

Local Focus



Bonds and Broken Budgets

The story of how Jefferson County, Alabama, waded into budget and bond muck stretches back to 1993, when the Cahaba River Society, a group dedicated to preserving the river that flows through Birmingham, complained that the county's sewer system was discharging raw sewage into waterways. Federal officials issued a consent decree in which Jefferson County promised to upgrade the system.

The county paid for the upgrade by issuing \$3 billion in bonds. As sewer service rates rose to meet those costs and Jefferson County struggled under its debt, county officials looked for a way to lessen the loan payments. In 2002 and 2003, they refinanced their bonds with variable-rate and auction-rate securities. (Auction-rate securities are bonds for which the interest rate is reset at auction every few weeks.)

Auction-rate securities were supposed to be safe, but the auction-rate market collapsed in February 2008. Then the bond insurance companies that were backing the county's debt suffered their own fiscal problems and their credit was downgraded. The result: Jefferson County's interest rates skyrocketed, much like the rates of homeowners whose subprime mortgages had just reset. The county's revenue from sewer fees could not cover the borrowing costs. On April Fool's Day 2008, Jefferson County failed to make payment on its debt. Instead, it reached an agreement with

its creditors to pay the interest and get an extension on the principal—an agreement that left the county of 660,000 teetering on the edge of bankruptcy.

County commissioners and other Alabama political players developed a variety of ideas to solve the sewer mess—to no avail. Without a solution in sight, the county made massive cutbacks: reducing department budgets by one third, canceling road maintenance contracts, closing courthouses, and laying off hundreds of county workers. “We’re having to downsize this government to the point that it may not be able to operate,” County Commissioner Bettye Fine Collins said in 2009.

Collins's comments were prophetic. In December 2011 Jefferson County filed for bankruptcy; by that time its debt had ballooned to more than \$4 billion, a crushing burden the county simply could not manage. Jefferson County then spent the better part of 2 years caught up in litigation with its biggest creditors, who faced the prospect of losing hundreds of millions of dollars. In 2013 Jefferson County reached a deal with these creditors, agreeing to pay them 60 percent of what they were owed. This allowed the county finally to emerge from bankruptcy.

As discussed in the opening section of this chapter, variations on the Jefferson County story have played out across the country, as the recession significantly weakened local governments' financial footing.