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Memo to Puerto Rico: Alabama County Shows Limits of Bankruptcy.

Four years after filing what was then the largest municipal bankruptcy in U.S. history, Jefferson County, Alabama, is learning that having debt wiped out in court doesn't solve all one's financial problems.

Alabama's largest county emerged from bankruptcy in 2013 freed from $1.3 billion of bonds that hastened its collapse, only to still be unable to make up for deep spending cuts for police, road work and health care. It's at risk of defaulting on some debt as soon as 2017. And it's counting on returning to the bond market next year for the first time since leaving court protection, seeking to free up needed cash by refinancing debt left behind.

"They're floundering, still bogged down with remnants of their past," said Richard Ciccarone, president of Merritt Research Services in Chicago, which tracks municipal borrowers. "They still have remaining structural issues that weren't resolved by their bankruptcy."

The 661,000-person county, which is home to Birmingham, provides a lesson for Puerto Rico, the Caribbean island 1,650 miles (2,654 kilometers) away. There, with the government rapidly going broke after running up $70 billion of debt as the economy sputtered, Governor Alejandro Garcia Padilla is pleading with U.S. lawmakers to give it the power to file for bankruptcy, just as local governments can. They've so far declined.

While such a step allows governments to escape from debts if a judge approves, it can leave behind other liabilities, delaying a fresh start, and doesn't always address the root cause.

Detroit, which was once felled by rising debt, pension bills and a shrinking population, in 2024 will have to start paying about $194 million a year in workers retirement bills that were delayed by the bankruptcy. Jefferson County is still contending with debt that was left intact and the blow of a court verdict that struck down a tax that provided 40 percent of its revenue.

"Bankruptcy was never a panacea, but necessary to deal with an unimaginable debt load," said James Stephens, president of the Jefferson County Commission, in an e-mail.

Jefferson County's bankruptcy was triggered by a sewer project that was dogged by mismanagement and corruption. When the price tag more than doubled to over $3 billion, officials refinanced debt with floating-rate bonds and derivatives, like homeowners who used exotic loans to buy houses they couldn't afford. The tactic backfired during the 2008 credit-market crisis, leaving the county on the hook for hundreds of millions in fees and demands to pay off the debt early.

Then, in 2011, an Alabama judge ruled that a wage tax that raised $75 million a year was illegal. That finally pushed it to file for bankruptcy, which allowed it to cut its sewer debt to $1.8 billion from $3.1 billion.

Still, the county reduced its workforce by 1,200, or one-third, in response to the loss of the tax. One jail was closed, and the county has been hard-pressed to invest in new infrastructure. The budget has been cut by 46 percent since 2008, according to Fitch Ratings, which estimates that the county will need to drain $38 million from its reserves this year.

Jefferson County is now seeking to free up money for infrastructure projects by refinancing about $666 million of debt sold for its schools in 2004 and 2005 as soon as first quarter of 2016, said Stephens.

Default Risk Lingers

It plans to do the same with about $69 million of obligations backed by leases on county buildings. The county has struggled to meet those bills: It initially planned to have bond insurer Ambac Financial Group Inc. cover some of the debt payments due this fiscal year, which Standard & Poor's said would be a default, until it was able to secure funds. That sparked a two-level upgrade by S&P on Dec. 1 to CCC, eight steps below investment grade.

"Because there's not a plan to make those payments after 2016, we think they're still vulnerable," said Jim Tchou, analyst at S&P.

By refinancing the school debt and pushing payments into the future, the county will be able to access about $36 million a year of taxes that support the debt and provide $18 million for schools, said Stephens, the county commissioner.

Jefferson County convinced state lawmakers to allow it to use some of the 1 percent sales tax that now goes to the school debt for other expenses after the refinancing. The sale still has another hurdle: The county's awaiting approval of the deal from an Alabama judge. A group of residents is also seeking to have the sales tax thrown out in court, which, if successful, would deal a fresh hit to the public purse.

"Bankruptcy provides more runway to deal with financial pressures but it doesn't resolve the systematic problems that existed before," said James Spiotto, managing director at Chapman Strategic Advisors LLC, which advises on financial restructuring.

In Puerto Rico, officials would like to give it a try. If only Congress would let them.

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