The Center for Local, State, and Urban Policy

Gerald R. Ford School of Public Policy >> University of Michigan

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Student Case Study Series

A Tale of Two Counties:

Reconciling Differences in Fiscal Stress Across Similar Rural Communities in Michigan

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Executive Summary

This case study compares two municipalities (Counties X & Y) with similar demographic characteristics and economic growth trajectories across objective and subjective indicators of fiscal health. After studying the financials of Counties X and Y, we found that fiscal ratios alone cannot completely explain why they rated their own fiscal health quite differently in the Michigan Public Policy Survey. Instead, we hypothesize that these ratings are based on transition periods: whether a healthy county is getting "sick," or whether a sick county is improving its financial health. It is suggested that local governments are evaluated across a broader range of financial circumstances to establish a more comprehensive understanding of their fiscal health.

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Background

Launched in 2009 by the Center for Local, State, and Urban Policy (CLOSUP), the Michigan Public Policy Survey (MPPS) is an annual state-wide survey of local government leaders in Michigan conducted in partnership with the Michigan Association of Counties, Michigan Municipal League, and Michigan Townships Association. The surveys gauge local officials' perspectives on a variety of public policy issues, including local finances and economic development. Included in the MPPS are questions about fiscal stress: respondents are asked to rate their municipality's fiscal stress on a scale from 1 to 10 (1 indicating perfect fiscal health, 10 denoting a state of fiscal crisis) in the present-day, as well as to provide predictions for financial stress in five years. This case study will focus on understanding how two counties, County X and County Y,[1] with similar demographics, economic backgrounds, and objective financial indicators, report different subjective scores concerning financial stress.

County X reported low stress with a self-reported index score of 2, and County Y reported relatively higher stress with a self-reported index score of 5. County X specializes in agriculture, healthcare, and manufacturing, after witnessing a decline in its manufacturing industries. County X is also struggling some financially. For County X households, median household income is approximately two-thirds of the national median and significantly lower than the Michigan average. In 2016, the percentage of Country X residents below the poverty line (approximately 14%) exceeded the national average (12.7%). Demographically, County X is older and majority white.

To assess County X, we will compare it to a peer government, County Y, whose economy also focuses on similar sectors after its own reductions in its industrial sectors. Despite County Y's larger population, many of its historic and demographic characteristics remain similar, as do its population and economic growth trends. Nevertheless, County X reported low fiscal stress while County Y has reported high fiscal stress. This case study will examine County X and County Y to establish what factors may have influenced the discrepancy in the self-reported fiscal stress of seemingly similar local governments.

Demographic Comparisons

	County X	County Y
population size	30,000	40,000
median age	48	45
median household income	40,000	40,000
median property value	90,000	100,000
poverty rate %	14	16
unemployment rate %	7	5

1 Cases are anonymized to protect the confidentiality of the survey.

Financial Condition Assessment

The counties are compared along three metrics of fiscal condition: liquidity, performance, and solvency.

Liquidity

Liquidity is concerned with how well governments can cover short-run obligations using liquid assets, and is not a major concern for County X or County Y, although County Y has a much lower cash level to cover daily operating expenses. Both counties have quick ratios above 1, which indicates that each entity can cover their respective liabilities using their most liquid assets, or cash and cash equivalents. Regarding more medium-term measures of liquidity, both counties have adequate current ratios and short-run financial position ratios that indicate a sufficient financial flexibility to cover expenses in an emergency. County X, however, has a higher cash cushion than County Y to cover daily operating expenses. County Y could cover roughly 45 days of operating expenses with its cash on hand, which is less than the recommended 90 days. Overall, the ratios calculated demonstrate that liquidity is not currently a major issue for either of these municipalities.

	County X	County Y
Current ratio	2.14	5.40
Short-Run Financial Position	0.19	0.16
Liquidity (Quick)	1.39	1.94
Liquidity (Quick) + investments	1.61	1.94
Days of cash on hand	157.60	45.79

Performance

Performance ratios are concerned with fiscal sustainability, or measuring how a government consistently balances its budget. In this section, we include ratios assessing county operating margins, net asset growth, and revenue composition. These measures allow us to understand profitability, financial autonomy, and the extent to which program revenues defray costs.

County X reported a deficit of $1.2 million for overall governmental activities in 2016, resulting in an 11.6% decline in net assets while County Y increased its net assets by $265,000, or 31.5%. Nevertheless, both counties grew their General Fund balances—the "rainy day" fund for most local governments—during 2016.

Both counties experienced roughly similar, "operating margin" ratios in 2016, which indicates that revenues from programs—typically fees or grants--are covering associated operating expenses at similar rates.

Both counties also have comparable non-own-source revenue ratios. County X relies on outside sources for 13.2% of its revenue, while County Y is more reliant on outside sources at 18.1%. While the decline in net assets for County X is worth keeping an eye on, overall, performance ratios do not suggest that either county is experiencing significant problems related to financial performance.

	County X	County Y
Operating margin	0.63	0.63
Net asset growth	-0.12	0.32
(Non) Own-source revenue	0.13	0.18

Solvency

Solvency is often most important to local governments, for it is frequently assessed by potential investors and the public regarding a municipality's capacity to pay off long-term debts. While some literature suggests that large national governments may continue to take on a large debt burden, experiences such as the 2013 Detroit Bankruptcy demonstrate that local governments have a limited borrowing capacity. Thus, it is important for local governments to remain mindful of their ability to pay their debts.

County X and County Y both have healthy indicators for solvency. With near-term solvency ratios close to 1, both county governments indicate that they could comfortably cover liabilities with annual revenues. Similarly, both counties are investing resources to grow the value of their capital assets. Debt service payments also take up a relatively small portion of current resources for County X at 0.1% of operating expenditures and County Y at 3.9%.

While County X has a lower per capita burden of debt from bonds, once retiree pension and healthcare debt are added in, County X has a higher per capita burden.

	County X	County Y
Near-term solvency	1.00	1.08
Debt burden (bonded debt only)	73.98	238.86
Debt burden (including pension/OPEB)	1131.69	559.67
Governmental funds debt coverage	0.00	0.04
Capital asset condition	0.02	0.05

Self-rated fiscal stress

County X reports a low level of fiscal stress with a score of 2 on a 1 to 10 scale. Looking forward, the county reported uncertainty regarding their financial future. County Y, despite facing similar current circumstances, reported a higher present fiscal stress score of 5. However, the county had a positive outlook and reported that it anticipates being in a slightly better financial condition in the next five years. This is telling of the situation and the similarities between both of these counties' financial positions, for it demonstrates that while both counties are in similar financial circumstance now, their subjective self-assessments reflect different financial trajectories.

Financial Ratio Analysis

Liquidity, Performance, and Solvency all influence each other. A government must take care to attend to its ability to pay off current liabilities, operate programs that are not over burdensome on general revenues, and cover long-term liabilities. Trouble in either of these domains may cause financial distress for a municipality and influence the way government officials perceive their fiscal stress.

For County X, performance ratios are below the ideal range and the government has expressed anxiety regarding growing long-term obligations. Thus, performance is an issue and solvency may become a future issue as costs continue to grow while the populace, the primary means for governmental revenue, is declining and aging. County Y has recognized these potential threats and given themselves a high fiscal stress score to reflect their financial condition, although they anticipate slightly less financial stress in five years.

County X has recognized some of these threats in their financial reports but reported a low fiscal stress score for the present-day. As discussed earlier, County X does express uncertainty regarding future finances, and were unable to rate their finances in the future. This uncertainty may be the result of concern regarding the future of current long-term obligations. Both counties face current trends of a diminishing tax base through shrinking populations and a smaller workforce as many residents are growing old. These factors contribute toward County Y's current view of their fiscal health and may explain County X's forecast of potential future fiscal stress.

Demographic And Economic Factors

County X and County Y have an aging workforce and declining population, consistent with issues faced across the state. County X & Y exceed the median state-wide taxable value of $32,915. This means that despite the county's issues regarding an aging and declining population, both counties have the potential to raise more through property taxes than other municipalities.

Budget deficits for business-Type Activities, particularly medical care facilities, have led to a decrease in County X's net position. This county is particularly worried about cost containment issues related to the rising cost of healthcare. In financial reports, County X has identified the rise in medical costs associated with their public hospitals as the primary reason for their decreased net position. County X's government has stressed that cost containment will be necessary as health care costs continue to rise. Nevertheless, considering that many residents in this municipality live in poverty, these losses may continue as medical costs increase and healthcare remains inaccessible to those in the county.

The expenditures of County X's medical care facilities exceeded their revenues by over a million dollars in FY2016 and over half a million per year in FY2017 and FY2018. These losses have had an impact on the municipality's financial condition, and it suggests that medical costs have exposed the municipality to a substantial risk. This also demonstrates that it is important to look beyond traditional governmental functions such as public works, law enforcement, and recreation, to see factors that may be influencing financial condition.

County Y's public health facilities have not faced such a deficit; their health facilities operated at a loss of several hundred thousand dollars in FY2016 and FY2017, but its revenues exceeded its expenses in FY2018 by nearly one million dollars. Additionally, most of the cities located within County Y have experienced growth in net-position and overall revenues which exceed expenses in the most recent fiscal year. However, these cities and the County Y government have communicated that there are still concerns for the region. The lack of economic growth in the region has made these governments aware of their need to closely monitor their spending as they note that state and federal grants are seemingly unpredictable, local revenues plateau, and costs continue to rise.

Conclusion And Takeaways

The question remains as to why these peer counties reported different states of fiscal stress. One possibility is that there may be a transition period as municipalities enter and exit from states of fiscal stress. This would explain why these two "patients," even with similar symptoms, were given different diagnoses. Their financial ratios, economic trends, and historical contexts suggest that these two municipalities lay in similar current states of being. Yet, local officials have offered differing assessments of fiscal stress based on potential trajectories.

This suggests that Counties X and Y exist in differing transitional phases of fiscal health. County X, after years of good fiscal health, may be headed toward a state of high fiscal stress. Meanwhile, County Y is recovering from high fiscal stress and anticipates a better position within a few years. Time and perception matter. Thus, a complete picture of financial health cannot be completed from financial ratios and statements alone. It is important to keep the limitations of these statements in mind when assessing the overall fiscal condition of a local government.

Nonetheless, these counties tell us a lot about how fiscal and budgetary factors influence financial condition. Looking at MPPS responses, local trends, and financial documents helped to identify one of the primary issues: that growing program costs outpace the revenues needed to support them. This problem was made bare by County X's weak performance ratios. Worse yet, a shrinking, aging population will only exacerbate the problem by continuing to reduce County X's capacity to collect needed revenues. If not resolved, these symptoms will only worsen, and in turn will affect liquidity and solvency – making it much harder for the municipality to meet their future financial obligations.

This case study also reinforces the importance of considering broader social, political, and economic circumstances when assessing the financial condition of a municipality. For instance, County X identified that one of its current challenges is grappling with rising medical costs. Across the United States, growing out-of-pocket healthcare and insurance prices are sure to cause many municipalities fiscal distress, especially when public hospitals must serve patients regardless of their ability to pay. This is particularly salient for jurisdictions with above average poverty rates or with a large population of un/underinsured residents. A consideration of broader circumstances such as this will only aid in detecting and addressing signs of fiscal stress and how municipalities can respond.

About The Local Fiscal Health Project

The Local Fiscal Health Project is aimed at developing a deeper understanding of the fiscal health and fiscal challenges of local governments in Michigan. These case studies, authored by student Policy Analysts, focus on specific Michigan local governments and are intended to highlight some of the unique and possibly overlooked fiscal challenges they face.

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The **Center for Local, State, and Urban Policy (CLOSUP)**, housed at the University of Michigan's Gerald R. Ford School of Public Policy, conducts and supports applied policy research designed to inform state, local, and urban policy issues. Through integrated research, teaching, and outreach involving academic researchers, students, policymakers and practitioners, CLOSUP seeks to foster understanding of today's state and local policy problems, and to find effective solutions to those problems.

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