More Cities on Brink of Bankruptcy

DEFAULT, BANKRUPTCY, HARRISBURG, PENNSYLVANIA, VALLEJO, CALIFORNIA, INCINERATOR, NEW YORK CITY, MUNICIPAL BONDS, MUNIS, LOS ANGELES, LABOR COSTS, TAXES, JIM LEBENTHAL, BONDS, CREDIT DEFAULT SWAPS, CDS, MARKIT MCDX
Posted By: Kate Kelly | CNBC Reporter
CNBC.com | 26 May 2010 | 11:01 AM ET

The possibility of a bankruptcy filing by the city of Harrisburg, Pa., the state capital, looms large these days—and it could be the first in a series, say some Wall Street traders.

Harrisburg, population 55,000, owes nearly $70 million in debt payments this year, and it's unclear where that money will come from.

Harrisburg now has one of the lowest credit ratings of any municipality in the United States.

Harrisburg Mayor Linda Thompson told CNBC Wednesday that she had assembled a group of bond stakeholders, the city council and other interested parties to work out the crisis "so that we don't become the poster child of the world in terms of bankruptcy."

Municipal bond underwriters are monitoring Harrisburg, which has struggled to contain the **costs of financing a troubled incinerator project.**

In 2003, the city borrowed $125 million to expand and retrofit its incinerator, which officials thought would make money for Harrisburg. The incinerator re-opened five years later, but it's turned out to be nothing but a money drain.

On May 1, the city missed a $452,282 loan payment related to the incinerator.

Raising taxes or selling assets, like real estate or parking lots, are options for Harrisburg. So is a restructuring plan—either inside or outside of bankruptcy.

If Harrisburg does file for bankruptcy, it would do so under Chapter 9—which is employed by cities, but rarely. In one closely watched case, the city of Vallejo, Calif., has been in Chapter 9 since 2008.

About the Harrisburg situation, Jim Lebenthal, head of public affairs for the longtime municipal-bond underwriter, Lebenthal & Co., said that while filing for Chapter 9 would be a small matter in the scheme of things, it's "emblematic" of the larger economic struggles that cities face right now. "If it can happen in a state capital, my God, it can happen anywhere," said Lebenthal.

The overall problem is that the $2.8 trillion muni bond market, long considered one of the safest havens for investors, now faces a daunting level of debt, as cities from Los Angeles to New York struggle with an array of headaches, including less tax revenue and high labor costs.

According to remarks made by Harrisburg mayor Thompson in April, the city spends rought 70 percent of its annual budget on labor.

Cities can always raise taxes to fight a budget shortfall. But costly projects, fewer people in the workforce and more demand for city services can make budgets tough to square these days.

Financial firms underwrite bond offerings for cities and public-works projects, and the default rate on muni bonds has historically been quite low—less than 1 percent—compared to nearly 13 percent for corporate bonds, according to ratings agency figures.

In that sense, the Street encourages investors to go long municipalities.

But investors and the Street can also short munis through credit default swaps, or CDS policies that pay out if an entity defaults.

The **Markit MCDX**, an index that tracks the cost of insuring against default of a basket of 50 municipalities, is on a recent high of $173,000 for $10 million of protection on a five-year bond—a point last reached near the beginning of this year. A swap that would pay out if the state of Pennsylvania defaults cost $112,000 for the same $10 million amount.

Jesse Bergman contributed to this story.

- ***Slideshow: Municipal Bonds at Greatest Risk for Default***

URL: http://www.cnbc.com/id/37354955/

.