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### **Is the Capital City Headed for Bankruptcy?**

Just last week, the state's capital city, Harrisburg (population 47k), was declared financially distressed under Act 47. Harrisburg becomes the 20<sup>th</sup> city since the statute became law in 1987 to be so designated, joining Pittsburgh, Reading, and Scranton among others.

As we wrote earlier this year (*Policy Brief Volume 10, Number 8*) much of Harrisburg's difficulties can be traced to the intricate financial ties it has with the Harrisburg Authority and a garbage incinerator that requires hefty debt payments. The Secretary of the Department of Community and Economic Development (DCED), whose department houses the machinery that drives Act 47, issued an order on December 15<sup>th</sup> finding Harrisburg met two of the eleven criteria necessary to be declared distressed.

First, the Secretary found that criterion 3 that a "municipality has defaulted in payment of principal or interest on any of its bonds or notes in payment of rentals due any authority" was satisfied due to the City failing to make debt payments of \$10 million and \$34 million in 2010.

Second, the order noted that "the aggregate sum of separate claims asserted against the City which are presently involved in litigation before the Dauphin County Court of Common Pleas equals \$73,212,366.85". Note that Harrisburg's budget is \$64 million. Thus, criterion 9, "a municipality has sought to negotiate resolution or adjustment of a claim in excess of 30% against a fund or budget and has failed to reach an agreement with creditors", was met.

Along with those two criteria there are the problems of junk bond status, a declining population, and a high poverty rate all of which call into question the ability of Harrisburg to carry out necessary functions if it is forced to make debt payments.

Now begins the long road to recovery, which is deemed sufficient through exiting from Act 47 status. And on that score the track record is not good: only six communities have been able to exit distressed financial condition.

There is also a very real possibility, perhaps even a fairly high probability, the City could be headed for a Chapter 9 bankruptcy filing. The topic has been raised several times

going back to February of this year when a member of City Council mentioned it. A separate party involved in the DCED proceedings requested the Secretary instruct Harrisburg to file for bankruptcy (this request was denied since only the municipality in question has the authority to take action to file for bankruptcy—it cannot be compelled by DCED). Recent news reports note that “City Council members are working with [a] New York law firm...about the city's options under Act 47 and Chapter 9 bankruptcy.”

The next steps in the Act 47 process include appointing a coordinator and writing a recovery plan to be voted on by the Council. That process could stretch out to April of 2011 (Harrisburg petitioned for Act 47 status October 1<sup>st</sup>), a situation far from ideal for Harrisburg or other municipalities that might be facing an imminent problem. Perhaps the City, in consultation with the law firm mentioned in print media, has already started putting the Chapter 9 wheels in motion. Certainly, if the bond holders threaten to bring legal action against the City for failure to honor its obligation, then there might be no reasonable alternative to Harrisburg’s filing for bankruptcy protection. Having entered into Act 47 status, and with the state government in no position to help further with the City and Authority debt problem, it is prudent at this juncture to have the documents ready to file.

Our report (*Number 10-05*) detailing legislative recommendations for the new Governor and General Assembly to deal with very urgent issues facing the Commonwealth made the following suggestions:

1. Streamline the bankruptcy filing process for municipalities currently outlined in Act 47, including possibly removing the process from Act 47 procedures. The statute should specify who has the authority to file and the financial conditions necessary for bankruptcy consideration.
2. Extend bankruptcy filing permission to school districts and authorities.
3. Create a quasi-judicial independent bankruptcy board of legal and financial experts with authority to hear and approve or disallow requests from municipalities, school districts, and authorities to file for Chapter 9 bankruptcy. Establish clear and objective criteria for the board to consider in the process of hearing requests. Establish time limits for hearing and responding to requests and provide for an appeal process.
4. Enact protections to prevent abuse and capricious misuse of bankruptcy provisions.
5. Specify the Commonwealth’s role in ensuring that the terms of bankruptcy court rulings are carried out and provide for state monitoring of the municipality to help prevent a return to the financial situation requiring the bankruptcy.

Pennsylvania has an opportunity to be at the forefront in coping with a very serious issue that is sure to be a problem across the nation in the future: local governments grappling with the costly reality of obligations related to debt, pensions, and health care and trying to balance those costs with the need to provide services and do so without levying economy crushing taxes. Under Act 47 Harrisburg will likely seek the ability to raise its wage tax in order to fall on people who work but do not live in Harrisburg.

Many of the current Act 47 communities have done that and are still in distressed status. If they get out of Act 47 on the strength of commuter revenue, they must face the reality of losing the non-resident tax dollars as soon as they exit Act 47. And then it's back in distressed status. Consider too that the commuter tax can drive jobs and commuters away, making the economic and financial situation even more tenuous.

All this strongly suggests it is time to take a new look at municipal bankruptcy and come up with state regulations that will offer a more effective and responsive way to solve deep, intractable financial problems.

***We wish our readers a Merry Christmas***

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