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Testimony to the Government, Military and Veterans Affairs Committee
Legislative Bill 1111
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Chairman Murante and Members of the Committee:

Thank you for the opportunity to provide testimony on the Fiscal Stress Management Act which creates a system to assess the fiscal condition of Nebraska local governments. My name is Matthew Cook, and I am a researcher working on state and local fiscal policy issues at The Pew Charitable Trusts. For the last five years, Pew has conducted extensive research on state strategies to monitor the fiscal condition of local governments and respond to fiscal distress. States have adopted such strategies both in order to better understand the fiscal health of localities and to detect early signs of budget strain. Pew has also published research on how states intervene in distressed local governments and the impacts of municipal bankruptcies.

Today's hearing is an important step in supporting the fiscal health of Nebraska local governments.

State governments have a vital interest in the fiscal health of their localities for many reasons. These include 1) ensuring the continuity of essential services to residents, particularly in areas such as public safety and health; 2) protecting the vitality of local economies, which generate revenue for governments at all levels; and 3) preventing one locality's financial crisis from negatively impacting other communities or the state itself.

Even states, like Nebraska, that have historically exercised minimal control over local affairs may find themselves compelled to provide assistance in a crisis. States may step in to prevent a bankruptcy filing, for example, or to prevent other communities—or the state itself—from impacts such as lower credit ratings or having to provide resources when struggling communities fail to pay what they owe in shared service agreements.

According to Pew's research, 23 states make some effort to monitor the fiscal health of local governments, meaning that they actively and regularly review financial information from localities in order to detect signs of distress or generally assess their fiscal condition. The Fiscal Stress Management Act creates a fiscal monitoring system that fits many of the promising approaches Pew noted in other states and would make Nebraska the 24th state in the country to assess the fiscal condition of local governments.

Fiscal monitoring benefits

States cite several benefits to monitoring local governments' fiscal health, including:

The ability to address problems before they become unmanageable.

Assessing and tracking local government fiscal condition may allow states to detect early signs of distress and help local governments address problems before they escalate. Early detection can allow states and local governments to respond in ways that are less intrusive—and less expensive—than those that could be needed in a fiscal crisis.

For instance, in Ohio, the state auditor’s office reviews the financial health of all 247 cities and 88 counties on 17 measures of fiscal condition. In August 2017, Licking County Auditor Mike Smith said he would consider rejecting additional borrowing by the county in the next two years because the state’s financial health review categorized the county’s debt service expenditures to total revenue ratio as “critical.” By raising awareness of the county’s finances—and specifically the county’s debt service expenditures—the state system prompted deeper scrutiny of a decision that could have a significant impact on the future fiscal health of the county.

Support from credit rating agencies.

Credit rating agencies generally support state oversight of local governments’ fiscal health, arguing that states often can help localities without hurting their own balance sheets. Moody’s Investors Services said in 2014 that all else being equal, it tends to assign higher ratings to distressed local governments in states with strong oversight.

Improved transparency and accountability.

Fiscal monitoring systems can also improve transparency and accountability to the public. The Fiscal Stress Management Act requires the Auditor of Public Accounts to analyze financial data the office already collects and make this information publicly available. This, in turn, will empower citizens to have more informed dialogues about the fiscal issues facing their communities.

Building capacity in local governments.

A fiscal monitoring system like the one described in Legislative Bill 1111 can provide local governments that lack the capacity or ability to detect, assess, or address fiscal issues on their own with a more robust understanding of their own finances.

Promising approaches for monitoring local government fiscal condition

There is no one-size-fits-all approach to state programs to evaluate local finances. An effective fiscal monitoring system will take into account an individual state’s unique economic, legal, and political context. The Fiscal Stress Management Act incorporates many of the promising approaches that Pew identified from other states.

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 the state remains committed to this analysis over time, through changes in administration and in times of tight budgets, and when detecting fiscal distress may be especially critical.

The Fiscal Stress Management Act also puts in place clear indicators, including outstanding bonded indebtedness and the maximum levy rate, and levels for when a local government is considered in fiscal stress. Describing these indicators in statute helps to ensure consistency and improve transparency and predictability for the public and local government officials.

Tailor state policies to identify the early warning signs of distress.

This bill creates a system that regularly evaluates fiscal condition instead of relying on local governments coming forward on their own. The earlier fiscal distress is discovered, the sooner conversations can occur in city or county council meetings or at the statehouse to ensure that citizens will continue to receive essential services.

In section eight, the Fiscal Stress Management Act requires that the auditor develop guidelines for fiscal practices and budgetary conditions that could result in a future declaration of fiscal stress. These guidelines will help the state and local governments in understanding the drivers of distress, and should allow for changes when problems are easier to solve.

Establish good working relationships with local governments.

States have taken a variety of approaches to collaboration, including allowing local governments a formal role in the monitoring process and creating frequent opportunities for state and local government officials to interact and have meaningful discussions about fiscal health. By delaying the implementation of the initiation of the fiscal watch list until fiscal year 2020-21 and incorporating a review process in section 5, local governments will be given the opportunity to provide feedback on the monitoring system.

Pew believes this fiscal monitoring system represents a significant step to improving the state's ability to support local governments. The policies described in this legislation will give Nebraska and local governments the opportunity to identify and respond to local fiscal distress before larger issues can arise.