



# State Strategies to Detect Local Fiscal Distress

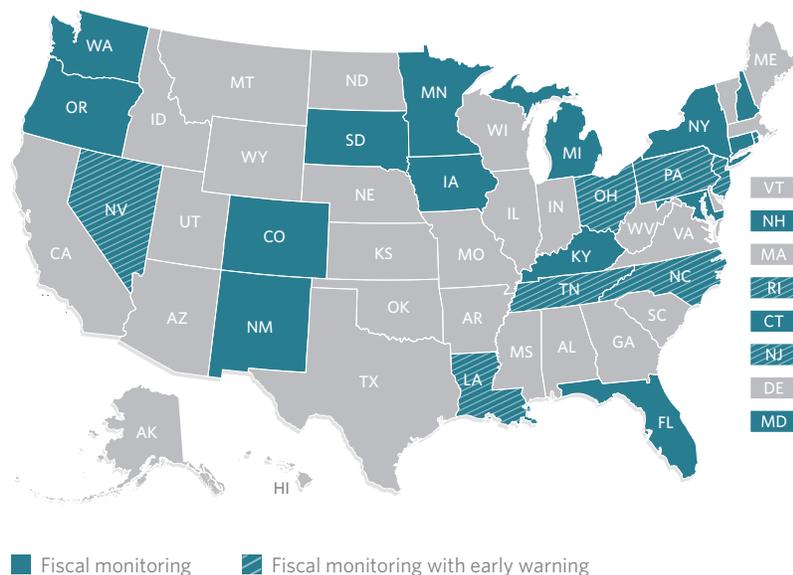
Local governments across the country are struggling with growing liabilities, including rising infrastructure costs, pensions, and other post-employment benefits. At the same time, revenue—including state and federal aid—remains constrained.

Research by The Pew Charitable Trusts has found that most states do little to track local governments' fiscal health. That can mean that when cities, towns, and counties have trouble balancing their budgets or show other signs of fiscal distress, state governments can be caught by surprise. Even states that are determined not to get involved in local affairs may find themselves forced to lend a helping hand, if only to prevent other communities—or the state itself—from impacts such as lower credit ratings or having to foot the bill when struggling communities fail to pay what they owe in shared service agreements.

Figure 1

## Fiscal Monitoring Across the United States

22 states have programs, including 8 with 'early warning systems'



In January 2017, Ohio, which already monitored local governments, published an analysis of its cities and counties based on 17 indicators, intended to “help communities avoid going over a fiscal cliff instead of resuscitating them after they crashed.” In April 2017, Virginia adopted a state budget provision that will create a system to alert local governments when there are signs that they may be in fiscal distress.

Note: Map based on data published in September 2016.

Sources: Pew analysis of state statutes and interviews with state officials

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By working proactively, however, states can detect and respond to early signs of trouble at the local level, potentially preventing disruptions in critical services, loan defaults, or bankruptcy.

Recent research by Pew illustrates the range of policies and practices that states have in place to track and assess local fiscal conditions. Of the 22 states with fiscal monitoring systems, Pew classified eight as having “early warning systems,” meaning laws defining when local governments are in fiscal distress and systems to identify signs that a locality is moving toward such a condition.

## Fiscal monitoring benefits

Pew identified several reasons that monitoring local governments’ fiscal health is beneficial, including:

### 1. The ability to address problems before they become unmanageable.

Fiscal monitoring allows state governments to detect early signs of distress and help local governments address problems before they escalate. Early detection can allow states to respond in ways that are less intrusive than those that could be needed in a fiscal crisis.

### 2. Support from credit rating agencies.

Credit rating agencies generally support state oversight of local governments’ fiscal health, arguing that states often can help localities without hurting their own balance sheets. “All else being equal, we tend to assign higher ratings to troubled local governments in states with strong oversight, well-established policies of intervention, and a track record of success,” Moody’s Investors Service says.<sup>1</sup>

### 3. Improved transparency and accountability.

State officials also say that fiscal monitoring improves transparency and accountability. New York, for example, created a fiscal stress monitoring system in 2013 that places localities in four categories, ranging from no designation to significant fiscal stress. “We’re not trying to ‘catch’ places,” said Craig Kinns, assistant director of operations for the local government and school accountability division of the New York state comptroller’s office. “What we want to do is bring information out to the public so that a community can understand the challenges that their local officials are facing ... so that those conversations can take place.”<sup>2</sup>

## Endnotes

1 Moody’s Investors Service, “U.S. State Oversight Is Often Credit Positive for Distressed Local Governments, but No Guarantee Against Default” (September 2013), [http://www.alacrastore.com/moodys-credit-research/US-State-Oversight-Is-Often-Credit-Positive-for-Distressed-Local-Governments-but-No-Guarantee-Against-Default-PBM\\_PBM153597](http://www.alacrastore.com/moodys-credit-research/US-State-Oversight-Is-Often-Credit-Positive-for-Distressed-Local-Governments-but-No-Guarantee-Against-Default-PBM_PBM153597).

2 Craig Kinns (assistant director of operations, Division of Local Government and School Accountability, New York Office of the State Comptroller), interview by The Pew Charitable Trusts, Sept. 11, 2015.

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