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Detroit Seen as Model in Ohio City Facing Collapse: Muni Credit.

The council president in East Cleveland said if she had her way, the city would follow Detroit's path and become Ohio's first municipality to file for bankruptcy to help solve its fiscal woes.

State Auditor Dave Yost said the suburb of 17,500, where oil baron John D. Rockefeller once had a summer estate, is insolvent. The community lacks a working ladder truck in its fire department, had its mobile phones shut off and faces \$1.7 million in unpaid bills.

City officials say the options include asking voters to raise taxes, deeper spending cuts, merging with Cleveland or filing for bankruptcy. Council President Barbara Thomas favors the latter, following the Motor City's record \$18 billion bankruptcy in July 2013. Detroit was able to reduce its liabilities by \$7 billion and exited Chapter 9 as of today.

"We might come out a little bit better, just like Detroit," Thomas said in a telephone interview. "Isn't it better to clear away your debt in a proven process than to keep trying to rob Peter to pay Paul?"

Second Stint

Ohio has rebounded from the recession that ended in 2009, recovering all but a quarter of the 375,000 jobs it lost. Yet it has designated 23 local governments as being in a state of fiscal emergency. While Yost's office said those municipalities aren't dealing with the same distress as East Cleveland, they meet certain criteria, such as failing to make payroll for more than 30 days because funds are lacking.

This is East Cleveland's second stint in the fiscal-emergency program, which triggers the appointment of a state commission to supervise the municipality's finances. The city spent 17 years under state oversight through February 2006 and returned to that designation in October 2012, according to the auditor's office. Unlike in Michigan, where the state can take over a community's finances, Ohio maintains local control during fiscal emergencies, said Carrie Bartunek, a Yost spokeswoman.

East Cleveland, a city of three square miles (7.8 square kilometers), has struggled with its finances for decades, said Finance Director Jack Johnson. About 43 percent of residents live in poverty, almost triple the state level, while median household income, at about \$20,600, is less than half the Ohio average, U.S. Census data show.

'Devastating' Challenges

It encountered "the perfect storm" after the recession, with the 2011 closing of a Cleveland Clinic hospital that generated about \$1.5 million a year in income taxes and the loss of about half its annual \$3 million in state aid since 2010, he said.

"There have always been challenges here, but those two things just sort of made it devastating," he

said.

The city, with about 170 full- and part-time employees and a general-fund budget of \$11 million, had deficits totaling \$4.9 million as of Oct. 31 — even after eliminating about a quarter of its workforce this year, Johnson said.

East Cleveland has no municipal debt, with its most-recent revenue bonds maturing in 1997, data compiled by Bloomberg show.

Yost sent a Nov. 21 letter to the commission overseeing its finances saying East Cleveland is insolvent, and that its recovery plan “is inadequate to return it to fiscal health in this current environment.”

Borrowing Plan

“It is fair to say the City is on the verge of collapse,” Yost wrote.

The city had anticipated borrowing as much as \$6.9 million to reduce cash-flow pressures and buy time to restructure, said Johnson, the finance director. Yost has said he can’t support that without a plan to eliminate the structural deficit.

East Cleveland must pass at least a temporary 2015 budget by year-end. The mayor and city council will decide on long-term options of asking voters for an income- or property-tax increase, more restructuring, merging with Cleveland or bankruptcy in coming months, according to Johnson.

Thomas, the council president, said she doesn’t see a viable alternative to bankruptcy. There’s no support in council for a merger, voters won’t pass a tax increase and it isn’t feasible to find revenue quickly enough through spending cuts, she said.

Mayor Gary Norton Jr. declined to comment.

Bartunek, the spokeswoman for Yost, said East Cleveland’s situation doesn’t reflect the performance of localities across Ohio.

The experience of Detroit shows bankruptcy can freeze the market for new debt in an entire state. Bond sales in Michigan plunged to the lowest in a decade in August 2013.

Not Stirred

Ohio issuers have sold \$8.6 billion of debt this year through Dec. 5, compared with \$10 billion in the same period of 2013.

Detroit’s Chapter 9 also shows how local distress can affect state finances. Standard & Poor’s revised its outlook on Michigan’s AA- rating to stable from positive in June, in part because of the possibility of future payments to strained municipalities.

S&P rates Ohio two steps above Michigan at AA+, the second-highest grade.

An East Cleveland bankruptcy would probably cause less of a stir among bondholders than those in Detroit and Central Falls, Rhode Island, said Howard Cure, head of muni research in New York at Evercore Wealth Management LLC, which oversees \$5.5 billion.

“Detroit is different because it’s the biggest city in Michigan, and Central Falls is different because Rhode Island is such a small state,” Cure said in a telephone interview. “Here, you have a small city

in a big state, and I don't think it would garner the same concerns."

Bloomberg

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Dec 11, 2014 8:26 AM PT

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