

STATE OVERSIGHT OF LOCAL GOVERNMENT FINANCES: NEW JERSEY'S ALTERNATIVE TO DEFAULT AND BANKRUPTCY

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Why New Jersey Takes Active Role in Overseeing Local Finances

- Some states think, “Not our problem” and take a hands off approach.
- The direct impacts of a hands off approach are obvious:
 - General government operations and services decline in quality.
 - Services are cut.
 - Acquisition/retention of good employees becomes more difficult.
 - The quality/quantity of participating vendors declines.
 - Property taxpayers pay more.
 - Borrowing costs increase.
 - Vendors impacted by nonpayment.
 - Employees lose their jobs or experience pay stagnation.
 - Retirees may lose promised/anticipated benefits.

Why New Jersey Takes Active Role in Overseeing Local Finances

Ehhhhhh, we're from "Joysey" and we would let them suffer, but we care too much about ourselves to let a municipality fail.

- Local financial failures impact more than the municipality in question:
 - Impacts to the State budget / services:
 - State revenues lag as fiscal distress impacts business location decisions.
 - State has significant properties within urban areas.
 - State resources are pulled to unmet regional capital and human service needs.
 - Impacts to surrounding communities / residents (i.e. "my constituents"):
 - Commuters and businesses are impacted.
 - Blight and crime spill across political boundaries.
 - Investor confidence in local governments within the region (*not just poorly managed local governments*) will decline (especially in the event of a bankruptcy or default) and local borrowing costs will increase.

Role of the State of New Jersey:

Four main components

System built in response to Great Depression – always evolving.

1. System makes true fiscal emergencies rare: Laws; Local Finance Board (LFB); Department of Community Affairs, Division of Local Government Services (DLGS); cultural tradition.
2. When emergencies do arise, State (though LFB) protects against nuclear option of bankruptcy or default.
3. DLGS intervenes aggressively to restore stability through a combination of strict oversight and assistance.
4. In better budget times (long, long ago), financial assistance is increased. In difficult times (today?) reforms are implemented to reduce local spending pressures in all communities.

1. Maintain system that makes fiscal emergencies rare.

- DLGS must approve local budgets prior to adoption (every year for outliers - otherwise once every 3 years.)
 - Funds must be appropriated for known liabilities (contracts, full actuarially determined pension payment, contract liabilities.)
 - Revenues from non property tax sources must be conservatively estimated.
 - Property tax is set at amount needed to balance budget.

1. Maintain system that makes fiscal emergencies rare (cont'd.)

- DLGS licenses local staff involved in budgets (CFO, Clerk, Tax Collector) to ensure standards.
- Local investments are restricted to conservative vehicles.
- Conservative borrowing policies except where LFB allows diversions (no used car lot debt):
 - Borrowing mostly restricted to capital purposes.
 - Down payments and Standard maturity schedules required for borrowings.
 - Do derivatives or variable interest debt.
- Qualified Bond Act – State aid intercept assures payment.

1. Maintain system that makes fiscal emergencies rare (cont'd.)

- Disclosure, disclosure, and more disclosure.
 - “User-friendly budget” required making New Jersey a leader in meaningful disclosure;
 - Key comparative data in one document concerning: revenues, costs, structural challenges, ratings, etc.
- Best Practices Inventory.
 - Municipal response to questionnaire on best practices conditions general aid and is a public document to guide local decision making.
- Strict enforcement of SEC disclosure rules.

1. Maintain system that makes fiscal emergencies rare (cont'd.)

■ Continuing education requirements and guidance for professionals in budget process.

- Training opportunities that meet State standards for budget officials (required for CFOs, Tax Collectors, and clerks to maintain licenses)
 - Usually offered through approved third parties (Rutgers, Associations, etc.)
- Guidance issued by State to all CFOs, tax collectors, clerks and other officials on issues as they arise;
- State advances best practices; requiring local officials to implement them or lose aid.

2. Prevent bankruptcy or default.

- Bankruptcy – State approval needed and not approved in more than 80 years.
 - Local governments can't declare bankruptcy without Local Finance Board approval.
 - Approval has never been granted.
 - State successfully sued Camden when it tried to circumvent the process.

2. Prevent bankruptcy or default (cont'd.)

- Not budgeting for debt obligations is not an option under state law.
- Midyear surprises uncommon due to enforced conservative budgeting policies.
 - Deliberate under-appropriations not permitted;
 - Revenue assumptions restricted by conservative State parameters.
 - Revenues from fees can't be more than prior year.
 - Revenues from sales/leases/other contracts must be certain at time of budget adoption (no speculation.)
 - Property tax required to be set annually at a rate that considers collection history and that balances budget.

3. Intervene to restore financial stability to distressed areas.

- Municipalities showing signs of distress receive help and may face consequences.
- The State intensifies its scrutiny and involvement.
 - Budgets reviewed more frequently.
 - Experts provide assistance in variety of management issues.
- Requests for help made in public, creating media/constituent scrutiny.
- Certain LFB approvals come with conditions, possibly including: reporting requirements, implementing certain reforms, or receiving state-approval for hires, etc.
- State cash flow loans can be provided though unlimited State budget authorization.

3. Intervene to restore financial stability to distressed areas (cont'd.)

- When distress triggers requests for extra financial assistance, State budget allows accommodation through Transitional Aid, but aid is tied to broad State oversight powers.
 - State personnel assigned as Fiscal Monitors.
 - Restrictions on political contributions by vendors.
 - Bans on nonessential spending.
 - Approval needed for new hires, raises, vendor selection, debt issuance, new programs, tax exemptions, etc.
 - Municipality-specific conditions.

3. Intervene to restore financial stability to distressed areas

(cont'd.)

■ Where extreme distress is recognized by State, but local government sidesteps oversight by not asking for Transitional Aid, the State has more heavy handed options:

- Director of DLGS can set local property tax levy to meet expenses.
- LFB under Supervision Law can assume virtually total control of municipal executive branch functions and indirectly/strongly influence the legislative body.
 - In limited cases under other laws, LFB control of the legislative body is also achieved. (Camden Law, Atlantic City Law.)
- LFB can establish recovery plan (virtually no limitations on plan or right of appeal) for authorities.

3. Intervene to restore financial stability to distressed areas (cont'd.)

EXAMPLES OF STATE ACTIONS

- Camden: replace police department, outsource bad debt collections, modernize fees, assist with development.
- Trenton: Take over recruitment/hiring of personnel to combat corruption (former mayor – not current.)
- Paterson: Terminations, increase in levy and sewer fees.
- Newark: Require employee contributions towards health insurance premium, provide substantial technical assistance to finance staff.
- Camden County Pollution Control Authority: Threat of Recovery Plan.

4. Active efforts by state to reduce spending pressures.

- Older reforms:
 - Decrease defined pension benefits - eliminate cost of living adjustment and increase retirement age;
 - Establish public employee contributions to pensions and health benefits.
 - Shift collective bargaining power to management.
- More recent reforms:
 - Advancing cost savings to common State health benefit plans: Medicare Advantage, more generic use and use of formulary, incenting choice of lower cost plans.

4. Active efforts by state to reduce spending pressures (cont'd.)

- Continuing to push for civil service reforms to allow easier ability to enter into shared services that reduce employee costs.
- Continuing to push for restrictions on accrued sick and vacation liabilities.

Atlantic City: P.L. 2016, c4.

“Municipal Stabilization and Recovery Act”

Enacted in 2016 in response to unprecedented Atlantic City Distress and insufficiency of City progress with respect to cost controls.

- City lost more than 50% of assessed property values attributable to a handful of casino properties over 5 years.
- State increased annual aid in support of approximately \$200 million municipal budget from \$6 million to more than \$100 million over 3 years to fill gap when ability to raise local revenue (property tax) declined.
- City reduced its payroll over five years by almost $\frac{1}{4}$, mostly through attrition, but salary and benefit costs remain very high.
- City continues to have a cash flow problem without access to private markets.

Atlantic City: P.L. 2016, c4.

“Municipal Stabilization and Recovery Act”

Most powers complement or duplicate broad powers already available to State.

- LFB adopts budget.
- DLGS has authority to award discretionary Transitional Aid (none awarded yet for 2016.)
- DLGS has veto power over much of the executive authority (hires, raises, promotions, etc.)
- DLGS can give grants and loans with terms.

Atlantic City: P.L. 2016, c4. (Cont'd.)

“Municipal Stabilization and Recovery Act”

- Critical new statutory provisions:
 - City was required to submit a 5 year recovery plan within 150 days of being designated a city that subject to the law.
 - If the State rejects the plan as insufficient:
 - DLGS' current authority to prohibit actions of the Mayor/Executive without DLGS' prior approval become enhanced with DLGS being able to act in the Mayor/Executive's stead (certain appointments, procurement, etc.)
 - LFB can empower DLGS to step into the shoes of the City Council and act in its stead. This is sweeping new authority.
 - Broad authority is given to DLGS to unilaterally modify compensation packages and make employee changes without regard to Civil Service Law. This is also a dramatic change from collective bargaining laws and case law.

Atlantic City: P.L. 2016, c4. (Cont'd.)

“Municipal Stabilization and Recovery Act”

Where is Atlantic City Now?

- In 2016, State gave City a \$72 million cash flow line of credit in 2016. City was in technical default of loan due to City Council not moving forward with elimination of an authority that runs its water systems. The default was willful and deliberate and is coupled with a faction of city council advocating default on City bonds.
- City's 5 year Recovery Plan was submitted to State, but rejected in late 2016.
- LFB assumed Executive and legislative powers of City officials in late 2016.
- New Monitor of Atlantic City was appointed: Jeff Chiesa.
- State is no longer permitting Atlantic City to defer pension and health benefit payments to State.
- State secured significant reduction from Borgata Casino with respect to a debt the City owed to Borgata.
- No CY 2017 budget proposed for City pending State budget proposal in February.
- Transitional Aid will supplement State budget aid – but based on application.

Information in this presentation is general in nature and care should be taken to understand laws and regulations as they relate to particular circumstances.
