



3 Steps States Can Take to Strengthen Localities' Fiscal Health

Early action can prevent more costly interventions

Overview

As the coronavirus pandemic persists, rising costs and revenue shortfalls will challenge local officials' ability to balance budgets while meeting residents' needs. States can play a vital role in stabilizing the fiscal health of cities and counties by helping their officials identify growing problems and sound solutions. Small localities in particular may lack the capacity and resources to withstand and respond to the extraordinary budgetary challenges ahead. Timely assistance from state government at this critical time can mean the difference between fiscal stability and fiscal emergency. Three steps that states can take are:

1. Regularly monitor local fiscal conditions to detect signs of distress.
2. Provide technical assistance and training to local governments to address fiscal concerns.
3. Intervene when a locality falls into fiscal crisis.

Regularly monitor local fiscal conditions

To identify and address fiscal problems before they escalate into crises, states can implement a regular process to assess and track local fiscal conditions. A sound approach to local monitoring can help states detect fiscal

distress early on so that both the state and locality can avoid more costly interventions. While the exact design will need to be adapted for each state, a high-quality system:

- **Establishes a clear definition of “fiscal distress” to guide early detection.** This provides transparency for the state’s analysis and sets a guidepost for local governments.
- **Assigns responsibility to a state agency or department.** To make this determination, policymakers should consider which offices are best positioned to collect the data, conduct the analysis, and work closely with local governments.
- **Identifies data sources that will provide the necessary information.** A variety of sources are often needed. Audits and financial statements provide final numbers but with a time lag, while budgets offer more current financial outlooks that are subject to change.
- **Determines clear indicators for detecting fiscal distress.** Based on the monitoring system’s objective and the available data, states select indicators that can help officials consistently assess local financial conditions, including deficits or minimum fund balances, cash-to-liabilities ratios, and sufficient cash for services. Economic data such as unemployment rates or demographic information—for example, the age of the population—may also be helpful.

Having procedures like these in place increases rigor and consistency. For example, Nevada examines local government audits, budgets, and other financial statements annually for 27 indicators of fiscal distress.¹ 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 and potentially offer technical assistance to head off a financial emergency.²

A strong monitoring system also improves transparency and helps local governments and residents take proactive steps to address problems. For example, New York implemented a system in 2013 that places localities into four categories: significant fiscal stress, moderate fiscal stress, susceptible to fiscal stress, or no designation.³ The state releases the results annually to inform the public of the challenges facing their local governments.

A monitoring system’s success depends on state and local cooperation. Establishing good relationships with local governments can enhance communication, collaboration, and outcomes. Some states have modified their approaches to account for local feedback. In 2018, Virginia refined its 1-year-old system, in part to respond to local governments’ concerns that the state was evaluating their financial health relative to other localities rather than on an individual basis.⁴

Provide technical assistance and training

States can also give local officials technical assistance and other resources to help them resolve fiscal problems before those problems become unmanageable. States can make resources available to local governments showing signs of fiscal distress or to all local governments regardless of fiscal conditions. Even during periods of economic growth, states can help strengthen local fiscal foundations for the long term.

Many states provide support in the form of technical assistance. Common types of this assistance include:⁵

- Preparing budgets.
- Identifying and implementing best practices.
- Assisting with master plans.
- Helping to write grants.
- Upgrading financial systems.

Each state should be flexible and creative in meeting the needs of its local governments while building trust with local officials. For example:

- **Massachusetts** uses local fiscal data to create an internal data dashboard that alerts staff to communities in potential distress.⁶ The state's Division of Local Services works closely with local officials and residents to determine what resources the community needs and devise an action plan.
- **North Carolina** provides multiple levels of assistance based on the amount of fiscal stress that a local government faces.⁷ The state's Unit Assistance List offers a toolkit to help with some of the most common fiscal challenges. For municipalities experiencing more serious fiscal problems, the state provides accountants, who assess several years' worth of audits and budgets and work with the locality to develop options.
- **Pennsylvania** used its Strategic Management Planning Program in 2019 to offer assistance to 100 communities that the state's monitoring system identified as the most fiscally distressed (out of 2,560 municipalities).⁸ The assistance includes guidance on developing short- and long-term financial, managerial, and economic development strategies.⁹

Although the dynamic between each state and its localities is unique, states should consider regularly communicating with and providing critical resources and expertise to their local governments to bolster sound fiscal management.

Intervene in times of fiscal crisis

When a local government falls into fiscal crisis, states may choose to help it recover. State intervention may require exerting some authority over the city or county's finances to mitigate the damage to its economy and both the state's and locality's financial standing. For example, a fiscal crisis may harm a city's credit rating and hurt its ability to borrow money for infrastructure and other public amenities that attract residents and businesses. States can take actions to address those challenges. They can also minimize interruptions to local services that are critical to public safety and health.

The entities commonly responsible for carrying out the intervention are a financial manager hired from the outside, a state agency, and a state-appointed commission.¹⁰ Typically, the designated authority has a hands-on role in supervising the locality's financial management and planning. Although intervention practices vary widely, some common types include approving bond sales or renegotiating the terms of existing bonds; increasing existing taxes and fees or levying new ones; and renegotiating labor contracts.

State policymakers should assess the costs and benefits of different types of interventions before acting. Regardless of the approach, states should consider three key steps:

- Involve all stakeholders in discussions.
- Be transparent with financial information.
- Return control to local officials quickly.

Taking these steps builds trust, minimizes tension, and promotes better cooperation between all parties as a local government recovers from a crisis.

A locality's road to recovery is often painful and costly once its finances decline enough to warrant state intervention. States can best avoid this outcome by taking a proactive rather than reactive approach to local fiscal distress.

Conclusion

There are a range of measures that states can take to support the fiscal health of their local governments. Policymakers should keep in mind that timing can be critical. While state intervention in response to a fiscal emergency can be successful, it can also be costly and sometimes not welcomed by local officials and residents. By monitoring local fiscal conditions and acting early, states can help local governments address problems at the outset and try to avert more severe fiscal challenges.

Endnotes

- 1 Nevada Rev. Stat. § 354.685, <https://www.leg.state.nv.us/nrs/NRS-354.html#NRS354Sec685>.
- 2 A.B. 54, Nevada Legislature (2015), <https://www.leg.state.nv.us/Session/78th2015/reports/history.cfm?ID=140>.
- 3 D. Lucas, "NY Comptroller Identifies Municipalities Facing Fiscal Distress," WAMC, June 18, 2013, <https://www.wamc.org/post/ny-comptroller-identifies-municipalities-facing-fiscal-distress>; Office of the New York State Comptroller, "Fiscal Stress Monitoring System Manual" (2017), <https://www.osc.state.ny.us/sites/default/files/local-government/documents/pdf/2019-12/system-manual.pdf>.
- 4 M.S. Mavredes, "Local Government Fiscal Distress Monitoring" (Auditor of Public Accounts, Commonwealth of Virginia, 2019, 4-5), <http://www.apa.virginia.gov/reports/LocalFiscalDistressMonitoring2018.pdf>.
- 5 Pew research on states' technical assistance to localities examined steps that states take to support local governments showing signs of fiscal distress. This research included questionnaire responses from 18 states that identified common types of technical assistance that those states offer their localities.
- 6 S. Cronin and Z. Blake (Massachusetts Department of Revenue, Division of Local Services), interview with The Pew Charitable Trusts, April 1, 2020.
- 7 S. Edmundson and D. Erwin (North Carolina State and Local Government Finance Division, Local Government Commission), interview with The Pew Charitable Trusts, Oct 8, 2018.
- 8 A. Sheaf (Pennsylvania Department of Community and Economic Development), interview with The Pew Charitable Trusts, May 20, 2020.
- 9 Pennsylvania Department of Community and Economic Development, "Strategic Management Planning Program (STMP)," accessed June 1, 2020, <https://dced.pa.gov/programs/strategic-management-planning-program-stmp/>.
- 10 The Pew Charitable Trusts, "The State Role in Local Government Financial Distress" (2013), <https://www.pewtrusts.org/en/research-and-analysis/reports/2013/07/23/the-state-role-in-local-government-financial-distress>.

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