

# Bloomberg

## 'Real Bad' Cash Jam May Force Michigan Towns to Borrow or Default by March

*By Tim Jones and Jeff Green  
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Cities and towns across Michigan have seen property-tax collections plunge as much as 20 percent in the past year, the steepest drop since a 1994 state tax rewrite, forcing scores of communities to choose by March whether to borrow to pay bills or risk default on bonds.

The municipalities rely on property taxes for as much as 60 percent of their revenue, according to the Michigan Municipal League. State support that typically composes another 20 percent to 35 percent of city budgets has been slashed by almost a third in the past year, during the longest recession since the 1930s.

The end of a three-year federal stimulus worth \$3.1 billion to Michigan -- a sum roughly equal to two annual budgets for Detroit -- will force "fundamental decisions," according to a memorandum by the Michigan Senate Fiscal Agency.

"This gets real bad in about 90 to 150 days," said Robert Daddow, deputy executive of Oakland County, which is adjacent to Detroit's Wayne County and has a per-capita income 146.8 percent of the state average, according to Moody's Investors Service. "The question becomes whether they can secure enough cash from banks and whether banks are willing to lend in a credit-crunch situation."

Down, Down, Down

The value of taxable housing in Oakland County, which is home to the headquarters of Chrysler Group LLC, fell 11.8 percent this year, Moody's said in a Nov. 23 report. It will drop 10 percent further in 2011 and 5 percent more in 2012, Moody's said.

"Declining housing values and a growing unemployment rate within the county demonstrates the county's exposure to the challenges in this region," Moody's said.

State unemployment in October was 12.8 percent; it has been as high as 14.5 percent in December 2009 as the auto industry contracted.

The state in October trailed only California and Florida in its number of foreclosure filings, according to RealtyTrac Inc., an Irvine, California-based data firm. A total of

19,288 properties in the state, or one in 235 households, received a default or auction filing or were seized by banks last month, the company said. The rate was up 17 percent from a year earlier.

“It’ll take us a decade or more for cities to be collecting what they were a decade earlier,” Summer Minnick, director of state affairs for the Ann Arbor-based Municipal League, said in a telephone interview. Some municipalities have seen property-tax revenue drop by a fifth, she said. “Right now, we have several communities on the brink of severe problems.”

### At the Edge

The recession has pushed many U.S. communities to the edge of Chapter 9 bankruptcy, or, in the case of Vallejo, California, into it. Harrisburg, Pennsylvania, averted a bond default only because the state accelerated an aid payment.

Under state law, Michigan has the final say on whether a municipality can enter bankruptcy. Detroit said in March it was considering moving toward a filing. Hamtramck, where General Motors manufactures the Chevrolet Volt, has also pressed state officials for a bankruptcy, saying that Detroit, which largely surrounds it, owes it money.

Southfield, an Oakland County city with what Moody’s in 2008 called a “satisfactory financial position,” anticipates \$19.9 million from its general operating tax levy this fiscal year, a 16.7 percent drop from three years ago, when it budgeted for \$23.9 million. Its administrator and treasurer asked the state Legislature in September for permission to sell \$50 million in bonds to cover operational costs.

### Emergency Calls

Under a 1990 law, a Michigan governor can declare a financial emergency for a city and install a manager to run its business. Of the seven such declarations, four have occurred since December 2008.

“Hundreds of jurisdictions” in the state may face financial collapse in the next three to five years, Rick Snyder, Michigan’s newly elected Republican governor, said Nov. 19.

Nationwide, the value of defaulted municipal securities fell to \$2.48 billion through October, compared with \$7.28 billion in 2009 and a record \$8.15 billion in 2008, according to Richard Lehmann, publisher of Distressed Debt Securities Newsletter.

Lehmann told Bloomberg News on Nov. 23 there may be a “new wave” of defaults in 2011 as federal economic-stimulus aid declines and budget pressures mount.

### Rich Town, Poor Town

The number of local governments on Michigan's three-year-old financial watch list, which measures stresses by debt, tax collections, cash flow and population changes, totaled 68 in 2008, the most recent accounting.

Cities on the Michigan Department of Treasury's list include the industrial centers of Detroit, River Rouge, Jackson and Benton Harbor. Wealthier suburbs are also in danger, Minnick said.

"These are upscale suburban bedroom communities that had new homes and tremendous price spikes," Minnick said. "Some are communities you would not have expected."

The Michigan Legislature has cut revenue-sharing payments to localities by almost one-third in the past year and by \$4 billion in the past 10 years, the Municipal League said.

The financial strain on cities is compounded by voter-approved constitutional limits on the growth of property taxes, which restrain annual increases to 5 percent or the rate of inflation, whichever is less.

#### Holding the Bag

Falling property-tax collections will create gaps starting next year in the "hundreds of millions of dollars" for cities and townships, said Eric Scorsone, senior economist for the Michigan Senate Fiscal Agency.

Michigan counties reimburse local governments for unpaid property taxes and charge fees and interest as the county attempts to collect delinquent amounts for three years, Scorsone said. If the county cannot collect, the city or township can be billed for the uncollectable tax value.

Scorsone said the financial liability is "certainly going to be a big number and it's going to hit a lot of places that aren't aware of the problem."

"A lot of governments are going to get squeezed pretty hard," Scorsone said.

The fall in property-tax collections comes even as Michigan is beginning to emerge from a long economic slump. The University of Michigan on Nov. 19 forecast a net increase in jobs in 2011, the first gain in more than a decade. The state's economic activity in September reached its highest level since June 2008, driven by resurgent manufacturing, according to a Comerica Bank report.

#### Dangerous Mix

**Meanwhile, the combination of foreclosures, falling tax revenue and unfunded municipal pension liabilities is becoming unmanageable, said Charles Moore, senior managing director at Conway MacKenzie Inc., which works with municipalities on financial restructuring.**

**“I think there’s a very high likelihood we’ll see defaults in 2011 and I expect it will only increase in 2012 and 2013,” said Moore, who is based in Birmingham, Michigan, a Detroit suburb.**

Communities are trying to persuade the Legislature to refinance their bond debt that was initially sold on the assumption that property values -- and property taxes -- would continue to increase at pre-2008 levels, Minnick said.

“I hope we can do the refinancing so we can prevent defaults. I don’t know if, at the end of the day, that will be enough,” she said.

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