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ResearchReport

Municipal Finance Advisory Commission Oversight

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Issue

How does a municipality come under Municipal Finance Advisory Committee (MFAC) oversight and what authority does MFAC have over them?

Summary

In 2017, the legislature established a four-tier system under which financially distressed municipalities are designated as tier I, II, III, or IV (PA 17-2, June Special Session). The higher numbered tiers indicate higher levels of fiscal distress and oversight. MFAC is responsible for overseeing designated tier I municipalities. The Municipal Accountability Review Board (MARB), which is not covered in this report, is responsible for overseeing the other tiers.

There are two paths by which a municipality may receive a tier I designation: upon the municipality's request or upon the Office of Policy and Management (OPM) secretary referring it to MFAC. All municipalities referred to MFAC must work with the commission to improve their financial condition. But not all municipalities that are referred to the commission necessarily become tier I municipalities. Under the law, MFAC may designate as tier I any municipality OPM refers to it based on a finding that at least one of eight fiscal distress criteria, described below, is met. According to OPM, currently only Derby is a designated tier I municipality.

Municipal Finance Advisory Committee (MFAC)

An eight-member commission that has, to varying degrees, oversight authority over:

- *municipalities OPM refers to it*
- *designated tier I municipalities (under the newer four-tier system)*
- *certified tier I & II municipalities (under the original two-tier system)*

Once designated as a tier I, a municipality:

1. must work with the commission to improve their financial condition (in the same way referred municipalities must),
2. must prepare a five-year financial plan for MFAC's approval, and
3. can access certain funding tools to issue bonds.

The four-tier system designation scheme is an alternative to an earlier two-tier scheme, which the legislature established in 1993. Municipalities in these tiers are referred to as "certified tier I and tier II" municipalities (as opposed to "designated" municipalities under the newer four-tier system). These certified municipalities may similarly use certain funding tools to issue bonds, including deficit financing bonds, if they agree to fiscal oversight and control by MFAC. According to OPM, there are currently no certified tier I or tier II municipalities.

Table 1 below provides an overview of the different paths by which a municipality may be referred to MFAC under the law and MFAC's oversight over them.

Table 1: Referrals to MFAC

Paths to Being Referred		MFAC Oversight
Based on fiscal criteria (mandatory referral)	OPM must refer a municipality to MFAC if it meets one of eight fiscal criteria (CGS § 7-395(d), as amended by PA 25-168, § 121)	Municipality must work with MFAC to improve its financial condition (e.g., the commission may require the chief executive officer to appear before it and report on remedial measures) (CGS § 7-394b)
Based on audit irregularities (mandatory referral)	OPM must refer a municipality to MFAC upon finding there are certain irregularities in the municipality's audit or financial practices (CGS § 7-395(b))	Same as above
Based on audit (discretionary)	OPM generally has discretion to refer a municipality to MFAC based on its audit review (CGS § 7-395(e))	Same as above

Table 2 below provides an overview of the paths by which municipalities become a certified tier I, certified tier II, or designated tier I municipality, as well as the level of oversight MFAC has over each category and the financial tools that may be available to them.

Table 2: Certified Tier I & II and Designated Tier I Municipalities

	Path	MFAC Oversight	Financial Tools Available
Designated Tier I	After an OPM referral based on fiscal criteria, MFAC may designate the municipality as tier I (CGS § 7-576a; PA 25-168, § 122, requires OPM to do so in limited circumstances) Municipalities may also voluntarily apply for this designation (CGS § 7-576a)	Must prepare five-year financial plan and work with MFAC to improve its financial condition (CGS § 7-576a)	Issue general obligations (but not to cover a general fund deficiency) for which there is a special capital reserve fund (SCRF; see below) (CGS § 7-573)
Certified Tier I	Municipality may apply for certification to the OPM secretary, who may certify it as tier I based on its bond rating (CGS § 7-572)	If a municipality intends to issue general obligation bonds supported by a SCRF, OPM must refer it to MFAC and the municipality must work with MFAC to improve its financial condition (CGS §§ 7-573 & 7-394b and Conn. Agencies Regs., § 7-572-2)	Issue general obligations (but not to cover a general fund deficiency) for which there is a SCRF (CGS § 7-573) OPM-provided staff and financial assistance to develop a comprehensive economic development plan (CGS § 7-578)
Certified Tier II	Municipality may apply for certification with the OPM secretary, who may certify it as tier II based on its bond rating and deficit obligations (CGS § 7-574)	Must work with MFAC to improve its financial condition, present a three-year financial plan and monthly financial report, and use MFAC's revenue assumptions when preparing its budget (CGS § 7-576 and Conn. Agencies Regs., § 7-572-2)	Issue general obligations (including to cover a deficit) for which there is a SCRF (CGS § 7-575) OPM-provided staff and financial assistance to develop a comprehensive economic development plan (CGS § 7-578)

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Referrals to MFAC

The OPM secretary must refer a municipality to MFAC if (1) there are certain problems in the municipality's audit or financial practices or (2) the municipality meets one of eight fiscal criteria. Otherwise, the secretary generally has discretion to refer a municipality to the commission. MFAC must work with all municipalities referred to it and may impose civil penalties on municipalities that do not comply.

Mandatory Referrals by OPM to MFAC

Audit-Based Referral. By law, the OPM secretary must review audit reports submitted by an independent auditor on municipalities, regional school districts, and certain other municipal agencies. He must refer a municipality to MFAC if his review finds (1) the audit was not prepared in accordance with generally accepted accounting principles, as required by law, or (2) evidence of unsound or irregular financial practices or management letter comments or a lack of internal controls.

The secretary must prepare and submit to MFAC a report on these findings that includes information to evaluate the findings and recommendations for corrective action (CGS § 7-395(b)). Upon receiving the secretary's report, MFAC must review the municipality's audits, budgets, accounting and fiscal management practices, and any other relevant information when determining the municipality's level of financial distress (CGS § 7-394b).

Fiscal Criteria-Based Referral. The OPM secretary must also refer to MFAC any municipality, unless it has previously been referred, that:

1. has a negative fund balance percentage ("fund balance percentage" means a municipality's general fund balance divided by the fund's revenues and operating transfers into it for the fiscal year (CGS § 7-560(14)),
2. reported a fund balance percentage of less than 5% in the prior three fiscal years,
3. reported an operating deficit in the prior two fiscal years and fund balance percentage of less than 5% in the prior fiscal year,
4. issued tax or revenue anticipation notes to meet cash liquidity in the three prior fiscal years,
5. failed to file an annual audit report within 12 months after the end of the fiscal year,
6. had a material or significant finding in its annual audit report that was also in the two prior fiscal years' audits,
7. received a bond rating below A, or

8. has been a distressed municipality for at least 15 years in a row and has a population between 15,001 and 20,000 people (currently only Ansonia qualifies) (CGS § 7-395(d), as amended by PA 25-168, § 121).

By law, the commission may designate a municipality referred to it for any of these reasons as a tier I municipality (CGS § 7-576a).

Optional OPM Referral

The OPM secretary has discretion to refer any municipality, based on a review of its audit report, to MFAC that has not previously been referred to the commission (CGS § 7-395(e)).

MFAC Oversight Over Referred Municipalities

By law, MFAC must work with any municipality that OPM refers to the commission to improve the municipality's fiscal condition. The commission may require the municipality's chief executive officer to:

1. provide information,
2. appear before it to discuss the municipality's financial condition and corrective measures to improve it, and
3. submit a report on these and other corrective measures the municipality takes.

The law authorizes the commission to impose a penalty of between $1,000 and $10,000 on municipalities that do not provide requested information or comply with the reporting requirement (CGS § 7-394b).

Designated Tier I Municipalities

Paths to Designation

After Mandatory OPM Referral. If the OPM secretary refers a municipality to MFAC based on the municipality's fiscal condition (meaning it meets one of the eight criteria described above), the law authorizes the commission to designate it as a tier I municipality (CGS § 7-576a, as amended by PA 25-168, § 122, which requires designation under limited circumstances). (Under a prior version of the law, these municipalities were automatically designated tier I (see PA 24-132, § 13).) The commission must base its decision on an evaluation of the municipality's financial condition and practices.

Upon Municipal Request. Even if a municipality does not meet any of the eight criteria described above, it may apply to the commission for a tier I designation. To do so, the municipality's chief executive officer must submit a report to MFAC showing that he or she expects the municipality will meet at least one of the criteria in the next 24 months. As with municipalities referred to it, the commission must base its decision on the municipality's financial condition and practices (CGS § 7-576a).

MFAC Oversight

In addition to meeting the requirements for municipalities referred to the commission (e.g., providing information and appearing before it), each municipality designated as tier I must prepare and present a five-year financial plan to MFAC for its review and approval (CGS § 7-576a).

Certified Tier I and Tier II Municipalities

The law's four-tier designation scheme (described above) is an alternative to a two-tier certification scheme the legislature established in 1993. Prior to the 2017 law establishing the four-tier system, a municipality could access the methods for issuing SCRF-backed general obligation bonds (see *Special Capital Reserve Funds* below) based only on statutory criteria that classifies qualifying municipalities into two tiers, which the law labels certified tier I and certified tier II, to distinguish them for its four-tier designation scheme. A certified municipality's finances are subject to MFAC oversight.

Path to Being Certified Tier I or II

Municipalities that want to access methods for issuing SCRF-backed general obligation bonds or deficit financing bonds may apply to the OPM secretary for the appropriate certification. The OPM secretary may certify a municipality that applies and meets the criteria shown in Table 3 below.

Table 3: Criteria for Certified Tier I and Tier II Municipalities

Certified Tier I (CGS § 7-572)	Certified Tier II (CGS § 7-574)
• Has a long-term investment grade or higher bond rating, • Unable to obtain bond insurance on reasonable terms and conditions, and • Meets other OPM standards	• Has a long-term investment grade or higher bond rating, • Unable to obtain bond insurance on reasonable terms and conditions, • Has not issued a deficit obligation within the last five years, • Has no outstanding deficit obligations, and • Meets other standards established by OPM

MFAC Oversight

Certified Tier I. OPM must refer a certified tier I municipality to MFAC if the municipality intends to issue general obligation bonds, as described below (CGS § 7-573). In addition to complying with the requirements for issuing these bonds, the municipality must comply with the same requirements that apply to other municipalities referred to MFAC (e.g., providing information to and appearing before the commission and reporting on corrective measures; see *MFAC Oversight Over Referred Municipalities* above). MFAC may require both certified tier I and II municipalities to have special audits done, at their own expense, to minimize the risk of state general funds being needed to cover the municipality's use of certain financial tools, specifically through a state-backed SCRF as described below (Conn. Agencies Regs., § 7-572-2).

Certified Tier II. By law, certified tier II municipalities are subject to more state fiscal oversight and control, as exercised by MFAC, than certified tier I municipalities. They also have access to financing tools that certified tier I municipalities do not, specifically general obligation bonds to fund a deficit, as described below.

Each certified tier II municipality must work with MFAC to improve its fiscal condition. It must prepare and present to the commission a three-year financial plan and a monthly financial report. Additionally, it must use MFAC-approved assumptions when preparing its annual budget, specifically assumptions about state revenue and property tax revenue (CGS § 7-576). Regulations specify that MFAC, in addition to other requirements, must monitor these municipalities' plans to eliminate any deficit (Conn. Agencies Regs., § 7-572-2).

Access to Financial Tools

General Obligations (Not to Fund a General Deficiency)

Designated tier I and certified tier I municipalities are eligible to issue general obligations (e.g., bonds), with a term of more than one year, that are supported by a special capital reserve fund (SCRF; see below). By law, these bonds may not be used to cover a general fund deficiency.

Tier I municipalities that want to issue these obligations must consult with the state treasurer, notify OPM, and, among other things, establish a property tax intercept procedure and debt service payment fund (CGS § 7-573 and Conn. Agencies Regs. §, 7-572-1 & -3).

"Property tax intercept procedure" *is a procedure allowing a municipality to collect and deposit in a debt service payment fund property taxes needed to back general obligations the municipality issues.*

"Debt service payment fund" *is a fund into which intercepted property taxes are deposited and from which debt service on a municipality's general obligations (with terms of more than one year) are paid, including those that are supported by a SCRF.* (CGS §§ 7-560(29) & (4) and 7-562)

General Obligation Bonds to Fund a Deficit

By law, municipalities generally may not issue any deficit obligation (e.g., a bond or note) to fund a general fund deficiency (CGS § 7-568(a)). However, the law provides an exception making certified tier II municipalities eligible to issue general obligation bonds, with a term of more than one year, that are supported by a SCRF. These bonds may be used to fund a deficit (except a projected fiscal year deficit) (CGS § 7-575). (There is also an exception to the general ban for municipalities willing to be designated tier III (CGS § 7-568) or already designated II, III, and IV and subject to MARB oversight, which is beyond the scope of this report.)

Certified tier II municipalities must get MFAC's approval before issuing these bonds (CGS § 7-576). They must also consult with the state treasurer, notify OPM, and, among other things, establish a property tax intercept procedure and debt service payment fund (CGS § 7-575 and Conn. Agencies Regs. §, 7-572-1 & -3).

Comprehensive Economic Development Plan

Certified tier I & II municipalities, within one year of their initial participation as certified municipalities, may develop a comprehensive economic development plan designed to increase the municipality's tax base to a level that will allow it to prove an adequate level of municipal services. The OPM secretary may provide qualified staff and financial assistance to the municipality to develop it. If a municipality develops one, the secretary and Department of Economic and Community Development Commissioner must annually evaluate it. If the municipality fails to show substantial progress in meeting the plan's goals, the state may suspend assistance to the municipality (CGS § 7-578).

Special Capital Reserve Funds

Certified (including tier I and II) and designated (including tier I) municipalities may, subject to certain approvals and requirements, establish a SCRF to secure general obligations (CGS § 7-571). A SCRF is a fiscal tool designed to ensure that funds are available when needed to repay bondholders. The fund must have in it a specified capital reserve (at minimum, the amount needed to cover the principal, interest, and other amounts that will be owed on the general obligation during the following fiscal year) and the law authorizes certified and designated municipalities to issue additional general obligations to fund it (CGS §§ 7-570 & -571).

SCRFs established by a certified or designated municipality may be state backed, potentially allowing the municipality to secure better market rates. If a state backed SCRF's balance falls below the required level, on December 1, the state must use funds from the state's general fund to restore the SCRF to the required level. If this occurs, the municipality must repay the state as soon as possible (CGS §§ 7-569 & -571).

Ending Tier Designation or Certification

Designated Tier I

Designated tier I municipalities retain their designation until MFAC unanimously votes to terminate it, based on an evaluation of its financial condition and practices (CGS § 7-576f(a)(1)).

Designated tier I municipalities may also become designated tier II or III municipalities and then become subject to the MARB's oversight instead. The municipality may apply to the OPM secretary for the designation if it meets certain criteria (e.g., has an equalized mill rate of at least 30 mills or state aid makes up 30% or more of its revenue). Even if the municipality does not apply for it, MFAC may (after meeting at least once with the municipality) recommend the tier change to the OPM secretary (CGS §§ 7-576b and -576c).

Certified Tier I or II

The OPM secretary may recertify and decertify a municipality. But he cannot automatically decertify a municipality because it is able to secure bond insurance (which is one of the criteria to be certified tier I or II) (CGS §§ 7-572 and -574)).

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