

## Financial reorganization of the municipality of Loèche-les-Bains

*(Speech by Mr. Michel Roten, section head at the Financial Inspectorate of the Canton of Valais)*

Ladies and gentlemen,

The aim and purpose of my speech is to present to you how the municipality of Loèche-les-Bains has been reorganized. It is not a common financial restructuring but rather an exceptional case in view of the volume to be reorganized and the solution found.

### **Some information on the municipality of Loèche-les-Bains**

Loèche-les-Bains is one of the 3,000 Swiss communities in the canton of Valais. The territorial division of Switzerland in 26 cantons can be compared with the one existing in Germany with the federate states (*Länder*). The canton of Valais has 153 municipalities for a population of 280,000 inhabitants. The community of Loèche-Les-Bains has 1,500 inhabitants and is located in a basin at around 1,400 metres above sea level. Loèche-les-Bains is one of the main tourist destinations in the canton, in particular in what concerns wellness treatments. The village's thermal springs stream daily near 3.9 million litres of hot water at a temperature of 51° Celsius degrees. Loèche-les-Bains has one of the most important alpine thermal spa offers in Europe and a significant infrastructure for winter sports. With this regard, here are some interesting data which emphasize the importance of tourism for the municipality: in Loèche-les-Bains there are about 30 hotels with approximately 1,400 beds, 1,700 holiday flats and chalets with 7,000 beds, as well as 2 hospitals with a capacity of 227 beds. Around 900,000 overnight stays are recorded per year.

### **Partial local government control over the municipality by the canton**

After the canton, as supervisory authority, was informed in spring 1998 about the financial situation of the municipality, the cantonal government decided on 21 October 1998 to place the municipality under cantonal administration in accordance with the legal provisions on the matter. This mission was entrusted to three experts from outside the canton. Their task was to prepare a rescue scheme. After four months of work, a proposal was presented in March 1999. These experts assessed the municipality's debt carrying capacity at around 40 million Swiss francs. Creditors were asked to consider 80% of the total debt (144.5 million francs) as irrecoverable. They did not accept the rescue plan. Consequently, the canton, in its capacity as supervisory authority, could not do but ask the cantonal Court to place the municipality of Loèche-les-Bains under the guardianship of the canton. This request was presented on 26 May 1999.

## The setting up of the guardianship

20 July 1999 was a distressing day for Swiss municipalities, especially for the municipality of Loèche-les-Bains. On that day the cantonal Court decided to place the municipality under cantonal administration and appointed one of the three experts mentioned above, Mr Andreas Coradi from Zurich, as manager. This was the first time that a municipality, in accordance with the federal act (dated 1947) for the collection of debt of municipalities and other cantonal public bodies, had been placed under guardianship. Now, what is meant by guardianship and in which financial situation was really the municipality of Loèche-les-Bains?

Guardianship is a measure whose first objective is to save the interests of creditors. This measure is taken when a municipality declares itself insolvent or when in all likelihood it is incapable of assuming its financial obligations for a relatively long period of time. This was the case of the municipality of Loèche-les-Bains. The cantonal Court decided on July 1999 that all debts of the municipality as at 31 December 1997 amounted to about 170 million francs, that is to say, about 113 million euros. Moreover, from 1997 annual accounts arises a negative self-financing margin of about 3.5 million francs. This means that a part of the operation expenses had been covered by new borrowings. Moreover, it turned out that those companies in which the municipality held a stake and which had been granted loans had very serious financial difficulties themselves and could not even pay the interests of these loans. For 1997 this represented about 4 million francs and the relevant provisions were lacking. The real situation was even worse than that arising from the accounts.

Starting from this deplorable financial situation, the municipality of Loèche-les-Bains was placed under cantonal administration by the cantonal Court for a period of three years, which was extended three years more by decision dated 9 July 2002. This responsibility is all-embracing and includes all administrative activities. In accordance with the legal provisions on the matter, the aim of guardianship is to ensure – without detriment to the current administration – that obligations incumbent upon the municipality are assumed on a both timely and regular basis within the framework of the financial programme. Furthermore, the guardianship task is expected to reorganize the financial planning and, if possible, reduce expenditure and increase income. In the case of Loèche-les-Bains, one of the first measures introduced by the appointed manager was to increase taxes up to the maximum legal rate. A tax for tourist promotion was introduced as well. As far as financial matters is concerned, those powers belonging to the primary assembly and to the elected authorities were almost completely abolished by the manager. Under these circumstances it was not astonishing that the people from Loèche-les-Bains compared him with the bailiff in Schiller's play, William Tell.

How is it possible that a municipality like Loèche-les-Bains, with such natural resources, especially its thermal sources, could find itself in a situation like this? To understand this better, let us have a look at the balance sheet as at 31 December 1997. Over a balance sheet total of about 180 million francs, 55%, that is to say, approximately 98 million francs, were apportioned to financial assets which could be sold without prejudice to the municipality's operation. Moreover, from the balance sheet can also be gathered that these assets were financed in their entirety with loans and that the shortage in the balance sheet amounted to 11.5 million francs. It can easily be understood that in the event of insufficient profitability or no profitability at all arising from these investments, the municipality's financial budget would unavoidably be affected by it. These disproportions between financial and fixed assets and between equity and debt capital have inevitably consequences on figures. This is easier understood if we calculate some key figures per inhabitant. For a population at the time of 1,700 people, gross debt per inhabitant amounted to 105,000.00 francs, that is to say, around 70,000 euros, whereas the average of municipalities in Valais was at 9,500.00 francs. The book value of financial investments of 98 million francs represented an amount of 58,000.00 francs per inhabitant. If these investments do not produce any return, calculating an interest rate of 5%, the municipality's accounts must absorb some interest charges of more than 10,000.00 francs per year and per inhabitant. Yes, you have understood it right, the interest charges came to about 6,666 euros per inhabitant.



As you may understand from these explanations, a large part of borrowed funds were used to finance investments in financial assets. What kind of investments was it about? The following chart shows the different stakes. From this it can be inferred that the municipality, in addition to stakes, also granted loans to the same companies. I will mention in particular *Parkhaus AG*, a company 100 per cent owned by the municipality. *Parkhaus AG* is a car park which also has an administrative building. The loan granted to the Loèche civic community for more than 10 million francs should also be mentioned.

What is a civic community (*Bürgergemeinde*)? Civic communities are public corporations whose task is – within the relevant legal framework – to confer civic community rights and administer civic community property. Most civic communities within the canton of Valais only have very few property of value. At present, civic communities are not much significant within the community life. As opposed to the municipal communities, they do not have any fiscal sovereignty. This means that their revenue only comes from the exploitation of their property. As regards the civic community of Loèche-Les-Bains, the situation is different. For generations, this latter has owned important sources and during the eighties the municipality acquired a hotel and wellness resort, as well as a transport company named LLB, altogether for about 19 million francs. In view of the fact that the profit yielded by the hotel exploitation was insufficient for the works of renovation and rebuilding, the municipality agreed to grant loans directly to the civic community, just as to its companies. As a result from it, matters concerning the civic community and the municipality got mixed up, this all the more so since both civic and municipal community were administered by the same council. In the following chart you can see the different shares of public corporations. It should also be added that the president of the municipal and the civic community was also the chairman of all companies. On account of these interconnections, people often refer to the Loèche-Les-Bains group when talking about the financial crash of Loèche-Les-Bains.

In the legal sense of the term, there is no such group as Loèche-Les-Bains. As already mentioned, it is a series of financial links among the different companies which were mostly in the hands of the public sector. These financial links as well as the debts of the different companies and civic or municipal communities arise from the following chart. The group's debts amounted to 344 million francs, 61 million apportioned to issuers, 85 millions to insurance companies and 198 millions to banks.

As you can see when looking at the stakes of the municipality of Loèche-les-Bains, it did not privatize any municipal task. Rather, the municipality of Loèche-les-Bains acted almost as an investor and acquired an interest in different companies which accomplished private-sector activities.

Given that fact that most of the time these companies had financial difficulties, they were not in a position to take on the payment of interests arising from the loans granted by the municipality. Seeing that the municipality on its part had an obligation to respect the payment of those interests, it had to run into debt even more. Considering the companies' development, it turned out that these loans and shares did not have any value any more. Their resale in order to reduce the debt was therefore not possible. However, this problem did not emerge from the balance sheet as at 31 December 1997.

### **Possible ways to come out of the financial crash**

One of the problems management had to face throughout the mandate of guardianship was that debts would remain beyond the management period, as long as they were not paid off through planned measures within that period. There are no certificates of indebtedness and therefore no difference could be made between old creditors who cannot assert their rights but within the framework of improving the debtor's financial situation and new debtors. Starting from this position, there were only two possible solutions:

- the canton assumes the municipality's debts or
- creditors accept a remission of debt.



## Derivative suit against the supervisory authority – the canton of Valais

The canton was of the opinion that it did not have to answer for those errors committed by a third party. However, this opinion was not shared by the municipality and creditors, and therefore five derivative suits were lodged to the federal court against the canton: one by the municipality of Loèche-les-Bains itself and the remaining four by creditors. By its verdicts of 3 July 2003, the federal court rejected the suits lodged by the following entities: municipality of Loèche-les-Bains, cooperative association for the provision of funds for Swiss municipalities (*Emissionszentrale der Schweizer Gemeinden*), Cantonal Bank of Basel, Rheinfelden and Oftringen municipalities. According to these verdicts the conditions for a liability of the canton are not given.

The second possibility was the remission of debt by creditors, a possibility which they refused. Although they were aware of the fact that it was a dead-end situation, they were not willing to accept a remission of debt regarding a municipality, as they did not want to set a precedent. In this almost inextricable situation, the new manager, who succeeded A. Coradi who resigned for health reasons at the end of 2001, had to look for a new solution which was found with an out-of-court rescue plan.

## Rescue plan

According to the manager's calculations, it turned out that the municipality was in a position to bear a 22% dividend, that is to say, about 40 million francs, over an acknowledged debt of 181 million francs. At that stage, the municipality's available liquid funds amounted to approximately 15 million francs. This meant that external funding up to 25 million francs was required for the payment of the residual amount. Resting on this, the manager prepared the following concept:

- Foundation of a civil law joint-stock company, *Sanag Leukerbad AG*, whose share capital is in the possession of the different municipalities within Loèche district (with the exception of the municipality of Loèche-les-Bains). The object of this company is the disencumbrance of the municipality of Loèche-les-Bains ensuring equal treatment of creditors.
- Allowance of a 30 million francs guarantee by the canton to secure a loan of 25 million francs granted to the recently established joint-stock company.
- Purchase of the creditors' claims against the municipality by the joint-stock company by means of the abovementioned financing.
- For those creditors who accept the rescue scheme, a purchase price (dividend) of 22% is foreseen, payable after purchase at the latest on 31 December 2003.
- Creditors who do not adhere to the rescue plan only receive their part in the municipality's available liquid funds (15 million francs). The available amount for the annual reimbursement of debts is proportionally paid to *Sanag Leukerbad AG* (assigned debts) and the other creditors (non assigned debts).
- Mending clause inserted in the contracts on the assignment of debts: in the event of selling until 31 December 2003 the low tension distribution network of Loèche-les-Bains, St-Laurent fountain at the central square of the village, the old school building and the old slaughterhouses, 50% of these receipts will be used to increase the dividend. Moreover, creditors have been granted a pre-emptive right over these items until 31 December 2023.
- The municipality must commit to take from its operating account a minimum annuity of 900,000.00 francs (distribution among assigned and non assigned debts).
- Furthermore, the reimbursement of the civic community's debt to the municipality must be incorporated into the reimbursement process. In the event of default of payment by the civic community, the municipality must raise an additional amount of 400,000.00 francs per year.
- After payment of these amounts, the municipality may release from its self-financing margin a maximum amount of 900,000.00 francs for the making of



investments and the feeding of a relevant fund. If the self-financing margin turns out to be higher, the difference would be used to reduce the debt.

- Taking into account an annual repayment of 1.3 to 1.4 million francs at an interest rate of 3%, the debt should be reimbursed in about 30 years.

The key of this rescue plan has been the granting by the canton of a guarantee for the raise of a loan by the *Sanag Leukerbad AG*. On 4 December 2003, the cantonal parliament of Valais approved the guarantee on condition that at least 85% of the total amount of acknowledged debts was included in the rescue scheme.

As already mentioned, the manager had acknowledged debts for an amount of 180.7 million francs. As at 31 December 2003, creditors had assigned claims for an amount of 175.9 million francs, that is to say, 97.3%. Thus, claims for an amount of 4.8 million francs (2.7%) had not been assigned. From these latter, in the meantime an additional amount of 400,000.00 francs were assigned; this means that today an amount of 4.4 million francs is not included in the rescue project.

After setting in motion this financial reorganization concept, two years have gone by and until today the municipality has complied with its contractual duties. The reorganization is going well. In 2004, *Sanag Leukerbad AG*, as a consequence of the payment effected by the municipality of *Loèche-Les-Bains*, has been able to reduce debts of around 980,000.00 francs down to 23 million francs. In 2005, the reduction of debt is almost at the same level. Besides, it is very likely that creditors who have not assigned yet their debts for an amount of 4.4 million francs to *Sanag Leukerbad AG* will join the rescue process.

19 May 2006

