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Fresno looks to set standard in 'political will' as credit quality drops

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The City of Fresno, which is finding itself among California's more financially pressured municipalities, may shape up to be a test-case for whether a substantially sized Golden State municipality can turn the corner on its financial condition without a significant restructuring, said city manager Mark Scott and three restructuring advisors.

Though Fresno has been linked to speculation of bankruptcy in news reports since California witnessed a trio of bankruptcy filings last summer, the city has no plans to seek protection and has not hired any restructuring advisors. "We haven't evaluated that legal option because there's not an upside to us," Scott said. He noted that the city has no plans to otherwise refinance its debt, impair its retirees, or unilaterally break expensive labor contracts.

Beset with structurally imbalanced budgets, thin liquidity, and a weak economic base, Fresno lost its investment grade rating from Moody's on its general fund-backed debt in January. That includes USD 174m in pension obligation bonds and USD 204m in lease-backed bonds, according to the city's FY11 audited financial statements, the most recent available. Moody's downgraded the lease bonds two notches to Ba1 and the other general fund debt three notches to Ba2.

Fresno is situated along the Route 99 corridor of California's Central Valley that has come to be known for municipal financial distress. The city expects to have structurally imbalanced budgets into the foreseeable future, noted the first and second restructuring advisors. That is likely to continue to narrow the city's financial flexibility, Moody's wrote in its 23 January 2013 report.

Nonetheless, unlike bankrupt Stockton, Fresno has a fully funded retirement system, which means it doesn't have exposure to its independently administered pension fund, though it does have to repay bondholders on its tax-backed pension obligation bonds. And Fresno has proactively sought to refocus its financial future through its 10-Year Workout Plan unveiled last year.

There are a number of reasons that bankruptcy doesn't appear to be in the immediate sight lines, said the three restructuring advisors. For one, if the city were to file a Chapter 9 petition, it would likely face challenges from capital markets creditors in proving its eligibility, and may be unable to prove that it is insolvent, the first restructuring advisor noted. Much of the city's bonds are insured by Assured Guaranty and National Public Finance Guarantee, both of whom are challenging Stockton's bankruptcy eligibility, the first restructuring advisor said.

Further, many financially challenged municipalities watching along as Stockton and San Bernardino tread water in the Chapter 9 process are beginning to lose faith that bankruptcy is the best use of time and money, said Karol Denniston, California-based attorney with Schiff Hardin.

Michael Sweet, a California-based partner at Fox Rothschild, noted that recent bankruptcy cases have also pushed creditors to try to avoid that outcome.

"In Vallejo, labor groups lost collective bargaining agreements. In Stockton, retiree health payments were taken away. In San Bernardino, there's discussion about whether [the California Public Employees' Retirement System] could be impaired," he said. "People are starting to see the draconian things that can happen in a bankruptcy. That incents folks to look for a workaround."

But compelling substantive structural changes requires a high degree of political will, Denniston said. Fresno has made it clear that it has a plan to address its shortfall, but whether it can compel its creditors to abide by that plan remains to be seen, she said.

Following the Moody's downgrade, Scott said in a press release: "Officials from Moody's advised us that while they appreciate our fiscal sustainability plan, they are nonetheless concerned that it relies so heavily on 'political will' to make it happen. And, on the other hand, they worry about our capacity to cut services to the public

further.”

For example, the city voted to privatize its Residential Solid Waste program late last year to bring in immediate revenues, but soon after encountered a lawsuit from a citizens group called Fresnoans For Clean Air and a petition drive that has delayed its implementation.

The city has already made deep cuts to its workforce, outsourced certain services, and delayed maintenance and equipment programs. And it plans to continue to try to elicit concessions from labor groups, whose contracts have been the biggest burden on the budget, Scott said. While the city has considered taking more drastic actions to break labor contracts, it doesn't have any plans to do so in the immediate future, he added. Currently, the city plans to continue the standard collective bargaining process.

“They've been proactive and they've been preemptive, but they will have to move the meter on numbers,” Denniston said. “Until you can put something up on the board, it's hard for the market to have confidence in a plan.”

S&P rates Fresno's lease bonds at BBB and Fitch rates the debt at BBB-.

A USD 25m tranche of Fresno's Series 2009A lease revenue bonds maturing in 2039 last traded in odd lots on 4 February at 108, yielding 4.85%, according to Electronic Municipal Market Access (EMMA). Bondholders could not be immediately identified. The bonds were issued by the Fresno Joint Powers Financing Authority, and Zions Bank serves as indenture trustee, according to EMMA.

by Ben Eisen