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Chapter 9 Bankruptcy: An Overview

As investors familiarize themselves with their respective issuer's credit profile, they are essentially looking to ensure that the debtor is financially strong enough to pay back its obligations in a timely manner. Now, what happens when a municipality is unable to meet its financial obligations? The simple answer is the reorganization of municipalities, which includes cities, towns, counties, taxing districts, municipals utilities and school districts, under Chapter 9 of the Bankruptcy Codes.

Although Chapter 9 cases are rare and the restructuring laws can be very different for every state, recent local government's bankruptcies like Detroit, Michigan (2013); Jefferson County, Alabama (2011); Stockton, California (2012); and San Bernardino, California (2012), were few of the major examples in recent times that served as a rude awakening for many municipal debt investors who originally thought that municipal debt was the safest investment option out there and showed full faith in the taxing power of each local government.

In this article, we will take a closer look at the purpose of municipal bankruptcy, the eligibility requirements for municipalities, plan of adjustment and, finally, how it impacts the bondholders.

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