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Moody's: Taboo Against Municipal Bankruptcies Has Weakened.

New York, August 06, 2015 — Municipal bankruptcy, while still a rarity, has become a less unthinkable way for distressed local governments to reduce their debt and pension liabilities, says Moody's Investors Service in a new report, "Municipal Bankruptcy Still Rare, but No Longer Taboo."

Moody's notes that our median municipal rating is Aa3, and less than 0.5% of all its rated cities, counties and school districts have speculative grade credit ratings. Any growing willingness to pursue bankruptcy among the lowest-rated issuers in this group would have no impact on the overall distribution of Moody's municipal ratings.

Municipal bankruptcies, however, may be more widely considered as the bankruptcies of Jefferson County, AL, Stockton, CA, and Detroit lay out a potential blueprint other distressed municipalities could follow, with Detroit restructuring and emerging in 16 months.

In general, the risks to bondholders and, as a result, the severity of rating downgrades generally accelerate when bankruptcy is seriously considered as an option, says Moody's.

"Emergence from bankruptcy can restore credit quality going forward, but the process itself is radical and often unpredictable," says Moody's Senior Vice President Al Medioli.

Moody's notes that recent municipal bankruptcies have protected pension liabilities at the expense of bondholders.

"There appears to be a dynamic at play that elevates retirees as a group above other creditors, and that further places pensions on a higher plane above all other liabilities, regardless of bond security or legal revenue pledge," says Moody's Medioli.

"The willingness to consider bankruptcy often means the interest of issuers and creditors have become diametrically opposed, which must be reflected in the rating," explains Medioli.

The number of public local government bankruptcies has remained low following the recession, but there has been a noted recent increase against the backdrop of their extreme infrequency since World War II. Moody's points to the slow economic recovery and the rise in government fixed costs, particularly pension costs, as the causes of the rise.

"A more frequent use of bankruptcy by distressed credits does not in and of itself alter our overall stable outlook on the state and local government sectors, but it does underscore how the recent recession has left in its wake significant pockets of financial pressure and a tighter budgetary 'new normal' that is less resistant to new shocks," says Medioli.

For more information, Moody's research subscribers can access this report [here](#).

