6.3% to over 60%, except in Orleans Parish, which had a 47% decrease and Jefferson Parish, which experienced an 8.2% drop. Even Jefferson, whose five-month total lagged its prior-year collections, had a 35% jump over its prior December and may be moving close to its earlier collection levels. However, December sales tax collections in Orleans Parish remained 49% below their pre-hurricane level. Projections for the City of New Orleans indicate that 2006 sales taxes will be less than half the 2004 collections.

A good share of the rebound in most parishes is attributable to spending redirected from the hardest hit parishes, FEMA and Red Cross money, and a rash of replacement and repair purchases. While some leveling off can be expected, it is unlikely that most of these parishes

will see any long-term sales tax revenue problems due to the storms. The exceptions, of course, may be the three parishes of Orleans, Plaquemines, and St. Bernard.

PROPERTY TAX ASSESSMENTS

Available information indicates that parish-wide property tax assessment totals rose from 2004 to 2005 in all but six of the 18 selected parishes. With the exception of the few hardest-hit parishes, the decreases were minimal. (See Appendix C.)

St. Bernard Parish was given an extension until June 2006 to file its rolls, and a 25% reduction in total assessed value is expected. The tax rolls for Orleans Parish, which were finally approved by the Louisiana Tax Commission at the end of March, show a reduction of 23% in total assessed value from 2005 to 2006.

STATE TREASURER'S SURVEY OF LOCAL DEBT

The state treasurer's survey of local governments was designed to assess any problems encountered by local governments in meeting debt service requirements. Appendix D summarizes the preliminary data received by March 28 from 26 public entities in the disaster area. While those reporting are a small percentage of the debtor entities in the area, they include some of the larger ones and represent different types of entities (parishes, municipalities, school districts, and special districts) from a variety of locations. If this sample is indicative of the larger picture, it is apparent that most governmental entities outside of Orleans Parish do not face serious problems in meeting their debt service obligations. However, no reports were received from Cameron or Plaquemines parishes and only the port authority had reported from St. Bernard Parish. In addition, some other entities that have delayed reporting may have done so due to uncertainties regarding their fiscal status.

DEMOGRAPHIC DATA

Population estimates remain tentative. However, estimates by the Louisiana Department of Health and Hospitals (DHH) of the population changes between July 2005 and February 2006 indicate that only five parishes experienced severe losses. Five more parishes had losses of 5% or less (see Appendix E.)

While St. Bernard was the biggest loser in percentage terms (-82.1%) as of January, New Orleans lost the most people, nearly 277,000 (down from 458,393). The DHH estimate pegs the city's current population at 181,400. Other projections range from 156,150 to 189,000. A local consulting firm projects a population of 250,000 to 275,000 by the end of 2006, and the Rand Corporation projects 272,000 by September 2008. There is also considerable uncertainty about the repopulation of St. Bernard and Cameron Parishes.

OUTSTANDING DEBT

When the available information is considered, it appears that St. Bernard, Cameron, Orleans, and Plaquemines are the parishes with the factors most likely to produce fiscal stress. The following is a summary of the outstanding local debt, and the portion that is insured, for those parishes:

Local Government Debt
(in millions)

	Total Debt	Insured
Orleans	$3,202.6	$2,307.2
St. Bernard	137.9	129.5
Plaquemines	96.9	96.9
Cameron	14.1	6.2
Total	$3,448.6	$2,539.7

The local governmental entities in Orleans Parish are responsible for 93% of the total debt in these four parishes and 99% of the uninsured debt. The total includes debt of multiple entities including municipalities, parishes, school boards, taxing districts, boards, and commissions.

HARD-HIT PARISHES

Based on available indicators, it appears that most local governments in Louisiana's FEMA designated 31-parish disaster area are not experiencing severe financial distress as a result of Hurricanes Katrina and Rita. However, a number of parishes face tremendous challenges in the short- and long-term. BGR and PAR focused on selected entities in three of those parishes to determine whether they were likely to need assistance in dealing with their financial issues. The entities reviewed included the City of New Orleans, Cameron Parish Police Jury, St. Bernard Parish, the school boards in the three parishes, and the Cameron Parish Water and Wastewater District No. 1.

Fortunately, many of the Louisiana local entities affected by the hurricanes have resources or options they can draw upon to avoid resorting to the courts. Some entities outside of New Orleans may require some additional assistance, but this need appears relatively small compared to the magnitude of the fiscal distress in New Orleans.

CAMERON PARISH

Cameron Parish lost, at least temporarily, one-fifth of its relatively small population (9,552). In spite of the Hurricane Rita damage, the parishwide property assessment total actually rose slightly in 2005. There was no loss of sales tax revenues as there is no local sales tax.

The Cameron Parish Police Jury entered the storm year in good shape. With a total budget of about $10 million for 2004, it ended the year with a $10.5 million balance, half of which was unrestricted. Parish long-term debt included compensated absences ($185,000), bank loans ($201,000) and bonds ($3.5 million). The West Cameron Port was responsible for $2.9 million

of the bonds and three fire districts were responsible for the remainder. Debt service on the bonds runs about $400,000 a year and $713,000 was available in the debt service reserves.

The Cameron Parish Water and Wastewater District No. 1 ended 2004 with an unrestricted surplus that alone, according to the auditor, would allow the authority to operate for nearly five years.

The Cameron Parish School District, with an $18.6 million budget, had unrestricted net assets of $20 million invested earning nearly $2 million a year. It had $8.7 million of its $15.9 million 2004 year-end general fund balance designated for emergencies and contingencies. The district had $11.8 million in outstanding general obligation bonds (one tenth of its state-imposed limit) and an annual debt service of $1.4 million. The school district was not included among those provided temporary hurricane relief funding in the Board of Elementary and Secondary Education's proposed Minimum Foundation Program formula for 2007.

While the storm has undoubtedly eaten into the reserves of these Cameron Parish entities and created serious rebuilding challenges, it is not clear that they could meet an insolvency test or that bankruptcy would be of any real help considering their small debt burden.

St. Bernard Parish

With 82% of its population of 67,419 displaced and most of its housing destroyed, the St. Bernard Parish government faces a very uncertain future. The return of residents and recovery of the tax base are uncertain, as is the timing of FEMA reimbursement of $50 million in clean-up work the parish contracted without going through the federal agency. Compared to these problems, the $6 million in annual debt service on long-term debt is probably not the major concern.

At the end of 2004, the parish government had $68.6 million in outstanding debt. The general government had $9.3 million of this ($6 million in sales tax bonds, $2.8 million in general obligation bonds, and the rest in certificates and special assessments). The bulk of the debt ($59.3 million) is in the parish Water and Sewer Division and is almost entirely sales tax bonds backed by a dedicated ½-cent sales tax. Late in 2004, the Parish issued $50 million in sales tax bonds to build new water facilities. The money was unspent at the end of the year. A reserve was created sufficient to cover a year's debt service on these bonds. The bonds are payable solely from and secured by a first lien upon and a pledge of the net revenues of the water and sewer system.

The St. Bernard Parish School District has general obligation property tax debt that requires debt service of about $3.4 million annually. Funding of these general obligation bonds requires a property tax millage increase from 9.3 mills to 14 mills. The school board's immediate major concern, however, is meeting its obligation to pay retiree health benefits. The district is looking to the proposed MFP to help pay its $6 million annual health premium. The proposed MFP would provide the district an extra $1,000 per student primarily for that purpose.

ORLEANS PARISH

As a result of multiple levee breaks, 80% of New Orleans was under water. The flooding left two or more feet of water in an estimated 65% of housing units. To date, large swaths of the city remain uninhabited, and sizeable areas may not be rebuilt in the near future, if ever.

New Orleans' pre-Katrina population was approximately 465,000. The City's Emergency Operations Center estimates the current population at 181,400. Only half the pre-Katrina population is expected to return by the third anniversary of the storm.

The population loss has left many businesses without a work force or customer base. Many are limping along with reduced schedules, services, and staffing. Whether they can survive until adequate workforce housing is built is problematic. Half the retail businesses in New Orleans are still not open.

In short, the local economy has contracted severely, causing a precipitous fall in projected sales and property tax revenues. The City has attempted to adjust to the changed circumstances by firing 3,000 workers, suspending planned capital expenditures, borrowing from the federal government, and negotiating to restructure its debt. It has also attempted, unsuccessfully to date, to borrow from financial institutions. In late March, the City issued a Request for Proposals for financial and management consultant services to advise the City about how to improve its' revenue forecast model, expand revenues, contain spending, and enhance its credit rating.

City of New Orleans' Finances

City Budget. The City's 2005 Operating Budget was $622 million. The General Fund -- the discretionary, undedicated money the City receives from sales taxes, property taxes, and other sources -- was $453 million. Unaudited figures show actual General Fund revenues of $375 million for 2005. The 2006 Projected Budget shows General Fund revenues of $186 million and an additional $36 million from a Community Disaster Loan.

The 2006 budget reflects a drastic decline in the City's traditional revenue sources. Tax revenues, including sales and property taxes, are expected to decline by 58%, falling from $260 million originally expected in 2005 to $109 million in 2006. Other traditional revenue sources, such as fines, license and permit fees, and other service charges, also show steep declines.

Sales taxes, the largest source of revenue for the City, are projected to decline from $151 million in 2004 (the most recent fiscal year with no Katrina-induced effect on revenue) to $69 million in 2006, a 54% decline. Property taxes, which were $80 million in 2004, are expected to yield $38 million, a 52% decline.

The City is counting on borrowings, including $36 million left of a Community Disaster Loan from the federal government, to pay its operating expenses. To maintain the current level of services, the City will need an additional $147 million. Without this money, the City will not

have sufficient funds to pay for unfunded state mandates and police, fire, and other services. Current cash flow projections show the City running out of funds in May.

The City does not expect its troubles to end in 2006. It projects a $138 million deficit in 2007.

City of New Orleans's Debt. The City's budget includes $39 million to pay debt service on certificates of indebtedness, taxable pension bonds, Louisiana Community Development Authority bonds, and indebtedness to the federal department of Housing and Urban Development. Such debt totals $308 million, including $138 million of certificates of indebtedness, $8 million of LCDA bonds, $6 million of a lease repayment, and $155 million of pension obligation bonds.

The City's budget does not include debt service for the City's general obligation indebtedness and Limited Tax Bonds. These are administered by the Board of Liquidation, City Debt, an independent body with exclusive control of all matters related to the issuance and repayment of the City's general obligation debt. Debt service for such bonds totaled $57 million in 2005 and is estimated at $58 million in 2006. The City currently has outstanding $494 million of general obligation bonds and $33 million of the Limited Tax Bonds.

Together, the City and Board of Liquidation budgets for 2006 include $96 million for debt service. Certificates of indebtedness and other debt paid directly by the City will consume 21% of General Fund revenues from sources other than borrowings. The debt service numbers do not include any provision for repaying $120 million borrowed from the federal government under the Community Disaster Loan program. Repayment of that loan can be postponed for five years. It should be noted that the City has exhausted its borrowing capacity under the Community Disaster Loan program.

Other Obligations. The City has other significant obligations. As of December 31, 2004, they totaled $646 million, including claims and judgments of $394 million and accrued vacation and sick leave of $52 million. The recent round of firings reduced payroll costs but increased obligations for unemployment taxes and vacation and sick leave payments.

Capital Projects. The City's 2006 Capital Budget does not include new capital projects. Projects approved in past capital budgets are either in construction or suspended. The City's preliminary estimates of Katrina related damage to city-owned facilities and streets are $348 million and $38 million, respectively. FEMA is expected to pay 90% of eligible expenses for its match for repairs to facilities, and the City has available $43 million in unencumbered non-street bond funds. Street repair costs for flood damaged streets will be shared equally by FEMA, the Federal Highway Administration, and the City. As of January, the Department of Public Works had $52 million available for street projects.

Impact on Taxpayers

Debt service on general obligation bonds is funded by property taxes. The millage rate for the City of New Orleans is set each year by the Board of Liquidation, City Debt at a level that will

yield revenue sufficient to pay principal and interest for the coming year. Pre-Katrina, the Board of Liquidation had planned to set the millage rate for general obligation indebtedness at 28.4 mills. After Katrina, the Board set the millage at 38.2 mills, a 35% increase over the pre-Katrina millage. In fixing the millage rate, the Board assumed a collection rater of 50%. The 2006 increase would have been even larger but for the fact that the Board of Liquidation is obligated to apply 75% of its reserve ($21 million) to debt service in 2006. Such reserves will not be available to cushion the tax increase in 2007.

To state the problem in plain English, the tax rate in Orleans Parish will rise to support existing indebtedness. The Orleans Parish School Board voted to raise its millage for debt 75%, from 7.7 to 13.45 mills. The cumulative impact on taxpayers of Board of Liquidation and School Board increases is 15.55 mills.

This means that the base tax rate in New Orleans would rise from 171.29 mills to 186.84 mills in 2006. The rate will be even higher in special taxing districts, such as the Downtown Development District, the New Orleans Regional Business Park and the Garden District, which impose taxes at the range of 15 to 23 mills.

The rate increases will occur in the face of declining city services and result in a level of taxation that exceeds the level in neighboring parishes, which ranged in 2005 from 116.57 to 175.04 mills in St. Tammany Parish and from 50.82 to 121.46 mills in Jefferson Parish. The increase to 186.84 mills could handicap recovery efforts to attract residents and businesses, and ultimately lead to disinvestment in the city.

ORLEANS PARISH SCHOOL BOARD

The Orleans Parish School Board had chronic financial, infrastructure, and academic problems before Hurricane Katrina. The school system was failing its students, with 102 of 118 schools rated as failing under state and federal standards.

In 2003, frustrated voters approved a constitutional amendment allowing the State Board of Elementary and Secondary Education (BESE) to take over failing schools. In November 2005, BESE swept 102 failing schools into a state-run Recovery School District (RSD), leaving 16 schools under the control of the School Board. On the fiscal front, the state's Department of Education selected a turn-around firm, Alvarez and Marsal, to reconstruct financial records and impose fiscal discipline.

Before the hurricane, the School Board operated 118 schools with approximately 61,000 students. As of March 2006, the School Board had only 8,400 students. Of the 16 schools that remained under the control of the School Board, four are operated by the School Board, nine are chartered by it, and three have not reopened. Four of the open schools were under the control of the RSD. Twenty-five schools are expected to be open by the end of the 2005-06 school year.

It is difficult to project the student population for the 2006-07 school year. BESE assumed 21,885 in devising the state and local Minimum Foundation Program shares for that year. Alvarez & Marsal estimated 28,500, and FEMA placed the number at 34,000. 56 schools would be needed to accommodate a population of the latter size.

Orleans Parish School Board Finances

Revenues. The pre-Katrina general fund budget, for the fiscal year ending June 30, 2006, included revenues of $430 million. The amended budget for that period, presented in March, projects a 45% decline to $235 million. This includes $40 million of extraordinary federal funds.

The original 2005-06 budget anticipated $223 million of locally-generated funds, while the current budget anticipates $91 million, 41% of the original. Local revenues come from sales tax (1.5 cents), hotel-motel tax (1.5 cents) and property tax. The property taxes are set at 45 mills of ad valorem taxes, plus whatever millage is necessary to support the School Board's general obligation indebtedness. In 2005, the latter amounted to 7.7 mills. In 2006, the rate was raised to 13.45 mills to compensate for lower assessments and an anticipated lower collection rate.

In the original 2006 budget, the School Board anticipated $200 million in state funds provided through the Minimum Foundation Program (MFP), a complex formula-based funding system designed to distribute funding among all the parishes on an equitable basis. The MFP calculation includes for each parish a per-pupil amount funded by the state and per-pupil amount funded locally. The state funding for Orleans Parish in 2005-06 is expected to be $96 million. In 2006-07, the proposed state per-pupil allocation for Orleans Parish is $3,802. Seventy percent of the state and local per-pupil allocation must be used for instructional services.

To help hard-hit parishes, BESE included in the proposed MFP allocation for 2006-07 a one-time payment of $1,000 per pupil. The proposal provides that the money is to be first used for retiree health benefits and may not be used for debt service or unemployment compensation costs.

Expenses. At first glance, the School Board's 2005-06 revenues appear large for a district with only 14% of its pre-Katrina student population. However, the School Board has significant fixed and extraordinary costs. In addition, a fixed amount of the local funding follows each student attending an RSD school. The amount equals the local per-pupil share calculated under the MFP. The proposed local share for 2006-07 is $3,187 per pupil.

Expenses in the 2005-06 budget total $223 million -- 53% of the original 2005-06 budget amount. They include $47 million for salaries and benefits (compared to $306 million pre-Katrina), $34 million for debt service, and extraordinary expenses relating to terminations. The extraordinary costs include an unemployment insurance liability of $11 million from firing almost all of the School Board's employees and $7 million for accrued vacation and sick pay.

Although the budget shows a surplus of $12 million, the picture is not as rosy as it seems for the following reasons:

- Revenues include $40 million of extraordinary grants and borrowings from the federal government to meet operating expenses. Had the School Board not received a $20 million Community Disaster Loan, the system would have a deficit for the year.

- The $11 million allotted in the budget for unemployment insurance liability is only a fraction of the total liability. The School Board expects to incur $68 million of unemployment insurance costs in 2005-06 and perhaps as much as $52 million in 2006-07. The 2005-06 budget assumes that 83% of the unemployment insurance compensation cost (as well as 83% of unemployment claims, debt service, insurance, and retiree health benefits) will be transferred to the RSD pursuant to legislation introduced in the current session. The proposal appears untenable, since the RSD has no taxing powers or other means of paying it. The unemployment insurance payments are not due until 2007.

- The School Board's debt was incurred for a much larger system. Assuming that the School Board has 11,442 students in 2006-07 (half of the student population projected by BESE), existing debt service would be about $3,000 a year per pupil, five times the per-pupil amount pre-Katrina. If the debt were spread over the student population for both the School Board and the RSD, it would equal $1,500 per pupil, two and one half times the pre-Katrina amount. While approximately 36% of the debt is supported by a dedicated millage, the balance competes with other expenses for funds provided by local government and the state through the MFP. To help meet its debt obligations, the School Board intends to apply for funds under the Gulf Opportunity Zone tax credit bond program should the state establish one. The School Board's financial advisors are examining debt refinancing options.

- Other fixed costs, such as retiree health care benefits, were also incurred in the context of a much larger system. As in the case of debt, these costs weigh disproportionately on a smaller student population.

<u>Obligations.</u> The School Board has outstanding long-term indebtedness totaling $266 million. It includes $141 million of general obligation bonds, $7 million of certificates of indebtedness, $99 million of refunding bonds, and $6 million of lease revenue bonds.

As noted above, the School Board expects to owe the state unemployment compensation fund as much as $120 million. It also owes $7 million for the current fiscal year for accrued vacation and sick pay. Other obligations include unpaid judgments and obligations to unpaid suppliers. There are also $14 million of questioned costs from 2001 and 2002 that may have to be repaid to the federal government.

Capital and Facility Maintenance. Alvarez and Marsal reports that $16.5 million of contracted, but unpaid, FEMA-related work is underway and that about $50 million will be needed to repair schools in the next five months for returning students.

CONCLUSION

Despite steps taken to date, both the City of New Orleans and the Orleans Parish School Board are teetering on the edge of a cliff. The School Board is dealing with chronic cash flow problems and would be running a deficit were it not for federal disaster-related grants and loans. The City is one month away from running out of cash, and there is no plan in place for dealing with the cash flow problem. In late March, the City issued a request for proposals for financial and management consultant services to advise the City about how to improve its revenue forecast model, expand revenues, contain spending, and enhance its credit rating.

The School Board has advised the State Bond Commission that it has the funding needed to pay debt service on its long-term obligations. The Board of Liquidation has made provision for paying city debt under its management. But the City's budget projections clearly indicate that the City currently lacks adequate funds both to pay debt service on its other obligations and to provide its current, rather dismal level of services. The School Board's extraordinary expenses and fixed costs could interfere with its ability to provide even a minimal level of education.

While BGR and PAR are cognizant of the importance of local government entities' paying outstanding indebtedness, they submit that debt repayment needs to be considered in the larger context of restoring the community's health and recovery: What conditions are needed to retain and attract residents and businesses? Would the various options for dealing with the entity's debt and other obligations promote or impede the creation of those conditions?

For destroyed communities, recovery depends in part on the government's ability to deliver vital services, such as police, fire, and sanitation, and to cause an attractive environment to rise out of the ashes. In the case of Orleans Parish, it also depends on the continued reform of the school system, and the availability of sufficient resources to elevate the level of public education.

For a devastated community, continuing to shoulder pre-Katrina debt loads and obligations may interfere with its ability to create the conditions needed for recovery. In that context, bankruptcy is a legitimate line of inquiry and should be evaluated. While its limitations and negative implications must be carefully considered, the drag of outsized debt, reduced services, and elevated tax rates on redevelopment should also be analyzed. It becomes a matter of a hard-nosed cost-benefit analysis. As noted at the outset, it is not the purpose of this report to advocate bankruptcy as a solution to local fiscal problems, but simply to examine it as an option.

The state has consistently taken the position that the disadvantages of bankruptcy outweigh any advantages a local public entity might gain. It must now take the next step and provide alternative means of relief. It could begin by tapping into relief funds and programs provided

by the federal government for hurricane relief. The state's options for assisting local government entities with their fiscal crises include:

- Providing grants or loans through the Gulf Opportunity Zone tax credit program.
- Allocating Community Development Block Grant funds to local government expenses.
- Using general fund revenues.
- Picking up the cost of unfunded mandates or other amounts owed the state, such as unemployment compensation.

BGR and PAR call on the state and distressed local governments to embark immediately on a joint effort to assess and address their financial problems and needs. The problems are not going to disappear on their own.

APPENDICES

Appendix A

Community Disaster Loan Disbursements and Draws (as of 3-9-06)

Parish	Entity	Allocated CDL Amount ($)	Total Draws ($)
Calcasieu	Calcasieu Parish	2,305,920	
Cameron	Tax Assessor	115,620	40,620
Cameron	Parish Law Enforcement District	960,838	480,419
Cameron	Parish Police Jury	1,921,629	
Cameron	Cameron Parish School Board	3,344,572	
Jefferson	City of Gretna	2,620,211	1,000,000
Jefferson	City of Kenner	5,180,000	
Jefferson	City of Harahan	965,525	500,000
Jefferson	City of Westwego	1,827,676	1,000,000
Jefferson	Hospital District #1	30,712,500	30,712,500
Jefferson	Hospital District #2	45,489,020	
Jefferson	Parish Government	52,010,988	17,334,220
Jefferson	Parish Law Enforcement District	22,602,120	6,000,000
Jefferson	Parish Public School District	57,764,231	17,000,000
Jefferson	Town of Grand Isle	561,735	
Jefferson	Town of Jean Lafitte	205,100	
Lafourche	Hospital District #1	2,100,000	250,000
Lafourche	Lafourche Parish Council	4,379,608	
Orleans	City of New Orleans	120,000,000	120,000,000
Orleans	Communication District	799,416	80,000
Orleans	Law Enforcement District	18,029,067	6,100,000
Orleans	Sewerage and Water Board	22,298,689	11,149,344
Orleans	Regional Transit Authority	19,463,229	
Orleans	Orleans Parish School Board	21,816,619	
Orleans	Orleans Levee Board	3,346,287	
Orleans	Port of New Orleans	5,627,230	
Orleans	New Orleans Aviation Board	8,112,103	
Plaquemines	Parish Law Enforcement District	3,163,271	2,400,000
Plaquemines	Parish School Board	11,278,642	4,291,832
Plaquemines	Tax Assessor	174,700	44,000
Plaquemines	Plaquemines Parish Council	8,900,000	
Plaquemines	Plaquemines Hospital District No. 1	869,864	
St. Bernard	Parish Government	8,979,262	5,689,372
St. Bernard	Parish Law Enforcement District	4,540,500	2,927,000
St. Bernard	Parish School Board	17,869,925	4,524,325
St. Bernard	Port, Harbor and Terminal District	769,881	

Community Disaster Loan Disbursements and Draws (as of 3/9/06), cont'd.

Parish	Entity	Allocated CDL Amount ($)	Total Draws ($)
St. Bernard	Lake Bourgne Levee District	831,588	
St. Tammany	City of Mandeville	2,030,000	650,000
St. Tammany	City of Slidell	5,023,595	1,000,000
St. Tammany	Fire District #1	2,572,719	2,572,719
St. Tammany	Fire District #12	513,375	450,000
St. Tammany	Fire Protection District #4	1,587,794	
St. Tammany	Fire Protection District #5	60,000	
St. Tammany	Fire Protection District #8	91,190	50,000
St. Tammany	Parish Government	12,231,219	2,000,000
St. Tammany	Parish Law Enforcement District	9,934,128	9,521,000
St. Tammany	Parish School Board	51,857,990	29,857,990
St. Tammany	Town of Abita Springs	209,000	109,000
St. Tammany	Hospital District No. 2	17,520,220	2,000,000
St. Tammany	City of Covington	1,800,900	
St. Tammany	Town of Pearl River	300,663	
St. Tammany	Fire Protection District @ 11	75,861	75,861
St. Tammany	Fire Protection District @ 2	100,000	
Vermilion	Town of Delcambre	174,572	104,285
Washington	Parish Law Enforcement District	1,172,000	610,000
Washington	Bogalusa School Board	3,243,951	
Washington	Washington Parish Council	1,397,879	
Washington	Washington Parish School Board	4,348,630	
Totals		**$628,183,252**	**$280,524,487**

SOURCE: Governor's Office of Homeland Security and Emergency Preparedness

APPENDIX B

Percent change from Prior Year in Local Sales Tax Collections by Month,
August through December, 2004 to 2005

	% Change from Prior Year					
Parish	Aug	Sept	Oct	Nov	Dec	Total % change Aug-Dec
Acadia					20	
Ascension	10.5	29.7	43.1	32.7	19.2	26.6
Assumption	-6.0	-7.1	17.4	16.4	8.8	6.3
Calcasieu	14.7	-60.2	38.1	7.7	33.2	6.7
Cameron*						*
Iberia	3.5	-1.5	13.7	24.8	33.5	14.6
Jefferson	-0.3	-53.7	-37.8	12.1	35	-8.2
Jefferson Davis	12.4	2.2	-1.4	32.6	27.1	14.1
Lafayette	6.1	4.3	19.1	34.2	24.2	17.4
Lafourche	-1.6	-17.9	18.2	27.8	24.1	9.6
Orleans	-3.0	-93.6	-38.8	-52.0	-49.4	-46.7
Plaquemines						NA
St. Bernard						NA
St. Charles	12.3	-59	28.3	26.3	29.9	8
St. James	-42.9	73.6	32.8	25.7	7.6	20
St. John	10.1	-52.4	65.9	114.1	-8.2	21.2
St. Martin	-4.8	10.5	11.8	21.5	24	12.5
St. Mary**	9	1.1	19.4	28.3	16.7	10.2**
St. Tammany	-33.3	8.3	64.2	50.9	71.2	34.3
Tangipahoa	-1.7	-24.7	45.7	59.1	21.4	19.1
Terrebonne	9.5	-7.9	28.4	46.6	40.8	23.2
Vermilion	15.4	16.3	47.4	46.1	157.9	60.8
Washington	-7.6	-34.4	13.1	55.1	23.6	8.4

Source: Data collected by Joseph F. Mann, Army Corps of Engineers (Feb. 24, 2006)
* Cameron has no local sales tax ** Parish reports cumulative year totals
NA: Not made available

APPENDIX C

Total Property Tax Assessed Values

Parish	2005 Total AV ($)	2004 Total AV	% Change
Acadia	254,822,530	$248,036,580	2.7%
Calcasieu	1,228,969,780	1,182,346,940	3.9%
Cameron	164,423,209	162,836,370	1.0%
Iberia	392,174,206	371,541,206	5.6%
Jeff Davis	160,452,505	153,627,950	4.4%
Jefferson	3,030,454,532	3,210,148,630	5.6%
Lafayette	1,288,587,140	1,213,764,199	6.2%
Lafourche	578,811,760	577,193,220	0.3%
Orleans*	1,997,667,374	2,604,609,957	-23.3%
Plaquemines	597,576,235	623,690,095	-4.2%
St. Bernard	N/A	415,911,140	-25%**
St. Charles	872,638,093	848,075,721	2.9%
St. Mary	363,988,306	372,300,073	-2.2%
St. Tammany	1,288,677,940	1,290,943,410	-0.2%
Tangipahoa	474,909,107	456,602,905	4.0%
Terrebonne	645,585,240	613,656,650	5.2%
Vermilion	292,970,720	286,037,320	2.4%
Washington	173,541,540	162,949,740	6.5%

* Data for 2006 and 2005
**Preliminary Data
SOURCE: Parish Assessors

APPENDIX D

Survey of Local Government Debt

Issuer	Outstanding Debt ($)	Problem Meeting Debt Service
Thibodaux	3,230,000	none
Sulphur	5,227,139	none
Lafourche Home Mort. Auth.	3,054,548	none
Lafourche Parish School Board	83,450,000	none
Washington Parish Hosp. Dist. #1	4,348,758	none
Hammond	15,615,000	none
Calcasieu Parish Police Jury	114,182,232	none
Lake Charles	31,860,000	none
Lake Charles Harbor and Term. D.	17,500,000	none
St. Bernard Port, H. and T. Dist.	6,798,000	none
Tangipahoa Par. Hosp. Dist. #1	42,855,000	none
St. Tammany Par. School Bd.	183,100,000	none
Jefferson Davis Police Jury	1,126,477	none
Jefferson Parish	434,786,871	none…but could use cash flow savings
Jefferson Par. Home Mort. Auth.	262,457,544	none
Grand Isle	8,905,367	Seeking deferment or relief for 18 months ($788,737)
Kenner	64,482,000	none
Covington	7,447,000	none
City of New Orleans	308,060,000	Seeking line of credit from commercial bank, debt service otherwise jeopardized
N.O. Board of Liquidation	981,406,748	Paid through July 2006, then depends on tax collections
N.O. Aviation Board	12,110,000	Planning to refund
N.O. Sewerage and Water Bd.	48,560,000	Requests advance refunding or participation in GO Zone tax credit bond program
Port of N.O.	160,821,358	none, but seeking line of credit in case of shortfall
Orleans Communications Dist.	9,515,000	Uncertain, may refinance
N.O. Exhibition Hall Auth.	499,915,000	Uncertain, request info on state programs
Orleans Levee District	65,115,000	Potential problem meeting first payment due to tax loss

SOURCE: Louisiana Treasury Department survey (returns as of 3/28/2006)

APPENDIX E

Population Estimates

Parish	Feb 2006 Est.	July 2005 Est.	Change Feb 2006 to July 2005
Acadia Parish	59,891	59,515	0.6%
Ascension Parish	96,835	88,142	9.9%
Assumption Parish	23,386	23,095	1.3%
Calcasieu Parish	181,759	185,862	-2.2%
Cameron Parish	8,011	9,552	-16.1%
Iberia Parish	75,224	73,897	1.8%
Jefferson Parish	367,573	458,029	-19.7%
Jefferson Davis Parish	31,276	31,252	0.1%
Lafayette Parish	199,363	197,268	1.1%
Lafourche Parish	91,382	92,169	-0.9%
Orleans Parish	181,400	458,393	-60.4%
Plaquemines Parish	17,433	29,432	-40.8%
St. Bernard Parish	12,064	67,419	-82.1%
St. Charles Parish	51,517	48,359	6.5%
St. James Parish	21,659	20,842	3.9%
St. John the Baptist Parish	49,022	44,590	9.9%
St. Martin Parish	51,219	49,746	3.0%
St. Mary Parish	52,523	51,698	1.6%
St. Tammany Parish	206,204	213,633	-3.5%
Tangipahoa Parish	108,674	103,232	5.3%
Terrebonne Parish	107,092	107,146	-0.1%
Vermilion Parish	53,875	54,502	-1.2%
Washington Parish	42,358	44,595	-5.0%
State Total	**2,089,740**	**2,512,368**	**-8.1%**

In those parishes shaded in gray other methods besides school enrollment-based estimates were used. For Orleans Parish, the City of New Orleans Rapid Population Estimate Survey is used (nighttime population).

The 2005 estimates are from the Research Division, Louisiana Technical College.

SOURCE: Louisiana Department of Health and Hospitals

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