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Three steps to sound management

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THREE STEPS TO SOUND MANAGEMENT

If the family budget is being squeezed today, so are municipal budgets in communities of every size. The numbers, however, are much larger and the reasons more complex. Contributing to the cities' problems are factors such as rising labor costs, demographic change, and the energy shortage, not to mention our seemingly inexhaustible demands for more and better public services of every kind.

The budget squeeze exists, even though cities are taking in more money than ever before. Figures gathered during the latest Census of Governments, which is performed every five years by the US Census Bureau, show that in 1971-72 all US municipalities collected general revenues of $35 billion—up 81 percent since 1967 and 270 percent since 1962. Despite recent tax increases of 10-25 percent, however, the US Conference of Mayors reports that a survey of 50 cities shows municipal revenues in 1975 running as much as $8 billion short of expenditures.

The result is that we can pick up any newspaper today and read that the application of federal bankruptcy law to the public sector is now being discussed as something of more than theoretical interest. New York City's fiscal crisis has, indeed, called attention to what may be in store for other communities if present trends continue.

The following articles shed light on the critical subject of municipal finance. Ted David provides a survey of the basic revenue sources available to urban governments, with commentary on various factors that may affect their suitability in specific localities. An understanding of one's options is essential when deciding the "mix" of revenue sources that will furnish consistent, reliable financial support. Philip Dearborn addresses the creditworthiness of city governments, arguing that timely payments are the most important criterion. He reviews some indicators that can help to guide one evaluating cash management in any city. In addition, Fred Rohn summarizes the type of information major rating agencies use to arrive at a quality rating for municipal general obligation bonds.

1. How to Evaluate Revenue Sources

By IRWIN T. DAVID/Partner, Chicago

The revenue sources a city taps and the extent to which it relies on each individual source are crucial factors in its financial stability. Public officials, taxpayers, and investors all, of course, consider such revenue strategy from their own particular perspective.

What are some of the characteristics of each major revenue source that affect its usefulness and future viability? The following table describes the source of basic municipal revenue options and some of the key features of each.

First, however, it must be emphasized that one of the distinguishing features of American local government is its diversity. In order to analyze any specific municipality, therefore, an array of variables must be taken into account. What makes sense in one location may be wholly impractical in another. Here are some of these variables and how they affect revenue structure and strategy:

Municipal revenue raising powers—In many states, municipalities cannot impose new revenue measures (e.g., new taxes) without specific legislative approval. Other municipalities have "home rule" powers which enable them to raise revenues in any way they see fit.

Municipal responsibilities—Some cities have responsibility for education, urban renewal, public housing, and/or welfare. In other localities, such functions may be the responsibility of separate special districts, the county, or the state. The functions for which the city is responsible will obviously influence its fiscal situation. For example, a city that operates a school system will have a much larger budget and will be much more dependent on state and federal aid than a similar city where the schools are independent of the municipality.

City size—A large city has more revenue sources available to it than does a small city. For instance, only cities over a specified size are eligible to receive block grant funds from the federal government. Likewise, larger cities have more forms of business and industry which can be taxed, and are more likely to have a commuter base which may be taxed.

Wealth of residents—As a community's wealth grows, so do property values, retail sales, and personal income. A larger tax base thus affects the revenue structure and strategy.

State revenue structure—If the state levies a particular tax, such as a sales tax, it often will provide administrative services to municipalities and allow them to "piggy-back" similar taxes of their own.

State of development—A new, growing city will face the task of financing schools, public buildings, sewerage, and all the other facilities its population requires. But a growing population and economic base provides increasing revenue potential, too. On the other hand, a mature or contracting municipality (a central city) often has a declining tax base due to a lower population, declining property values, and lower per capita income and wealth.

Such municipal characteristics must be kept in mind when searching for new revenue sources for an individual municipality. They will also help put the information in the table in its proper perspective.

MUNICIPAL REVENUE SOURCE GUIDE

LOCAL REVENUE SOURCES: 67% of municipal general revenue, 1971-72.	CONSEQUENCE OF REVENUE SOURCE: FAVORABLE	CONSEQUENCE OF REVENUE SOURCE: UNFAVORABLE	TREND
Property Tax— Applied to the assessed valuation of property located in a taxing jurisdiction; in 1971-72 accounted for 66% of municipal tax revenues and 49% of total municipal general revenues. More sig-	Property taxes obtain more total dollars from well-to-do persons or families than from lower income families. Determining taxes is relatively simple after assessed valuations are established.	Regressive, since it takes a larger proportion of the income of low-income families than of higher income families. Tax is based on an assessment of market value, which is difficult to make and seems arbitrary at times. Different assessment practices between jurisdictions lead to different taxable values for similar properties. To "equalize" assessment values between jurisdictions is very complex and can cause controversy. The assessment process is sometimes vulnerable to poor administration and "scandals."	Not a fruitful source of additional future revenue, since the pressure for property tax relief has been increasing. States will continue to provide some relief by such methods as the "circuit breakers," which

	CONSEQUENCE OF REVENUE SOURCE		
REVENUE SOURCE	**FAVORABLE**	**UNFAVORABLE**	**TREND**
nificant for smaller cities, since larger ones have wider range of revenue options available.	Comparatively stable as a revenue source during periods of economic decline.	In times of inflation, property tax revenue does not increase as rapidly as does the revenue from other sources, such as the income tax or the sales tax.	limits taxes to a certain percentage of total income.
Examples of cities relying heavily on property tax are Boston, Hartford, Syracuse, and Indianapolis.	Power to seize the property itself reduces delinquency problem.	Prospect of forfeiture has limited impact in some center-city areas where wholesale property abandonment occurs.	With their superior tax base, wealthier communities can spend more per capita for public services. Attempts to equalize through court action have had little success. In a recent test, the Supreme Court refused to order the overhaul of a state's school financing system to correct variations in per capita spending attributable to differences in taxable wealth.
	Taxes based on property value have some relationship to services provided by local governments, since many municipal services are directed toward protecting and enhancing property.	The relationship between taxes paid and services is indirect and imprecise, especially compared to user charges.	
	Property tax encourages owners of nonproductive or marginal properties to either develop the property or sell it to others.	The tax tends to discourage improvements, since improvements require higher tax payments.	
		Impact of lump sum payments is more painful to taxpayers than "pay as you go" methods used for the sales tax and income tax.	
Sales Tax— Applied to all or selected classes of retail sales. Also, may be charged for such services as hotel rooms and leases. Accounted for about 9 percent of municipal revenue collections in 1971-72.	Inequities are less serious than those caused by other taxes with higher rates.	Regressive, since it takes a larger percentage of the income of low income individuals than of higher income individuals; regressiveness can be reduced by exempting such staples as food and drugs.	Will likely be used more in future years. Municipal rates will be in addition to state rates but should be coordinated with other municipalities to avoid a "back-lash."
	Related to what people take out of production; savings are not included.		
	Affects all individuals, even those who are able to avoid other taxes. Tourists and nonresidents pay something toward the cost of government.		
	Sales tax revenue increases in inflationary periods more rapidly than property and income tax revenue.	Much more sensitive than property tax to recessionary periods.	Each municipality will, to the extent allowed, consider ways to eliminate "regressive" features when establishing the tax.
Examples of cities relying heavily on this tax are Jacksonville, Seattle, Houston, New Orleans, and San Antonio.	Lends itself to state administration. State collections and compliance administration avoids duplication, double taxation, administrative inefficiencies, tax return preparation, and compliance problems.	Collection depends upon local retailers; assuring proper collection and control can require a sophisticated, quite often computer-based, system which may be beyond the scope of many municipalities.	
	Coordinating rates among adjacent communities can avoid loss of retail sales in an individual municipality.	Impact of even slight rate differences among adjacent communities is much greater than for property or income taxes. A one percent difference between the rates of a central city and surrounding suburbs can cause a six percent reduction in per capita city sales.	

How to Evaluate Revenue Sources

REVENUE SOURCE	CONSEQUENCE OF REVENUE SOURCE		TREND
	FAVORABLE	UNFAVORABLE	
Income Tax— Applied to wages earned, generally collected by a withholding system with annual tax returns. In 1971-72 accounted for 7 percent of all municipal revenue. Examples of cities relying heavily on this tax are New York, Philadelphia, Washington, DC, Columbus, and Detroit.	Provides revenue beyond what can feasibly be raised by increasing other taxes. Effective way to tax the commuter who uses city services.	Not widely used because of the political problems and pressures against its adoption. The commuter's lack of voice in how money collected will be spent is a political inequity; to differentiate between residents and commuters in the tax base creates an administrative difficulty. The withholding system can alleviate some of this problem. Special state legislation may be necessary to secure the power to impose an income tax.	The local income tax is extraordinarily productive and preserves local autonomy; its use is likely to grow in both relative and absolute terms.
	The withholding method makes this a "pay as you go" tax, hence more palatable than the property tax.	Withholding may be a problem because of differences in jurisdictions and application. For instance, tax may apply in the municipality where an individual works, where he resides, or both.	
	When dealing with salaries and wages, the income tax is progressive since taxes paid are tied to individual income.	May be regressive if it applies only to salaries and wages, since high income individuals earn more of their total income in non-labor (dividends and interest) income. If non-labor income is included, state administration of local systems may be required.	
	Once established, the costs of administration are fixed.	The tax is often dependent upon employer collection (the withholding system), which requires an audit, compliance, and administrative structure that is typically beyond the means of all but the largest cities. State or county administration of the tax is sometimes the answer to this problem.	
	Even if the surrounding municipalities do not use the income tax, it is difficult for an individual to change jobs or his place of residence to avoid the tax. Therefore, differences between jurisdictions are less likely to result in revenue reductions than in the case of the sales tax. In general, income tax cities are characterized by lower property taxes as a percent of total taxes and by lower per capita total taxes. Per capita property tax and total taxes have generally increased at a lower rate than in other cities.		
User Charges— Direct charges for services rendered. Applied to items such as school lunches, recreational facilities, sewers, garbage collection, hospital care, parking, and tolls.	Directly relates cost of service to benefit from the service; services need not be subsidized; expansion of the service is matched by expanded revenues; user fees can be used to ration the output of the service; fee setting can promote increased social planning in a municipality.	Often based on "what the traffic will bear" rather than allocation of actual cost.	Likely to increase, since system is adaptable to many services.

REVENUE SOURCE	CONSEQUENCE OF REVENUE SOURCE: FAVORABLE	CONSEQUENCE OF REVENUE SOURCE: UNFAVORABLE	TREND
Special assessments for sidewalks, other improvements are similar but, like a tax, they are mandatory. In 1971-72, user charges accounted for 11% of municipal general revenues. Cities relying heavily on these charges are Jacksonville, Seattle, New Orleans, and Denver.	Theoretically enables citizens who do not wish to use a service to avoid having to pay for it.	Some services are vital to life and health (such as sanitation and hospital services). While the citizen can regulate his use of such services, he cannot fully avoid them.	
	Volume of user fees indicates when the services should be expanded or reduced.	User charges are often administered through special districts established to handle a particular service, which fosters fragmentation of government.	
	Special assessments enable municipality to charge for improvements that enhance property value.	Property owner does not have individual choice concerning installation of the improvement.	
FEDERAL AND STATE GRANTS— 33% of municipal general revenue in 1971-72.			
Categorical Grants— Federal or state funds for specific programs or categories of service; for example, school grants to aid underprivileged children, handicapped children, non-English speaking children, and delinquent children.	Grant programs promote national and state priorities at the municipal level and provide significant funds to local governments.	Not clear that social objectives are met by the programs. At times the specific needs of a local government are ignored. Extensive federal or state "strings" attached to categorical grants restrict municipal decision-making and autonomy. Considerable duplication and overlapping among programs.	The percentage of total government spending devoted to grants has been declining for several years (although absolute amounts are still rising). Therefore, the local governments should place a premium on efficient administration to gain maximum return from each grant dollar. Federal and state aid offices will be established by more cities to seek and coordinate grants. Centralized accounting systems that can track grants in all city agencies will be used more.
	Localities which are organized and systematic in their approach to grants can secure needed funds they would otherwise have to do without.	Competitive application process sometimes overemphasizes "grantsmanship." Programs may be started simply because a grant is available for that purpose. Municipalities frequently have trouble raising the local matching amount required under most categorical programs.	

How to Evaluate Revenue Sources

REVENUE SOURCE	CONSEQUENCE OF REVENUE SOURCE		TREND
	FAVORABLE	UNFAVORABLE	
General Revenue Sharing— Automatic grants to state and local governments based on statutory formula that take into account population, per capita income, and tax effort. Enacted in 1972 for a five-year period, with about $6 billion distributed each year. Few limitations on how the funds may be used.	Each unit of local government receives its proportionate share of the funds as prescribed by law; "grantsmanship" is not a factor.	Large cities assert they should receive a more generous share of the funds than the formula now permits.	Local governments will be increasingly nervous about committing revenue sharing funds to long-term activities until the extension beyond 1976 is assured. They may result in postponements of needed programs and projects. If Congress refuses to continue revenue sharing, the credibility of federal fiscal commitments to local government will be impaired. The continuation of revenue sharing will depend upon how the people feel about the ability of local governments to allocate monies more effectively than the federal government.
	Shifts decision-making to local levels and reduces the policy-making powers of Congress.	Reduces power of Congress to set national priorities.	
	Encourages the absorption of fragmented special districts by units of general-purpose government (states, counties, cities, towns) since only the latter are eligible for revenue sharing.	Ineligibility for additional funds may be unfair penalty for communities where absorption of special districts by city government is impractical.	
	Provides flexibility and autonomy to local governments in setting priorities and spending funds.	Economic conditions and the soaring cost of public services mean localities have little leeway in deciding how to spend revenue sharing funds.	
	Revenue sharing funds have helped localities avoid tax increases that would have been necessary otherwise.	Many local officials argue revenue sharing was "sold" as incremental money, not a stopgap. Also, they charge Congress and the Administration use the availability of revenue sharing as an excuse for underfunding other grant programs.	
	Requires no local match.		
	Provides consistent source of funds.	Amount does not increase in times of economic distress.	
	Not subject to annual Congressional appropriations.	Program is not permanent; continuation after 1976 depends on extension by Congress.	
	Relatively small federal staff administers revenue sharing.	Limited ability to insure compliance with rules on equal employment opportunity, construction wages, and other matters.	
	Requires citizen participation in spending decisions.	The form and extent of citizen participation varies greatly, depending on local circumstances.	
	Local priorities can be established without "interference" from Washington.	In some cases, minority groups do not get what they consider their fair share of revenue sharing funds.	
Block Grants or "Special" Revenue Sharing— Grants for broadly-defined activities in general areas such as manpower, criminal justice, social services, and community development.	Gives cities greater control over the programs involved.	Many localities lack previous experience in such areas as manpower training and community development. Few municipalities now have the staff capabilities to prepare the annual plans required by block grant programs.	Respective roles and responsibilities of federal agencies and local grantees will continue to undergo an often painful sorting-out process.

REVENUE SOURCE	CONSEQUENCE OF REVENUE SOURCE		TREND
	FAVORABLE	UNFAVORABLE	
Eligibility for funds and amount received each year is determined by statutory formula for each program. Several block grant programs are limited to cities over a certain size.	Provides more local autonomy than categorical grants. Requires citizen participation in most of the programs. Requires accountability for the use of the funds from the local officials. Statutory formula reduces the "grantsmanship" factor.	More federal "strings," less local autonomy, than in general revenue sharing. Citizen participation is subject to same variation observed in the case of revenue sharing. Local governments are hard pressed to provide accountability since they lack experience in evaluating and documenting the results of grant programs. Financial control is also a problem where block grant funds are distributed to numerous city and non-profit agencies. Federal approval of annual spending plans is generally required; to some extent, municipalities must tailor their plans to fit federal priorities and preferences.	May be further consolidations of categorical grants into new block grant programs due to their popularity with local officials. Cities will press Congress for increased funding to go along with the greater power afforded by block grants.
Borrowing— Borrowing for long-term needs (capital improvements) or for shorter term requirements (tax anticipation notes). In 1971-72, total municipal debt outstanding was \$52.6 billion. Of this, \$45.9 billion (88 percent) was long-term debt, of which 60 percent was backed by the cities' full faith and credit. Of all municipalities, New York City is the most heavily reliant on borrowing as a revenue source.	Because of exemption from federal income tax, interest expense is lower than on comparable industrial bonds. Newer forms of tax-exempt bonds such as industrial development, revenue, and "moral obligation" bonds can be issued without the full faith and credit of the issuing body. 1975 securities reform law extends SEC regulation to dealers in municipal securities, reducing the potential for abuses in the tax-exempt bond market. Special districts can be created to issue debt, thus avoiding restrictions pertaining to municipality. Provides large amounts of funds for capital improvements and related efforts.	Interest costs tend to be burdensome for local governments even with lower interest rates. The viability of "moral obligation" bonds is currently being tested in specific cases such as New York's Urban Development Corp. Increased regulation could mean increased disclosure by municipalities, although language inserted in the law seeks to prevent new reporting demands on issuers. Proliferation of special districts can splinter local governments and lead to coordination and communication difficulties. Some people object to borrowing as "mortgaging the future," especially if used to pay operating expenses.	Plight of New York City and other large municipalities may have adverse effects upon all local governments seeking to issue bonds. Continued exemption for municipal bonds may be challenged during upcoming Congressional tax reform hearings. Corporations using tax-exempt industrial pollution control bonds to finance air and water pollution abatement facilities may offer increasing competition to municipalities, who may seek to have exemptions for such bonds revoked.

2. How to Get a Quality Credit Rating

by PHILIP M. DEARBORN, Executive Director
District of Columbia Municipal Research Bureau, Inc.

What does the quality of a city's credit depend on? It is usually linked to a variety of factors, such as amount of debt, quantity and quality of tax base, historic record of debt repayment, and legal and administrative requirements and practices. But these elements do not really define quality in terms that directly relate to the investor's major concern—getting interest and principal payments on time. The fact is that when an investor perceives that payments will not be met, he will consider the quality of the debt less desirable than it is when he is assured the payment will be on time. This will be true even though the ultimate security of each investment may be equal.

It is my purpose to demonstrate that quality involves more than testing protection of debt against permanent or extended default—which has not occurred in a general obligation issue since World War II, and which many observers think may never occur for any major issues. It requires getting into the inner workings of government and analyzing the flow of cash through that government.

The ultimate test of credit quality is having cash available in the future to pay debt service commitments when due. The key element is cash—not physical assets, not the balance sheet accruals, not secondary guarantees, and not the potential for raising cash. While all of these may contribute to the eventual solution of a financial problem, they are of immediate value only to the extent that they can be converted to cash when cash is needed to pay debt service.

In analyzing credit one must weigh the factors that will influence future cash availability. Good cash flow information is not available on a historical or comparative basis from the census or other national sources. It requires detailed analysis of individual financial reports. Since a multitude of factors may affect cash flow, such projection models have been unreliable until now. That is why it is important to analyze the factors affecting internal cash flow. It is only by understanding such a conceptual model that we can then perceive how external factors—economy, social changes, federal aid, political pressures, etc.—can cause some governments to have problems meeting their debt service requirements.

If we assume that no general purpose local government will ever reach the point at which it has no assets and no taxable wealth with which to meet its debt service requirements, then it must follow that any cash flow problem can be resolved by appropriate government action taken on a timely basis.

In our cash flow discussion it will be assumed that a sequence of events will occur somewhat as follows. During the fiscal year a financial crisis will occur and the government will find itself with payrolls, debt service, and other claims due that cannot be paid from current cash flow. Such an occurrence may be caused by a revenue failure stemming from litigation, economic downturn, or major taxpayer bankruptcy; it may be caused by excessive claims caused by litigation, labor settlements, mandated obligations, or short-term debt that cannot be renewed; or it may be caused by fraud or general mismanagement.

When such a financial crisis occurs, the first requirement will be to find cash to meet current claims so that the government can continue to operate. After these immediate cash problems are resolved, there must then be an analysis to determine how the problem will be solved over the longer term. Ordinarily the solutions will mean increasing revenues, decreasing expenditures, or both. The effectiveness of the actions taken will in turn depend on the variety of legal and practical alternatives available.

There are three important factors that must be evaluated when considering the risk of default. First, the government must have sufficient cash available to pay debt service during any period of crisis. Because most local governments budget and tax on an annual basis, cash equal to at least one year's debt service is desirable.

Second, there must be some compulsion on local officials to take prompt corrective action to restore liquidity and to meet future debt service obligations.

Third, the local officials must have the ability to correct the problem. This means they must not only be able to perceive the problem correctly but also be legally and practically able to take action.

Each of these factors have gradations that affect the risk. For example, more weight has customarily been given to the ability to take corrective action. General obligation securities which have low cash availability and low assurance of corrective action, but which are secured by unlimited taxing authority, are rated higher than revenue bonds having good cash availability, good assurance of corrective action by officials, but no ability to use increased taxes to resolve the problem. The factors are illustrated in the following outline and are arranged in a tentative descending order of security. A brief description of each factor and how it relates to cash flow and perceived risk will provide a starting point for data collection and model building.

I. Cash Availability

We have postulated that ideally one year's debt service should be available in cash to meet a crisis contingency. Thus, it is necessary to review the potential cash situations of governments as they relate to payment of debt services.

1. *Reserve Held by Independent Trustee:* The strongest cash position occurs when cash is held by an independent

trustee with authority to disburse funds directly to the government's debtors without approving action by the government. This arrangement is typically associated with mortgage revenue bonds. While it is conceivable that in a national financial crisis the trustee might be unable to perform, even this risk could be avoided by requiring the trustee to invest the reserve funds in short-term U S government securities, kept in a segregated account. The trustee would normally be a bank, but could also be a state or federal agency.

2. *Reserve Held by Government Itself:* The next best alternative is a debt service cash reserve fund under the control of the government. Such a fund should be segregated from other funds in its banking and investments and should be payable by local officials under well-defined conditions of crisis, without further local legislative action.

3. *Cash Balance in Debt Service Fund:* Some governments may maintain a year-to-year cash balance in their debt service fund. Such a balance is generally without the protection of full segregation and without the requirement that officials disburse such funds only under certain conditions. The hazard is that the funds will be used when they are not needed to meet a crisis, and will, therefore, not be available at a time of crisis.

The ultimate test of credit quality is having cash available in the future to pay debt service commitments. The key element is cash—not physical assets, not the balance sheet accruals, not secondary guarantees, and not the potential for raising cash.

4. *State Guarantee:* This is a direct guarantee of the debt based on the state's credit or a guarantee fund; or in the form of a commitment to pay debt service, from the next state funds due a local government. In either instance, the critical considerations are the extent to which action is discretionary on the part of state officials; the delay that may result between the due date of debt service and actual payment; and the cash resources available at the state level to support the commitments during periods in which a large number of units may require aid.

5. *General Fund Cash Balance:* Some governments, instead of maintaining cash balances or cash reserves for debt service, choose to maintain a good cash balance for any unforeseen requirement. This option provides the government more flexibility in its use of cash resources. Unfortunately, many of the same reasons that might precipitate a crisis would probably wipe out a cash balance available for general purposes, and leave the government without these funds for debt service. For example, if a police payroll were due prior to the debt service payment, it is likely that the cash would be used for the payroll and not held for the debt service payment.

6. *Availability of Short-Term Borrowing:* When the government's overall financial condition is sound and the banking industry is healthy, short-term borrowing is a logical and feasible method of obtaining cash. However, in the past many crises have been characterized by the inability of banks to make or renew such loans.

7. *Emergency State or Federal Aid:* It is likely that cash assistance from another level of government at a time of crisis would carry a high political cost for local officials—probably loss of local control over finances. If the financial crisis threatens only debt service, such a price may be too high. If, however, the crisis is such that it also imperils a broad range of local services, this may be a practical alternative.

II. Ability to Take Corrective Actions

Because financial crises may occur for a variety of reasons, it is difficult to predict in advance the particular action which will be required. In general, most crises will be resolved by increased revenues, decreased expenditures, or a combination of both, but within each of these general solutions are a variety of individual actions. Any foreclosing of options will narrow the ability of officials to pick the best actions to fit the circumstances. Therefore, the government possessing the most options should be the one best able to respond to crises.

1. *Unlimited Power of Local Officials to Impose or Increase any Taxes or Charges:* Unless the national economy becomes a complete disaster, it is unlikely that any substantial unit of local government will reach a point at which there is no cash flow and no tangible wealth in the community. This would, of course, represent ultimate government bankruptcy, but no such case has occurred in this country. The government's problem is using a mix of taxes and charges in a way that will be effective in generating cash to meet obligations. One tax alone, such as the property tax, may be unable to do the job if there is a deep recession in property value, or if several major taxpayers fail. However, if the community can increase the sales tax, which taps the cash flow of federal transfer payments as well as locally generated cash flow, the problem can be more easily resolved.

2. *Unlimited Right to Increase Property Taxes for Debt Service:* States that have been unwilling to give broad unlimited taxing powers have usually given unlimited property taxing powers for debt service. However, a property tax may be the least effective tax option in a crisis, and it also presents political problems when limited to debt service. How long, for example, can a government expect taxpayers to pay taxes for debt service while they are not receiving other vital government services?

3. *Legal and Practical Right to Lay Off Employees and Reduce Expenditures:* While it is easy to suggest reducing expenditures, the facts may make a difficult option. Many local governments have a high percentage of fixed costs for debt service, employee pensions, expenditures required by state law, and other long-term commitments. Other fixed costs, such as employee pensions, may have annual increases that add additional pressure.

But even costs that are in theory controllable may be politically or legally impractical to reduce. Civil Service restrictions and labor contracts often make layoffs a long and ineffective solution. Other expenditures such as utility bills are practically uncontrollable—can sewage treatment pumps be turned off? In fact, the long-term problem on the expenditure side may be how to provide for the future increased costs rather than expecting that reduced costs can help resolve a crisis.

4. *Legal Right of Local Government to Sell or Otherwise Liquidate Assets to Fulfill Claims:* Traditionally there has

3. How to Apply for Bond Ratings

by FRED H. ROHN/Partner, Newark

According to today's headlines, executives in many cities are looking for ways to improve their community's financial status in the eyes of investors. Discussions with major rating agencies reveal that they have little specific information available on individual municipalities. The following is a checklist of supplementary data required to secure a rating. It appears to be the type of information that agencies need. Note that the list is limited to general obligation bonds.

1. Schedule of outstanding debts, listed by maturities, segregated by security, with comment on any overlap with other taxing units.
2. Five-year projection of capital improvements, including those with overlapping taxing jurisdictions, together with anticipated methods of financing. Include outline of material assumptions.
3. Current population estimate, and census for at least past 10 years.
4. Three latest annual reports, including auditor's letters of recommendations and auditor's report, if any.
5. Current and past two years' budgets.
6. School enrollment currently and over past five years. Analysis of projected enrollment over next five years and description of how projections were prepared. Tabulation of present school structures, capacity. Details of any sending or receiving district relationships. Description of academic program.
7. Assessed valuations for past four years, segregated among industrial, commercial, and residential properties. Basis of assessment and latest reassessment.
8. Brief summary of the community including:
   a. Building activity level, industrial, commercial, residential.
   b. Available land and its zoning; zoning map.
   c. Utility and transportation facilities, their adequacy.
   d. Largest taxpayers including levels of employment.
   e. Agricultural and mineral activity (if applicable).
   f. Public institutions, if any; employment.
   g. Family income.
   h. General economic conditions.
   i. Industries moving in, moving out.
9. Tax collection data for past four years; current anticipations and basis for estimate.
10. Qualifications and experience of management personnel.

This checklist can serve as a guide to those responsible for applying for general obligation bond ratings. Presenting a complete package of such background information, together with the pre-sale material, will enable the rating service to give a prompt evaluation.

Requirements supporting revenue bond applications vary, but generally require a formal feasibility study. ▲

appeared to be little market for most municipal assets. Recent trends have suggested that this may not be the case. For instance, many local governments have found it possible to sell sewage or water treatment facilities, airports, mass transit systems, port facilities, and other assets to regional or state authorities for a profit or at least for assumption of debt. Other assets can also be sold privately, such as surplus vacant land.

5. *The Federal Bankruptcy Act:* This act does not provide any ultimate solution to a crisis, but it does provide a practical means for a government to impose a solution on debtors. Under this law a government can refinance its debt so as to make debt service payments compatible with its long-term solution. In at least one instance (Ranger, Texas), however, the refinancing of debt has not been accompanied by a long-term solution. This has resulted in a periodic reoccurrence of the crisis and has defeated the purpose of this bankruptcy act.

III. Requirement for Corrective Actions by Local Officials

All the available alternatives to resolving a government's problem will be of little help if there is no compulsion on local officials to recognize their problems and take corrective action. A variety of compulsions may exist to bring about such actions.

1. *Contractual Commitment Enforceable Against Local Officials:* Every public official is sensitive to actions brought against him personally. In the case of Hamtramck, Michigan, a bitter, divided city council found a basis for taking corrective action when they were individually facing contempt of court. A contractual commitment to raise taxes or service charges when supported by a court order will certainly supersede most political considerations, and therefore must be ranked as an effective solution to making officials face their responsibilities. Such a solution does, however, negate the concept of political accountability for actions, and may be an unacceptable solution in many communities.

2. *State Law Requiring Specific State Officer or Agency to Take Action:* A carefully written state law requiring action by local officials under conditions of financial crisis can be effective, if a specifically designated state official or agency has the responsibility for active enforcement. This implies, of course, that the state will collect adequate reliable current financial information to determine compliance, and that state officials will be politically insulated so that they can carry out their responsibilities.

3. *Passive State Law:* A considerably less effective state law requires local corrective action, but without making a specific state officer responsible for monitoring local finances and taking action. Frequently such laws require a "balanced budget," or that obligations not be incurred in excess of estimated revenues. Such laws have had a history of misinterpretation. Even when the law is explicit, local officials may find it desirable to delay compliance, or to misinterpret what is required of them, if the law requires a politically unpopular tax increase.

A contractual commitment to raise taxes or service charges when supported by a court order will certainly supersede most political considerations, and therefore must be ranked as an effective solution to making officials face their responsibilities.

4. *Local Law Requirement:* Local charters frequently impose strict duties on local officials. If followed, there should be quick recovery from any temporary financial crisis. Unfortunately, the same local officials who have the responsibility to act are generally the officials required to enforce the charter provisions. To bring legal action by citizens or debtors, however, is costly and time consuming.

5. *General Legal and Moral Duty:* In the final analysis, it may be that the only effective compulsion for corrective action by local officials is their own legal and moral obligation to maintain a sound, well-managed government. Each of the other alternatives, while effective in theory, will probably fail if there is not a commitment by local officials to resolve the problem. This leads to a dilemma in credit analysis, because it requires quantification of the predicted behavior of local officials in times of crisis. This is a particularly difficult task, because officials change rapidly in local governments. Because of these difficulties of evaluation, the practical solution is to give a low rating to corrective actions based primarily on reliance on general moral and legal obligations, even though this is unfair to those communities with highly responsible officials.

Philip Dearborn directed the 1973 report of the Advisory Commission on Intergovernmental Relations entitled, "City Financial Emergencies: the Intergovernmental Dimension." Research for his article was sponsored by the National Science Foundation.