

# State Engagement in Overcoming Local Government Financial Distress

## Selected Approaches

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# Context

## A Challenging Period for Local Governments

- Municipal and county governments and school districts are under heavy financial strain
  - Expanding personnel costs, particularly for public safety, health, and post-employment benefits
  - Limited access to credit market to meet infrastructure and other needs
  - Reduced property values and more foreclosures weighing on property taxes
  - Taxation as percent of personal income at historic highs in many places
- It remains to be seen if Vallejo, California's recent filing for bankruptcy, attributed to economic slowdown and police and fire contracts it cannot afford, is isolated an event, or signals wider trend

# Context

## Why State Intervention?

- Financial distress among local governments threatens the prosperity and economic welfare of the inhabitants of the county and the people of the state
- The public interest and policy of the state to assist local governments to provide, without interruption, services essential to their inhabitants while meeting their obligations to the holders of their outstanding securities
- The impairment of the credit of the local government may affect the ability of other localities in the state to issue their obligations at normal interest rates
- Intervention to provide budgetary discipline and short-term budgetary relief is necessary to allow a distressed local government to restore enduring fiscal health and availability of adequate funding for essential services
- State intervention discussed today pertains to distress due to underlying economic and financial conditions, not state responses to natural disasters and other emergencies, such as Iowa's Disaster Relief and Emergency Assistance Act

# Context

## A Selection of States Applying Fiscal Distress Intervention

- Pennsylvania
- New York
- Connecticut
- Florida
- Michigan
- District of Columbia (Federal Government as “State”)
- Washington
- New Jersey
- Ohio
- North Carolina
- California
- Massachusetts

# Four Approaches to State Intervention

- Either on a stand-alone basis – or in combination – states can apply the following approaches to supporting local governments facing financial distress
  - Monitoring
  - Assistance
  - Oversight
  - Control

# Approaches to State Intervention

## Monitoring

- State of Ohio's Early Warning System
  - State Auditor's Office provides local governments with ratio indicators to benchmark financial performance and identify fiscal distress
- State of Washington's 10 Indicators of Washington Local Government Fiscal Stress
  - Conducted in 2006, to identify which of 320 cities and counties facing financial distress and support formulation of appropriate response, in context of State intervention with Ferry County and elimination of Motor Vehicle Tax revenues to local governments
  - Not an annual monitoring process, but could be
  - City or county with 4 or more indicators considered distressed
  - Data collected through the State's Local Government Financial Reporting System

# Approaches to State Intervention

## Monitoring: Washington's 10 Indicator of Fiscal Stress

- General Fund revenue per capita
- Cash balance – 5% or less of expenditures
- Revenue elasticity – revenue growth vs. change in personal income
- Proportion of expenditures used for capital or debt – 15% or more warning sign
- Proportion of revenue restricted for specific uses
- Property tax burden – overlapping property taxes exceed 2% of property value
- General fund operating gap
- Economic condition – unemployment, per capita income, population growth
- Tax base condition – major tax revenue per capita 50% below state average
- Service demand – high proportion of Health & Human Service clients, school dropouts

# Approaches to State Intervention

## Oversight & Assistance

- State-coordinated agency, board and/or receiver reviews local government budgets and other financial management decisions
- May have ability to require local government to revise budgets if assumptions/content not within standards of reasonableness
- Oversight entity may have access to a revenue stream, with the ability to issue debt on local government's behalf more affordably than locality can on its own
- Local government failure to meet requirements may trigger hard control, while standards for entering into, and exiting, oversight period are established in authorizing legislation
- State legislation authorizing oversight may be accompanied by assistance in the form of grants, restructuring of local revenue sources, advisors to development financial plans

# Approaches to State Intervention

## Oversight & Assistance: East Orange, NJ

- Small/mid-sized city in northern New Jersey, that State's Department of Community Affairs about to add to Distressed Cities program in late 1990s
  - Special State Aid subsidy to plug hole in City budget, accompanied by oversight, monitoring, and certain controls
- Newly-elected Mayor saw State oversight as inevitable, and determined to stay in front of it through development of own financial recovery plan, which the State reviewed and provided implementation support, particularly in tax collection
- City successful in labor arbitration on costly benefit, wage, and work rule provisions, reducing size of workforce through attrition, improving revenue management, organizational structure, and internal controls
- City gained first investment grade credit rating in many years, and became the first to graduate from Distressed Cities program

# Approaches to State Intervention

## Oversight & Assistance: PA's Act 47

- Pennsylvania's Municipalities Financial Recovery Act of 1987 (Act 47) does not provide for a state takeover; rather, the State's role is to provide strong oversight and develop a partnership with municipalities experiencing severe distress
- The State's Department of Community & Economic Development, through its appointed Act 47 coordinator, applies:
  - Broad-based program of fiscal management oversight
  - Technical assistance, provided by State-appointed legal and financial advisors
  - Planning and financial aid to municipalities
- Emphasis placed on long-term solutions that focus on:
  - Early identification of municipalities with tendencies toward financial distress
  - Fiscal management improvements
  - Intergovernmental cooperation
  - Community development activities

# Approaches to State Intervention

## Oversight & Assistance: PA's Act 47

- Criteria for declaration of distress include:
  - Maintenance by a local government a deficit of 1% or more over the previous three fiscal year periods
  - Allowing expenditures to exceed revenues for three years or more, and
  - Accumulation and operation of a local government for the previous two successive years with a deficit equal to 5 percent or more of its revenues
- 23 PA municipalities have been designated as distressed under Act 47, including Pittsburgh and Scranton, and 7 have had the designation rescinded or de-sanction
- Altoona and Erie avoided Act 47 designation by seeking changes to binding arbitration language of Act 111, as well as reduction of designation of tax-exempt properties to improve fiscal health

# Approaches to State Intervention

## Oversight & Assistance: PA's Act 47 & Pittsburgh

- In late 2003, the City of Pittsburgh asked the Commonwealth of PA to declare it financially distressed under Act 47, following the layoff of 446 employees (100 police officers), cuts in many City services, credit rating downgrades to “junk bond” status, and projected large, compounding deficits if no corrective action
- A Recovery Plan was put in place with support of State-appointed advisors, setting forth specific spending reduction and productivity initiatives, accompanied by a plan to restructure City revenues to provide greater stability and resources
  - The Commonwealth approved the Revenue Plan
- City formulated and pursued strategy to contain personnel costs through collective bargaining, with support of State technical advisors
- Since the Act 47 Recovery Plan was adopted in June 2004, Pittsburgh has achieved budget surpluses and restored services. It has petitioned the Commonwealth to end the distress designation and bring the City out of Act 47 oversight

# Approaches to State Intervention

## Control & Assistance

- Direct decision-making over budget formulation and execution, procurement, debt issuance, under state-appointed board, authority, and/or receiver
- Can extend to comprehensive day-to-day operational responsibility, hiring and firing (Springfield)
- May extend to ability to abrogate labor agreements, removal/adjustment of spending responsibilities, and/or restructuring of local government revenues(District of Columbia)
- May be accompanied by the issuance of debt, the proceeds of which are used to productivity-enhancing infrastructure, and to buy time for sustained cost reduction, revenue enhancements, and organizational improvements to take effect
- Statute establishes standards for entering into, and exiting, control period

# Approaches to State Intervention

## Control & Assistance: The District of Columbia

- In 1995-96, Congress reacted to the District of Columbia's financial crisis with the Financial Responsibility and Management Assistance Authority, or "Control Board"
- Budget and Four-Year Financial Plan annually adopted, and controls put in place under direction of powerful Chief Financial Officer (later became Mayor)
- In time, Control Board took directly managed Police, Schools, and other key functions, appointing a Chief Management Officer. Large numbers of employee positions eliminated over time, with heavy investment in technology
- The Federal Government, acting as the "state", later removed many state-like financial responsibilities from the District (certain pensions, prisons), favorably adjusted intergovernmental financial provisions, and provided economic development stimulus
- As reform-minded Mayor elected and consecutive balanced budgets achieved, Control Board eased hands-on management then, in time, dissolved
- The District's financial and economic progress have gained remarkably over 12 years

# Approaches to State Intervention

## Examples of Positive Outcomes

- District of Columbia
- New York City, NY
- Philadelphia, PA
- East Orange, NJ
- Miami, FL (six years removed from State financial oversight board)
- Number of smaller PA local governments no longer in financial distress under Act 47
- Pittsburgh, PA
- Springfield, MA (Progress on financial controls, FTE reductions, credit ratings)
- Flint, MI
  - Local government financial emergency declared in 2002, given lack of plan for recovery
  - Financial Plan implemented. General Fund deficit of \$26mm turned to \$9mm surplus in 2006
  - Governor Granholm revoked fiscal emergency
  - Significant underlying challenges remain
- Results of hard control in Camden are uneven, but progress under present leadership is promising

# Approaches to State Intervention

## Conclusions

- Many states are compelled to support the financial recovery of their local governments, applying case-by-case and systematic approaches to monitoring, providing assistance, establishing oversight and/or control
- State intervention is applied to local governments of all sizes
- While once-distressed local governments continue to face many challenges, there are many examples of successful interventions
- Establishing and implementing multi-year financial recovery plans – tied to budgeting, personnel/labor management, productivity enhancements, and capital investment – is a standard, proven approach
- Proactive engagement by states, before fiscal strain becomes a crisis – blending firm controls with technical assistance, local government input, and measured/targeted levels of financial assistance tied to sustained improvements – is an effective formula in challenging times