

# State Strategies to Detect Local Fiscal Distress

How states assess and monitor the financial health of local governments



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## External reviewers

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**Cover photo:** Justin Sullivan, Getty Images

A worker washes the windows on a building in Stockton, California. Stockton is one of several localities that received nationwide attention because of bankruptcy filings in recent years.

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## Overview

As local governments across the country struggle to resolve budgetary challenges, some states are exploring ways to help their counties, cities, towns, and villages avoid defaulting on loans or filing for bankruptcy.

Local governments are grappling with growing liabilities, including pensions and other post-employment benefits<sup>1</sup> as well as costly infrastructure needs<sup>2</sup> and reduced state and federal aid.<sup>3</sup> In many communities, revenue and spending have not returned to the levels seen just before the Great Recession began in 2007. In fact, as of 2015, only 7 percent of U.S. counties had recovered to pre-recession levels based on indicators analyzed by the National Association of Counties: jobs, unemployment rates, economic output, and median home prices.<sup>4</sup> Even as the recovery has proved sluggish and uneven, the reality of the next downturn is beginning to loom. Although economists are divided on when that will occur,<sup>5</sup> some local governments are already beginning to plan for the next recession.

State policymakers have a critical stake in ensuring the fiscal health of localities so that they can maintain essential services to residents and protect the vitality of their economies, which generate revenue for governments at all levels. James Spiotto, an expert on municipal distress who has testified before Congress on the topic, said that although states do not necessarily take on the financial liabilities of local governments, they are ultimately responsible for the disposition of failed municipalities. In other words, Spiotto said: “The state is always going to be responsible if the local government fails. [The state is] the parent.”<sup>6</sup>

Despite this responsibility, many states historically have done little to track the budgetary well-being of local governments. Most routinely collect documents such as audits, financial reports, and budgets from local governments, but less than half analyze this information to try to detect signs of fiscal distress or, more generally, take the fiscal pulse of localities. The reasons for this vary. Some states view these tasks as beyond their responsibility, some say they lack the money and staff, and others say that because they don’t have the legal authority to intervene even when distress is evident, they see no reason to try to monitor local fiscal health.

As many states have learned, however, taking a hands-off approach to local government fiscal health can lead to costly surprises. Several localities have received nationwide attention because of bankruptcy filings in recent years, including Detroit; Jefferson County, Alabama; Stockton, California; and Central Falls, Rhode Island. In addition, the threat of default and possible bankruptcy is looming in Atlantic City, New Jersey. In the case of Detroit, the state of Michigan spent \$195 million from its rainy day fund to help the Motor City exit bankruptcy.

In general, however, insolvencies remain relatively rare. Over the past 60 years, only 64 counties, cities, towns, and villages have filed for bankruptcy.<sup>7</sup> That is in part by design: Twenty-one states do not allow local governments to file for bankruptcy, and several others place conditions on these filings.<sup>8</sup>

Although local government bankruptcies are not a widespread problem, many localities struggle to meet the needs of their residents. The concern, as *Governing* magazine put it, is “the ones on the edge—the ‘distressed cities’ ... that likely will never declare bankruptcy but are nonetheless struggling to become economically viable again.”<sup>9</sup> There are myriad examples of municipalities and counties in serious enough fiscal distress to erode critical services and hamper the community’s ability to thrive.

States can do more than just wait to react to the next fiscal emergency; they can work proactively to detect local distress and then use that data to determine the best steps to take. In 2013, The Pew Charitable Trusts explored how and when states intervene in local governments in [The State Role in Local Government Financial Distress](#).<sup>10</sup> The report described the stages of municipal difficulty, from distress to crisis to bankruptcy; the

reasons for state intervention; and approaches states can take, including refusing to become involved even when local governments ask for help, intervening on a case-by-case basis, and repeatedly exercising state authority to make decisions for local governments. The report recommended that states monitor the fiscal conditions of local governments with an eye toward helping them avoid full-blown crises, if possible.

This follow-up report examines the range of policies and practices that states have in place to assess and track fiscal conditions at the local level, with a focus on whether and how states try to detect local fiscal distress. To operate a “fiscal monitoring system” for purposes of this research, a state must actively and regularly review the finances of at least some of its general purpose local governments, such as counties, cities, and towns, to monitor fiscal conditions or detect problems.<sup>11</sup> The research includes analysis of relevant state statutes and interviews with officials in all 50 states. To learn about the issue from the perspective of local governments, researchers also talked with officials from municipal leagues across the country. These efforts add up to the most comprehensive study to date of fiscal monitoring across the country.

Pew’s research found:

- 22 states<sup>12</sup> make some effort to monitor the fiscal health of local governments, meaning that they actively and regularly review financial information from local governments with the aim of trying to detect fiscal distress or, more generally, assessing their fiscal conditions.
- Of the 22, eight can be classified as “early warning” states, meaning that they have laws defining when local governments are in “fiscal distress” and systems to identify signs that a locality is declining toward such a condition.<sup>13</sup>
- State efforts to monitor local government fiscal health vary widely in scope, frequency, and who does the monitoring. Options available to deal with fiscal distress are also very different.

Based on this research, states should adhere to certain key principles when designing fiscal monitoring systems:

- Formal systems and processes that spell out how fiscal monitoring should work, along with when and how states and local governments should respond when various stages of fiscal distress are detected, help promote transparency and predictability. Establishing specific indicators, for example, helps ensure that monitoring happens consistently, no matter who is conducting the analysis. Codifying monitoring in statute strengthens the commitment to detect fiscal distress and help local governments even in times of tight budgets and through administration changes.
- Detecting distress early can help local governments address fiscal problems before they become unmanageable.
- Good working relationships between state and local governments are critical. Although state oversight of local governments can naturally lead to tensions, some states have succeeded in working with localities cooperatively, so that local governments view the state as a partner, not an enforcer. When well-designed and operated, fiscal monitoring systems can be mechanisms for regular communication between levels of government.
- States should undertake fiscal monitoring with the goal of avoiding state intervention or the need to take over local decision-making authority, if possible. Intervention is costly for the state, typically not welcomed by local residents or officials, and difficult to execute well. States should focus on helping these governments get back on their feet and move toward fiscal sustainability.

Some state officials feel that they have little reason to worry about the fiscal health of local governments. A number of them said municipal distress is not an issue in their state, citing fiscally conservative cultures or mechanisms set in place by their states to attempt to ensure local fiscal health, such as limits on taxes, expenditures, and borrowing.

The reality, however, is that a record of fiscally healthy local governments cannot guarantee what will happen in the future. One Rhode Island official said the Central Falls bankruptcy, filed in 2011, “was certainly a wake-up call ... for everyone. ... Before, no one really envisioned a municipality going bankrupt.”<sup>14</sup>

Just as governments at all levels learned from previous crises, states have an opportunity to re-examine their roles in helping local governments avoid or grapple with fiscal distress. That would follow the model set when the Great Depression prompted New Jersey and North Carolina to adopt rigorous local monitoring and intervention systems in the 1930s, and the financial crises of the 1970s and 1980s in cities such as Cleveland, New York, and Philadelphia spurred initiatives in multiple states.

As many local governments struggle to adjust to the reality of decreased or stagnant revenue and increased costs, several states—including New York, Rhode Island, and Tennessee—have either adopted fiscal monitoring systems or strengthened existing ones in recent years. Ohio and Colorado are among the states considering strengthening their systems to detect fiscal distress. For states that want to figure out how local governments are faring and whether any may be headed for fiscal crisis, this report analyzes the fiscal monitoring landscape across the country.

## **When local governments struggle: Why states should care**

Colorado state officials were shocked to learn in 2013 that the city of Olathe was in dire financial straits when they heard through media reports that the city had decided to cancel what would have been its 22nd annual sweet corn festival—a major event in that region—because of budget constraints.<sup>15</sup> The unexpected cancellation sent a clear message that the city was in financial trouble. “We do all this work with the communities, and we were thinking, how did this slip by us? You know, how did we not know they were quite so far in, spiraling to a crisis?” said Chantal Unfug, director of the Division of Local Government in Colorado’s Department of Local Affairs. “Could we have done anything?”<sup>16</sup> (The festival was later revived with the help of volunteers.<sup>17</sup>)

The department, which provides local governments with grants, technical assistance, and research, is working to develop a voluntary fiscal health monitoring program that would allow for a better understanding of conditions within local jurisdictions to help detect emerging problems in communities like Olathe. (For more on Colorado’s monitoring system, see the case studies in Appendix A.)

Nationwide, recovery from the Great Recession has been uneven and, in some cases, quite slow, resulting in difficult fiscal conditions in many cities. Although some areas recovered quickly and robustly, others still continue to struggle to match expenditures to revenue, whether because of the steep downturn or other, more permanent economic shifts. In fiscal year 2013, for example, 17 of the 29 large U.S. cities studied by Pew were still spending less on operations than they had in 2007, before the recession began, after adjusting for inflation.<sup>18</sup>

The impact of strained county and municipal budgets can be seen in reductions to critical public services such as trash collection, public safety, social services, and education. In Michigan, for example, officials felt forced to choose between maintaining public safety and infrastructure, which contributed to the lead contamination crisis in Flint. In Oregon, some struggling cities have held yard sales to keep governments afloat.<sup>19</sup> To save money,

at least one county government is open for business only four days a week.<sup>20</sup> Such measures may worry state policymakers eager to ensure that residents continue to receive essential services.

States also have a strong self-interest in the fiscal health of their largest cities, which drive state economies: The nation's 100 largest metropolitan areas produce 75 percent of the country's gross domestic product.<sup>21</sup> For communities of all sizes, states may want to prevent the spread of fiscal distress to other communities, known as contagion.<sup>22</sup>

State tracking and analysis of local government fiscal conditions also can help protect states' credit ratings and those of other local governments to help ensure access to the best rates for borrowing. Moody's Investors Service, for example, issued a statement in April 2016 that a default by Atlantic City, even without bankruptcy, could harm other financially distressed New Jersey municipalities such as Newark and Paterson because it would show that the state was not willing to provide local governments with the level of support previously expected.<sup>23</sup>

States also typically want to:

- Ensure that state revenue distributed to local governments is used appropriately and efficiently.
- Better understand where potential fiscal problems may lie so they can prepare for potential revenue impacts to the state budget.
- Try to avoid the expenses that can be involved when local governments enter fiscal crises, including bankruptcy.

Some experts argue that states bear some responsibility for the fiscal health of local governments because they often tie the hands of local officials, preventing them from solving their own budget problems. A study by the Michigan State University Extension, for example, found that "Michigan's particular mix of stringent limitations on local revenue and its relatively low level of financial assistance to cities, coupled with spending pressures stemming from spiking local service burdens and increased labor costs, creates conditions that drive up the potential for local fiscal distress."<sup>24</sup> It is important for states to understand the role they play in local fiscal health.

## Why fiscal monitoring?

Ideally, fiscal monitoring can help state governments detect early signs of local fiscal distress and allow them to help local governments address problems before they become unmanageable. Early detection can mean that states help in less intrusive ways than could be needed in a full fiscal crisis.

In Tennessee, Ron Queen, senior financial analyst in the state Comptroller of the Treasury's Office of State and Local Finance, sees fiscal monitoring as a way "to prevent [local governments] from going into a situation where they aren't able to manage their cash flow and they don't have the resources at the end of the year to meet next year's obligations." For example, the state reviews local government budgets and financial statements looking at indicators such as cash balances, cash flows, and debt service to see whether the local units have the resources to meet their obligations. Staff also examine compliance issues—such as transactions between government funds—that may hint at underlying financial stress. (For more on Tennessee's monitoring system, see the case studies in Appendix A.) Queen said that over time, his state's system "has put Tennessee local governments in better shape than other states because upfront we have the budget process."<sup>25</sup>

Credit rating agencies generally support the concept of states overseeing the fiscal health of local governments, arguing that states often can help localities without hurting their own fiscal condition. "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,”<sup>26</sup> Moody’s Investors Service says. An official with the New Jersey League of Municipalities explained that the state’s oversight of local governments “helps municipalities reassure their lenders that budgets are structurally sound and not based on political whim. The budgets are seen as trustworthy.”<sup>27</sup>

State officials also say that fiscal monitoring improves transparency and accountability to the public. New York, for example, implemented 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 New York Office of the State Comptroller’s Division of Local Government and School Accountability. “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>28</sup>

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Having this information publicly available and compiled into a readable format also helps new local leaders get up to speed quickly on the state of their local government. “In New York, there is continuous turnover in local government officials,” said Peter A. Baynes, executive director of the New York State Conference of Mayors and Municipal Officials. “So I think where a fiscal stress monitoring system can help is as an orientation tool when a new set of [leaders] comes into a municipality, particularly if they don’t have a public sector background.”<sup>29</sup>

North Carolina, which has one of the nation’s most extensive local monitoring systems, has an interactive online database for benchmarking local governments. Developed in coordination with researchers at the University of North Carolina-Chapel Hill, the tool shows the fiscal condition of each municipality and county in the state.<sup>30</sup> Local government administrators can use the database to help elected officials consider fiscal matters when developing policy. (For more on North Carolina’s monitoring system, see the case studies in Appendix A.)

In addition, the knowledge that a review process is in place can encourage local officials to pay closer attention to fiscal matters and make good decisions. “The state monitoring does provide a check and balance ... for local officials,” said Kevin Krushenski, a research analyst with the Tennessee Municipal League. “Just the awareness that someone else is going to be putting their eyes on it helps.”<sup>31</sup>

Fiscal monitoring may also benefit local governments that lack the capacity or ability to detect, assess, or address fiscal issues on their own, especially in smaller municipalities, more rural areas, or places where it may be harder to attract job candidates with strong financial backgrounds. “The biggest problem that we find ... is [that] in the smallest of cities, it’s very difficult to get really good financial expertise ... finance directors who really, really know what they’re doing, are familiar with state law,” said Ken Strobeck, executive director of the League of Arizona Cities and Towns.<sup>32</sup>

Fiscal monitoring can provide local officials with external validation to make politically difficult decisions. In Connecticut, for example, William Plummer, local government program manager at the state Office of Policy and Management, said recommendations by the Municipal Finance Advisory Commission, a group appointed by the governor to help local governments improve their fiscal health, can make it easier for municipal leaders to win support to adopt new taxes or raise existing ones. Referring to an instance in which a municipality levied a one-time tax following a commission recommendation, Plummer said, “I think the taxpayers were more ... put at ease that this isn’t just the town trying to take in more monies for whatever reasons.”<sup>33</sup> (For more on Connecticut’s monitoring system, see the case studies in Appendix A.)

Likewise, in Michigan, the state oversight system can help local administrators or finance directors “take the appropriate steps that they might need to do, that might be difficult otherwise,”<sup>34</sup> said Anthony Minghine, associate executive director and chief operating officer of the Michigan Municipal League.

## Limitations of fiscal monitoring

Despite the potential benefits, monitoring cannot always help prevent local distress, which can be caused by macroeconomic forces beyond the control of a local or state government. It may be obvious, for example, that Atlantic City would benefit from diversifying its economic base beyond casinos or Detroit beyond auto manufacturing, but executing such a plan, particularly in a short time frame, is not easy. Similarly, most fiscal monitoring systems are not designed to address broader issues that can have significant effects on local budgets, such as collective bargaining, state restrictions on local taxes, or unsustainable retirement benefits.

Fiscal crises also sometimes emerge so quickly that states discover emergencies only after the fact. Hillview, Kentucky, for example, became the first municipality after Detroit to file for bankruptcy protection, in August 2015, when it faced a \$15 million legal judgment from a land dispute.<sup>35</sup> Hillview later settled with its largest creditor, and the bankruptcy case was dismissed.<sup>36</sup> Meanwhile, Brokaw, Wisconsin, which has about 250 residents, is struggling because the paper mill that the town was built around closed.<sup>37</sup> Smaller communities like Brokaw that lack diversified economic bases are particularly susceptible to sudden difficulties—like a major employer moving or going out of business, a lawsuit, or scandal. A handful of states try to counteract the possibility of this type of emergency by checking in with local governments more frequently—in some cases quarterly—or by having final say over local budgets. That can help address some potential problems before they become insurmountable.

Monitoring fiscal health also can provide states with a better sense of how prepared local governments are to weather fiscal surprises: Do they have healthy rainy day funds? Are they engaged in long-term budget planning? This kind of knowledge allows states to flag local governments that might be at higher risk for fiscal distress.

## Resistance to fiscal monitoring

In many of the states that do not monitor the fiscal health of local governments, municipal officials said they were happy the state stays out of their business. In Arizona and elsewhere, municipal officials talked about long histories and cultures of allowing local governments fiscal independence. The division of authority between cities and that state has been the subject of multiple lawsuits that have gone to the Arizona Supreme Court. “Cities and towns are as autonomous as possible within their own borders, and that includes the way that they handle finances,” said Strobeck of the League of Arizona Cities and Towns.<sup>38</sup> “The Legislature would love to review our budgets, but we think our cities and towns are performing every bit as well, if not better than the state, and we don’t see any value in having them come in and do that.”

Municipal league officials from several states said there is no need for state monitoring because local officials typically are well-aware when their governments are facing financial trouble—an assessment state officials typically did not dispute. “You know when you’re in fiscal distress,” said Kathie Wasserman, executive director of the Alaska Municipal League.<sup>39</sup> “I mean, detecting it is not the issue. The issue is trying to get out of it.”

Some states—such as California and Alabama—appear determined not to intervene in local government affairs, even when fiscal crisis is evident. If states are reluctant to offer help or intervene, some see little reason to put in place systems to detect fiscal distress. “I can’t even get them to the point where the Legislature feels that they should help these communities at all, so monitoring is way beyond us,” Wasserman said.

### State Checks on Local Government Finances

Fiscal monitoring—actively reviewing local governments’ fiscal conditions—is just one of many tools states reported using to try to ensure that local governments stay fiscally healthy. Although the focus of this report is specifically on fiscal monitoring systems, state officials referred to a broad range of mechanisms intended to keep local governments on a sound fiscal path, including:

- Debt limits.
- Revenue and spending caps.
- Limits on tax rate increases.
- Requirements for balanced budgets.
- Technical assistance or training for local government officials.
- Review or approval of local debt issuances.
- Review or approval of local budgets for compliance with the law.
- Limits on how local governments can invest their money.

While some states reported that these types of requirements, limits, and restrictions were intended, in part, to help prevent fiscal distress from occurring, local officials may find such measures can exacerbate budget challenges. One recent analysis of the relationship between such state laws and municipal fiscal conditions finds “some states incubate local financial distress by driving up spending pressures on their cities while curtailing their capacity to raise critical revenue.”\* Evaluating the impact of any of one of these—or similar—mechanisms requires a close look at the full array of state laws and regulations within which a local government must operate.

\* Joshua Sapotichne et al., *Beyond State Takeovers: Reconsidering the Role of State Government in Local Financial Distress, With Important Lessons for Michigan and Its Embattled Cities*, Michigan State University Extension (Aug. 31, 2015), [http://msue.anr.msu.edu/uploads/resources/pdfs/beyond\\_state\\_takeovers.pdf](http://msue.anr.msu.edu/uploads/resources/pdfs/beyond_state_takeovers.pdf).

Finally, the cost of fiscal monitoring—particularly when done intensively and paired with direct financial aid, technical assistance or possible intervention—can impose barriers to adoption of systems in some states, particularly at a time when many are struggling to close budget shortfalls.

However, even where state policymakers take a strong hands-off approach when it comes to the affairs of their localities, a better understanding of local governments' fiscal positions—based on a regular review of data—can help drive better planning and decision-making. For example, reviewing revenue and population trends can help state officials track regional economies within their states and identify areas that are growing or struggling. These data can guide state decisions about how and where to invest, and can shape state projections for growth. Finally, reviewing local fiscal conditions can allow policymakers to understand diverse needs that may exist within their states: comparing rural communities to urban ones, large cities to smaller towns, or counties with diverse populations.

## Local governments seeking oversight

In some states, municipalities have pushed for legislation to increase oversight over local governments; some have succeeded, while others have not. In Iowa, for example, cities helped to approve the Municipal Oversight Law in 2013, which increased reporting requirements for smaller cities. Municipal officials said they didn't like how fiscal problems in one city had tarnished others' reputations. "The smaller cities themselves were one of the major forces for passing the Municipal Oversight Law because there were people in small cities saying, 'Hey, we don't want to be painted with that brush,'" said Andy Nielsen, deputy auditor of state. "'Let's allow this oversight so that there is some deterrent factor there from an audit or examination.'"<sup>40</sup> (For more on Iowa's monitoring system, see the case studies in Appendix A.)

In South Carolina, municipalities pushed unsuccessfully a few years ago for the state to adopt a municipal financial accountability law, a proposal inspired by North Carolina's monitoring system. The South Carolina legislation would have required local governments to submit certain financial data to the state on a regular basis. If the state detected potential problems, a volunteer committee would help the local government come up with a plan for getting back on track.

"The theory was to assist them before they got into the ditch," said Melissa Carter, research and legislative liaison for the Municipal Association of South Carolina. Carter said the effort ultimately failed even though most association members favored the bill. "Most of the cities were fine with it because they were already doing the [right] things."<sup>41</sup>

## How to strengthen fiscal monitoring systems

In recent years, a number of states have adopted new fiscal monitoring systems or strengthened existing ones. The New York state comptroller implemented a system in 2013 that places localities into four categories (significant fiscal stress, moderate fiscal stress, susceptible to fiscal stress, or no designation). The office releases the results annually as a way of informing the public of the challenges facing their local governments. Currently, New York lawmakers craft individual legislation to help distressed communities or provide assistance through the Financial Restructuring Board for Local Governments because there is no formal intervention system attached to the monitoring program. (For more on New York's monitoring system, see the case studies in Appendix A.)

After the Central Falls bankruptcy, Rhode Island beefed up its oversight system. Under the state's monitoring system, municipalities must file proposed tax rates and budgets to the state before they are advertised and must seek permission if they wish to exceed the state's 4 percent levy cap. All municipalities are required to file reports

in the second, third, and fourth quarters; those that show deficits must file a plan to balance their budget. In addition, the state can invoke state oversight if certain other criteria are met.

Ohio has an extensive system for dealing with fiscally distressed local governments but a more limited system for detecting distress. The state has 16 indicators that local governments can use voluntarily to assess their fiscal health. Ohio is considering a more formal system of indicators to monitor local government fiscal health. (For more on Ohio's monitoring system, see the case studies in Appendix A.)

Tennessee has continued to tweak its extensive system, adding efforts to monitor cash flow as well as a new requirement that governments that want to take out balloon loans receive approval from the state. Colorado's Department of Local Affairs, which helps local governments with grants, technical assistance, and research, is developing a voluntary fiscal health monitoring program that would allow for a more nuanced understanding of conditions within local jurisdictions.

Moments of budget crisis have served as wake-up calls for several states and prompted them to become more proactive in finding local fiscal distress and helping to resolve it. Approaches range from scrutinizing local budgets and borrowing decisions to direct interventions after a situation has reached crisis stage. For example, after Hillview, Kentucky, filed for Chapter 9 protection in August 2015, state Representative Brad Montell (R) of Shelbyville proposed that the state study municipal bankruptcy laws across the country and examine prevention practices that have been implemented to address local bankruptcy. Lawmakers approved the legislation, and the study is now underway.

In Washington, the Wenatchee Public Facilities District missed bond payments in 2011, the first time a local government had done so in the state. The Legislature eventually passed a measure to allow the city of Wenatchee to raise its sales tax without voter approval to rescue the public facilities district from default. The episode spurred the State Auditor's Office, already required by law to examine the financial condition of counties every three years, to start development of an online tool that will allow local governments to calculate five basic financial ratios to assess financial health.

The Wenatchee incident "was a big deal for our state," said Sheri Sawyer, deputy director of local government services for the Auditor's Office. "Even though they're not a huge local government, that doesn't happen in our state very often."<sup>42</sup> The timing of the incident—just as Washington was coming out of the recession—also caused concern that more defaults could lie ahead, Sawyer said. (For more on Washington's monitoring system, see the case studies in Appendix A.)

States with strong fiscal monitoring systems argue that despite their limitations, the systems have helped localities address fiscal issues before they became unmanageable, maintain strong bond ratings through fiscal downturns, and inform the public about critical issues. As Pew discussed in its report "[After Municipal Bankruptcy](#)" (2015), filing for Chapter 9 bankruptcy protection is both painful and costly. In places like Jefferson County and Central Falls, residents will see their utility rates and property tax bills grow for years. Retired public employees in Central Falls and Detroit saw their pensions and cost-of-living benefits cut. And bankruptcy itself is an expensive legal process, with attorneys' fees in Detroit running close to \$170 million. Finally, a bankruptcy can tarnish a city's reputation, hindering economic recovery well into the future.

## A 50-state survey of state policies to monitor local fiscal health: Findings

States take a wide variety of approaches to detecting fiscal distress in local governments. Few have formal monitoring programs, but many perform related functions, including collecting audits, training local government officials on budgeting practices, and suggesting changes to municipal budgets.

Pew examined how states monitor the fiscal health of counties and municipal governments, including cities, towns, and villages. The analysis excluded school districts, which are subject to more state scrutiny nationwide, and special purpose districts, such as municipal utility authorities and fire districts. The goal was to understand not only what financial data states use to monitor fiscal health but also how and when the states interact with local governments. (For a detailed methodology, see Appendix B.)

This analysis includes states with fiscal monitoring systems, whether or not those activities are required by state statute. It also includes states that regularly examine counties but not cities or towns. This research focuses on states that actively try to assess local government fiscal health, meaning states take the initiative to review and evaluate such information, and excludes states that wait for local governments to inform them that they are experiencing fiscal distress before taking action. (For more on states that have mechanisms for responding to local governments in crisis but do not actively monitor fiscal conditions, see the sidebar “States That Intervene but Don’t Monitor,” on Page 16.)

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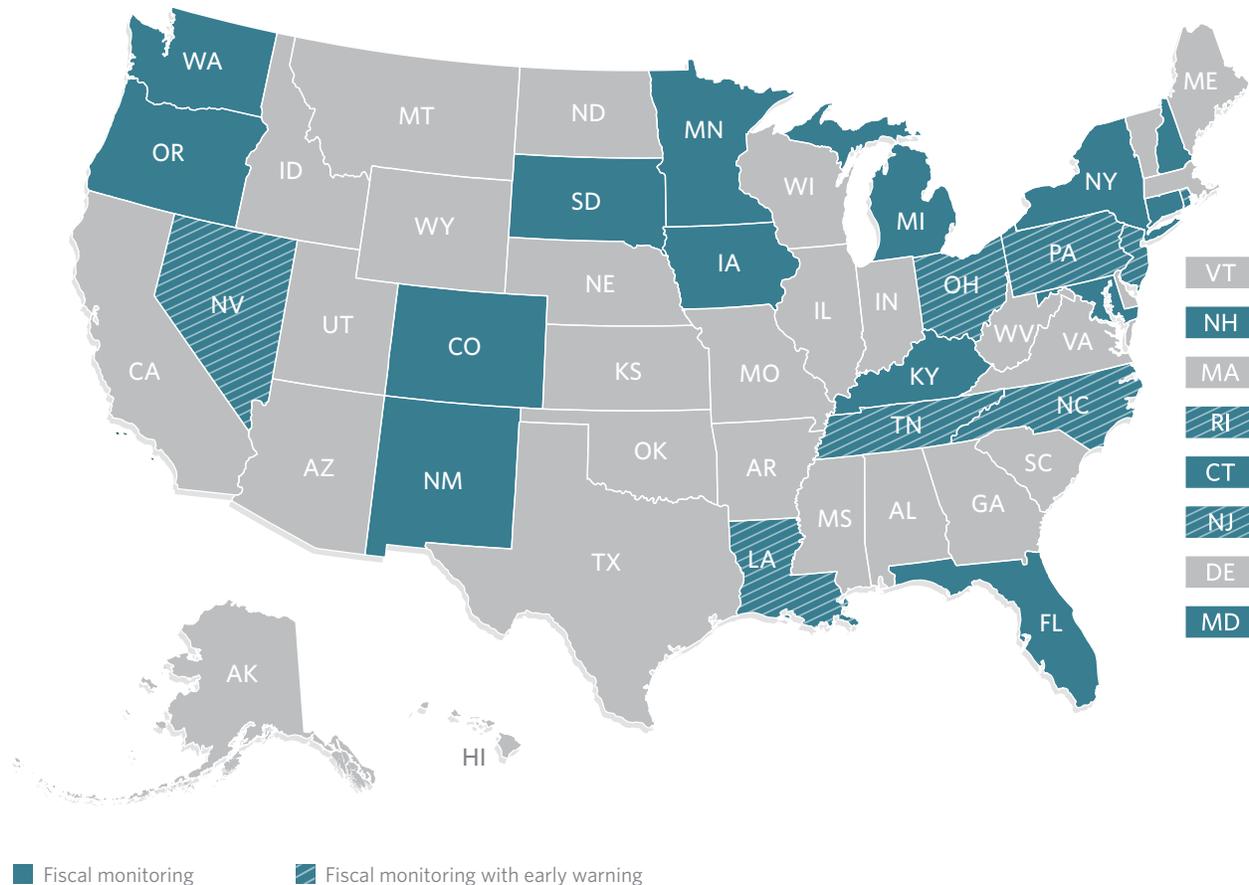
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For the purposes of this study, Pew identified states that actively and regularly review financial information from local governments with the aim of trying to detect fiscal distress or more generally assessing the fiscal condition of local governments (see Figure 1). Twenty-two states (Colorado, Connecticut, Florida, Iowa, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, and Washington) meet those criteria. Within this group, there is a broad range in the scope and intensity of monitoring efforts. For example, Oregon collects information from county financial reports and other sources to produce biennial reviews of counties’ financial conditions, while North Carolina analyzes audits for signs of fiscal distress and approves all local debt issuances. North Carolina has a well-established monitoring system that includes an online database of financial information that allows localities to compare themselves to other local governments. (For detailed information about each state’s fiscal monitoring system, see the case studies in Appendix A.)

Figure 1

## Fiscal Monitoring Across the United States

22 states have programs, including eight with early warning systems



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

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Monitoring the fiscal health of local governments can and must look different in every state, based on their unique political, legal, and cultural contexts. States grant local governments varying levels of autonomy in determining tax rates and how to use the taxes raised. States provide different levels of aid to local governments as well.<sup>43</sup> By necessity, Illinois, which has more than 2,800 general purpose local governments, requires a different fiscal monitoring strategy than, for example, Rhode Island, with only 39 cities and towns. Because there is no one-size-fits-all solution to detecting local government fiscal distress, states and local governments should tailor their approaches to their particular needs, goals, and parameters. For instance, New Jersey, with a long history of involvement with local government budget matters—from certifying municipal financial officers to providing additional state aid to those struggling financially—will take a very different approach than California, which has declined to become involved even when cities, including Stockton, San Bernardino, and Vallejo, have filed for bankruptcy.

In various states, responsibility for fiscal monitoring falls to a range of departments, including revenue, treasury, finance, and economic development; sometimes the responsibility is shared by different departments. In some

states, it is handled by units specifically dedicated to local government services. States also rely on different methods and indicators to detect fiscal distress, frequently using information found in audits, financial reports, and sometimes budgets. (For a summary of the department or office responsible for fiscal monitoring and the types of documents each state reviews, see Table 1.) Many state officials said they often hear about financial troubles in their day-to-day work with municipalities or learn about them through the media—helpful sources but not systematic.

Table 1  
States With Fiscal Monitoring

State	Department*	Documents†	Early warning?‡
<b>Colorado</b>	Department of Local Affairs; Office of the State Auditor	Audits	No
<b>Connecticut</b>	Office of Policy and Management	Audits	No
<b>Florida</b>	Auditor General	Audits	No
<b>Iowa</b>	Department of Management; Auditor of State	Audits, budgets, annual financial reports	No
<b>Kentucky</b>	Department for Local Government	Audits, uniform financial information reports, quarterly financial reports (counties only), budgets (counties only)	No
<b>Louisiana</b>	Office of the Legislative Auditor	Annual financial reports	Yes
<b>Maryland</b>	Office of Legislative Audits, Department of Legislative Services	Audits	No
<b>Michigan</b>	Division of Local Government Services, Department of Treasury	Audits	No
<b>Minnesota</b>	Office of the State Auditor	Audits	No
<b>Nevada</b>	Department of Taxation	Audits, budgets, financial reports	Yes
<b>New Hampshire</b>	Municipal and Property Division, Department of Revenue Administration	Numerous, including budgets, financial reports, estimated revenues	No
<b>New Jersey</b>	Division of Local Government Services, Department of Community Affairs	Budgets, annual financial reports	Yes
<b>New Mexico</b>	Local Government Division, Department of Finance and Administration	Quarterly financial reports, budgets	No
<b>New York</b>	Division of Local Government and School Accountability, Office of the State Comptroller	Annual financial reports	No
<b>North Carolina</b>	State and Local Government Finance Division, Office of the State Treasurer	Annual financial reports	Yes
<b>Ohio</b>	Division of Local Government Services, Auditor of State	Audits	Yes

*Continued on the next page*

State	Department*	Documents†	Early warning‡
Oregon	Audits Division, Secretary of State	Audits	No
Pennsylvania	Department of Community and Economic Development	Annual survey of financial condition, financial reports	Yes
Rhode Island	Division of Municipal Finance, Department of Revenue; Office of the Auditor General	Proposed and adopted budgets, quarterly financial reports, audits, five-year forecasts	Yes
South Dakota	Department of Legislative Audit	Audits	No
Tennessee	Comptroller of the Treasury	Adopted budgets, reports on debt, financial statements, requests to issue debt, cash analyses	Yes
Washington	State Auditor	Budgets, audit reports, financial statements, financial schedules	No

\* State agency or agencies that monitor local governments for fiscal distress.

† The primary documents used for fiscal monitoring.

‡ States are identified as “early warning” if they both have a law defining fiscal distress for local governments (not including schools) and have a system designed to identify signs that a locality is declining toward fiscal distress.

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Some states have laws directing specific state agencies to monitor the fiscal health of local governments. In others, fiscal monitoring occurs as part of a department’s broader duties to help ensure the fiscal health of localities or to assist local governments.

## Formal systems and processes

The most rigorous fiscal monitoring systems were those that had the most formal structures to analyze and monitor local fiscal health, meaning established procedures spelling out who will review which indicators and how to respond. This level of formality in fiscal monitoring systems also results in improved public transparency and predictability, which helps local governments take proactive steps to address problems.

Examples:

- Nevada examines local government audits, budgets, and other financial statements annually for 27 distinct indicators of fiscal distress. The state also approves proposed tax rates, another opportunity to learn of worrisome trends. When a local government meets the criteria for any indicator, Nevada can place it under fiscal watch, which means the state will monitor it more closely. The designation enables the state to offer technical financial assistance in an attempt to head off a severe financial emergency. (For more on Nevada’s monitoring system, see the case studies in Appendix A.)
- New Jersey municipalities must submit their budgets to the state Division of Local Government Services for approval every one to three years, depending on their financial status. Municipalities that apply for special state aid when confronting a budget crisis, known as transitional aid, are assigned a fiscal monitor from the state and required to sign a memorandum of understanding allowing the state to intervene in day-to-day

operations of the municipality. In addition, local governments wishing to issue debt are required to go before the Local Finance Board, which ensures that municipalities are fiscally sound enough to issue debt. (For more on New Jersey's monitoring system, see the case studies in Appendix A.)

- Rhode Island officials can learn about local fiscal distress through multiple channels. For example, municipalities must present proposed tax rates and budgets to the state before they are advertised. They also are required to file reports in the second through fourth quarters of the fiscal year; those that show a deficit must come up with a plan to balance their budgets. The Division of Municipal Finance reviews audits for signs of trouble and the state can impose state oversight if certain criteria are met. Municipalities eligible for additional state aid through a distressed municipalities program receive greater state scrutiny. And for the longer term, municipalities must file five-year forecasts that include projected costs for pensions and other post-employment benefits. (For more on Rhode Island's monitoring system, see the case studies in Appendix A.)

By contrast, when some state officials were asked how they assess local fiscal health, they said that they did not look at specific indicators but relied more on their experience in working with municipalities, or that they did not have requirements for which documents to review and when but that they learned about potential fiscal distress more organically.

### Frequently Used Indicators

Among the indicators that are commonly used by states in assessing the fiscal condition of local governments are:

- Submitting audits or other financial information on time.
- Deficit or minimum fund balance.
- Debt service payments or debt service per capita or relative to operating revenue.
- Sufficient cash for services.
- Total revenue and/or expenditures per capita.
- Unrestricted fund balance level/unassigned fund balance.
- Cash to liabilities ratio.
- Interfund transfers to supplement the general fund.
- General obligation debt/revenue or total debt per capita.
- Whether the local government filed a municipal debt readjustment plan pursuant to Chapter 9 of the bankruptcy code.
- Pension plan funding ratios.

However, states with an established toolbox for responding to findings of potential or actual fiscal distress have more options for helping local governments, particularly in the earlier stages of an emerging problem. Tennessee, for example, has the authority to approve local budgets and can direct local governments to cut expenditures or increase taxes, and New Jersey municipalities that apply for additional funding from the state to address budget gaps must allow the state to intervene in their day-to-day operations.

## Ways to identify fiscal distress

Most states with fiscal monitoring systems assess financial information indicators on an annual basis, looking at data from the previous fiscal year's financial reports, audits, or both. To identify states that try to predict fiscal distress before the crisis stage, Pew asked whether states have a law defining "fiscal distress" for local governments<sup>44</sup> and whether they have a system designed to identify signs that a locality's fiscal condition is declining toward fiscal distress. Formal definitions codified in statute allow local governments to know how they will be assessed and provide consistency despite personnel changes. Only eight states (Louisiana, Nevada, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, and Tennessee) meet both of these "early warning" criteria.

Although Connecticut, New Mexico, and New York also have robust monitoring systems that try to predict fiscal distress, none has a law that clearly defines that condition for general purpose local governments, meaning cities, towns, villages, etc., but not special purpose districts such as fire districts.

In recent years, several states have made changes to try to detect fiscal distress earlier or to act sooner once distress has been identified. In 2015, for example, Nevada enacted legislation that allowed the state to put a local government under "fiscal watch." That allows the state to work informally with the locality to help solve its financial problems to avoid what the law calls "severe financial emergency" status.<sup>45</sup> In late 2014, Pennsylvania amended its long-standing fiscal distress program to codify a voluntary early intervention program for local governments showing signs of fiscal distress, among other changes.<sup>46</sup> Similarly, in 2011, Ohio created a designation for local governments showing signs of fiscal trouble, with the intent of allowing the state to address issues before they become crises.<sup>47</sup> All three are examples of states working with localities specifically to avoid reaching the intervention phase, when states take over decision-making authority from local officials.

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To identify states that try to predict fiscal distress before the crisis stage, Pew asked whether states have a law defining "fiscal distress" for local governments and whether they have a system designed to identify signs that a locality's fiscal condition is declining toward fiscal distress.

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## States That Intervene but Don't Monitor

Five states do not monitor local governments for fiscal distress but do take action when they learn of it through other means: Indiana, Illinois, Maine, Massachusetts, and Texas. That can lead to some confusion about who determines when a local government is actually in financial trouble. (For a summary of states' fiscal monitoring and intervention approaches, see Appendix C.)

In Illinois, for example, Lauren Shiliga, local government director at the state Comptroller's Office, said: "There's not been any mandate or policy that says who can determine which governments are in fiscal distress and how you label that. And then as a result, what are the steps to remedy it? ... There's not really, to my knowledge, any constitutional office or any commission that owns that sort of policy."<sup>\*</sup>

<sup>\*</sup> Lauren Shiliga, (director, Office of Local Government, Illinois Comptroller's Office), interview by The Pew Charitable Trusts, Nov. 10, 2015.

## State and local cooperation is key

Some degree of tension and mistrust between state and local officials can occur when one is monitoring the other, although some states have managed to work cooperatively with local governments.

Lisa Krzywicki, director of the Municipal Databank and Local Aid Section in the Massachusetts Revenue Department, acknowledged that the state's efforts to gather fiscal data on local governments can sometimes result in mutual frustration. Although Massachusetts does not have a fiscal monitoring system, the state's Division of Local Government Services in the Department of Revenue gathers local fiscal data and certifies that localities have equitable and fair taxes, as required by state law. Those efforts can lead to the state working informally with local governments to improve their financial health.

"It's just like when you get issued homework, and you don't do it, and the teacher reprimands you," said Krzywicki.<sup>48</sup> "That's how they feel about us some days."

Underlying tensions can make monitoring more difficult. Wasserman, of the Alaska Municipal League, said many of that state's smaller communities feel that they do not matter to state government and state legislators—or worse, that state officials and lawmakers see them as a drain on state resources. "I think what the state needs to do more than address whether a municipality is in fiscal distress is sit down and have an honest discussion on do they really care if these municipalities go on, because you can't just allow them to piddle along and get further and further and further in debt," Wasserman said.<sup>49</sup>

From the perspective of Alaska officials, however, the state does not have the authority to step into local government affairs. "If something goes wrong at the local level, it's up to the local government and people to step up and fix it," said John Nickels, local government specialist at the Alaska Department of Commerce, Community, and Economic Development's Division of Regional Affairs.<sup>50</sup> "There is no legal authority to step in and intervene. So because of that, the state cannot step in and bail out communities."

Once fiscal distress is identified, local officials often feel that they are in the best position to determine how to address it. “My position is the best government is local government,” said Blake Crosby, executive director of the North Dakota League of Cities.<sup>51</sup> That state collects local government audits but does not review them to try to detect fiscal distress. “Those cities know what they need and why they need it,” Crosby said. “Leave them alone and they’ll be fine. Things start to fall apart when the state gets involved.” The Office of the State Auditor says there has not been a specific instance of concern about the financial health of a local government in North Dakota in at least 25 years.<sup>52</sup>

## How to build collaborative relationships

Some states have successfully managed to build solid working relationships with local governments, creating an atmosphere of collaboration—or at least an appreciation of the benefits of monitoring. In Colorado, for example, which monitors municipal fiscal health but has little regulatory oversight over local governments, state officials said their role is to support local governments and help them to make good decisions on a range of fiscal issues, including tax structures, community and economic development strategies, and land use codes. All of that work rests on a foundation of trust, according to Unfug, the director of the state Division of Local Government.<sup>53</sup>

Colorado has eight regional managers and four regional assistants who live and work throughout the state to assist local communities. “We’re not trying to force them to do anything,” Unfug said. “But we have really solid, honest, helpful assistance. And that goes farther than I think anything could ever go between the state and local relationships.”<sup>54</sup> Mark Radtke, a municipal research analyst with the Colorado Municipal League, also described the atmosphere as “very cooperative.”<sup>55</sup>

In North Carolina, which has had an extensive monitoring system in place for decades, local government officials typically do not complain about the work involved in complying with the state’s rules. In general, said Chris Nida, director of research and policy analysis for the state League of Municipalities, local governments appreciate that the state’s efforts help to maintain North Carolina’s high bond rating and general local fiscal health.<sup>56</sup>

Gary Carlson, director of intergovernmental relations for the Minnesota League of Municipalities, said local officials in his state—which monitors the fiscal health of local governments but does not intervene in crises—largely accept the state’s efforts to ensure that taxpayer dollars are spent appropriately. “Basically, I think there’s an understanding that, with our state-local fiscal structure, with the state collecting a lot of revenue and our local government spending a lot of money, that there needs to be some accountability at the local level for the transfer of those dollars and the use of those dollars,” Carlson said.<sup>57</sup> He added that although there is a natural tension between those who are auditing and those who are being audited, the State Auditor’s Office emphasizes education rather than heavy-handed enforcement. For example, the office sends a weekly newsletter to cities highlighting when various reports are due, which he said has helped improve state-local relations.

Some states have helped to ensure cooperation between state and local officials by including local government officials in the monitoring process. Illinois, for example, has a Local Government Advisory Board, which advises the state comptroller on issues such as what kind of financial information to collect from local governments. The board includes members from the private sector, the state municipal league, nonprofits, and elected public officials from local governments.

“They can tell us the challenges that local governments face with their financial reporting. And they can also ... help us understand what are the barriers to their financial reporting and how to overcome those and the ways we can better serve local governments as well as constituents,” said Shiliga of the Illinois Comptroller’s Office. The

division reviews audit reports and works with local governments when there are negative findings but does not monitor more broadly for fiscal distress.<sup>58</sup>

Connecticut includes input from local governments through its Municipal Finance Advisory Commission, an eight-member group that makes recommendations to cities and towns on how to improve their financial standing, in hopes of avoiding state intervention. By law, four of the members must be fiscal or executive officers from municipalities. Several local governments have asked to meet with the commission to seek advice, one indication of the success of the advisory panel.

"I think towns are more receptive to having a peer from another town as a commission member as opposed to someone who's not involved in municipal government at all making decisions or handing down determinations that they need ... to do something different," said George Rafael, director of government finance and research at the Connecticut Conference of Municipalities.<sup>59</sup>

## Challenges and solutions

The 22 states that monitor local fiscal issues use various approaches to detect fiscal distress in local governments depending on their contexts and needs. Pew identified promising responses to the challenges of local fiscal distress for states to consider when developing new fiscal monitoring systems or strengthening existing ones.

**Challenge:** Inconsistent monitoring when procedures are informal and not codified in statute.

In some states, fiscal monitoring occurs solely because of the initiative of individuals interested in staying ahead of the problems caused by local distress. New York, for example, has a fiscal monitoring system today because in 2013, State Comptroller Thomas DiNapoli implemented a process to help identify governments that might be headed toward fiscal distress. But the state's monitoring efforts have never been codified in statute, meaning the next comptroller could abandon the efforts. In other states, procedures for detecting fiscal distress can rely heavily on the experience of those charged with examining the financial health of local governments.

**Solution:** Formalize monitoring policies and procedures to promote consistency, transparency, and predictability for local government officials and the public.

Codifying fiscal monitoring in statute can help ensure that a state remains committed to both detecting fiscal distress and helping local governments, regardless of administration changes or tight budgets. That said, monitoring systems should remain flexible to adapt to the changing needs of states and local governments. Establishing specific indicators for state review can help ensure that fiscal monitoring happens consistently year after year and across all municipalities. Formalizing the systems and processes involved can help to ensure consistency and improve transparency and predictability for the public and state and local government officials.

**Challenge:** Learning about fiscal distress too late.

States that try to detect fiscal distress by reviewing audits once a year will inevitably learn about problems after they have developed rather than as they are emerging.

**Solution:** States check in with local governments on a frequent and regular basis to try to detect distress earlier. Reviewing budgets along with recent financial statements can also help states stay ahead of the curve.

The earlier that states learn of fiscal distress, the sooner they can help—and the less they may need to become involved in the long run. Several states analyze local government budgets for signs of fiscal distress, giving them a sense of what may be ahead instead of what has already occurred. Some, including New Mexico, Rhode Island, and Tennessee, check in with local governments as often as quarterly (or in specific cases, monthly). Although states typically cannot discover fiscal problems before the localities themselves, they can learn about emerging issues and offer assistance earlier. Detecting problems early also reduces the risk of a budget surprise when state officials determine that they must provide direct aid to a local government or ensure that a debt payment is made on time.

#### Challenge: Tensions between state and local government officials.

State efforts to monitor local governments for fiscal distress can lead to tensions between state and local governments. In some instances, local governments may resist fiscal monitoring because they fear or do not want state oversight.

#### Solution: States can establish good working relationships with local governments.

Although state oversight can naturally lead to tensions, some states work cooperatively with local governments, so that the jurisdictions view the state as a partner, not an enforcer. Among the effective strategies are:

- Hire personnel from local governments to staff state divisions dealing with counties and municipalities to help establish trust in the state operation. In Michigan, for example, hiring former local government staff into the state audit division “helped to improve their credibility,” according to Minghine of the Michigan Municipal League.<sup>60</sup>
- Allow local governments a formal role in the monitoring process. Connecticut includes input from local governments through its Municipal Finance Advisory Commission. Local officials make up half of the advisory group that offers cities recommendations to improve their financial standing.
- Emphasize training for local government personnel to help prevent problems from occurring, instead of enforcement. To that end, Minnesota’s state auditor sends weekly newsletters to municipal governments highlighting when various reports are due, in an effort to help localities stay on track.
- Create frequent opportunities for state and local government officials to interact and have meaningful discussions about fiscal health to keep lines of communication open throughout the year, not just at audit time. Colorado, for instance, has eight regional managers and four regional assistants who live and work throughout the state to assist local communities.

#### Challenge: Seeing intervention as the only response.

States that intervene in local fiscal crises but have few or no intermediate steps to help local governments may lack sufficient options.

#### Solution: Identify smaller steps to help local governments that stop short of intervention.

States can develop a range of options to help local governments at all levels of fiscal distress, from early warning signs to crisis. Providing technical assistance, working with local officials on their budgets, and training are common tools. In 2015, Nevada created a “fiscal watch” designation, which allows the state to work informally with a local government to help solve its financial problems before reaching the “severe financial emergency” status.

In 2014, Pennsylvania amended its long-standing fiscal distress statute to codify a voluntary early intervention program for local governments showing signs of fiscal distress, among other changes. Similarly, in 2011, Ohio created a designation for local governments showing signs of fiscal trouble, with the intent of allowing the state to address issues before they reach the crisis stage. States should encourage strong fiscal practices on an ongoing basis to avoid fiscal distress in the first place. They can provide training and even certify local government officials, as New Jersey does, to help ensure financial fluency.

## **Conclusion**

States take a broad range of approaches to monitoring the fiscal health of local governments. Although the specific systems must vary according to the individual needs, goals, and contexts of each state, a number of promising approaches can be applied broadly.

Although some local fiscal crises are truly unpredictable, states can play a critical role in ensuring that local governments remain fiscally healthy and that state agencies learn about emerging signs of fiscal distress sooner rather than later. As state and local governments prepare for the inevitable next economic downturn, lawmakers may want to consider adopting monitoring systems or strengthening existing ones so that they are less likely to be unpleasantly surprised the next time a local government struggles to pay its bills.

## Appendix A: Case studies

### How 22 states monitor local government fiscal health

#### Colorado builds strong relationships with local governments

When a new mayor and city council are elected or a city manager is hired in Colorado, one of the first places they turn to for advice is the state's Department of Local Affairs. Over the last 50 years, the department has assisted local government officials by providing grants, technical assistance, and research on local issues. Department staff are located around the state, making them accessible to local officials. The staff essentially "live and breathe in these communities. ... They're the eyes and ears of the state ... for local communities," said Chantal Unfug, director of the local government division.<sup>61</sup>

The connection between state and local government officials is especially important in Colorado, which has a strong tradition of home rule and preference for local control of fiscal matters.<sup>62</sup> In 1992, voters approved a constitutional amendment called the Taxpayer Bill of Rights, or TABOR, which strictly limited annual revenue and spending growth for all levels of government and restricts the governments' ability to increase tax rates without approval from voters.<sup>63</sup>

Under the state's monitoring program, the local affairs staff collects budget data from local governments. Because the lag time in obtaining the final financial data can be up to two years, the Local Affairs Department keeps tabs on current city finances through frequent communication with local officials.

In addition, the State Auditor's Office monitors the audits and financial reports of counties, cities, towns, and school districts.<sup>64</sup> The process includes a trend analysis looking at the last three years of financial data to identify potential areas of concern. "It's a good place to start in taking a look at where they are financially at the end of the last fiscal year, and whether they appear to be heading in the right direction," said Crystal Dorsey, the local government audit manager.<sup>65</sup>

Working with the Local Affairs Department, the Auditor's Office developed an online fiscal health analysis tool in 2013 to allow local governments to gauge fiscal conditions on their own using a set of seven possible indicators of distress.<sup>66</sup> The tool produces a set of ratios on significant fiscal conditions such as a local government's operating margin and debt burden.<sup>67</sup> "It's not necessarily a tool to point the finger at anyone and say, 'Naughty, naughty.' But we feel like it's a tool to be used by local governments ... to start the conversation and to understand what the impacts of their decision-making may lead to," Dorsey said.<sup>68</sup>

#### Connecticut commission helps local governments avoid state intervention

Before there was a Detroit or Jefferson County, Alabama, there was Bridgeport, Connecticut. Unable to balance its budget after years of help from the state, Bridgeport in 1991 became the largest city at that time to file for bankruptcy protection.<sup>69</sup> Though a federal judge dismissed the bankruptcy petition, the episode reinforced the state's resolve to oversee and if necessary intervene in local government finances.

The determination to avert another Bridgeport continues today. The state reviews local government finances and has a process in place to intercede in the worst cases: Four cities currently report to a state commission that advises financially struggling local governments.<sup>70</sup>

Connecticut's 169 municipalities are required to submit annual reviews of their budgets and audit statements, which are collected by the state Office of Policy and Management. Agency officials look for warning signs of

fiscal distress such as a budget gap, substantially underfunded public pension liabilities, high debt levels, or any unusual activity that might warrant closer examination. Once agency officials uncover evidence of fiscal distress, the state begins a conversation with local officials to understand the cause and discuss solutions. If the situation is unresolved, the agency secretary can refer the city to the Municipal Finance Advisory Commission, an eight-member advisory group appointed by the governor.<sup>71</sup> Though local governments are not required to take the commission's advice or implement its recommendations, the commission offers cities an intermediate step to avoid more drastic state measures.

The makeup of the commission is crucial, officials said. By law, half of its members must come from local governments—who are often regarded as peers by other local officials—so the commission stands a better chance of gaining acceptance for its recommendations.<sup>72</sup> As a testament to the commission's credibility, some cities have asked for help instead of waiting for the state to mediate. In 2010, the town of East Haven asked to meet with the commission to get recommendations for improving its financial situation, including strategies to collect delinquent property taxes.<sup>73</sup>

As a last resort, if the commission cannot remedy a city's finances, the governor and Legislature would create a financial review or control board to replace the city's elected officials and balance the local government's budget, as Connecticut attempted in Bridgeport (1988) and West Haven (1991).<sup>74</sup>

Review boards are rare, officials say, a credit to the state's monitoring of local government finances. Though the governor can approve a municipal bankruptcy filing, the state monitoring and intervention system is designed to prevent that. "It's good that the state does this to keep tabs on things," Rafael said.<sup>75</sup>

### Florida adjusts monitoring system deemed too sensitive

Independent auditors that examine local governments in Florida annually must notify the state when municipalities meet any of four criteria that could bring a designation of financial emergency.<sup>76</sup> The most common problem that they find is failure to make loan payments or service bond debt when due.<sup>77</sup>

Previously, the state automatically designated a local government that met any of the criteria as being in financial emergency. At one point, there were five criteria, though one was eliminated in 2012. The Florida League of Cities argued that the process resulted in too many municipalities being improperly labeled as financially delinquent and advocated successfully for the state to review each situation individually. "Before this last change, [the law] simply said that if any of these [criteria] are triggered, you go into a state of financial emergency," said Ken Small, the league's financial technical assistance manager.<sup>78</sup> After a financial emergency is confirmed, the governor's office determines if state intervention is warranted.<sup>79</sup>

In addition, the state Auditor General's Office has compiled a list of 18 financial indicators that local government auditors may use to look for signs of distress. The auditors use indicators such as a municipality's change in net position or its long-term debt to population ratio to alert state and local officials of potentially worrisome trends.<sup>80</sup>

But Small said the auditor warnings to local government officials often have limited impact because they lack enforcement authority. "The auditor is putting it in the audit, 'You're in a declining state of financial emergency,'" Small said. "But there's no teeth at that point. The teeth don't come in, in my opinion, until you actually cross the line and, you know, crash."

The monitoring processes tend to look backward, using data that can be nine months old by the time of review. Small said state officials developed the monitoring process in part because Florida has "a history of not wanting Wall Street to have problems with any unit of local government."<sup>81</sup>

At the end of fiscal 2014, 67 local governments met at least one of the financial emergency criteria.<sup>82</sup> All but one occurred in what are known as special districts, generally set up for a specific purpose such as a water or sewer authority. The number of special district financial emergencies increased with the mid-2000s growth of community development districts.<sup>83</sup> Those were the “special districts whose limited single special purpose is to act as an alternative mechanism to manage the provision of infrastructure systems, facilities and services to the real property within a community development.”<sup>84</sup>

The state first created community development districts more than 30 years ago as a way to manage infrastructure systems in new projects. Developers used the districts to obtain tax-exempt bond financing, but the Great Recession made it difficult for many to pay back loans tied to these districts. “When the big bust happened, that was where most of our problems came in. ... It doesn’t take much, and those things are going to go underwater,”<sup>85</sup> Small said of the special districts.

### Iowa reviews budgets and audits

The Iowa Department of Management examines all local government budgets, while the Office of Auditor of State reviews selected audits and financial examination reports. The two offices work together closely, sharing information and coordinating on steps such as implementing new laws.

The analysis of budgets includes three years of financial figures: previous, current, and the next fiscal year. State responsibilities are restricted to verifying that local governments are following state code, taxing within their authority, and meeting legal guidelines. Analysts also check year-to-year changes to a city’s fund balance, looking for a negative fund balance or declining revenue streams.

City size determines the frequency of audits; the law requires every city to undergo an audit or financial exam (essentially an abbreviated audit) at least every eight years. “When we see a trend where they continue to dig deeper instead of getting out of the hole ... we make sure that the citizens know about it,” said Andy Nielsen with the Auditor of State’s office.<sup>86</sup>

Iowa does not intervene in local government affairs, so issues discovered are dealt with informally, either through direct conversations or an organization such as the Iowa League of Cities.

### Kentucky approves county budgets and reviews financial updates quarterly

Roger Recktenwald of the Kentucky Association of Counties said his state responds aggressively when it learns one of its counties is heading toward fiscal distress. “The state usually is not humble about standing back and letting it happen,” he said. “They’ll be in their face. They’ll be saying, ‘What are you doing about this, where is it going, why are these expenditures so excessive, and what are you going to do about it?’”<sup>87</sup>

The state Department for Local Government, which approves annual budgets and reviews quarterly financial updates for Kentucky’s county governments,<sup>88</sup> leads the monitoring so officials can keep tabs on each county’s expenditures and revenue collections. This process gives the state near-constant oversight of county finances, alerting officials well before a problem becomes serious and allowing county officials time to address it. “The counties see it as somewhat of a necessary evil,” Recktenwald said.<sup>89</sup>

Counties can request assistance, or state officials may approach them if they notice something unusual in the financial information. With the latter, the state contacts the local treasurer or county executive to go over options for balancing the budget, including the need to raise taxes or cut services.

The state's local finance officer has the legal authority to supervise many of county government operations. After a tornado struck Morgan County in 2012, the county ran up borrowing costs and budget deficits that led to state financial supervision. State officials then investigated and made recommendations to plug the budget gap.<sup>90</sup>

Kentucky does not monitor city and town finances. To fill that void, the Kentucky League of Cities created a database so cities and towns can compare themselves on common measures such as per capita spending or public safety expenditures.<sup>91</sup> The league offers technical advice to distressed local governments, most recently to Hillview, a city of about 8,000 people south of Louisville. The city filed for bankruptcy protection in 2015—something that had not happened in the state for over 70 years—because of an unexpectedly large legal settlement that it could not afford to pay.<sup>92</sup>

### Louisiana helps formulate corrective action strategies and trend analyses to avoid appointing fiscal administrators

Historically, the Office of the Louisiana Legislative Auditor (LLA) has collected annual financial reports from local governments and reviewed them for compliance and internal control problems. It also works in coordination with the Fiscal Review Committee, consisting of the legislative auditor, the attorney general, and the state treasurer, to determine whether a local government is “financially stable.” Financial stability is defined in statute as “a condition in which the political subdivision is capable of meeting its financial obligations in a timely manner as they become due without substantial disposition of assets outside the ordinary course of business, substantial layoffs of personnel, or interruption of statutorily or other legally required services of the political subdivision, restructuring of debt, revision of operations, or similar actions.”<sup>93</sup>

If a local government is found to be not fiscally stable, the committee determines if a court should appoint a financial administrator to oversee the finances of that locality.<sup>94</sup> If the committee decides that the government meets the criteria for the appointment of a fiscal administrator, it will authorize the attorney general to petition the court to appoint one. Once appointed by a court, the administrator has control over all fiscal operations of the local government.<sup>95</sup>

In 2013, after the municipalities of Jonesboro, Richwood, and Gibsland were placed under the control of fiscal administrators due to financial distress,<sup>96</sup> Legislative Auditor Daryl Purpera directed his staff to find a better way to determine earlier which entities might be headed toward distress.<sup>97</sup> In response, Advisory Services within the LLA developed an early warning system to try to flag local governments when they first show signs of potential distress. Under the early warning system, the LLA examines 10 financial ratios as well as other information collected, which “gives us an idea of how close they are to ... being put under fiscal administration,” Steven Kraemer, Advisory Services senior adviser.<sup>98</sup>

If legislative audit staff members have concerns about fiscal distress in certain entities, they can provide technical assistance and continue to monitor the local governments. The division can also provide distressed governments with voluntary corrective action strategies to try to resolve issues without a fiscal administrator.<sup>99</sup> The division also helps local governments estimate how much additional revenue they would need to eliminate deficits and explore potential cost-cutting measures. In addition, the division provides distressed communities with trend analyses covering the revenue, expenditures, and fund balances of the general fund over the previous five-year period. “So to the degree possible, we’re trying to prevent the entity from going into fiscal administration, and this is ... our attempt to ... help them help themselves out of the problem,” said Kraemer.<sup>100</sup>

Though the early warning system is in its early stages, they are beginning to see its benefits in measuring the fiscal health of local governments. “We look at ... what this model says about that entity, and we can incorporate that information to help us,” said Eric Sloan, Advisory Services manager.<sup>101</sup>

The Louisiana State Bond Commission is also involved in the fiscal health of local governments. Governments that want to issue debt must apply to the commission, which by law must approve all debt issuance by local governments.<sup>102</sup> No local government has declared bankruptcy in Louisiana, but if one were to pursue that course, it would need to seek commission approval.<sup>103</sup>

### Maryland monitors but lacks enforcement authority

The Office of Legislative Audits (OLA) in the Maryland Department of Legislative Services monitors the fiscal health of local governments but has no mechanism for intervention if problems arise. Each year, the office publishes the *Review of Local Government Audit Reports*, which looks at compliance issues and flags local governments that could face problems.<sup>104</sup> The office looks at deficit fund balances and unfavorable trends and ratios based on an analysis of the previous five years of independently audited financial statements. “We perform only a rudimentary financial analysis of the local governments,” says Bob Garman, assistant director of quality assurance in the Office of Legislative Audits.<sup>105</sup> OLA staff conduct the analyses to help local governments understand their fiscal position, but they are not required by statute.

The legislative auditor can, at its own discretion, audit any local government in addition to the independent audit requirement, and those results will be reported to the Legislature. Municipalities are required by law to submit audits, but they can go as long as two years without submitting one before the comptroller is asked to stop sending state aid. When OLA sends findings to the locality, the office can also send notice to the state delegate or senator.

### Michigan’s monitoring evolves from scorecards to eliminating budget deficits

Michigan’s monitoring efforts have evolved. In 2002, the state pioneered a system of rating local governments based on budget indicators developed by Michigan State University. The intent of the Local Government Fiscal Indicator System, according to a Senate Fiscal Agency report, was to provide “warning and preventative actions to avoid a fiscal crisis leading to a potential State takeover.”<sup>106</sup> But the state dropped the system after four years of published data. Among the complaints of local elected officials were that the system flagged too many cities as being in distress when they were not.

Today, instead of rating local governments based on fiscal indicators, state officials focus on working with local governments to resolve potential problems. “They’re not sending in a team of auditors every month,” said Minghine, of the Michigan Municipal League. “It’s a relatively nonintrusive monitoring, but enough to let them know that they’re paying attention.”<sup>107</sup>

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The state emphasizes helping localities erase budget deficits. The state Department of Treasury's local government financial services division collects the independent audits that local governments are required to conduct each year and reviews those that pinpoint problems. A local government with a budget gap must submit a plan to state officials for eliminating the deficit. State officials then check to make sure the city is carrying out the plan.<sup>108</sup> State oversight is more rigorous than it was under the fiscal indicator monitoring system. "The deficit elimination plans used to be a much more perfunctory bureaucratic activity," said Minghine. "If you had a deficit, you sent in your plan, you said, here's my plan. And the monitoring was minimal." The state is developing a program to help cities before they fall into fiscal crisis; until recently, state efforts had focused on intervention in only the most troubled cities. Officials are now attempting to put more resources behind the fiscal responsibility section that is meant to help localities before they fall into fiscal crisis.

Under the intervention program, emergency managers have been appointed to run cities such as Detroit, which is recovering from bankruptcy, and Flint, where the public health emergency over the water supply continues. While there is controversy surrounding Michigan's intervention statute, Minghine said the state's monitoring system helps local governments get back on track. "I think on the monitoring stuff, if there's tension ... it creates a sense of urgency," he added.<sup>109</sup>

### Minnesota provides comparison data and trains local officials

The Office of the State Auditor (OSA) leads Minnesota's fiscal monitoring efforts. Local governments must submit annual financial statements and audits to it. The OSA's City Audit Project staff review the number and nature of findings from those audits for one or two years. Cities that have a large number of findings or a combination of certain types of findings that could be problematic going into an economic downturn receive a follow-up letter. The letters request information on how they plan to address the findings and may include educational materials, based on the nature of the problem. "What we're doing is value-added," said State Auditor Rebecca Otto. "I'm trying to figure out where we can add value and provide resources."<sup>110</sup>

The Auditor's Office works to be proactive, providing data for comparisons as well as training for local officials. The OSA reviews, analyzes, and then publishes the data from the annual financial statements online so that local governments and the public can learn about the fiscal condition of their communities. "Although there's a natural tension between those that are being audited and those that are auditing, it just seems to me that the ... current [mode of operation] is one of more education than necessarily kind of heavy-handed enforcement," said Gary Carlson, director of intergovernmental relations for the Minnesota League of Municipalities.<sup>111</sup>

If a locality goes into fiscal distress, the state has no formal process to take over its finances. However, the state has backup payment procedures if a municipality thinks that it will be unable to meet a debt obligation.<sup>112</sup> Localities are given a great deal of leeway to deal with their issues either through elections (getting rid of local officials) or other changes they enact as a result of something like a fall in their credit rating.

### Nevada offers fiscally stressed governments technical advice through 'fiscal watch'

Of the western states, Nevada has the most extensive monitoring and technical assistance program for its local governments. The state expanded its monitoring and intervention system in 2015 in part as a response to the lingering impact of the Great Recession, which stopped Nevada's rapid growth and slowed tourism in a state that depends on gamblers' dollars. State and local tax revenue plunged, especially in the city of North Las Vegas, which teetered on the verge of insolvency. (Nevada does not permit local governments to file for Chapter 9 bankruptcy protection.)

Nevada had never been confronted with a fiscal crisis in a city the size of North Las Vegas (pop. 235,000), and state leaders were not eager to take it over.<sup>113</sup> Practically, the state Taxation Department did not have a staff large enough or with the expertise to manage the city. Politically, the governor and others did not want the stigma of a takeover of its fourth largest city at a time when the state was trying to attract businesses and reinvent its economy.<sup>114</sup>

To address the crisis and avoid similar distress in other cities, counties, and school districts, lawmakers added a level of state monitoring called “fiscal watch.”<sup>115</sup>

Before this legislation, the Department of Taxation routinely monitored local government finances using a set of 27 indicators such as revenue and expenditures, cash and fund balances, and debt.<sup>116</sup> That monitoring continues but under the new law, if state officials identify a serious problem, the locality is put on fiscal watch. Under this process, the Committee on Local Government Finance, a group of 11 specialists<sup>117</sup> from around the state, provides technical advice on budgets, contracts, spending, and debt management to head off a state takeover.<sup>118</sup> “It’s always better for a local government to find their own path to financial health than for us to impose it on them,” said Terry Rubald of the Department of Taxation.<sup>119</sup>

If these steps do not work, Nevada officials may declare a financial emergency, allowing the state to step in and appoint a temporary manager to take over day-to-day operations.<sup>120</sup> The manager has the power to raise taxes, cut spending, and renegotiate labor contracts—a last resort.<sup>121</sup> “Taking over entities is pretty serious,” Rubald said, adding that fiscal watch offers “all kinds of opportunities to correct [problems] before the state actually takes over.”<sup>122</sup>

### New Hampshire learns about local government condition through property tax rate system

In New Hampshire, the state government sets the property tax rate for each town, city, and unincorporated place. To do that, the Department of Revenue’s Municipal and Property Division (MPD) collects financial information, such as appropriations, revenue, expenditures, and available funds, from every local government, as required by state law.<sup>123</sup> In deciding where to set each tax rate, the division reviews the information to assess the fiscal condition of local governments and to ensure that they collect enough property taxes to fund government activities. MPD has the authority to revise the submitted estimates if they feel that the figures from the local governments are likely to differ from what will actually occur.<sup>124</sup>

“We have a robust process to make sure that we understand the actual fiscal condition in advance of setting their local tax rate,” said Stephan Hamilton, the MPD director.<sup>125</sup> Hamilton feels that the process allows New Hampshire to address local government distress before it becomes a problem. “All of the information they provide to us flows into the establishment of the local tax rate, which is based on the current year’s appropriations and revenues, so that there really isn’t an opportunity for fiscal calamity.”<sup>126</sup>

The MPD also strives to be a resource for local governments. In statute, the division is tasked with offering technical assistance to local governments, but the guidance is not binding.<sup>127</sup> “It’s not an adversarial audit,” said Cate DeVasto, retired manager of MPD’s Municipal Services Division. “It’s just like if we notice something, we say ... ‘This is our view,’ and by law ... our technical advice is advisory. ... It’s up to the town to take it.”<sup>128</sup>

For example, when the Municipal Services Division discovered issues in Carroll County in 2015 in the course of its analysis, the division went to county leaders and offered to help. “They said this is what we see that is indicating the problem, and we would like you to authorize us to come work with you instead of against your will. The county agreed on [a] cooperative basis,” said Judy Silva, executive director of the New Hampshire Municipal

Association.<sup>129</sup> Carroll County had overestimated the revenue that was expected when adopting its budget.<sup>130</sup> The division continues to work with the county by reaching out on a regular basis to ensure that it had the expertise needed to stay on track.

Under Chapter 13 of New Hampshire state law, local governments can apply to the governor for financial assistance if they feel they do not have the resources to meet their obligations. This statute has been used only once since 1935, when the town of Unity was authorized to issue emergency notes in the amount of \$10,000.

### New Jersey keeps a close watch on local government decisions

New Jersey has a long history of oversight and strong authority over localities with a system in place since the Great Depression. The Division of Local Government Services under the Department of Community Affairs is responsible for “provid[ing] technical and financial assistance in budgeting, financial reporting, joint services, purchasing, and management issues.”<sup>131</sup> A staff of about 40 oversees some 1,000 cities, counties, authorities, and special districts. The division has three groups that review budgets, work with local governments requesting additional state aid, and certify local finance officials.<sup>132</sup>

The division analyzes financial data submitted by local governments, including information about budgets and debt. The state specifies a uniform system of accounting, including the forms, books, and other materials needed.<sup>133</sup> For instance, New Jersey requires local governments to be more conservative in reporting reserves than the Generally Accepted Accounting Principles that are typically used by local governments.<sup>134</sup> The state mandates that municipalities post three years of budgets to their websites, including data on costs, staffing, and revenue.<sup>135</sup> If a municipality has not set aside enough money to cover its obligations, New Jersey can reject its budget. The state also can force municipalities to cut revenue estimates if they seem too optimistic.<sup>136</sup>

High-performing municipalities that do not show evidence of structural imbalances are allowed to do self-audits or self-evaluations two out of every three years, instead of submitting their budgets for approval annually.<sup>137</sup> While it is rare for states to be so involved in local government finances, Michael Darcy, executive director of the New Jersey League of Municipalities, said that as a result, budgets are seen as trustworthy. “It helps municipalities reassure their lenders that budgets are structurally sound, not based on political whim,” Darcy said.<sup>138</sup>

The division also has significant power to intervene and oversee finances through the Local Finance Board, which is staffed by the local government division. The board reviews and approves financing applications from local entities that want to issue debt or borrow through a bond program to ensure that debt thresholds are not exceeded and that cash flow can support debt service payments.<sup>139</sup>

Localities unable to meet their financial obligations can apply for additional state funding, known as transitional aid.<sup>140</sup> Those seeking this aid must sign a memorandum of understanding that allows the state to intervene in their day-to-day operations. New Jersey also assigns a fiscal monitor to each municipality that receives help. The system allows the state to take over decision-making directly or monitor the actions of municipal officials while the local entity is receiving transitional aid.<sup>141</sup>

## New Mexico keeps in close contact with municipalities

In New Mexico, the Division of Local Government in the state Department of Finance and Administration oversees and monitors local fiscal health and provides advice to local entities. The division reviews financial information on a quarterly basis and approves local budgets. It analyzes financial reports on cash positions, investments, expenditure levels as compared to the budget, and reserve levels. The department provides revenue projections and analyzes revenue trends for local governments as well. Quarterly monitoring allows the state to be in continuous communication with local officials and to pick up signs of distress before they escalate.<sup>142</sup>

“There’s that constant interaction between a municipality and the person that is responsible for that municipality within the Local Government Division,” said Ed Zendel, risk services director at the New Mexico Municipal League.<sup>143</sup> If state officials find any signs of trouble, they will send an auditor to work on-site with the local entity or request a corrective action plan.<sup>144</sup> The state also sends letters to local leaders voicing concerns, providing recommendations, and/or requiring additional financial information. The state has the authority to suspend any official of any local public body where a special audit reveals fraud or violation of law or regulation. If suspension occurs, the state may take charge of the office of the person(s) suspended. This has happened once, in 2012, with Sunland Park, in a case marked by mismanagement of funds and allegations of corruption.<sup>145</sup>

In addition, the State Auditor’s Office routinely provides a broad look at local government fiscal health across New Mexico. For example, the office in late 2015 published *The Findings Report: A Summary of New Mexico’s Governmental Financial Audits*, which provided an overview of the opinions and findings from audits across the state.<sup>146</sup> The analysis offers context for local entities as well as agencies, school districts, and higher education institutions.

## New York looks for looming problems through fiscal stress monitoring system

In New York, the state comptroller has the constitutional and statutory authority to examine and report on the financial affairs of local governments.<sup>147</sup> In 2012, the office of State Comptroller Thomas DiNapoli noted a number of trends and deficiencies within local government that caused concern. It found that 300 local governments had run up deficits in recent years and that many were unable to pay their bills.<sup>148</sup> The following year, DiNapoli instituted a fiscal stress monitoring system with the goal of identifying those governments among the state’s 2,300 counties, cities, towns, villages, and school districts facing major budget pressures.<sup>149</sup>

Utilizing an existing reporting system, DiNapoli’s office began reviewing the financial data for common signs that local governments were facing looming problems, including rising costs, dwindling cash, increasing reliance on one-time revenues, declining fund balances, and whether they issued large amounts of short-term debt for cash flow purposes. Looking at nine indicators in five categories,<sup>150</sup> the comptroller classifies local governments into levels of stress: significant, moderate, susceptible to stress, or no designation, meaning the condition did not meet the threshold to be put in a stress category.<sup>151</sup> The results are reported to the public.

The state comptroller cannot compel a local government to make changes to its operations. Instead, officials say the monitoring system provides information that can help the local government or school district solve problems before they escalate.

State officials say they try to ease the tension inherent whenever they step into local affairs. When state analysts find that a local government is in a stress category, they double-check the data and talk to local officials to review findings and answer questions before information is publicly released.

“We want transparency,” said Craig Kinns, assistant director for operations. “We’re not trying to ‘catch’ places. 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.”<sup>152</sup>

So far many local officials say the stress categories are reasonable. “I think the Comptroller’s Office has been reasonable about where they have set the fiscal stress bar, which has helped focus attention on the municipalities that need the most assistance,” said Baynes, the New York Conference of Mayors director.<sup>153</sup>

Although the comptroller does not intervene in local governments, there are other mechanisms for intervention in New York. The state Legislature can pass legislation to create an emergency financial control board and lay out the specific powers of the board in that legislation. New York City and Yonkers have fallen under this legislation.<sup>154</sup> New York also has the Financial Restructuring Board for Local Governments, which provides aid if a local government agrees to implement recommendations based on the board’s review.<sup>155</sup> The fiscal stress monitoring system has no formal role in either of these intervention efforts.

### North Carolina system aims to prevent local fiscal distress

When state and local officials talk about best practices in financial oversight, they often point to North Carolina. The state’s monitoring and intervention authority is so strong that officials determine whether a local government can afford to issue debt—and then the state sells the bonds on behalf of the city or county. By taking the initiative on monitoring, state officials aim to keep local governments from sliding into budget difficulties. “Our primary goal is to prevent a unit from ever allowing itself to get in distress,” said Greg Gaskins, deputy treasurer for state and local government finance.<sup>156</sup>



Our primary goal is to prevent a unit from ever allowing itself to get in distress.”

*Greg Gaskins, deputy treasurer for state and local government finance*

The State and Local Government Finance Division annually collects, analyzes, and distributes financial data; provides technical advice; and issues debt. If a local government falls into fiscal distress, the state can step up monitoring and oversight to ensure that the city, county, or town keeps its budget balanced. State officials start by requiring every local government to have a Generally Accepted Accounting Principles audit conducted by a licensed, independent certified public accountant. Staff in the local government finance division review the audit and analyze fiscal indicators, ratios, and trends. They look at fund balance available for appropriation as a percentage of annual expenditures, tax collection rates, and cash flow, among other indicators.<sup>157</sup>

If the examination reveals anything that warrants more attention, the state assigns a staff accountant who then seeks monthly or quarterly updates, depending on the issue. From there, the accountant can request to see draft budgets if a locality is showing signs of distress. State officials often deal with small local governments that lack the financial knowledge and experience that larger cities may have in managing budgets. “It tends to be for smaller units that don’t have a sophisticated staff,” said Melinda Canady, an official in the local government finance division, which is part of the Department of State Treasurer.<sup>158</sup> If staff believes that the unit could benefit from a more hands-on approach, the unit will be assigned to a newly formed team. The team consists of two experienced staff members whose primary responsibility is to spend time in the localities with their finance staff, teaching them how to comply with the general statutes and best practices.<sup>159</sup>

The state monitoring extends to debt issuance. A nine-member commission, which includes the state treasurer, secretary of state, state auditor, secretary of revenue, and appointees with financial and business experience, approves debt proposals and issues debt for local governments.<sup>160</sup> Before the commission considers a request, staff holds a conference with local officials in part to smooth the way for commission approval. “If we don’t think something is going to be approved, it usually doesn’t get put on the agenda,” said Tim Romocki, director of the Debt Management Section of the State and Local Government Finance Division.<sup>161</sup> The staff works with localities to help resolve problems that could prevent the commission from approving the debt proposal.

North Carolina has an online benchmarking tool that allows local officials to compare their entity’s finances to their peers’. Users can examine five-year trends in government funds and ratios in categories such as liquidity and financial performance.<sup>162</sup>

No monitoring system can completely prevent mismanagement, criminal conduct, or chronic economic distress. The local government commission has twice taken over the town of Princeville after periods of significant financial trouble; Scotland County, meanwhile, has faced years of state oversight because of financial woes caused by a declining tax base, high unemployment, and underperforming enterprise funds. But even during the last recession, when the state had one of the highest jobless rates in the country, North Carolina’s local governments survived in relatively good shape, in part a credit to state monitoring and intervention.

### Ohio has escalating levels of assistance for distressed municipalities

Ohio can place local governments facing budget problems into three escalating categories of distress: fiscal caution, fiscal watch, and fiscal emergency. The state adopted its first municipal fiscal emergency law in 1979 in response to Cleveland’s budget crisis. Since then, lawmakers have expanded the system to include counties and townships, and to add the fiscal caution and fiscal watch designations to try to help local governments in the earlier stages of distress. The state auditor can declare a locality in the fiscal caution category if it meets any of five criteria including:

- A local government’s financial records are found not to be auditable and the entity fails to resolve the problem within the time frame required.
- Significant deficiencies or material weaknesses, noncompliance with laws and regulations, or management letter comments are identified that indicate deeper problems.
- When the deficit fund balance in the general fund at the end of the fiscal year is greater than 2 percent of the fund’s revenue for the year.

If a government is placed in fiscal caution, local officials are notified and given 60 days to propose a plan to resolve the issues identified. The state auditor can visit, inspect, and provide technical assistance to the entity as it carries out the plan.

Similarly, the state has various criteria for the fiscal watch and fiscal emergency designations, which allow increasing degrees of state involvement in local decision-making. Local governments that fall under the fiscal emergency designation are overseen by a financial planning and supervision commission, which approves financial recovery plans, can make suggestions, and has the authority to make sure that a local government operates within the budget approved in the financial recovery plan.

The state has specific criteria for each of the designations. Unice Smith, chief of local government services in the Auditor of State’s Office, said that if an entity is found during an audit to have deficits, her office will look further into the locality’s financial condition to determine if the entity should be placed in fiscal caution.<sup>163</sup> However, the state

often learns about local governments in fiscal distress through word of mouth, either from the local governments themselves or through the media. In addition, many smaller local governments use a state accounting system that automatically alerts the Auditor's Office if a government is in deficit and temporarily freezes the accounting system. That prompts the Auditor's Office to investigate whether a fiscal caution designation is warranted.

The Auditor's Office has compiled 16 indicators to help local governments assess their own fiscal health, though their use is strictly voluntary. The state is considering whether to impose a more formal indicator system to monitor the fiscal health of local governments.

Ed Albright, director of legislative services for the Ohio Municipal League, said the state's monitoring and intervention procedures mean that everyone becomes aware of problems and starts addressing them sooner.

"Some people love it, some people hate it," Albright said of the state's watch over local governments. "Maybe not love it, but they appreciate it. They can always get help from the Auditor's Office."<sup>164</sup>

"For the most part it works well," he concluded. "The state and the local leaders have their fingers on the pulse of Ohio's communities."

### Oregon examines county financial conditions

Historically, Oregon has not closely monitored local government fiscal health. Recently, however, the state has begun examining the fiscal conditions of counties at the prompting of Gary Blackmer, the now-retired state auditor who also served as auditor for Multnomah County, Oregon's most populous county, and the city of Portland. The Audits Division of the Secretary of State's Office conducted reviews in 2012 and 2014 to evaluate the financial condition of counties.

The reviews were intended to inform public debate on finances but also can help identify counties that may be headed toward fiscal distress at a time when some local economies are under strain. The federal government has reduced harvesting of trees, which has been a primary source of revenue for many communities. At the same time, voters have rejected tax increases in these places, which has led counties to reduce some services.

"It's continuing to get worse," said Laura Cleland, communications and operations director for the Association of Oregon Counties.<sup>165</sup> "A lot of counties just haven't felt the pain yet because the counties are doing so much more with so much less. That's going to come to an end soon."

Since 2011, Oregon has enacted a handful of laws to help counties affected by revenue decreases resulting from reduction in timber harvesting, as well as one that allows a county to request that the state become more involved if public safety is threatened as a result of fiscal issues.

### Pennsylvania tries to help municipalities before it's too late

Pennsylvania has a well-established program that allows the state to intervene to help the most financially distressed local governments. In the nearly three decades since the law was enacted that created the Act 47 program—named for the bill number of the 1987 Municipalities Financial Recovery Act—30 cities have entered and 12 have exited. Under the law, a state-appointed coordinator creates a recovery plan for a distressed city, although the jurisdiction cannot be forced to execute the plan. Distressed cities under Act 47 are also granted permission to temporarily raise taxes above normal state limits.

State officials try to identify and work with municipalities that are in danger of entering fiscal distress before they end up in Act 47. All of the approximately 2,600 cities, boroughs, and townships must file financial reports

and surveys of financial condition<sup>166</sup> with the state Department of Community and Economic Development each year. The surveys include 11 questions that can serve as indicators of potential distress. For example, they explore deficits, indebtedness, payroll, and number of municipal employees.

After examining the compiled information, department staff can recommend that municipalities participate in the state's voluntary early intervention program. They can address emerging problems through state services that include training for local government officials as well as direct technical assistance with accounting or budgeting issues.

Fred Reddig, the state's special assistant for Act 47 and local government affairs, said the early intervention program "is a step to hopefully intervene and assist a municipality that is experiencing some level of fiscal difficulty and provide them with recommendations that would avert a worsening of their fiscal condition."<sup>167</sup>

The state added new early intervention steps to the core program in 2014. Since then, it has worked with about 80 counties, cities, boroughs, and townships to address issues before they become crises. Of those, only five (New Castle, Reading, Harrisburg, Altoona, and Shamokin) have moved into Act 47. About a dozen were in the early intervention program as of mid-2016.<sup>168</sup>

Once accepted into the program, municipalities receive state grants, which require a partial local match, to hire consultants to analyze fiscal trends and come up with plans to resolve financial issues. Municipalities can apply for additional funding to implement recommendations, such as upgrades to financial management systems or studies of particular areas of operations.

Reddig said that the early intervention program can help ensure that municipalities have sound financial management systems in place, that they are delivering services efficiently, and that they can generate timely and accurate financial reports. But the early intervention program, like the broader Act 47, still has a limited ability to address the macroeconomic issues that can mire municipalities in distress.

Amy Sturges, director of governmental affairs for the Pennsylvania Municipal League, which advocates for local governments, said many of those issues can be addressed only by the Legislature in Harrisburg. "There's not enough flexibility in local taxation, and our pension and collective bargaining laws governing public safety workers are outdated," Sturges said. "They're all things that are leading to fiscal distress and until we get them changed at the state level, it's just going to continue."<sup>169</sup>

Still, Sturges said municipalities generally prefer to tackle problems early and avoid the stigma that can come with Act 47 status and designation as a distressed community. "I think they view early intervention as helpful and certainly something to do rather than just go straight to Act 47, which most local officials fear," she said.<sup>170</sup>

In 2014, then-Governor Tom Corbett (R) signed an overhaul of Act 47 that placed the early intervention program in statute for the first time.<sup>171</sup> The measure also set a five-year deadline for municipalities to exit Act 47 and outlined a procedure to merge or consolidate municipalities deemed no longer viable.

Reddig said the range of state services has helped prevent many instances of local fiscal distress. "I think the numbers bear that out," he said, noting the small number of localities that have gone into Act 47. "You know, we've only had in its history, a 28-year history, 30 municipalities out of 2,600 that have fallen into distress, or basically about 1 percent."<sup>172</sup>

## Rhode Island takes multiple approaches to looking for fiscal distress

Every year, each municipality presents its proposed budget to the Division of Municipal Finance in the state Department of Revenue. State officials note that they lack the authority to compel changes to local budgets but that these reviews can serve as the first step in a conversation if they see warning signs of fiscal distress. Local governments also submit financial data each quarter but the first, which permits monitoring throughout the year. If a municipality shows a deficit in any quarter of the fiscal year but the first, it must also submit a plan to resolve the imbalance.<sup>173</sup>

The state also requires that local governments submit five-year projections to provide a longer view of their fiscal conditions. The forecasts provide the state a better sense of long-range trends for a municipality, said Susanne Greschner, chief of the state Division of Municipal Finance.<sup>174</sup>

In August 2011, the state-appointed receiver for the city of Central Falls filed for bankruptcy protection. The event “was certainly a wake-up call for everyone,” Greschner said. “Before, no one really envisioned a municipality going bankrupt.”<sup>175</sup>

One result of this wake-up call was the state’s effort to create additional mechanisms to define, monitor, and respond to municipal distress.

In Rhode Island, the state can trigger a series of interventions in response to varying levels of distress under the Fiscal Stability Act, which was passed in 2010. Under the law, state officials can choose from three levels of oversight, depending on the situation. The act was structured to provide multiple tiers of state support for fiscally unstable entities.

Alternatively, local governments can request state involvement. For example, in 2013 West Warwick projected a deficit if it were to fully fund its pension obligation going forward. Local officials asked the state to consult with the town as it negotiated with unions and retirees. Ultimately the town was able to “stave off any issues before they actually occurred,” said Stephen Coleman, deputy chief of the Division of Municipal Finance.<sup>176</sup>

Peder Schaefer, associate director of the Rhode Island League of Cities and Towns, said the system is not perfect, but “it’s worked pretty well.”<sup>177</sup> Consistent and regular reporting are key aspects of its success. Regular communication between the state and financially vulnerable communities is especially important. Policymakers need to know that if the next recession hits and the state “solves the problem by cutting state aid, distressed communities get hurt,” Schaefer said.<sup>178</sup>

The state changed the municipal reporting process in 2016, with some of the changes aimed at streamlining the process for local governments. The changes included reducing the frequency of reporting and allowing for online reporting. Schaefer said the league is “cautiously optimistic that these changes will improve the monitoring effort.”

## South Dakota examines audits for distress

The state audits counties and larger municipalities annually or biennially. Auditors and state officials review the audits, looking for signs of distress and examining overall net positions and debt loads, for example. The state offers well-attended training to local officials on budgets and annual reports.

Rod Fortin, director of local government assistance in the Department of Legislative Audit, said the state is in constant contact with local officials and the state Municipal League.<sup>179</sup>



We're easily accessible here in South Dakota. They know who to call, and it doesn't take much to get that help."

Rod Fortin, *director of local government assistance in the Department of Legislative Audit*

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"We're easily accessible here in South Dakota," Fortin said. "They know who to call, and it doesn't take much to get that help."

Local governments are required to approve and adopt balanced budgets. In addition, the state sets strict limits on debt issuances. "We don't get into a situation where local governments are issuing debt for which they are not able to pay that back," said Fortin.<sup>180</sup>

### Tennessee exercises broad control over local governments

When municipalities in Tennessee run into fiscal problems, the state comptroller of the treasury can direct local officials to come up with corrective action plans, issue funding bonds, appropriate money to pay their debts, reduce expenditures, or even raise taxes. In some cases, Tennessee requires that local officials obtain state approval before writing a check. These steps are part of a broad system, still evolving, aimed at preventing local governments from falling into fiscal distress.

State officials say the system helped to ensure that local governments survived the 2007-09 recession relatively unscathed.

"What we're trying to do is educate them ... on how to better manage their finances because they've got a duty" to manage them well, said Ron Queen, senior financial analyst with the Tennessee Comptroller of the Treasury's Office of State and Local Finance.<sup>181</sup> "A lot of what we're doing is really proactive and upfront, rather than after things have gone wrong."

The State and Local Finance Office reviews budgets and financial statements for counties, municipalities, and utility districts to determine whether they have sufficient resources to meet their obligations. Staff look at cash balances, cash flows, spending that exceeds revenue, and debt service, as well as compliance issues—such as transactions between government funds—that may hint at underlying financial stress.

Since 1986, municipalities, counties, and metropolitan governments (combinations of a county and a city or multiple cities) with outstanding debt have been required to submit budgets to the state for approval. The state can direct local governments to make changes that demonstrate, for example, that they are maintaining balanced budgets while paying off debt.

If a local government projects it will end the budget year with a month of cash or less, the state warns municipal officials that they do not have enough money to cover an emergency, according to Sandi Thompson, director of the Comptroller's Office of State and Local Finance.<sup>182</sup> The state then requires the local entity to begin a monitoring process that flags when any account has a negative balance to ensure that spending does not exceed available cash in any month, a violation of state law.

Under a law adopted in 2014, the state requires that local governments get the comptroller's approval before issuing balloon loans.<sup>183</sup> These loans can signal that a locality faces financial trouble because it seeks to make small payments for most of the length of the loan and a large payment at the end. The state keeps a close watch over debt in cash-short local governments.

Within the past five years, the State and Local Finance Office also began asking local governments for monthly cash flow statements, including projections for future months, information not always found in financial statements. Queen explained that the cash flow requirement came about because local governments were taking revenue from one utility to subsidize another utility's operations or to plug gaps in the general fund.<sup>184</sup>

The Division of Local Government Audit, also within the Comptroller's Office, audits local governments annually. The state either conducts the audits or contracts with CPA firms. When auditors come across indicators of financial distress, such as negative fund balances, they refer the information to the State and Local Finance Office. The division is developing ratios using audited financial data to help identify counties that may be in financial distress, said Jim Arnette, director of the Division of Local Government Audit.<sup>185</sup>

To encourage good fiscal practices, the state Department of Economic and Community Development provides various incentives to counties for economic development through a program called ThreeStar. To be eligible, counties must meet certain fiscal strength and efficient government criteria, such as submitting budgets on time and maintaining audit committees to follow up on any findings by state reviewers. All 95 counties now have audit committees. In fiscal 2016, the state awarded \$730,000 in ThreeStar grants.

Local governments generally agree that the state monitoring system serves an important purpose, but some feel the state can be overly concerned about details not critical to local fiscal health.

"I think the biggest strength is definitely awareness and kind of that mental check and balance that's put into place, you know, the idea that someone else is watching what you are doing," said Kevin Krushenski, a research analyst with the Tennessee Municipal League, which advocates for cities.<sup>186</sup> "The weakness has become a perception of a gradual transition toward micromanagement."

Krushenski praised the state's certified municipal finance officer program, which requires most of these officers to be certified through the Office of the Comptroller of the Treasury. Training and testing for the certification are provided by the Municipal Technical Advisory Service. The service offers assistance and consulting services to local governments on accounting, financial, legal, and budgetary issues through the University of Tennessee's Institute for Public Service. Established in 2007, the certified finance officer program requires municipal staff, including city recorders, treasurers, and finance directors, to take certification exams and receive annual continuing education.

"That has gone a long way towards creating more faith and more strength in our local financial reporting system and local monitoring," Krushenski said.<sup>187</sup>

### Washington monitors without intervening authority

Washington has no formal definition of local government fiscal distress and no formal intervention policies, but the state has an extensive fiscal monitoring program. State law requires local governments to submit financial documents annually to the State Auditor's Office, which assesses the financial condition of every local government at least once every three years, although state law leaves it to the State Auditor's Office to determine how to do that.

As part of the assessment, the Auditor's Office looks at about a half-dozen indicators. More recently, the office has developed tools and resources using those indicators to allow local government officials to do the assessments themselves more frequently and to take action when needed. The state works to give local officials the tools and resources they need to recognize when fiscal conditions are declining and to respond.

## Appendix B: Methodology

This report identifies which states have systems in place to detect fiscal distress in local governments or, more generally, to assess the fiscal condition of local governments. The study further identifies states that have laws in place defining local fiscal distress and attempt to determine when localities are showing early warning signs of fiscal trouble. Pew researchers examined state efforts to monitor general purpose local governments including counties, cities, towns, and villages; the study does not capture state policies or programs limited to school districts or special purpose districts or authorities.

Pew began by collecting publicly available documents, reviewing state government websites, and analyzing state statutes and administrative code. This process included searching Lexis for statutes relevant to fiscal distress, fiscal monitoring, or state intervention. Researchers conducted Google searches for publicly available documents, focusing on state agencies that work most closely with local government finances. Because states vary in how they describe their fiscal monitoring systems and procedures, searches were conducted using a broad list of terms to help ensure all relevant information was collected. For each state, researchers used these sources to collect information on the following:

- The financial documents the state regularly collects or requires local governments to submit and how frequently this data is reviewed.
- The office, department, agency, and/or individual(s) tasked with receiving, reviewing, and/or assembling this data.
- How the information is processed or analyzed by state officials.
- The process for disseminating the results of the analysis.
- How the state responds to indicators that a local government is at risk of a budget crisis or already meets criteria for distress.
- Whether and to what extent these policies and practices are required by state statute.

Once the initial searches were complete, researchers conducted telephone interviews with state officials to gather additional information about state practices that may not be codified in publicly available documents. For states without monitoring systems, researchers spoke with the state departments that work most closely with local governments on fiscal issues. For states with monitoring systems, researchers contacted the office, agency, or department tasked with collecting and reviewing the relevant data. Researchers contacted state officials in all 50 states to gather information on the approach of each to municipal fiscal distress. Researchers also conducted telephone interviews with representatives of state municipal leagues to gather local perspectives on the fiscal monitoring system (or lack thereof).<sup>188</sup>

Pew researchers also reviewed the literature on fiscal monitoring. These studies provided context for how previous state-specific and cross-state research has defined and classified fiscal monitoring systems. The most relevant work includes:

- A 1993 survey by Scott R. Mackey for the National Conference of State Legislatures, which found that 36 of 41 states that responded had some kind of financial reporting requirements for local governments, with the state auditor, state comptroller, state treasurer, or legislative agency typically being charged with reviewing the documents. Of those 36 states, 15 condition at least some state aid on financial reporting.<sup>189</sup> Mackey's numbers differ from the Pew study in part because Pew looked for states that analyze the information collected from local governments to either detect fiscal distress or more generally assess fiscal condition, rather than simply collect the information.

- Beth Walter Honadle (2003, 2005), who found that 10 states had formal definitions of fiscal crises for local governments (including school districts) and that states tended to get involved after a crisis rather than before. The 2003 study found that just under half of all states said they made an effort to predict local government fiscal crises, through methods including audits, monitoring systems, and local government reporting. In the 2005 study, Honadle discussed when states get involved in local fiscal crises, finding that they were more involved in mitigating than trying to avert them, and that a lack of resources was a factor in states' limited involvement.<sup>190</sup>
- Philip Kloha, Carol Weissert, and Robert Kleine, who found in 2005 that 15 of 48 states that responded to a survey used indicators to evaluate their local governments' fiscal positions. Of those, only seven used early warning declarations, while the others found fiscal distress only after the fact. The study focused on the indicators used by the states to predict fiscal distress.<sup>191</sup>
- Charles Coe's 2008 study of nine states—the seven found by Kloha et al. to predict local government fiscal distress plus New Mexico and Kentucky. Coe found that the nine states use indicators extracted from annual operating budgets, annual financial reports, and interim financial reports.<sup>192</sup>
- Public Financial Management (PFM), which discussed four general approaches (monitoring, assistance, oversight, and control) to municipal financial recovery programs in the United States when examining Pennsylvania programs in a 2011 study. PFM found 12 states that used one or more of the four approaches.<sup>193</sup>
- Moody's (2013), which analyzed state oversight programs in all 50 states. Researchers concluded that strong state oversight of local governments generally is beneficial for local credit ratings, but it does not completely prevent default or bankruptcy. They found that 22 states have some type of oversight, including activities we classified as monitoring and intervention, over local governments.<sup>194</sup>

In addition to studies by academics and practitioners on state monitoring systems, researchers and practitioners have offered various models and indicators that can be used by states or local governments to evaluate local fiscal health. They include:

- The International City/County Management Association's *Evaluating Financial Condition: A Handbook for Local Government*, first published in 1980, which was revised and republished in 2003. It includes 42 financial and environmental indicators that can be used to "examine local government financial condition," "identify existing and emerging financial problems," and "develop remedies for these problems."<sup>195</sup>
- Ken W. Brown, at the time an associate professor of accounting at Southwest Missouri State University, who proposed a 10-point test of financial condition for smaller cities in 1993.<sup>196</sup>
- Kloha, Weissert, and Kleine presented a model in 2005 to predict local fiscal distress in Michigan using a 10-point scale.<sup>197</sup>

## Classification

Pew researchers defined a fiscal monitoring system as a state process to actively and regularly review financial information from local governments with the aim of detecting fiscal distress or more generally assessing their fiscal condition.

Pew found that many states performed functions related to fiscal monitoring, including helping to educate local government officials and staff on best financial practices; collecting audits or financial reports and reviewing them with varying degrees of attention to fiscal distress; providing technical assistance to local officials; and weighing in on local government decisions related to fiscal health, such as decisions to borrow or adopt budgets. Researchers classified states that reported some type of effort to monitor local governments for fiscal distress as states with fiscal monitoring systems, as long as the efforts were regular and active. Researchers classified states that were reactive, waiting for the local governments to request help or hearing about distress only through word of mouth or the media, as states without fiscal monitoring systems.

Within the group of states with these systems, Pew researchers further classified states by whether they attempt to detect fiscal distress before it reaches a crisis stage. Pew determined that states have early warning systems if they have a law defining fiscal distress for local governments and have a system to identify signs that a locality's condition is declining toward it. The statutes that Pew used to determine if the state has a definition of fiscal distress were gathered through Lexis searches, Pew's 2013 report *The State Role in Local Government Financial Distress*, and interviews with state officials and municipal league representatives. To meet the criteria for a legal designation of fiscal distress, state definitions must be related to fiscal health concerns, not only financial mismanagement or fraud. Researchers used any statute that related to either fiscal monitoring or state intervention to determine whether the state has a definition of fiscal distress. A list of definitions of fiscal distress in the United States is available from the researchers.

This report does not attempt to establish empirical comparisons of states regarding the effectiveness of fiscal monitoring systems in either detecting the early warning signs of distress or preventing a default or bankruptcy. The purpose of this research is to cast a wide net in analyzing the range of state policies to detect municipal distress and avert crises. Importantly, some of the states included in the fiscal monitoring group acknowledged that their systems and procedures could be more robust.

## Appendix C: Fiscal monitoring and intervention summary

State	Law defining fiscal distress <sup>a</sup>	Bankruptcy authorization <sup>b</sup>	Intervention <sup>c</sup>	Fiscal monitoring <sup>d</sup>
Alabama	No	Yes	No	No
Alaska	No	No	No	No
Arizona	No	Yes	No	No
Arkansas	No	Yes	No	No
California	No	Conditional	No	No
Colorado	No	Limited	No	Yes
Connecticut	No	Conditional	Yes	Yes
Delaware	No	No	No	No
Florida	Yes	Conditional	Yes	Yes
Georgia	No	No	No	No
Hawaii	No	No	No	No
Idaho	No	Yes	No	No
Illinois	Yes	Limited	Yes	No
Indiana	Yes	No	Yes	No
Iowa	No	No	No	Yes
Kansas	No	No	No	No
Kentucky	No	Conditional	No	Yes
Louisiana	Yes	Conditional	Yes	Yes
Maine	Yes	No	Yes	No
Maryland	No	No	No	Yes

Continued on the next page

State	Law defining fiscal distress <sup>†</sup>	Bankruptcy authorization <sup>‡</sup>	Intervention <sup>‡</sup>	Fiscal monitoring <sup>§</sup>
Massachusetts	No	No	Yes	No
Michigan	Yes	Conditional	Yes	Yes
Minnesota	No	Yes	No	Yes
Mississippi	No	No	No	No
Missouri	No	Yes	No	No
Montana	No	Yes	No	No
Nebraska	No	Yes	No	No
Nevada	Yes	No	Yes	Yes
New Hampshire	Yes	No	Yes	Yes
New Jersey	Yes	Conditional	Yes	Yes
New Mexico	No	No	Yes	Yes
New York	No	Conditional	Yes	Yes
North Carolina	Yes	Conditional	Yes	Yes
North Dakota	No	No	No	No
Ohio	Yes	Conditional	Yes	Yes
Oklahoma	No	Yes	No	No
Oregon	Yes	Limited	Yes	Yes
Pennsylvania	Yes	Conditional	Yes	Yes
Rhode Island	Yes	Conditional	Yes	Yes
South Carolina	No	Yes	No	No
South Dakota	No	No	No	Yes

Continued on the next page

State	Law defining fiscal distress*	Bankruptcy authorization†	Intervention‡	Fiscal monitoring§
Tennessee	Yes	No	Yes	Yes
Texas	No	Yes	Yes	No
Utah	No	No	No	No
Vermont	No	No	No	No
Virginia	No	No	No	No
Washington	No	Yes	No	Yes
West Virginia	No	No	No	No
Wisconsin	No	No	No	No
Wyoming	No	No	No	No

\* Pew analysis of state statutes.

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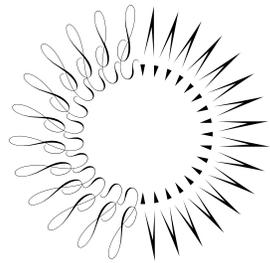
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