Municipal Fiscal Distress and Recovery

Background

The Municipalities Financial Recovery Act,[1] or Act 47, was enacted in 1987 as the product of a Local Government Commission-sponsored task force convened to look for solutions to growing financial problems among municipalities in Pennsylvania. Many municipalities faced, and still struggle with, financial challenges related to changes in the business cycle, shifts in population and economic opportunity, as well as poor local management and rising legacy costs, and other cyclical and structural issues. Act 47 is an effort to provide a process for these "distressed" municipalities to work with the Pennsylvania Department of Community and Economic Development (DCED) and reestablish financial stability. In 2013, the Local Government Commission authorized the creation of a new task force to examine the efficacy of the Act 47 program and recommend revisions where warranted.[2] Many of the resulting recommendations were adopted in a comprehensive enactment amending Act 47 in 2014.[3]

Strategic Management Planning Program

A municipality that is experiencing financial challenges that threaten to develop into distress if unaddressed has the opportunity to participate in a voluntary strategic management planning program with DCED. Participating municipalities are eligible for matching grants to develop multi-year fiscal plans and establish both short-term and long-term objectives. According to existing guidelines established by DCED, the program is "designed to offer a preemptive step for municipalities who feel as if their financial situations, while not yet formally declared distressed, are realizing difficulties and seek to improve their financial position."[4]

To participate in the program, a municipality must undergo a financial audit performed by an independent auditor or firm to provide an accurate picture of the municipality's fiscal situation. DCED is able to provide resource assistance to assist a municipality in identifying, prioritizing and addressing financial difficulties; engaging in a review of management operations and service deliv-

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[1] Act 47 of 1987 (53 P.S. § 11701.101 et seq.).

[2] Additional information regarding the task force process and recommendations is available in detail in the *Act 47 of 1987 Municipalities Financial Recovery Act 2013 Task Force Report,* Local Government Commission, October 16, 2013, available at http://www.lgc.state.pa.us/Reports/act47/101713/Act%2047-of-1987-2013-Task-Force-Report-FINAL-10-16-2013.pdf (accessed April 6, 2020).

[3] *See* "Summary of House Bill 1773 (Act 199 of 2014)" available at http://www.lgc.state.pa.us/Reports/ act47/summary-of-hb1773.pdf (accessed April 6, 2020).

[4] *Strategic Management Planning Program,* Governor's Center for Local Government Services, Department of Community and Economic Development, April 2019, p. 2, https://dced.pa.gov/download/strategic-management-planning-program-smpp-guidelines/?wpdmdl=91021 (accessed October 2, 2020).

ery; implementing a multi-year financial management plan; implementing a financial trend analysis; promoting multi-municipal and regional planning and strategies, including cost sharing; adopting best management practices; and integrating community and economic development strategies.[5]

Declaration of Distress

Ideally, the tools provided by the Early Intervention Program allow a municipality to reestablish sound financial footing without any additional intervention, but where the program is unsuccessful or not utilized, the act provides a set of criteria by which the Department can assess whether a municipality is in defined fiscal distress. Distress can vary in nature from a multiyear deficit, to missed payments on existing payroll or debt obligations, to inability to maintain governmental services from revenues derived based on the legal limitation of existing tax authority. Specified parties have the ability to go to DCED and seek a determination that a situation of distress actually exists. DCED's findings, after considering the request and holding a hearing and investigation, could lead to a declaration of distress under the act,[6] or a municipality's attempt to file for bankruptcy would cause an automatic declaration of distress.[7]

Appointment of Coordinator and Formation of Plan

After distress is declared, a coordinator is appointed by DCED to assess the financial situation, issue a report on findings, and propose a plan for recovery. The coordinator is given broad authority[8] to inspect records related to the municipality's operations and finances, as well as those records held by authorities that serve the municipality.

The coordinator's recovery plan may recommend changes to the municipality's staffing, assets or services, and may also propose multi-municipal cooperation, privatization, debt restructuring and disposition of assets, among other things.[9] In addition, where recommended by a plan, distressed municipalities may be able to petition the court of common pleas for special authorization to increase the real estate tax, the earned income tax on residents and nonresidents, as well as the local services tax, where the court finds that appropriate conditions are met.[10] In addition, an Act 47 municipality may permanently replace its mercantile/business privilege tax with the payroll preparation tax.

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[5] *See generally,* "Summary of HB 1773," Chapter 1-A, pp. 5-7, *supra,* note 3.

[6] *See generally* Act 47 of 1987, Ch. 2, Subch. A.

[7] *Id.* at § 261.

[8] *See generally id.* Ch. 2, Subch. B.

[9] *Id.* at § 241.

[10] *See id.* at § 123 for details. Eligibility for certain taxing options depends on municipal classification, taxes currently levied and objective need for additional revenues, among other things.

Frequently Asked Question: The municipality in which I work raised my taxes even though I don't live in a distressed municipality. How does this happen?

Answer: Under certain circumstances, and after receiving court approval, a distressed municipality may be authorized to levy a higher tax on earned income. Where a person works in a municipality with a higher rate of tax on earned income than the rate levied where he or she lives, the municipality where that person works is entitled to collect the difference in rates. Alternatively, a distressed municipality may petition to levy a local services tax of up to $3 per week. The local services tax is a payroll tax paid to the municipality where a person is employed. Ordinarily, the local services tax is capped at $1 per week.

Application: Carl is a resident of Pickelsburg, a borough located in Oak County Pennsylvania, but he works in distressed Cabbageville, a neighboring borough in the same county. Upon recommendation in its recovery plan, Cabbageville petitions the Oak County Court of Common Pleas for an increase in the rate of its tax on earned income, to which the Court approves a rate of 1.5 percent on residents and nonresidents alike. Because Pickelsburg levies a tax of 1 percent (to the benefit of Pickelsburg and Carl's local school district), Carl will continue to pay not only 1 percent tax on earned income to Pickelsburg, but also an additional 0.5 percent to Cabbageville.

Administration of Plan and Enforcement

A distressed municipality is required to adopt a recovery plan, either as proposed by the coordinator or as developed by the governing body of the municipality with the Secretary of DCED's approval.[11] Where a municipality fails to adopt or implement a plan, DCED may suspend certain funding sources to the municipality from the Commonwealth or, in some cases, determine that the municipality is experiencing a fiscal emergency.[12] Once adopted, the plan must be implemented by the coordinator, by another specified person or with the coordinator's oversight.[13] During the course of plan implementation, the coordinator is also required to participate in the municipality's budget process to ensure that the annual budget is compatible with the plan's provisions.[14]

Time Limits, Exit Plans and Options

Under the amendments adopted in 2014, distressed municipalities will be eligible for Act 47's tools and assistance for a limited period of time to ensure that distressed municipalities do not delay difficult fiscal planning and decision-making by artificially balancing budgets with special tax levies under the act. Newly distressed municipalities will be eligible to adopt an initial recovery plan for a period of five years. For municipalities in distressed status as of the effective date of the 2014 revisions, the five-year period would begin to run from the effective date of the most recent recovery plan or amendment.[15] For municipalities in their last year of a recovery plan on the effective

[11] *See generally* Act 47 of 1987, Ch. 2, Subch. C.

[12] *See id.* at §§ 248, 602.

[13] *Id.* at 247.

[14] *Id.* at 247.1; *see also* "Summary of HB 1773," p. 9.

[15] Act 47 of 1987, § 254.

date, the date for the termination of distressed status would be three years from the termination date of the current plan. During the first half of the final year of the recovery plan, the coordinator is required to prepare a report assessing the ongoing distressed status of the municipality and making one of the following recommendations:

- That the distressed status of the municipality be terminated.
- That the municipality be disincorporated (*see* below).
- That the municipality, because of noncompliance with recovery recommendations, should be declared in a state of fiscal emergency with the possibility of receivership (*see* below).
- That a three-year exit plan be adopted.[16]

The Secretary of DCED is responsible for reviewing the coordinator's report and determining whether the coordinator's recommendation is appropriate, or whether another option should be selected. If a three-year exit plan is selected, at the end of the three years, the Secretary will determine whether the municipality's distressed status should be terminated, a fiscal emergency should be declared or in extremely rare circumstances, the municipality should be disincorporated.[17] Although not explicitly listed as an option, a municipality also has access to the federal municipal debt adjustment process through bankruptcy where insolvent and the Secretary of DCED has granted the municipality's application to file for bankruptcy.[18]

Fiscal Emergency and Receivership

Amendments adopted in 2011 added chapters 6 and 7 to Act 47, which provided for the Governor to declare a state of fiscal emergency in a city of the third class under certain circumstances. The 2014 amendments expand eligibility for fiscal emergency and receivership to any municipality, other than Philadelphia,[19] where the municipality is either in current or imminent danger of insolvency or the municipality fails to adopt or implement a recovery plan necessary to address its distress.[20] Following a declaration of fiscal emergency, which may result in the appointment of a receiver, the municipality is to negotiate a consent agreement with DCED to ensure the continued provision of vital and necessary services. A receiver is charged with creating a plan to address the

[16] Act 47 of 1987, § 255.

[17] *Id.* at § 256.

[18] *See generally id.* Ch. 2, Subch. C.1.; *see also* "Summary of HB 1773," pp. 10-14.

[19] Act 47 does not apply to Philadelphia due to the adoption of the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class in 1991, which is intended to provide recovery assistance to Philadelphia's financial challenges.

[20] Act 47 of 1987, § 602.

municipality's distress; however, the receiver's plan overseen by the Commonwealth Court, is legally binding against the municipality, and is enforceable in Commonwealth Court over the objection of the governing body of the municipality where necessary.[21]

Disincorporation

Under very rare circumstances, some municipalities may have an inadequate tax base to continue to function as a municipality.[22] Upon such a recommendation of "nonviability" by a coordinator or receiver under Act 47, the Secretary of DCED is required to consider whether:

(1) the municipality is unable to provide necessary municipal services;

(2) the municipality has experienced a collapse of its tax base such that all reasonable efforts to recover have failed; and

(3) merger or consolidation of the municipality with a neighboring municipality is either unachievable or insufficient to establish viability.[23]

Where the Secretary finds that such conditions of nonviability exist, a municipality is authorized through its governing body, or by a citizen petition, to ask a court of common pleas to initiate the process of disincorporation of the municipality. With the court's approval, DCED would appoint an administrator charged with planning for winding down and terminating the municipality's affairs, and would provide for state administration of services through the establishment of an unincorporated service district, which would replace some municipal functions but operate as a corporate body of the Commonwealth. The long-term goal of disincorporation is to provide for the eventual reestablishment of a municipality or the consolidation of the district's territory into a neighboring municipality.[24]

If you believe that your municipality or a municipality you represent may be distressed or is in need of financial consultant assistance, you should contact the Governor's Center for Local Government Services within the Department of Community and Economic Development. Additional information on Act 47 and the Strategic Management Planning Program are also accessible on DCED's website at dced.pa.gov.

The Governor's Center may be contacted at:

- 4th Floor, Commonwealth Keystone Building, Harrisburg PA 17120.
- 1-888-223-6837.

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[21] *See generally* Act 47 of 1987, Ch. 6 and 7; "Summary of HB 1773," pp. 22-24.

[22] *See* Act 47 of 1987, § 102 (b).

[23] Act 47, § 431.1.

[24] *See generally id.* Ch. 4, Subch. C and D; "Summary of HB 1773," pp. 14-22.