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Cities In Distress: Municipal Recovery Lessons From Pennsylvania

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Five years after the city of Detroit filed for Chapter 9 bankruptcy on July 18, 2013, experts look at the financial troubles of a few other U.S. cities in this ***special series****.*

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To say that there ever was a "wave" of municipal bankruptcies is necessarily an overstatement given the miniscule number of them since municipal bankruptcy became part of federal law in the 1930s. Yet the mini-wave of municipal bankruptcy filings culminating in Detroit's 2013 filing led academics to question the efficacy of Chapter 9 of the Bankruptcy Code[1] and led observers to ask which city, county or town would be next.[2] There has not been a general-purpose municipal bankruptcy filing since Detroit's filing in 2013, yet there have been several "who is next and what if" scares, most notably regarding Atlantic City, New Jersey, which ultimately did not file for bankruptcy and is working toward improving its financial condition under state supervision.

Each state's role in ameliorating its municipalities' financial distress is critically important yet is sometimes lost in the discussions of municipal bankruptcy. The decision to allow a municipality to file for bankruptcy rests with its state as a matter of federal law.[3] The role that the state plays in the bankruptcy, however, is a matter of state law.[4] As we reflect on municipal financial distress in the five years since Detroit's bankruptcy filing, Pennsylvania's experience in intervening in its municipalities' financial distress provides some useful insights on the problems plaguing municipalities as well as lessons for states.

All cities must have the authorization of their states to file for Chapter 9; Pennsylvania is one of several states that requires state participation in the Chapter 9 process. Like some states, Pennsylvania tries to keep its municipalities out of Chapter 9 through a system of financial oversight. Since 1987, Pennsylvania has managed the financial distress of its cities, townships and boroughs under its Municipalities Financial Recovery Act, better known as Act 47.[5] Under Act 47, Pennsylvania provides supervision and technical support to its distressed municipalities. When the Pennsylvania Department of Community and Economic Development designates a municipality as distressed, it appoints an Act 47 coordinator to develop a recovery plan for the municipality.[6] Although Act 47 expresses the state's policy preference for avoiding Chapter 9, it is designed to accommodate a Chapter 9 filing if necessary. If a municipality files for Chapter 9, the state coordinator, or the state-appointed receiver if applicable, remains in place.[7] Act 47 is expressly not a state takeover of municipalities; the governing body stays in place even if the state appoints a receiver for the municipality.[8] One of the original goals of the legislation was to develop "a state assistance plan to aid distressed municipalities in restoring their financial integrity while leaving principal responsibility for the conduct of financial affairs of the municipality to its locally elected officials."[9] The act was specifically designed to avoid bailouts by the state.[10]

Pennsylvania's distressed municipalities are also coming up on a five-year anniversary. In 2014, Pennsylvania enacted a comprehensive set of amendments to Act 47. One of the motivations for amending the act was that municipalities could not shake distressed status and exit the program.[11] Thirty-one Pennsylvania municipalities have been designated as distressed pursuant to Act 47 since its enactment in 1987. Fourteen have succeeded in obtaining rescission of their distressed status, leaving 17 municipalities in the program. Seven of the remaining municipalities have languished in the program for more than 25 years (for example, Scranton and Johnstown were designated as distressed in 1992).The amendments were designed to push cities through the program more quickly by adding a five-year deadline to exit Act 47 supervision.[12] If a municipality cannot meet this deadline, its coordinator can ask for a three-year extension, recommend dissolution of the municipality, or can recommend the declaration of a fiscal emergency, which would allow the governor to appoint a receiver for the municipality.[13]

For municipalities in the program at the time that the amendments went into effect, the five-year period started to run at the time the municipality's most recent recovery plan went into effect.[14] Scranton prepared its three-year exit plan last year and the state capital, Harrisburg (in Act 47 since 2010 in the midst of the financial troubles that led to its unauthorized 2011 bankruptcy filing), is facing its deadline to exit the Act 47 program this year.

The new five-year limit promises to further test the efficacy of Act 47. The legislative commission that studied Act 47 recognized that there was a mismatch between the causes of municipal financial distress and the solutions provided by Act 47.[15] Indeed, the stories of each municipality's slide into distress illustrate both the frailty of some Pennsylvania municipalities and the need for a multipronged approach to municipal financial distress.

Despite its geographical advantages of a riverfront location and proximity to Philadelphia and Wilmington, Delaware, the city of Chester, after 23 years in Act 47, remains one of the poorest cities in Pennsylvania. The fact that Chester is home to a university and a major health care facility is a double-edged sword — real estate owned by nonprofit entities is nontaxable. Chester has suffered from the decline in local manufacturing and migration to the suburbs. Braddock, in the western part of the state, has been in Act 47 for 29 years and tells a similar story of deindustrialization and depopulation, exacerbated by the closing of a significant health care facility. The borough of Franklin will mark 30 years in Act 47 at the end of July. Franklin, which lost 85 percent of its population between 1940 and 2010, points to both the decline of the steel industry and its inability to recover from the 1977 Johnstown flood as the causes of its distress.[16] Scranton lost about 45 percent of its population between the 1930s and 2010 due to the decline of the coal industry and the relocation of manufacturing to lower-cost regions. Scranton has some of the lowest-funded pensions in Pennsylvania.

Many questions remain as to whether distressed municipalities will meet the five-year exit deadline. Scranton appears poised to complete its exit plan after monetizing its sewer and parking authorities and extracting pension concessions from its police and fire unions.[17] In Harrisburg, however, Mayor Eric Papenfuse insists that the city will not be able to balance its budget without legislative action making the temporary tax increases permitted by Act 47 permanent.[18] Chester is also looking for legislative relief. A new casino within Chester's borders promises financial benefits from sharing of gaming revenues, but the Act 47 report suggests that Pennsylvania law should be amended to allow for a higher percentage of gaming revenues to flow to host municipalities in Act 47.

For some municipalities, the situation is more dire. The Act 47 report for the tiny borough of Franklin concedes that the municipality is nonviable. Yet, although Act 47 provides for dissolution of a municipality, the dissolution is a temporary solution that does not merge the territory of the nonviable municipality with that of another elected government.[19] In

Pennsylvania, there is no municipal consolidation without a willing partner.

Some municipalities that successfully exited Act 47 did so in part by amending their governing charters to become home rule municipalities. Such action gave former Act 47 municipalities Altoona, Clairton and Nanticoke more flexibility in setting tax rates after leaving Act 47. But home rule is not a cure-all; Scranton has been a home rule municipality since 1974. Other former Act 47 municipalities, such as the borough of Millbourne, were able to cut costs by sharing some municipal services with neighboring municipalities.

The story of Pennsylvania's distressed municipalities and the state's attempt to alleviate their distress without resorting to Chapter 9 bankruptcy illustrates that the solutions to municipal financial distress do not reside within one set of federal or state laws. As we reflect on the state of our nation's distressed municipalities five years after Detroit's historic Chapter 9 filing, it is useful to consider the many legislative tools in the municipal financial recovery toolbox to address the causes and alleviate the consequences of municipal financial distress.

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[1] See, e.g. Vincent S.J. Buccola, Law and Legislation in Municipal Bankruptcy, 38 Cardozo L. Rev. 1301 (2014); Laura Napoli Coordes, Restructuring Municipal Bankruptcy, 2016 Utah L. Rev. 307 (2016); Clayton P. Gillette & David A. Skeel, Governance Reform and the Judicial Role in Municipal Bankruptcy, 125 Yale L. J. 1150 (2016)

[2] See, e.g. Brent Johnson, 3 things you should know about a possible Atlantic City bankruptcy, NJ.com, Jan. 21, 2016, available at https://www.nj.com/politics/index.ssf/2016/01/3_things_you_should_know_about_a_possible_atlantic_city_bankruptcy.html.

[3] 11 U.S.C. § 109 (c)(2).

[4] The Pew Charitable Trusts assembles a useful compendium of the various state laws governing intervention in a municipality's financial distress. See The Pew Charitable Trusts, The State Role in Local Government Financial Distress, July 2013, available at http://www.pewtrusts.org/en/research-and-analysis/reports/2013/07/23/the-state-role-in-local-government-financial-distress.

[5] 53 P.S. § 11701.101 et seq.

[6] 53 P.S. § 11701.221 (d).

[7] 53 P.S. §§ 11701.263 (c), 11701.706 (a)(9).

[8] 53 P.S. § 11701.708.

[9] General Assembly of Pennsylvania, Local Government Commission, Municipal Fiscal Distress: Background and Legislative Remedy, January, 1987 at 1, available at http://www.lgc.state.pa.us/download.cfm?file=/Reports/PubListing/Municipal%20Fiscal%20Distress,%20January%201987.pdf.

[10] Id.

[11] General Assembly of Pennsylvania, Local Government Commission, Act 47 of 1987 Municipalities Financial Recovery Act 2013 Task Force Report, October 16, 2013 at 1, available at http://www.lgc.state.pa.us/download.cfm?file=/Reports/act47/101713/Act%2047-of-1987-2013-Task-Force-Report-FINAL-10-16-2013.pdf (2013 Local Government Commission Report).

[12] 53 P.S. § 11701.254.

[13] 53 P.S. § 11701.255 (a).

[14] 53 P.S. § 11701.254 (b).

[15] 2013 Local Government Commission Report, supra note 11, at 24.

[16] The Pennsylvania Department of Community and Economic Development 47 web page contains links to all of the recovery plan documents for each municipality in Act 47. The plans provide detailed descriptions of the causes of each municipality's distress. See https://dced.pa.gov/local-government/act-47-financial-distress/.

[17] Liz Farmer, In Scranton, Pa., Fiscal Progress Comes with Political Costs, Governing, May 30, 2017, available at http://www.governing.com/topics/finance/gov-scranton-recovery-fiscally-distressed.html.

[18] Lizzy Hardison, Harrisburg imposes austerity measures, hopes for legislative action as it faces hard realities of Act 47, The Burg, June 25, 2018, available at https://theburgnews.com/news/harrisburg-imposes-austerity-measures-hopes-for-legislative-action-as-it-faces-hard-realities-of-act-47.

[19] Michelle Wilde Anderson, Who Needs Local Government Anyway?: Dissolution in Pennsylvania's Distressed Cities, 24 Widener L.J. 149, 179 (2015).