



## As anticipated, Jefferson County Alabama inches closer to a bankruptcy filing

Not since the Orange County California crisis in 1994 have we seen such a large municipality on the verge of a bankruptcy filing. In fact, there are similarities between the two issuers; namely, an out-sized and reckless derivative exposure that back-fired. Roughly 90% of the issuer's capital structure was comprised of variable rate debt and interest rate swaps. While other entities had a problem with variable rate debt, they didn't finance their obligations in an irresponsible manner with virtually no fixed rate bonds. For this reason, the problems and challenges that Jefferson County faces should be considered an isolated incident, and not an indication of risks that are widespread among municipal issuers.

At the heart of the issue is the fact that the County is unable to make the interest payments on their variable rate debt, having surged after failed auctions and remarketing efforts. If the county elects to file for bankruptcy, they may petition the judge to forgive a substantial portion of their debt. This would make the bankruptcy proceedings quite different from others that we have seen in the past. The reason being is that there is a large difference between an issuer saying that they need help paying their debt service and an issuer saying that they need to reduce the amount of debt outstanding to remain solvent.

Typically, when an entity needs help in alleviating the pressure on their budgets, a variety of actions can be taken such as renegotiating union contracts, lessening pension fund payments, or picking up trash just once a week. These measures however, would be grossly inadequate for Jefferson County as their interest expense is so high relative to their other expenses. For this reason, the county may ask the judge for debt forgiveness. This has never been done before because a bond contract has meaning: an obligor must make the principal and interest payments on the debt outstanding.

What does RSW believe? Sometimes history does provide a unique insight into what the outcome will be. Let us reflect back on the Kentucky complaint (taxing the interest income on out-of-state-municipal bonds). Here, the Supreme Court dismissed the petition because they ruled that changing a fundamental aspect of tax-exemption would be too disruptive for an established municipal market. Could you imagine a court taking the unprecedented step of reducing the amount of an issuers' debt that is currently outstanding. In summary, in the Kentucky case, the court was petitioned that the earth was flat, but it didn't make it so, and we know how that ended. The same outcome should prevail here.

Sincerely,  
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Managing Member

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