Cities in Crisis: How States Can Help Municipalities Facing Bankruptcy & Fiscal Distress

BY June Speakman, Professor
Roger Williams University

2017

View full article on-line: collaborativeri.org/research/cities-in-crisis-how-states-can-help-municipalities-facing-bankruptcy
How can states help municipalities avoid fiscal crisis and bankruptcy?

Fiscal Crisis & Recovery in Central Falls

In 2010, facing large budget shortfalls, Central Falls became the first city in Rhode Island history to declare bankruptcy. Rapid and forceful action by the state stabilized the city's fiscal situation and fostered a quick and ongoing recovery.

<table>
<thead>
<tr>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>State revenue-sharing program cut by 50%, entirely eliminated the following year.</td>
<td>Property values dropped by 44% since 2006 in the wake of the Great Recession.</td>
<td>February Mark Pfeiffer replaced by Robert Flanders as State Receiver.</td>
<td>January New collective bargaining agreements cut pensions 55%.</td>
<td>April 2013 State receivership abolished. Administrative and Financial Officer (AFO) installed to supervise spending, personnel, and budget decisions. Powers of elected officials (Mayor and Town Council) are restored, although fiscal oversight remains with the AFO.</td>
<td>April 2018 AFO's tenure ends.</td>
</tr>
<tr>
<td></td>
<td>May City Council votes to declare insolvency. Mayor petitions court for judicial receivership.</td>
<td>July State Receiver closes library and community center and lays off 50 city workers.</td>
<td>September Judge approves debt adjustment plan to end bankruptcy.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>June RI GL 45-9 Fiscal Stability Act becomes law, establishing state receivership in Central Falls.</td>
<td>July General Assembly passes S0144A/ H5736A, giving bondholders the right to place liens on tax revenue, ensuring that they will be paid in full.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>July State Receiver Mark Pfeiffer appointed. Mayor and Town Council lose authority over city government.</td>
<td>July General Assembly recesses without plan to aid Central Falls, despite Governor's request.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>December State Receiver recommends to Governor that Central Falls merge with Pawtucket.</td>
<td>July State Receiver proposes to cut pensions by 50%. Retirees reject proposal.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>August City files for Chapter 9 bankruptcy. Collective bargaining agreements for city employees are voided.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Strong State Intervention in Massachusetts

Massachusetts designs its response to municipal fiscal distress on a case-by-case basis. In Springfield, the state created a five-member Financial Control Board to take over the day-to-day operations of the city.

Authority Granted to Springfield’s Financial Control Board

The Financial Control Board created by Massachusetts to restore financial stability in Springfield was granted extensive authority, including the ability to:

- Replace binding arbitration with voluntary mediation for labor contracts,
- Hire and fire city employees,
- Set the terms and conditions of employment for non-union employees,
- Approve all contracts for goods and services,
- Reorganize city government,
- Raise or cut fees for services, licenses, permits, and
- Institute budget guidelines and procedures for all departments.
States can play a role in keeping their cities and towns in good fiscal health.

**Challenge**

The Great Recession of 2008 brought several municipalities to the brink of fiscal crisis, including Central Falls, which in 2010 became the first city in Rhode Island history to declare bankruptcy. Rapid and forceful action by the state stabilized the city’s fiscal situation and fostered a quick and ongoing recovery. Through its response in Central Falls, Rhode Island created a framework for dealing with future municipal fiscal crises. This framework might be strengthened by examining how other states have dealt with similar issues and implemented preventative measures to stop fiscal crisis before it starts.

**Research**

State approaches to helping municipalities in fiscal crisis vary widely according to politics, ideology, custom, available resources, and past practices. Some states choose not to intervene at all, while others have formal or informal systems for helping get cities back on track. This article explores the approaches taken by Rhode Island and three other states – Massachusetts, Pennsylvania, and North Carolina – in response to municipalities in fiscal distress. Though there is no one-size-fits-all model, lessons from these states may help Rhode Island keep its cities and towns in good financial health.

**Findings**

The research reveals two key strategies that are critical for handling municipal fiscal distress: an early warning system to identify potential problems and strong state action when necessary. Pennsylvania’s system for monitoring local fiscal health allows it to identify trouble early and help cities develop plans for recovery. Massachusetts’ interventions in times of crisis highlight the value of a strong state response tailored to the needs of each city. North Carolina has perhaps the most promising model, combining a robust early-warning system with powerful mechanisms for pressuring cities to stay on track.

**Insights**

In its response to the crisis in Central Falls, Rhode Island laid down a framework for dealing with municipal fiscal distress. Going forward, the state may consider ways to strengthen that framework by drawing on lessons from other states. In particular, North Carolina’s approach can serve as an instructive model. Its system combines proactive oversight and strong state control over municipal borrowing, and has been widely praised by academics and practitioners.

**Pennsylvania’s System for Monitoring Municipal Fiscal Health**

Pennsylvania has a rigorous monitoring system for anticipating and responding to municipal financial distress. Cities must submit annual financial reports to the state with data on key economic indicators.

Eleven key indicators are used to assess the fiscal health of Pennsylvania’s municipalities under Act 47:

1. A deficit over a three-year period.
2. Expenditures exceeding revenues for a period of three years or more.
3. Default on bond payments or rent al payments.
4. Missed payroll for thirty days.
5. Failure to make payments to judgment creditors for 30 days.
6. Failure to forward withholding taxes.
7. Accumulated deficit of 5% or more of revenues.
8. Failure to make budgeted payments to pension funds.
9. Failed attempts to negotiate resolution of a claim in excess of 30% against a fund or budget.
10. Filing of a Chapter 9 debt readjustment plan.
11. Decrease in levels of municipal services due to tax levy caps.
Apply today to become a Collaborative Scholar!

The College & University Research Collaborative (The Collaborative) is a statewide public/private partnership of Rhode Island’s 11 colleges and universities, connecting public policy and academic research.

The Collaborative’s mission is to increase the use of non-partisan academic research in policy development and to provide an evidence-based foundation for government decision-making.

The Collaborative turns research into action by sharing research with policymakers, community leaders, partner organizations, and the citizens of Rhode Island.