



## PUBLIC SECTOR SERVICES

# State Stewardship of Local Governments' Fiscal Health

## The Risks of Local Government Fiscal Emergencies

Local governments face a shifting fiscal environment due to economic uncertainty, increased costs, higher interest rates and a federal COVID funding cliff. These factors all heighten the risk of local governments falling into severe fiscal distress.

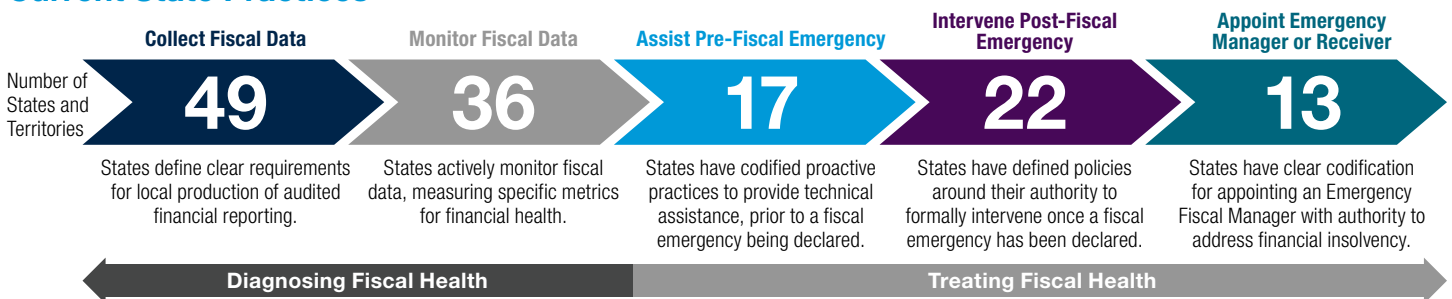
The consequences of a fiscal emergency are very real for a community's residents. Critical services like public safety and public health are disrupted, investment in capital infrastructure is delayed, and layoffs and reductions in employee compensation must be considered—all leaving a tarnished quality of life for residents for an indefinite length of time.

If fiscal distress isn't addressed in a timely manner, the ultimate result can be municipal bankruptcy. While the bankruptcies of the cities of Detroit, Michigan and Stockton, California have generated the most attention nationally, **over 30 general-purpose local governments in over a dozen different states have filed for bankruptcy since 2001<sup>(1)</sup>**. This number doesn't include localities that have become financially insolvent in the nearly half of states that don't authorize their municipalities to declare bankruptcy.

Further, fiscal distress in one locality almost always has repercussions outside that locality's boundaries. In particular:

- The economic growth and creditworthiness of neighboring local governments is threatened.
- A state "bailout" can become a necessity, however unpopular it may be.

## Current State Practices



A 2023 independent analysis by Alvarez & Marsal of U.S. state and territory policies to monitor, mitigate, and relieve local government fiscal distress reveals significant opportunities for states to enhance local fiscal health. Only about one-quarter of states have a fully defined process for monitoring local fiscal health—seeking to collaborate with local leadership before a true fiscal emergency occurs and formally intervening when such an emergency has occurred.

## Key Principles

A&M recognizes that each state and territory has its own unique needs in its specific economic and fiscal governance environment, but research on leading practices across the country points to a set of key principles that should be embedded in state policies, processes and actions:

### Proactive Monitoring

- Monitoring fiscal health indicators like those utilized by the Credit Rating Agencies to provide advance insight for identifying fiscal problems before they become much harder to address

### Transparency

- Providing user-friendly information to the public regarding community finances
- Engaging with local community leadership
- Allowing for local objections to be heard and considered in an open forum

### Timely Decision Making

- State and local officials or designees make informed decisions before the fiscal situation worsens and the options available to resolve the situation become even more difficult

### Sustainable Solutions

- Focusing on short-term actions with long-term implications
- Ensuring that financial decisions are made in a holistic way that sets up the community for future success
- Continued monitoring during exit

### Accountability

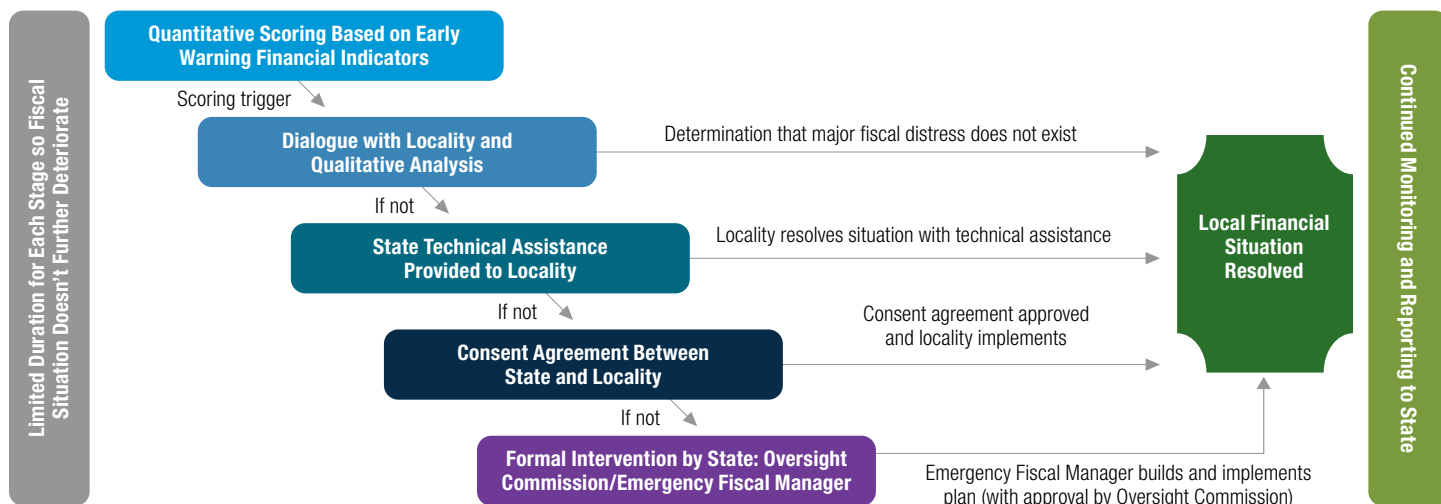
- Emergency Fiscal Manager accountable to a State-Appointed Oversight Commission with final responsibility for approving plans
- Oversight Commission reports regularly to elected state leadership

(1) A Look at Municipal Bankruptcies Over the Past 20 Years | The Pew Charitable Trusts ([pewtrusts.org](https://www.pewtrusts.org))

## The Path to Resolving Local Fiscal Distress

Addressing local fiscal distress ultimately requires elected and appointed officials to make smart and often tough decisions about the operations, finances and long-term economic strategy of a community. **A proactive, comprehensive process formalized in state law, however, gives officials the best opportunity to address signs of fiscal distress before they become so severe that formal state intervention, with diminishment of the powers of local leaders, is required.**

A&M's recommended model provides multiple opportunities and tools to address fiscal distress before a true financial emergency occurs, while also recognizing key decisions must be made in a timely manner, with a graduated process in place to escalate the level of state intervention on a prescribed time scale when necessary.



## How A&M Can Help

Alvarez & Marsal has extensive experience helping state and local governments create plans to achieve long-term financial sustainability, including working with local governments that have experienced full fiscal emergencies. A&M can put that experience, along with the research described here, to work to help states:

- Evaluate and strengthen existing laws and processes around local fiscal distress monitoring and intervention.
- Review and improve fiscal health indicators to be more effective in predicting fiscal distress before it's occurred.
- Stand up technical tools and assistance for local governments facing fiscal distress before the situation worsens.
- Build consent agreements between state and localities that local leaders can implement to resolve fiscal distress.

A&M can also serve as the Emergency Fiscal Manager for local governments where the financial situation has reached the point that full state intervention is necessary, bringing the firm's breadth of expertise to bear to identify holistic, long-term solutions for the community.

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