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## OLR Bill Analysis

**sHB 5427 (as amended by House "A")\***

### ***AN ACT CONCERNING THE RECOMMENDATIONS OF THE OFFICE OF FINANCE WITHIN THE OFFICE OF POLICY AND MANAGEMENT.***

#### **SUMMARY**

This bill changes the criteria for designating, and terminating the designation of, municipalities as tier I, II, III, or IV for purposes of state fiscal oversight and control by the Municipal Finance Advisory Commission (MFAC) or Municipal Accountability Review Board (MARB), as applicable (see BACKGROUND). In doing so, it generally establishes new criteria for detecting municipal fiscal distress. As under existing law, the municipality's degree of distress determines its designated tier.

Currently, municipalities must request designation as a tier I or II municipality. The bill establishes criteria for the Office of Policy and Management (OPM) secretary to designate them as such, without them requesting it (e.g., for failing to submit an audit or being in a condition that would trigger eligibility for voluntary designation). The bill also establishes conditions under which MFAC may recommend to the OPM secretary that a designated tier I municipality that it is working with be redesignated as tier II or III, making the municipality subject to MARB's oversight.

The bill subjects all designated municipalities to the same criteria for determining whether their designation terminates. The revised criteria are similar to the criteria currently used. The bill also makes it easier to re-designate a municipality as tier I-IV after its initial designation terminates.

Regarding MARB's oversight, the bill also does the following:

1. specifies that the OPM secretary must consult with it to

determine whether any Municipal Restructuring Fund assistance funds should be provided as a loan (§§ 6 & 14) and

2. limits the municipalities for which MARB is authorized to approve or reject a municipal or board of education collective bargaining agreement or amendment (§ 10).

This bill also makes the following changes in other municipal finance laws:

1. requires municipalities, before issuing pension deficient bonds, to submit a five-year, instead of a three-year, financial plan (§ 1);
2. requires certain municipal entities, such as special taxing districts, to annually file a financial statement with the OPM secretary upon request (§ 2);
3. allows the OPM secretary to refer a municipality to MFAC, instead of or in addition to assessing a penalty, if it does not file its audit in a timely manner (§ 3); and
4. requires municipalities to file financial reports electronically, using a uniform reporting template (§ 5).

The bill also makes technical and conforming changes.

\*House Amendment "A" replaces two references in the underlying bill to "current year audited" revenues with "most recent audited financial statement" revenues, to clarify designation criteria.

EFFECTIVE DATE: October 1, 2022

## **§ 1— MUNICIPAL PENSION DEFICIENT BONDS**

Under current law, before issuing pension deficient bonds (to fund some or all of an unfunded past benefit obligation) under the statutes, a municipality must submit a three-year financial plan to the OPM secretary for him and the state treasurer to review. The bill instead requires this plan, which under existing law includes the major assumptions and financial plan for the bonds, to cover a five-year

period.

## **§ 2 — FILING FINANCIAL STATEMENTS WITH OPM**

Municipal entities with annual receipts of up to \$1 million are exempt from the requirement applicable to other municipal entities that they annually submit an audit to the OPM secretary (CGS § 7-393). Instead, existing law requires these municipal entities, such as special taxing districts, to annually file a financial statement with the local town clerk within 90 days after the end of the fiscal year. The bill additionally requires the statement to be filed with the OPM secretary upon his request. The bill extends existing law's penalty for failing to file the statement with the town clerk (\$500 per statement not filed) to include failure to file with the OPM secretary.

## **§ 3 — MFAC REFERRAL AFTER LATE AUDIT SUBMISSION**

Municipal entities that are required to file an audit with the OPM secretary must do so within six months of the end of the fiscal year unless they apply for and are granted one or more extensions. Currently, municipal entities that miss the regular or extended deadlines are assessed a civil penalty ranging from \$1,000 to \$10,000 unless it is waived by the OPM secretary.

The bill instead requires the OPM secretary to refer an entity that misses the filing deadline to MFAC, assess the civil penalty, or do both. As under current law, the secretary can generally waive these penalties if there was reasonable cause for the delay (see § 4, below, requiring MFAC referrals when audits are more than a year overdue).

## **§ 4 — MANDATORY MFAC REFERRAL AND TIER I DESIGNATION**

The bill changes the criteria the OPM secretary uses to refer a potentially fiscally distressed municipality to MFAC if it has not been referred previously. If a municipality is referred under this set of criteria, it is designated tier I (see § 7, below).

Under current law, the secretary must refer a municipality to MFAC if it has done any of the following:

1. reported a declining fund balance trend in the two immediately

preceding fiscal years;

2. had a general fund annual operating budget deficit of at least 1.5% of its general fund revenues in the immediately preceding fiscal year; or
3. had a general fund annual operating budget deficit of at least 2% of its average general fund revenues in the two immediately preceding fiscal years.

The bill replaces these three triggers with a requirement that the secretary refer a municipality that reported (1) an operating deficit in the two immediately preceding fiscal years and (2) a fund balance percentage of less than 5% in the immediately preceding fiscal year.

Under current law, the secretary must also refer a municipality if it issued tax or bond anticipation notes in the three immediately preceding fiscal years to meet cash liquidity. The bill instead requires a referral if it issued tax or revenue anticipation notes for this purpose.

The bill also adds two new referral criteria. The secretary must refer the municipality if it has done either of the following: (1) reported an annual audit that included at least one material or significant audit finding that was reported in the annual audits of the two immediately preceding fiscal years or (2) was at least 12 months late in filing its audit.

Under existing law and unchanged by the bill, the secretary must refer a municipality if it (1) has a negative fund balance percentage; (2) reported a fund balance percentage of less than 5% in the three immediately preceding fiscal years; or (3) received a bond rating below A.

## **§ 5 — FILING MUNICIPAL FINANCIAL DATA ELECTRONICALLY**

Beginning by January 31, 2023, and annually thereafter, the bill requires municipalities (including school districts and special taxing districts) to electronically file with OPM their audited financial statements and any other requested information on their financial condition. (Presumably, this requirement is related to OPM's

implementation of the Fiscal Health Monitoring System).

Currently, these municipalities must use the uniform chart of accounts that OPM's secretary developed. The bill specifies that financial reports using this uniform reporting template must be filed annually by January 31. In practice, this is already occurring.

#### **§§ 6 & 14 — MUNICIPAL RESTRUCTURING FUND LOAN**

The law establishes the nonlapsing Municipal Restructuring Fund to provide financial assistance to designated tier II, III, and IV municipalities (i.e., those subject to MARB oversight). To receive assistance, an eligible municipality must submit a plan for approval to the OPM secretary that details the municipality's overall restructuring plan, including the local actions it will take and how it will use the funds.

In deciding whether to fund the plan, the secretary must consult with MARB about the amount and timing of the fund distributions and the conditions on how the funds can be used. The bill specifies that the secretary must consult with MARB to determine whether any funds should be provided as a loan.

#### **§§ 7-8 & 11-12 — FINANCIAL PLANS COVERING FIVE-YEAR PERIOD**

Currently, if the OPM secretary refers a tier I designated municipality to MFAC, it must prepare and present a three-year financial plan to the commission for its review and approval. The bill instead requires municipalities to prepare and present a five-year plan.

Current law allows MARB to require designated tier II municipalities to prepare three-year financial plans and submit them to MARB for its review and approval. The bill instead allows MARB to require a five-year financial plan.

The bill also makes related conforming changes (§§ 11 & 12).

#### **§ 7 — DESIGNATION AS TIER I MUNICIPALITY**

##### ***By Request***

Under current law, a municipality's chief elected official (CEO) may apply to the OPM secretary to have the municipality designated as tier I if it meets one of the three sets of criteria as shown in Table 1 below.

The bill eliminates these criteria and instead allows a municipality to be designated as tier I if the CEO (1) expects, in the next 24-month period, that the municipality will meet at least one condition requiring the OPM secretary to refer it to MFAC (see § 4 above) and (2) submits a report to MFAC, in a form and manner it prescribes, that confirms this.

**Table 1: Tier I Designation Criteria in Current Law**

<i>Measures</i>	<i>Set 1</i>	<i>Set 2</i>	<i>Set 3</i>
Bond rating	No rating or its highest rating is A or above, so long as all of its ratings are investment grade	No rating or its highest rating is A, so long as all of its ratings are investment grade	Bond rating is AA or above, so long as all of its ratings are investment grade
State municipal aid as percentage of current year general fund budget	Less than 30%	Less than 30%	30% or more
Fund balance	Positive	Positive fund balance of less than 5%	Positive
FY 18 municipal revenue increase as a percentage of revenue	At least 2%	Not applicable	At least 2%
Equalized mill rate	Not applicable	Not applicable	Equalized mill rate less than 30 mills

### ***Mandatory Designation Related to Audit Issues***

If the OPM secretary refers a municipality to MFAC after reviewing its audit, or for failure to file an audit as described above (see § 4), it is designated a tier I municipality automatically under the bill.

## **§ 8 — DESIGNATION AS TIER II MUNICIPALITY**

**By Request**

Under current law, a municipality's CEO may apply to the OPM secretary to have the municipality designated as a tier II municipality if it meets one of the five sets of criteria as shown in table 2 below.

**Table 2: Tier II Designation Criteria in Current law**

<b>Measures</b>	<b>Set 1</b>	<b>Set 2</b>	<b>Set 3</b>	<b>Set 4</b>	<b>Set 5</b>
Bond Rating	No rating from a bond rating agency or its highest rating is A, so long as all of its ratings are investment grade	No rating from a bond rating agency or its highest rating is A, so long as all of its ratings are investment grade	Highest bond rating is AA or higher, so long as all of its ratings are investment grade	Highest bond rating is AA or higher, so long as all of its ratings are investment grade	Highest rating is Baa or BBB, so long as all of its ratings are investment grade
State aid as percent of prior or current fiscal year general fund budget	30% or more	30% or more	30% or more	Not applicable	Not applicable
Fund balance	Positive fund balance of at least 5%	Positive fund balance of less than 5%	Not applicable	Negative	Positive
FY 18 municipal revenue increase as a percentage of revenue	At least 2%	Not applicable	Not applicable	Not applicable	Not applicable
Equalized mill rate	Less than 30 mills	Less than 30 mills	30 or more mills	Not applicable	Less than 30 mills

The bill replaces the current criteria with a requirement that the municipality be designated as tier I, have held at least one meeting with

MFAC, and either (1) has an equalized mill rate of at least 30 mills or (2) received 30% or more of its most recent audited financial statement revenues in the form of state aid.

Under the bill, if a CEO applies to OPM for tier II designation, it must provide a copy of the application to MFAC within 10 days.

Under the bill, the OPM secretary must designate the municipality as tier II, as requested, and refer it to MARB if he determines its financial condition warrants it, based on his review of MFAC's reports and findings. Currently, he must refer to MARB any municipality that requests tier II designation.

### ***Designation Upon MFAC's Recommendation***

The bill establishes a procedure for MFAC to recommend a municipality be designated tier II. (See § 9 for a discussion on MFAC's authority to recommend a tier III designation for a tier I municipality.)

After MFAC holds at least one meeting with a designated tier I municipality, it may recommend to the OPM secretary that the municipality be designated tier II based on its financial condition, which MFAC must document in a report it submits to the secretary. MFAC must also provide a copy of the report to the municipality within 10 days.

Within 45 days of receiving the report, the OPM secretary may approve or reject MFAC's recommendation; if no decision is made, it is deemed rejected.

## **§ 9 — TIER III MUNICIPALITY DESIGNATION**

Current law provides two paths for designating a municipality as tier III: (1) the municipality (through the CEO or legislative body) requests it because it meets specified bonding capacity and fiscal distress criteria or (2) the secretary designates the municipality as tier III based on specified distress criteria.

### ***By Request***

Current law allows a municipality to request designation as tier III if



it meets one of the following criteria:

1. the municipality has at least one bond rating from a bond rating agency that is below investment grade or
2. the municipality has no bond rating from a bond rating agency, or its highest bond rating is A, Baa, or BBB, so long as all of its ratings are investment grade, and it has either (a) a negative fund balance percentage or (b) an equalized mill rate of 30 or more, and it receives 30% or more of its current or prior fiscal year general fund budget revenues in state municipal aid.

The bill replaces these bonding-capacity criteria with different fiscal distress criteria and specifies that a tier I municipality can request designation as tier III after holding at least one meeting with MFAC if it (1) has an equalized mill rate of at least thirty mills or (2) received 30% or more of its most recent audited financial statement revenues as municipal aid from the state.

As under current law, the OPM secretary must designate a municipality as tier III if the information MFAC provides supports the designation.

Under current law, if the municipal CEO is making the request, he or she must give the local legislative body at least 30 days to approve or reject the request, after which, if no action is taken, it is deemed approved. The bill extends this waiting period to 45 days.

Under the bill, if a municipality applies to OPM for tier III designation, it must also provide a copy of the application to MFAC within 10 days.

### ***Designation by OPM Secretary***

Under current law, the OPM secretary must designate any municipality as tier III, regardless of whether it applied for such designation, if it meets the criteria for voluntary tier III designation (see above) or it issues either of the following:

1. a deficit funding bond or issued one between July 1, 2012, and July 1, 2017; or
2. refunding bonds with over 25-year terms that fail to achieve net present value savings as the law requires, and its total annual debt obligations, including the refunding bonds, exceed the obligations for the refunding bonds for the first full year after they were issued.

The bill retains these criteria (except for the component on deficit funding bonds issued before July 1, 2017) and additionally requires the OPM secretary to designate a municipality as tier III if it receives a bond rating below investment grade.

The bill requires municipalities that are eligible for designation under any of these criteria to notify OPM within 10 days after the triggering condition occurred.

#### ***Designation Upon MFAC's Recommendation***

The bill establishes a process for MFAC to recommend to the OPM secretary that a tier I municipality, with which it has met at least once, be designated as tier III due to its fiscal condition. MFAC must document the municipality's fiscal condition in a report it gives to the OPM secretary. The secretary must approve or reject the recommendation within 45 days after receiving the report. His failure to act is deemed a rejection.

#### **§ 10 — MARB ACTION ON LABOR CONTRACTS**

In addition to reviewing and commenting on municipal budgets, existing law authorizes MARB to approve or reject any municipal or board of education collective bargaining agreement or amendment, to the extent the local legislative body can. The bill limits MARB's authority to do so by specifying that it only has this authority over municipalities that are referred to it on or after October 1, 2022.

Under current law, MARB must act on agreements within 30 days after their submission to MARB. The bill instead specifies that agreements are deemed approved after 30 days if MARB has not

approved or rejected them.

## **§ 12 — DESIGNATION AS TIER IV MUNICIPALITY**

The bill makes a minor change to the criteria MARB uses to designate a tier III municipality as a tier IV municipality. It extends, from three years to five, MARB’s lookback period when it reviews a municipality’s budget projects. This conforms to other changes in the bill requiring municipalities to prepare five-year, instead of three-year, financial plans (see above).

## **§§ 13 & 15 — CONDITIONS FOR ENDING DESIGNATION**

The bill subjects all designated municipalities to the same criteria for determining whether their designation terminates. The revised criteria are similar to the criteria currently used.

The bill also (1) alternatively allows MFAC, by unanimous vote, to end a municipality’s designation as tier I after evaluating its financial condition; and (2) makes it easier to re-designate a municipality as tier I-IV after its initial designation terminates.

### ***Criteria for Ending Designation***

Under current law, a municipality designated as tier I or II must generally retain this designation until, in the fiscal years after its designation, it meets four criteria as listed in Table 3. The bill modifies these criteria and makes them applicable to tier I-IV municipalities, as shown in Table 3. The currently applicable criteria for tiers III and IV are also shown in Table 3.

**Table 3: Ending Designation Under Current Law and the Bill**

<b>Current Law</b>		<b>The Bill</b>
<b><i>Tiers I &amp; II</i></b>	<b><i>Tiers III &amp; IV</i></b>	<b><i>Tiers I - IV</i></b>
There have been no annual operating deficits in the municipality’s general fund for two consecutive fiscal years	There have been no annual operating deficits in the municipality’s general fund for three consecutive fiscal years	There have been no audited operating deficits in the municipality’s general fund for two consecutive fiscal years
The municipality’s bond	The municipality’s bond	The municipality’s bond rating

rating has either improved or remained unchanged since its most current designation	rating has either improved or remained unchanged since its most current designation, so long as it has no bond ratings that are below investment grade	has either improved or remained unchanged since its most current designation
The municipality has presented, and MFAC or MARB has approved, a financial plan that projects a positive unreserved fund balance for the three succeeding consecutive fiscal years	The municipality has presented, and MARB has approved, a financial plan that projects a positive unreserved fund balance for three succeeding consecutive fiscal years	The municipality has presented, and MFAC or MARB has approved, a financial plan that projects a positive fund balance for the three succeeding consecutive fiscal years, and in which a positive fund balance of at least 5% is projected for the third fiscal year
The municipality's audits for these consecutive fiscal years have been completed and contain no general fund deficit		

Under existing law and unchanged by the bill, a tier IV municipality retains its designation if it issues bonds or other debt to fund a general fund deficit after being designated.

***Re-designating a Municipality***

The bill makes it easier to re-designate a municipality as tier I-IV after its initial designation terminates. It does so by repealing provisions specifying that a municipality whose designation was removed must remain undesignated unless:

1. for a tier I or II municipality, a change in circumstances requires it to be designated in a higher tier than its most recent designation and
2. for a tier III or IV municipality, it (a) has an annual operating deficit in its general fund equal to 1% or more of its annual general fund budget; (b) experiences an annual operating deficit in its general fund in consecutive years of any amount; or (c) has one or more bond ratings that are below investment grade.

## **BACKGROUND**

### ***MFAC and MARB***

MFAC oversees the two-tier certification system that predates the four-tier designation system for classifying financially distressed municipalities as established by MARB legislation (PA 17-2). MFAC oversees certified tier I and II municipalities and designated tier I municipalities. MARB oversees designated tier II, III, and IV municipalities. (The higher numbered tiers relay higher levels of fiscal distress and oversight.)

Generally, MARB may, among other things and depending on the tier designation, (1) require monthly status reports and monitor compliance with financial plans and budgets; (2) review and comment on budgets and approve revenue assumptions; (3) review and comment on, or approve, debt obligations; (4) recommend efficiency measures and hire consultants or a financial manager; and (5) set an interim budget.

The law allows municipalities working with (1) MFAC or MARB to issue deficit financing bonds and (2) MARB to obtain state financial assistance in the form of funds to repay outstanding debt (i.e., contract assistance) and restructure finances (i.e., municipal restructuring).

## **COMMITTEE ACTION**

Planning and Development Committee

Joint Favorable Substitute Change of Reference - FIN  
Yea 26 Nay 0 (03/25/2022)

Finance, Revenue and Bonding Committee

Joint Favorable  
Yea 51 Nay 0 (04/06/2022)