THE BOND BUYER

THE DAILY NEWSPAPER OF PUBLIC FINANCE

RESTRUCTURING

Turnaround Firms to the Rescue

Governments Turn To Distress Pros

Wednesday, June 22, 2011

By Christine Albano

Corporate turnaround firms are known for rescuing companies on the brink of collapse in corporate America and on Wall Street, but lately some of them say they are putting more time and energy toward helping distressed state and local governments.

While such firms have worked with troubled municipalities as part of their public finance work for several years, they say the need for fiscal oversight and financial restructuring has recently increased.

The trend has been boosted by the passage of laws, such as the Financially Distressed Municipalities Act, known as Act 47, in Pennsylvania, which provide for the restructuring of debt and other financial relief provisions.

Troubled governments are seeking the services of global professional consulting firms, like Conway MacKenzie Inc. and Alvarez & Marsal LLC. These firms focus on the operational elements of a restructuring, such as downsizing staff and consolidating overlapping services, renegotiating union contracts, and restructuring day to day management.

Their services range from streamlining budgets to taking over the helm of a municipality, like a troubled school district, for instance.

Conway MacKenzie in 2009 started to see a lot of opportunity in the state and local government sector, according to Charles Moore, the firm's senior managing director.

"Governments that had financial troubles thought they could get around them with accounting and other one-shot provisions without addressing the underlying factors," he explained. "Some of these entities have taken cost-reduction actions on their own, but most people in a leadership position do not have restructuring experience because it is foreign to them."

He said governments faced with a liquidity crisis have to deal with declining revenues "that are not going to increase anytime soon," Moore said.

"The financial distress for local municipalities is well past started," agreed Jeff Werbalowsky, co-chief executive officer at Houlihan Lokey, an international investment banking firm based in Los Angeles and New York.

"The question is whether the financial distress will be followed by defaults, and that's a question of political will and other factors, including the future state of the economy," he said.

Houlihan has a large group specializing in financial restructuring, such as selling assets and structuring negotiations in complex distressed situations.

While municipalities historically have a low default rate, the latest economic downturn left many struggling with severe revenue shortfalls. Some are looking to corporate turnaround firms for assistance.

Alabama's Jefferson County faces a $77 million deficit by the end of the fiscal year due primarily to the loss of tax revenue, according to a 23-page report from corporate turnaround firm FTI Consulting in April.

The county is in default on $3 billion of sewer debt.

Cash-strapped Harrisburg, Pa., was recently advised to sell its incinerator and other assets to help repay $220 million of incinerator bonds after entering Act 47 in December due to an inability to pay the debt.

Alvarez is now advising the Harrisburg City Council on its debt restructuring linked to the bonds.

"There is a lot of stress out there, but municipalities have more tools at their disposal to deal with the stress than corporations," Werbalowsky said. "Corporations can't raise taxes where municipalities can."

"There are pension deficiencies, unfunded health care promises for both current and retired employees, and deferred infrastructure maintenance ... and all of those obligations are finding their way in unprecedented quantities into all levels of our government at the federal, state, and city level," he said.

Werbalowsky noted that Houlihan has done municipal-related work for years, such as restructuring of troubled revenue bond issues, but it does not currently have a dedicated effort for state and local government workouts.

Houlihan Lokey is negotiating the terms of the Las Vegas Monorail Corp.'s reorganization plan after it defaulted on $451.5 million of first-tier bonds issued issued in 2000 by the Nevada Department of Business and Industry.

The bonds were wrapped with Ambac Assurance Corp. insurance. The Monorail filed for Chapter 11 in January 2010 due to inability to make its bond payments because of a depressed economy and declining revenues.

In some cases, however, municipalities are often reluctant to seek a financial workout because they are sensitive to paying professional fees while struggling with a budget crisis, Werbalowsky noted.

"It's difficult to solve complicated financial problems when the people who are in charge of making the hard and often unpopular decisions are answering to an electorate who can make a decision to throw them out," he said.

Bill Roberti, managing director of Alvarez & Marsal, said municipalities that want to avoid a worst-case scenario will eventually opt to seek assistance.

"I think as time marches on and as more and more political entities have financial trouble they are not going to have a choice but to bring in a professional to help," he said.

Roberti said his firm has served municipalities in its public group work for eight years, and now has a 20-person team to handle such failing entities as urban public school systems.

Though not solely dedicated to state and local government restructuring alone, the team is currently helping the Detroit Public School System try and solve a $327 million structural deficit.

"We are not just the typical consulting firm that writes a report," Roberti said. "We will roll our sleeves up alongside the people who hired us."

The firm did its first municipal restructuring back in 2003 when it took over the finances and operations of the St. Louis Public Schools System as it faced a $79 million shortfall.

Roberti said there were few turnaround firms participating in the public sector when his firm began eight years ago.

"I think as you continue to see interest rates low, and corporate insolvencies are low, restructuring firms are looking for other ways to utilize their resources,'' he said.

There also is a trend toward utilizing non-elected officials as emergency financial managers, sources noted.

"An EFM is called in to make these difficult decisions that the elected officials are unwilling and incapable of making," Werbalosky said.

In the end, most municipal entities can overcome their fiscal difficulties, according to Roberti. But what happens next depends in large part on what happens with the economy in general.

"If you see a double-dip recession," Werbalowsky said, "you will see an unprecedented amount of defaults."