Municipal Fiscal Distress - Act 47 and Municipal Bankruptcy

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Mr. Chairman and members of the Committee, thank you for the opportunity to provide written testimony this morning on the Municipalities Financial Recovery Act (MFRA), Act 47 of 1987 (Act 47), SB 1157 and HB 1773 which would provide various amendments to the Act. My comments will address both bills.

The Department of Community and Economic Development (DCED), is responsible for the administration of the MFRA, Act 47, and has a responsibility to assist Pennsylvania municipalities that are experiencing severe financial difficulties in order to provide for the health, safety and welfare of their citizens; meet debt and other financial obligations when due; restore financial viability, and; maintain managerial stability and continuity. DCED likewise has a responsibility under Act 47 to monitor the fiscal condition of all local governments and provide technical assistance to those experiencing certain symptoms of distress.

In the fall of 2011, DCED, along with local government officials and other stakeholders, provided testimony to a joint committee hearing of the House Urban Affairs and Senate Local Government Committees on Act 47 and the fiscal health of Pennsylvania's local governments. Subsequent to the two days of hearings and discussion on the results of the hearing by the Local Government Commission (Commission), the Commission convened a 23 member task force co-chaired by Senator John Eichelberger and Representative Chris Ross to review and provide recommendations on ways to strengthen and enhance Act 47. Represented on the task force were the various local government associations, public sector labor organizations, federal bankruptcy court, PA Bar Association, legislative staff and other stakeholders. The task force met from March through September of 2013 and issued its final report through the Commission in October. The recommendations of the report are now embodied in SB 1157 and HB 1773, which were introduced in the fall of 2013.

As was reported at the 2011 hearings, it has been our experience that municipalities designated under the Act generally experience some degree of economic/tax base decline, demographic changes and managerial deficiencies/mismanagement. Following DCED intervention, a triage process is implemented to first stabilize the municipality, then address those issues within the purview of local officials, and finally to develop and implement intergovernmental, community and economic development strategies that will achieve long term recovery.

Certain strategies have emerged as key steps in this recovery process.

- Address the immediate financial crisis by providing emergency/long-term loans and/or assisting with market based financing to address critical creditor issues.

- Develop, institute and/or strengthen sound fiscal management policies and effective municipal management procedures.

- Implement cost containment measures addressing personnel costs, operational costs and capital projects.

- Identify and implement revenue enhancement measures to maximize current revenues. Recognizing tax competitiveness issues, utilize new revenue sources only as a last resort including the use of the extraordinary taxing authority provided by Act 47. Clearly state that such taxing authority, if used, is transitional revenue and will be phased out as longer term changes occur that correct structural imbalances.

- Develop partnerships with county government and adjacent municipalities to build capacity and identify opportunities for shared services that will improve service delivery and reduce cost.

- Develop and implement community and economic development strategies designed to strengthen the tax base over the long term. Build public-public and public-private partnerships necessary to implement these strategies.

To date, 27 municipalities have been declared as distressed. Of these, seven have emerged from the program, though ten have been in the program for ten years or more. The most recent revision is Millbourne Borough, which just occurred on March 20th of this year.

Act 47 has been successful in stabilizing the deteriorated fiscal conditions that led to distress in designated municipalities. Through extensive technical assistance resources provided by the coordinator and DCED, along with the grant and loan provisions of the Act, municipalities have been able to restore fiscal stability and adequately provide for the health, safety and welfare of their residents. Act 47 has resulted in strengthened financial management systems, credit enhancement and fiscal credibility in the marketplace, more effective management structures and in a number of instances, service efficiencies through intergovernmental cooperation.

Act 47 currently provides short term solutions that can stabilize the municipality; however, it does not address the core issues that limit the ability to achieve cost containment especially with personnel costs and of limited revenues that cannot keep pace with increased costs for services. The more a municipality's distress is attributable to economic decline, the more difficult the recovery process is. It is evident that the solutions to fiscal distress lie both within and beyond municipal boundaries and require actions from both within and outside the realm of local government. In its almost 27 year history, Act 47 has successfully stabilized fiscal conditions and addressed most of the issues that have been within the control of the municipality. Act 47 has struggled, however, to provide long term solutions necessary to achieve ultimate recovery. Legacy cost issues including debt, pension and other post-employment benefits (OPEB) liabilities, have been difficult to fully address, in part due to other statutes that have an effect on Act 47. The impact of national economic trends and even broader global trends has had a definite influence on municipal fiscal health as well. An economic slump and the decline in the steel industry in the mid to late 1980s resulted in the enactment of Act 47 and an initial surge of distressed municipalities.

Nine municipalities were designated distressed in the first five years of Act 47. As the broader economy improved, marginal municipalities were able to maintain fiscal stability during the mid and late 1990s. Only one municipality was designated as distressed in the nine-year period from January 1993 to the end of 2001. The post 9-11 downturn resulted in an increase in fiscal stress and an increase in Act 47 municipalities with four municipalities receiving designations from 2002 – 2004. The current economic downturn has resulted in four additional municipalities being designated distressed over the last five years and the potential exists for other marginal municipalities, especially several of our 3rd class cities to be so designated.

There are a number of legislative and policy remedies that could assist municipalities in managing the fiscal stress and challenges they currently face. These remedies would remove certain impediments to change, address conflicts between statutes, provide greater flexibility to address the unique characteristics of Pennsylvania municipalities and strengthen the fiscal health of municipalities across the commonwealth.

Senate Bill 1157 & House Bill 1773 address some of these issues and Chairmen Eichelberger and Ross should be commended for their actions. These bills strengthen certain provisions of Act 47 including: the codification of the Early Intervention Program (EIP); providing additional taxation options (though there are certain operational concerns with the use of the payroll preparation tax), and; the establishment of a process to manage municipalities deemed non-viable. We have concerns with the disincorporation procedure and note that it is important that the municipalities adjacent to the non-viable municipality and the county are engaged in the development of a governance solution that will provide for health and safety of residents, and ensure that necessary and vital services are provided.

The bills also provide definitive timeframes for the Act 47 engagement. It is difficult for municipal officials to implement tough recovery plan recommendations. The provisions included in this legislation would establish a time-frame for local officials to make the decisions in order to reach a point where they can exit the program. The bill also provides for a process to move a municipality that is in Receivership under Chapters 6 and 7 back to the underlying Act 47 provisions at such time as the fiscal emergency that invoked Chapters 6 and 7 has ended. While we agree that this effort is necessary, we have offered clarifying language on this matter based on our experience with Harrisburg.

Act 47 requires a significant commitment in both human and financial resources on the part of the commonwealth. It is in the best interest of all to identify and address fiscal problems in municipalities that may be trending towards distress as early as possible while they are still manageable. Early intervention through detection from our Early

Warning System can address fiscal problems before they reach a crisis and avoid a condition that could adversely impact on the health, safety and welfare of residents as well as save the commonwealth and municipalities valuable resources over the long term.

Recognizing the fiscal stress many municipalities are facing, DCED in recent years has taken a more proactive approach to dealing with fiscal distress and has taken major steps in improving tools it uses to identify municipalities trending towards distress thru and in enhancing and increasing the funding for its Early Intervention Program (EIP). DCED supports codifying EIP as part of any reform to Act 47.

The EIP was established to assist Pennsylvania local governments in addressing financial management and fiscal difficulties in a timely and planned manner in order to avert a more severe fiscal crisis that would have an adverse impact on health, safety and welfare of their residents. The EIP is a pre-emptive step for counties and municipalities who realize their financial situation is deteriorating and want to take steps to avoid Act 47. It provides for an analysis of their historic and current fiscal position and a multi-year financial plan with accompanying recommendations which, if implemented, will maintain fiscal stability. To date 18 counties, 33 cities, 25 boroughs and 11 townships have participated in the program. Only five ultimately entered Act 47 while the rest have been able to successfully avoid a worsening of their financial situation thru the EIP remedies.

DCED has recently revised the Act 47 Survey of Financial Condition form that is used to obtain information on the fiscal health of municipalities. More than 220 municipalities have provided positive responses to the form thus far in 2014. DCED has created an Early Warning System to more accurately identify municipalities trending towards distress. These two tools allow DCED to intervene when a municipality exhibits warning signs of fiscal stress and address it before it becomes a crisis. We can then recommend that the municipality engage in our EIP to provide them with a strategy to avert a worsening of their situation. The codification of the EIP into SB 1157 & HB 1773 would further support this initiative.

DCED stands ready to continue to work with both the Senate Local Government Committee and the House Urban Affairs Committee to further refine these bills in a way that best addresses the fiscal health of Pennsylvania's local governments and affords them a bright and promising tomorrow.

Thank you.