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**Testimony to Nebraska Legislature's**
**Government, Military and Veterans Affairs Committee**
**Legislative Resolution 455**
**December 13, 2018**

Good afternoon, Chairman Murante and Members of the Committee:

Thank you for the opportunity to provide testimony on Legislative Resolution 455. My name is Adrienne Lu and I am a researcher working on state and local fiscal policy issues at The Pew Charitable Trusts, a nonprofit, nonpartisan research and advocacy organization. For the last three years, Pew has conducted research on strategies states use to assess and track the fiscal condition of local governments. Pew has also published research on how states intervene when local governments fall into severe fiscal crisis and the impacts of municipal bankruptcies.

Even in the most well-run states, local governments can fall into fiscal distress for a variety of reasons, including economic shifts and demographic changes beyond a locality's control. When states are able to detect local fiscal distress sooner rather than later, they have more time, and more options, to try to help address problems before it is too late.

Across the country, 23 states make some effort to monitor the fiscal health of local governments, meaning that they actively and regularly review financial information from localities. The most recent state to adopt a monitoring system is Virginia, which adopted a state budget provision last year to create an early warning system to alert local governments when there are signs that they may be in fiscal distress.

Dr. Craig Maher, director of the School of Administration and the Nebraska State and Local Finance Lab at the University of Nebraska – Omaha, regretfully could not be here to testify today so I am here to present on the results of his study, which Pew provided funding for, on developing an early warning system for local government fiscal distress in Nebraska. Dr. Maher has held faculty positions in Wisconsin, Illinois and Nebraska and he has been heavily involved in local government organizations and finance for nearly 20 years. Some of his most recent work has been focused on building models that predict fiscally distressed communities throughout the U.S. Last session, he was also asked to comment on LB1111, a bill to establish an early warning system for county and municipal governments. He holds a Ph.D. in state and local government from the University of Wisconsin – Milwaukee.

Dr. Maher's study was intended to identify a fiscal monitoring plan that is grounded in theory, is easily replicable, and relies on existing government financial data in Nebraska. The study focused on identifying the most appropriate indicators for the state to use in trying to detect local fiscal distress.

Dr. Maher's team used local financial data from 2009 to 2016 to build datasets for counties, municipalities, and school districts in Nebraska. All of the data used in the study are already collected by the state Auditor of Public Accounts.

The analysis started with five financial ratios based on previous literature. After calculating two-year percent changes for key variables, the team narrowed their focus to four ratios:

- Net cash balances as a percentage of expenditures
- Two-year percentage change in net cash balances
- Debt as a percentage of property valuation
- Two-year percentage change in debt

From these, Dr. Maher's team evaluated measures of both operating, or short-term budget solvency and long-term solvency.

- A local government was considered to have weak short-term budget solvency if their net cash balance as a percent of expenditures was in the bottom decile for that year AND net cash balance decreased over the previous two years;
- A local government was considered to have weak long-term solvency if their debt as a percent of property value was in the bottom decile for that year AND debt increased over the previous two years.

Under the analysis, a local government was considered fiscally distressed if it was found to have both weak short term and long-term solvency.

Based on those criteria, the good news is that Dr. Maher's study found that as of 2016, the last year for which data were analyzed, there were not any communities facing fiscal problems that the state did not already know about. In the period of the study, the analysis found one county that met the criteria for distress, Valley County, in fiscal year 2012.

The study also found several municipalities that met the criteria for distress. Two cities, South Sioux City (2011 and 2014) and Ralston (2014 and 2015), appeared more than once. Other municipalities that met the study's criteria for distress were Pilger (2013), Tecumseh (2013) and Battle Creek (2015).

Although there were a few school districts that met the study's criteria for distress, Dr. Maher found that net fund balances were strong and reserves were at relatively healthy levels. As a result, Dr. Maher characterized all school districts as being on solid financial ground during the period studied.

Finally, Dr. Maher noted that although there may not be much fiscal distress right now in Nebraska's local governments, future trends look challenging. He noted demographic changes such as population migration to urban areas and the graying of the state. Those, combined with the fact that Nebraska has more local governments than most states, most of which are very small and removed from the growing urban centers in Omaha and Lincoln, could lead to fiscal distress down the road. Dr. Maher said that in recent interviews with various local government associations, they agreed with that assessment.

Dr. Maher said that the indicators he has chosen should be able to help the state to anticipate fiscal problems caused by economic and demographic changes, although they are less likely to be able to predict distress caused by poor fiscal management or sudden events such as natural disasters.

Dr. Maher also noted that an early warning system should not be used as a tool by state lawmakers to accuse and judge local governments. Instead, an early warning system should be the beginning of a conversation between the state and local governments to determine the best course of action.