



A MUNICIPAL FINANCE SURVIVAL GUIDE TO THE PANDEMIC

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HOUSEKEEPING



DIAL-IN NUMBER

Phone lines will be muted – if you ask a question, please keep background noise to a minimum



Q&A

Please feel free use the chat feature to ask questions to the presenters. If we are unable to get to your question, you can find the answer at www.bwslaw.com/municipalfinance



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AGENDA

- I. Introductions
- II. Fiscal Challenges –Burke
- III. Consequences of COVID-19 –Whitehead
- IV. Actions to Protect Finances and Engage Stakeholders – Branson
- V. Restructuring and Other Non-Bankruptcy Options - Kupetz
- VI. Chapter 9 of the Bankruptcy Code and the Preliminary Neutral Evaluation (Mediation) Process - Kupetz



DONALD M.

DAVIS

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Don Davis has provided contract city attorney and general counsel services to public agencies throughout California for over 25 years. He currently serves as the City Attorney for Rolling Hills Estates, Assistant City Attorney for the City of Camarillo, General Counsel for the Friant Water Authority, and General Counsel for the Bear Valley Community Services District. Don also provides special counsel services for numerous other Burke public entity clients.



RUSS BRANSON

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Russ Branson is the founder of Russ Branson Consulting. Russ works with local governments and special districts addressing difficult financial issues facing municipal governments today. Prior to starting his own firm, Russ was a Director for Public Financial Management (PFM) and was responsible for overseeing a range of services including the development of long-range financial plans, ensuring sustainable financial health, and optimizing municipal performance. Russ spent over 13 years with the City of Roseville, California in financial leadership positions, including Assistant City Manager and Treasurer, overseeing Finance and Administrative Services.



VANESSA

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Vanessa is a Partner in The Pun Group LLP where she leads the firm's Northern California and Arizona assurance practice and growth of the firm's financial management advisory practice. With over 30 years of combined experience in auditing, consulting and finance, she has served clients in a variety of industries, including federal, state and local government agencies, public pension plans, insurance companies, not-for-profit organizations, healthcare, technology and manufacturing and distribution clients.



DAVID

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David S. Kupetz is a Partner with the law firm SulmeyerKupetz. He has spent over 30 years servicing clients in the areas of financial restructuring, business reorganization, municipal debt adjustment, bankruptcy, and other fiscal crisis solutions and related litigation. His representation of local government in Chapter 9 includes the Ventura Port District, Tri-City Mental Health Center, the Orange County Transportation Authority OCTA, and a group of cities that were creditors in the Chapter 9 case of Desert Hot Springs.



MIKE

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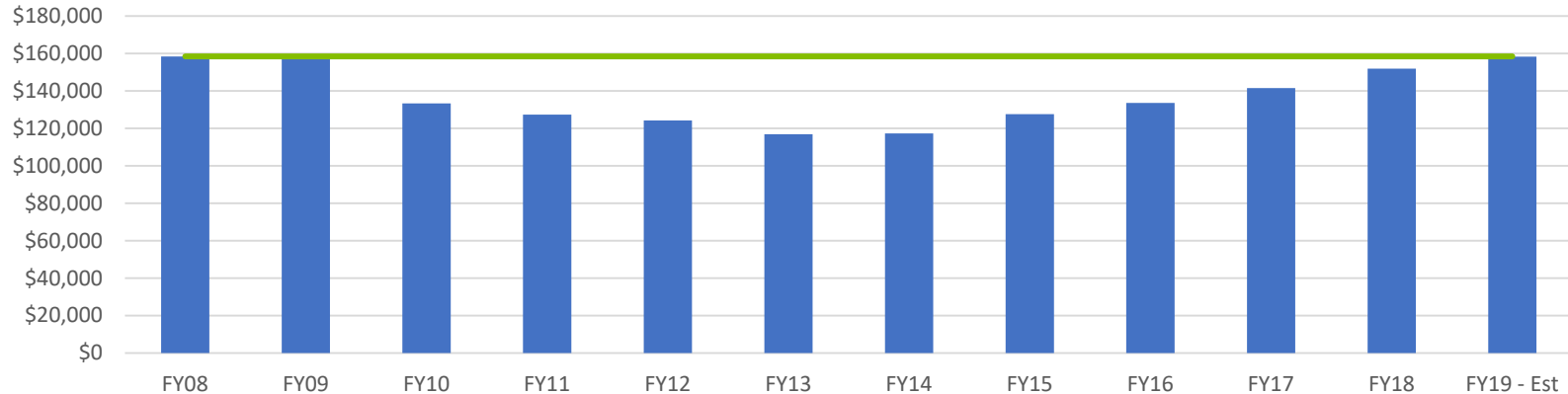
Mike Whitehead is the Administrative Services Director and City Treasurer for the City of Rolling Hills Estates where he has served for over 15 years. Under Mike's leadership, his department has received annually the Certificate of Achievement for Excellence in Financial Reporting Award from the Government Finance Officers Association, and the Quality IT Practices Award from the Municipal Information Systems Association of California.



MANY LOCAL AGENCIES HAVE JUST RECOVERED FROM THE GREAT RECESSION

- Recent-term gains in revenues often mask the fact that an agency is just getting back to pre-Great Recession revenue levels
- This lack of long-term growth, combined with increases in personnel costs, have put many agencies in fiscal distress prior to COVID-19

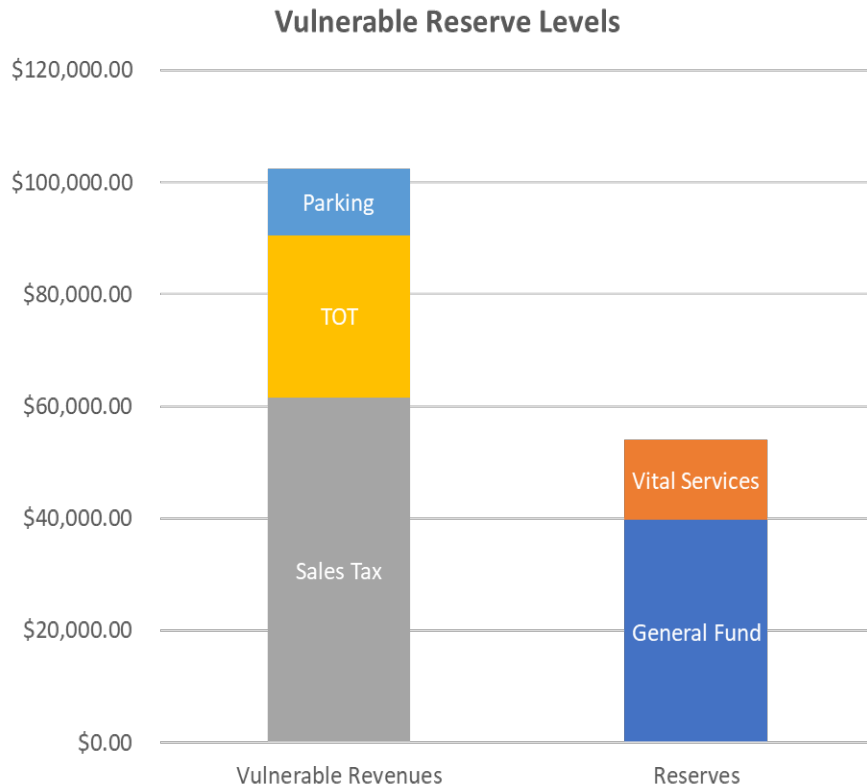
**Total Property Taxes
FY08 - FY19**



COVID-19 IS STRESSING RESERVES

- How deep and resilient are your reserves?
- Balancing budget cuts and use of reserves is difficult
 - Not only a budget development issue, but also a political issue

This City has a 7.5% policy reserve level AND a high level of vulnerable revenues during this crisis. An ongoing fiscal disruption could drain reserves to a dangerously low level





INDICATORS OF FISCAL DISTRESS

- State of California developed a high-risk local government agency identification program
- Regulations became effective on July 1, 2015
 - Partly in response to past municipal failures
- Purpose of identifying, auditing, and issuing reports agencies at high risk
 - Potential for waste, fraud, abuse, and mismanagement
 - Major challenges associated with its economy, efficiency, or effectiveness

INDICATORS OF FISCAL DISTRESS



INTERNAL CONTROL

RED FLAGS

- Governing Board Oversight Responsibilities
- Management Integrity and Ethical Values
- Organizational Structure
- Transparency in Financial Reporting – Errors & Competency
- Failure to Monitor Operating Results
- Poor Technology
- No or Little Long-Range Forecasting
- Budgeting Process
- Internal Control Failures & Findings
- Not Correcting Deficiencies in Internal Controls
- Override of Internal Control by Management
- Use of Restricted Funds to Sustain General Fund Operations
- Risk Management Mindset





INDICATORS OF FISCAL DISTRESS

Financial:

- Recurring Operating Deficits
- Transparency In and Timely Financial Reporting
- Complex Financing Structures
- Bond Disclosures / Compliance / Ratings
- Internal Control Deficiencies / Corrective Action
- Declarations of Fiscal Emergencies
- Inability to Raise Revenue
- Inability to Pay Current Fiscal Year, or Next Fiscal Year Debts When Due

Budget:

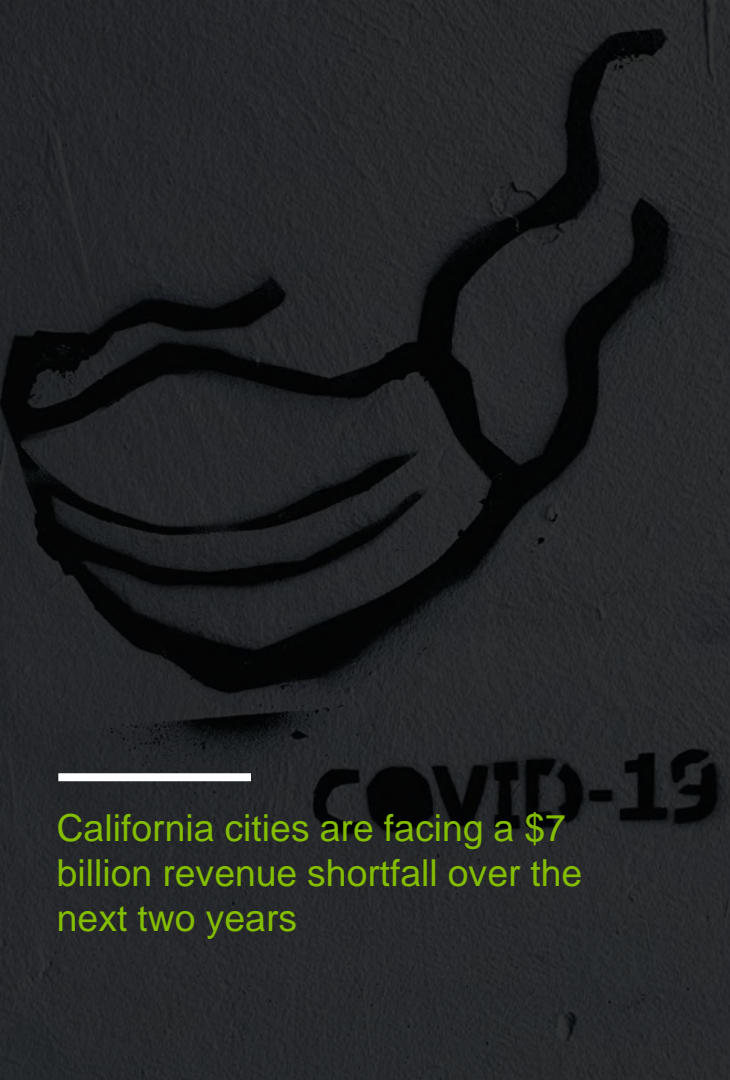
- Fiscal Sustainability vs Past Obligations/Commitments
- Structural Budget Imbalance
- Future Budget Gaps
- Inadequate Reserves / Continued Use of Reserves to Balance Budget
- Slow or No Response to External Pressures

Service:


- Service insolvency / Cuts in Essential Service
- Furloughs
- Reductions

FISCAL CONSEQUENCES OF PANDEMIC

- While Recessions are Gradual, the Pandemic Slammed the Door Shut
- Businesses Forced into Closing or Scaling Back
- Revenue Streams Declined Affecting Essential Services
- Uncertainty Looming for Years
- Wall Street Hiccapped
- Consumer Confidence
- Economy...
- Timeline?



California cities are facing a \$7 billion revenue shortfall over the next two years

A small sailboat constructed from US dollar bills is shown floating on a dark, calm body of water. The sailboat's sails are made of folded dollar bills, with the number '3' visible on the main sail. The background is a dark, overcast sky with heavy clouds, suggesting a storm or a difficult economic environment. The water reflects the boat and the sky.

FISCAL CONSEQUENCES OF PANDEMIC — REVENUES IMPACTED

- Bedroom Communities Best to Weather the Storm with Reliance on Property Tax
- Tourism and Entertainment Dependent Cities are Hit the Hardest
- Cities with Large In-Door Mall and Car Sales (RV and Trailers Sales are Up)
- Top Major Revenue Shortfalls
 - Sales Tax – (on next slide)
 - Transient Occupancy Tax (TOT) - Ouch
 - Utility Taxes
 - Business Licenses – especially if based on percent of gross
 - Gas Tax (HUTA) as workers stay home
- Property Tax is a Major Revenue Source On the Watch List

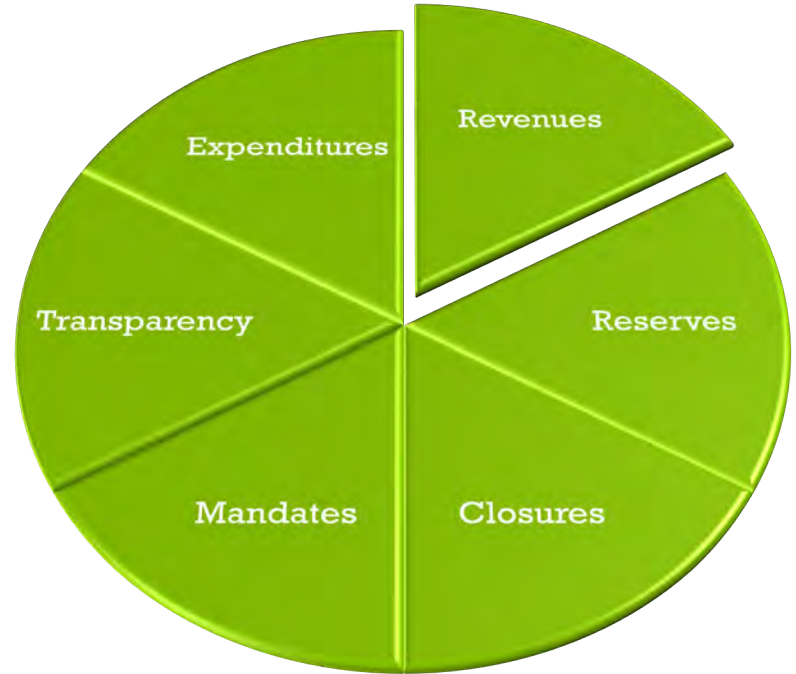
FISCAL CONSEQUENCES OF PANDEMIC — SALES & USE TAXES

- **Loss of Taxable Sales** in Specific Industries
- Consumer Spending Shifting to Online
 - Why? Ease, Stores Shipping for Free, Favorite Stores Closed, or Staying at Home?
 - Sign of the Times?
- **Late or No Filings by Industry**
 - Auto
 - Online
 - Home Improvement
 - Department Stores
- **Taxable Sales Up**
 - Online
 - Grocery Stores
 - Home Improvement
 - Big Box



FISCAL CONSEQUENCES OF PANDEMIC — KNOWN AFFECTS

- Original Budget Estimates are Thrown out the Window
- Scramble to Balance the Budget
 - Freezing and Cutting Expenses
 - Work Force Layoffs and/or Furloughs
 - CIP Stopped or Scaled Back
 - Deferred Maintenance Items
- Maintaining and Using Reserves
- Closure of Public Facilities
- Rethinking of Council and Departmental Policies
- Public Engagement
- New Model as This Shutdown Has Never Been Seen Before
- IT Department is Working Overtime Supporting Remote Workers and Teleconferencing
- LASTING EFFECT OF THE PANDEMIC IS A HUGE UNKNOWN



FISCAL CONSEQUENCES OF PANDEMIC

BUDGET IMPLICATIONS AS A RESILIENT AGENCY

- Different Approaches due to “What ARE Your Hardest Hit Revenues?”
- Do You Have Reserves? What is Your Reserve Policy?
- Present Quarterly Budget Updates
- New Revenue Streams
 - Some Cities are Now Re-Thinking Cannabis Tax
- What Expenditures Have You Frozen, Cut, or Deferred?
- Your Workforce Stable? Maintaining Services? Time to Reboot Thinking?

A person in a dark suit and blue striped tie is holding a white piggy bank with both hands. They are dropping a coin into the top of the piggy bank. The background is dark and out of focus.

NEW Pandemic Funds

- CARES Act Mar. 1 – Dec. 30
- CDBG-CV
- Others

A black and white photograph of a hand placing a block on a bar chart. The chart has several bars of increasing height, and the hand is placing a block on the tallest bar. The background is dark and textured.

ACTIONS TO PROTECT SERVICES, RESERVES, AND BUDGETS

BUDGET RESPONSES TO COVID-19 IMPACTS

COVID-19

Short-Term View

Run Down Reserves

Long-Term View

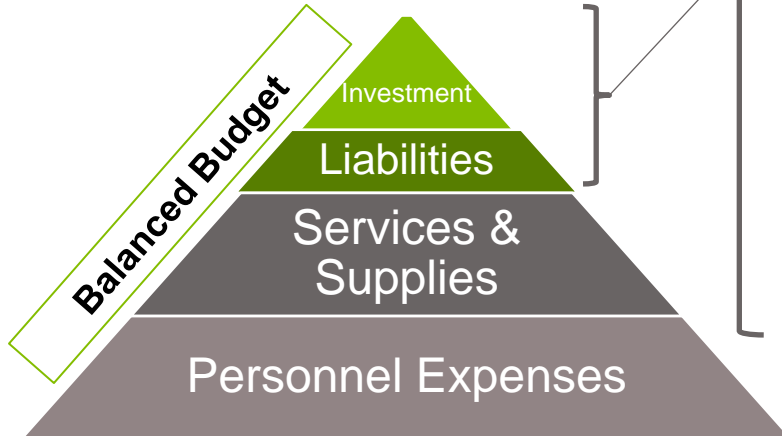
Cut Expenses to
Match Revenue Loss

Middle-Ground

Do a little bit of both

#1: FOCUS ON EXPENSES, NOT REVENUES

- **Recalibrate** expenses to include the total cost (and risk) of doing business
- If you can't afford what it takes to run your agency...you need to adjust all expenses



Deferred Maintenance

- Streets & Buildings
- Parks & Playgrounds
- Technology



Retiree Benefits

- Buffer Pension Increases
- OPEB & Retiree Payoffs
- Employee Cost Share




Community Investments

- Pools/Recreation/Youth Programs
- Community Centers/Libraries

#2 RESPOND TO PUBLIC ENGAGEMENT

Build your budget so that any citizen can understand:

- Where your money comes from
- How you are prioritizing services
- How your spending plan reflects community values
- What revenue risks are and how you will respond to a revenue crisis



The issue of how a City/County spends its money is becoming a mainstream (and divisive) topic. What does this mean for how we develop and talk about budgets?



#3 USE BUDGET FORECASTS TO HIGHLIGHT POLICY

- **Require a budget forecast prior to budget adoption**
 - Show impact of changing expenses and revenues
 - Illustrate ability to fully fund the cost of operating your organization
- **Informs current-year budget decisions**
 - Forecast, **not prediction** – The value is NOW
- **Budget forecasts as policy plans**
 - Long-term sustainability
 - Impact of **changing revenue streams**
 - Matching spending to **Community Values**

“It’s difficult to make predictions,
especially about the future”

- Niels Bohr, Mathematician (1885-1962)

A woman with long dark hair, wearing a light blue surgical face mask and a dark business suit over a white shirt, is holding a pink piggy bank in her left hand and dropping a gold coin into it with her right hand. The background is a plain, light-colored wall.

#4 TALK ABOUT ECONOMIC VULNERABILITY

A budget forecast can help communicate real budget vulnerabilities

- Revenue Volatility
- Pensions and Health Care
- Labor Costs
- Reliance on New Development

The cost of “business as usual” may increase your risk of major economic dislocation



LET THE FACTS DO THE WORK

TELLING YOUR STORY

Mine your data for your stories

- How fast are you going through your reserves?
- Uncertainty of future revenue levels – quick rebound vs. longer-term impacts
- Longer-term impacts from pension increases, reserve replenishment, critical infrastructure needs
- Show that uncertainty requires both caution and **action**—just hoping to hang on may not be the right strategy

RESTRUCTURING AND OTHER NON-BANKRUPTCY OPTIONS

- Local public entities facing severe financial straits must explore debt restructuring, moratoriums, and adjustment as potential solutions
- Exploration takes place in the shadow of the resolution of last resort: Chapter 9 of the U.S. Bankruptcy Code
- Initial focus should be on accomplishing the necessary restructuring outside of court



ACTIONS TO MAXIMIZE OPPORTUNITY FOR SUCCESSFUL OUT-OF-COURT RESTRUCTURING

1. Evaluate cash flow, finances, and availability of unrestricted funds and develop financial and operational plans;
2. Commence discussions with key stakeholders (the reality of a potential Chapter 9 filing encourages negotiation and creates leverage for an agreement);
3. Prepare the outlines of a possible Chapter 9 plan of debt adjustment or term sheet (to help facilitate negotiations and make use of the leverage); and
4. Retain experienced professionals to provide guidance and representation

FISCAL EMERGENCY DECLARATIONS

- The Contracts Clause under the U.S. and State constitutions ordinarily preclude contract impairment
- Constitutions do not bar a state or municipality from enacting legislation impairing contracts if required by a financial emergency
- May be constitutional if reasonable and necessary to serve an essential public purpose



OUT-OF-COURT

EMERGENCY POWERS ARE LIMITED

- Local governments may attempt to constructively use a fiscal emergency declaration to commence, promote, and positively leverage negotiations with labor and other key stakeholders
- Any non-consensual modifications that arise out of a fiscal emergency declaration are temporary
- Cannot feasibly address long-term systemic problems such as unsustainable pension and retiree health care obligations

CHAPTER 9



Chapter 9 provides a framework for eligible governmental entities to restructure debt



Chapter 9 is federal law



Bankruptcy Code is designed to implement impairment of contracts overriding constitutional Contracts Clause



State law governs the gateway to Chapter 9

AB 506 — GATEWAY TO CHAPTER 9 FOR CALIFORNIA LOCAL PUBLIC ENTITIES

- California law (AB 506) requires municipal debtors to engage in “neutral evaluation” (Mediation) before being eligible to file for Chapter 9
 - Except in the case of a declared statutory fiscal emergency
- The likelihood that payment and other obligations will be suspended during the chapter 9 case and reduced and/or modified under a Chapter 9 plan can create significant leverage that can lead to negotiated changes that may be adequate to allow the local public entity to avoid Chapter 9

MEDIATION

PROCESS

- The mediation process allows “confidential” negotiations out of court and within the exceptions of Brown Act
- It provides a format for attempting to shape perceptions of liquidity and feasibility of go-forward plans
- If an agreement is reached with some or all key creditors, Chapter 9 may be avoided or made more efficient if still necessary
- Timeframe unlikely to lead to successful overall resolution in large or complicated cases



AB 506

- Enacted after the Chapter 9 filing of Vallejo
- Stockton first used the mediation process before its chapter 9 filing
- San Bernardino discovered it was out of cash, could not negotiate with creditors, declared a fiscal emergency, and entered Chapter 9 without mediation
- Unlike in Chapter 9, there is no automatic stay of litigation or other creditor action as part of the AB 506 process and, accordingly, where an immediate stay is needed, the mediation process will not be a viable option



PURPOSE OF CHAPTER 9

- Enables a municipality that is unable to pay its debts as they come due to continue to provide essential services while working out a plan to adjust its obligations
- Avoid disruption of necessary services
- Facilitate the continuance of insolvent municipalities rather than their dissolution
- Not unlike Chapter 11 bankruptcy reorganization for non-governmental entities, two primary benefits of a Chapter 9 filing are
 - Breathing spell imposed by the automatic stay, and
 - The ability to adjust creditors' claims through the plan process

CHAPTER 9 PLAN

- Creditors are to be provided as much as the realistic alternatives
- Municipal debtor must show the court it can meet its obligations under the plan and to continue to provide public services
- In order to cramdown a plan over the objection of a class of creditors, plan must provide creditors with only as much as can be reasonably expected under the circumstances
- Creditors should not expect that, under a plan of debt adjustment, all excess cash go to payment of their claims
- A municipal debtor is to emerge from Chapter 9 having made the adjustments necessary to achieve long-term financial sustainability

SUSPENSION OF OBLIGATIONS AND REJECTING/MODIFYING CONTRACTS

- Following commencement of case, payment of pre-Chapter 9 debt can be suspended
 - e.g., pension and healthcare payments to retirees, payments on bonds (except with respect to pledged special revenues), lease payments, trade debt, bank and other loans, labor claims, court judgments, and obligations owing to the State
- Under a Chapter 9 plan, local public entities can restructure debt to permanently reduce or modify outstanding obligations
- Collective bargaining agreements and other contracts can be rejected and/or modified and retiree payments and benefits can be suspended and/or modified



ANY QUESTIONS?



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