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KICK THE CAN

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As we observe the efforts to address the various fiscal challenges facing municipal markets across the country, it is interesting to note the "common solution" appears to be avoiding any "real solution." In most cases, the "solution" either does not address the issues or pushes the problems as far into the future as possible through refinancing. In the last 90 days, two of the biggest fiscal challenges (Birmingham, AL and Harrisburg, PA) have both been "resolved" in remarkably similar manners.

A few years ago, the Sewer District of Birmingham, Alabama drove the city into bankruptcy. The Sewer District's issues ranged from excessive use of credit default swaps resulting in huge losses, to corruption, to massive cost overruns. In December they issued approximately $1.3 billion of new bonds to refinance their "in default" bonds. The majority of these new bonds have very long maturities and some are zero coupon bonds. The net effect of utilizing these structures is that Sewer District customers will, going forward, pay back over $6.6 billion in total payments. While the sewer district may be able to service this enormous debt burden in coming years since some of the bonds have no current coupon rate to pay and few bonds are maturing, the odds that they will have the financial resources to ultimately pay off these bonds is questionable. Nevertheless, by the time these large maturities ultimately come due, most officials involved with the Sewer District will be long gone and therefore they will have KICKED THE CAN DOWN THE ROAD.

In a remarkably similar manner, Harrisburg, Pennsylvania issued nearly $290 million Capital Parking Systems Revenue bonds to assist with the retirement of debt related to a city owned and guaranteed solid waste disposal facility. Concurrently, this solid waste disposal facility was then sold, resulting in a significant loss. The transfer of the parking systems will result in a 40 year lease back to the City of Harrisburg. The parking bonds are generally only guaranteed by the revenue of the parking lots included in the lease back agreement, about 36% of Harrisburg's available parking facilities. The total debt burden on this revenue source will ultimately be over $850 million in total debt services. In the short run, parking revenue may be adequate to service this debt, but in the longer run it appears to be an enormous burden on a limited number of parking facilities in a small Pennsylvania community. Again, they have KICKED THE CAN DOWN THE ROAD.

While other major issuers with similar problems (think Detroit, The State of Illinois, Puerto Rico, and various cities in California among others) have not addressed their issues to the degree that Birmingham and Harrisburg have, it is our belief that the overall structure in most of their debt restructuring will also successfully KICK THE CAN DOWN THE ROAD.

Finally, do not be surprised if the federal government ultimately plays copycat with what states and municipalities are doing. A simple example of this is the current fiscal negotiations going on in Washington D.C. The compromise budget deal being discussed includes a plan that would reduce the deficit over the next 10 years by $20-$25 billion. With a current deficit in excess of $17 trillion this deal may reduce the deficit by .00156% over the next 10 years. Many experts predict that in the next 5-10 years the deficit is more likely to creep toward $20 trillion than stay around $17 trillion. By not taking serious steps to reduce our deficit in the near term, we are, in our opinion, KICKING THE CAN DOWN THE ROAD.

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