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Just Before Deadline, County in Alabama Delays Bankruptcy Move

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There may still be a way out for Jefferson County, the Alabama county being crushed by its debt.

The governor of Alabama, who for months told the county to deal with its woes on its own, has been working behind the scenes in recent days on a state-brokered deal to avert what could be the biggest municipal bankruptcy filing in United States history. On Wednesday evening, a proposal was aired to a small group of lawyers for the county in a private meeting, according to one official present.

Hours before a deadline Thursday, the commissioners agreed to delay the vote on a bankruptcy filing for seven more days, while they reviewed the new offer from the county’s creditors. The proposal would reduce the total amount owed and use state backing to bring down the county’s interest rate.

In some ways, the proposal is similar to what was done this month to help Greece, or to resolve New York City’s financial crisis in 1975. Jefferson County would get debt relief through the creation of an independent borrowing authority, whose bonds Gov. Robert Bentley has agreed to guarantee. The authority would issue new bonds to replace the impaired ones that creditors now hold.

“That was the game-changer,” said John Young, a court-appointed receiver on the case, referring to the governor’s willingness to put the state’s own credit on the line. The state legislature would still have to approve the new authority. Municipal securities analysts said they welcomed the state's involvement, which could help ease market jitters.

Jefferson County's finances are in such disarray that it cannot currently borrow at any price. But the new borrowing authority would be independent of the county, and the state guarantee would strengthen the authority's rating even further, Mr. Young said. That would lower its borrowing cost. The reduced costs would benefit Jefferson County residents, whose fatigue and rage over the debt they have to pay reached a boiling point this summer.

Whether Jefferson County's commissioners will embrace the proposal is unclear. Rate increases are their foremost concern. They said one potential rate schedule being floated would lead to an annual increase of 8 percent in sewer rates for four years or more, an unacceptable level.

The governor's finance director, David Perry, said the plan included no specific rate schedules, but called for a reduction in debt that could be achieved several ways.

Commissioners also complained that they had been given nothing in writing on Thursday and could not yet properly evaluate the proposal. Commissioner T. Joe Knight said he had agreed to the seven-day standstill out of deference to the governor.

Jefferson County's debacle began years ago, when it was ordered by a federal court to rebuild its failing sewer system. It had to issue bonds to finance the huge construction costs, and followed consultants' advice that it lower its borrowing costs by issuing bonds linked to derivatives, which were supposed to protect the county if interest rates rose. The revenues from sewer ratepayers were pledged to pay back the debt.

But the revenue projections were too optimistic, the bond deals were plagued by pay-to-play and bid-rigging scandals, and the complex bond-derivative structures collapsed in the financial turmoil of 2008. The costs ballooned, and now the county owes about $3.2 billion. Some officials who helped with the bond deals have been convicted of corruption charges, and some of the banks have been forced to pay back some of their fees under regulatory pressure. In November 2009, J.P. Morgan made the county a $75 million payment as part of a settlement agreement with the Securities and Exchange Commission. With other federal investigations and prosecutions continuing, county residents are increasingly unwilling to help pay debts incurred amid so much impropriety.

This summer's flirtation with bankruptcy grew out of a sudden and steep shortfall in the county's general fund revenues, which are separate from the sewer revenues. In April, the State Supreme Court declared an important county tax unconstitutional on technical grounds, cutting off 44 percent of the county's discretionary revenues. Despite appeals to the state legislature for help, little was done, and the county had to lay off nearly 550 employees, around a quarter of the workforce, and make deep cuts in services.

As this was happening, Mr. Young, the court-appointed receiver for the sewer system, issued a report recommending a 25 percent immediate increase in the rates paid by households on the system to pay the outstanding bonds. Residents howled in protest, complaining of the previous rate increases and then the county service cuts.

With tensions high, Mr. Young then sent letters to the county, demanding that the $75 million payment from J.P. Morgan be diverted to help shore up the sewer system's finances.

But the money represented the county's only cash reserves, and officials saw no alternative but to declare bankruptcy. Just as they were about to file at the end of June, the governor intervened, convincing Mr. Young and the county to declare a standstill period for 30 days.

Frustrated by half-hearted legislative attempts at a solution, the governor had also been informed that the state and its taxpayers could be liable for part of the county's ballooning debt because the state had been named in the federal order to rebuild the sewer system.

Mr. Young said the governor also had been told by bankruptcy experts that a Chapter 9 filing by the state's most populous county would spook the municipal bond market, which is already jittery because of an analyst's prediction of big defaults across the country, and a possible downgrade of the United States' Treasury's debt. If the state showed it was unwilling to help Jefferson County, it might unnerve investors considering bonds issued by other Alabama towns and counties, and even the state itself.

"A bankruptcy in Jefferson County would have a negative impact across the whole state of Alabama, and potentially all across the country," Mr. Young said. The governor issued a statement saying he was "supportive of the seven-day extension" and looked forward to a thorough review of the creditors' latest offer.

It was not apparent that the new terms would appease county residents, many of whom have started to think, incorrectly, that Chapter 9 would be a good way to walk away from the debt completely. Commissioners said their constituents generally favor bankruptcy, and in interviews with residents around the county, many said bankruptcy should have been declared years ago.

Spotting a reporter leaving the county courthouse on Thursday, a man in a pickup truck yelled out the question on everyone's mind: "Did they file yet?"

Upon hearing it would take a few more days, the man cursed and drove on.

Mary Williams Walsh reported from New York, and Campbell Robertson from Birmingham.