

**REPORT ON THE  
FEASIBILITY OF VESTING AN AGENCY OF THE  
COMMONWEALTH WITH THE RESPONSIBILITY  
AND NECESSARY AUTHORITY  
TO DEAL WITH LOCAL FINANCIAL EMERGENCIES  
TO  
THE GOVERNOR  
AND  
THE GENERAL ASSEMBLY OF VIRGINIA**



**HOUSE DOCUMENT NO. 8**

**COMMONWEALTH OF VIRGINIA  
RICHMOND  
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# COMMONWEALTH of VIRGINIA

*Office of the Governor*

*Richmond 23219*

Wayne F. Anderson  
Secretary of Administration and Finance

## MEMORANDUM

TO:           The Honorable Charles S. Robb  
                  Governor of Virginia

and

The General Assembly of Virginia

I am transmitting the report in response to House Joint Resolution No. 65 of the 1983 Session of the General Assembly. The report concerns the feasibility of vesting an agency of the Commonwealth with the responsibility and necessary authority to deal with local financial emergencies.

A handwritten signature in black ink, appearing to read "Wayne F. Anderson", written over a horizontal line.

Wayne F. Anderson

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COMMONWEALTH WITH THE RESPONSIBILITY AND NECESSARY AUTHORITY  
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1983

In 1973, the U. S. Advisory Commission on Intergovernmental Relations (ACIR) issued a detailed report, City Financial Emergencies: The Intergovernmental Dimension. In that study, and in subsequent studies, the ACIR recommended that states adopt mechanisms for determining when state intervention was needed and for providing corrective action.

After receiving and considering requests for Commonwealth loans or grants from two local governments that experienced financial emergencies in 1982, the 1983 General Assembly adopted House Joint Resolution Number 65, which requested the Secretary of Administration and Finance "to study the feasibility of vesting an agency of the Commonwealth with the responsibility and necessary authority to deal with financial emergencies arising in Virginia's local units of government." This report is hereby respectfully submitted to the 1984 General Assembly by the Secretary of Administration and Finance in compliance with the joint resolution.

This study is designed to explore why local government financial emergencies occur, the consequences of a local financial emergency, and the appropriate response of the state government to a local financial emergency. After addressing these aspects on a general or 50-state basis, this report will describe recent financial emergencies in Virginia, the Commonwealth's powers to assist local governments in trouble, and how these powers could be strengthened.

FINANCIAL EMERGENCIES AND THEIR IMPACTS

The possibility that the financial emergencies which occurred in New York and Cleveland during the past decade could be repeated in one's own state--to name only the two most publicized incidents--is bringing more and more states to replace ad hoc solutions to local financial emergencies with a more orderly and comprehensive approach to the problem. Prompting state action are the twin pressures faced by both states and localities of difficulty in raising new revenue and rising costs of government. Reductions in federal aid have provided yet another pinch on local governments. As the ACIR has pointed out, "restricted in many cases by Proposition 13 and its progeny from raising needed funds and facing an uncertain future with the loss of federal dollars, [local governments] must nevertheless cope with economic conditions that force their costs up and erode the revenues they do collect." To dramatize the serious nature of

the problem even more, events of recent years have demonstrated that adverse economic conditions can seriously strain even well managed local governments--and devastate poorly managed ones.

There are three major arguments that can be made to any state as to why it should adopt mechanisms for determining when state intervention is needed to assist local units of government that are experiencing financial difficulties and for providing corrective action:

1. The health, safety, and welfare of the inhabitants could be jeopardized in a local financial emergency because there could be a cessation of services provided by the local unit of government. Services could be affected because unpaid employees may refuse to work, vendors and suppliers may refuse to sell to the local government, and unpaid holders of obligations may seek judicial enforcement of their legal rights to the future revenues of the local unit of government.
2. Serious damage to the credit of the local unit of government, governments throughout the state, and to the state government itself could result if a locality defaults.
3. The state, as the source of the local governments' constitutional and statutory authority for operating, is responsible for them.

Many states have not only adopted means for controlling local government financial emergencies, but also procedures designed to prevent them. The efforts to anticipate difficulties have focused on developing indicators of trends in general economic conditions and in local revenues, expenditures, and management practices. Analyzed together, these indicators can detect that the locality is beginning to show signs of fiscal stress and that corrective action is needed. Ideally, it is assumed that management guidance from the state will then prevent the need for major state corrective intervention.

#### ACIR RECOMMENDATIONS AND MODEL LAW

To prevent the adverse consequences of financial emergencies in local units of government, the Advisory Commission on Intergovernmental Relations (ACIR) recommends that states assist local governments with financial management more actively, regulate short-term operating debt more carefully, and supervise locally administered retirement systems more closely. The ACIR also recommends that the states "establish by statute a set of guidelines to determine when the financial condition of local government necessitates state intervention and to set forth the requisite procedures for carrying out remedial state action."

From analyses of past financial emergencies, the ACIR concluded that the following "warning signs" foretell impending financial emergencies:

1. An operating fund revenue-expenditure imbalance in which current expenditures significantly exceeded current revenues in one fiscal period;
2. A consistent pattern of current expenditures exceeding current revenues by small amounts for several years;
3. An excess of current operating liabilities over current assets (a fund deficit);
4. Short-term operating loans outstanding at the conclusion of a fiscal year (or in some instances the borrowing of cash from restricted funds or an increase in unpaid bills in lieu of short-term operating loans);
5. A high and rising rate of property tax delinquency;
6. A sudden substantial decrease in assessed values for unexpected reasons.

Presented as Attachment I is a model law created by the ACIR entitled "An Act to Provide for Prevention and Control of Local Government Financial Emergencies." This model law could easily be adapted for Virginia.

#### ACTIONS TAKEN BY OTHER STATES

The ACIR's recommendations for dealing with local government financial emergencies have been given great weight by states which have addressed the problem in recent years. Each state's individual approach has been influenced by its particular experience, but the general approach to the problem has been relatively uniform. Triggering mechanisms for the declaration of a financial emergency have been erected, authority to address the emergency has been given to a specific official or body, and the elements of that authority have been defined in varying amounts of detail. Some descriptions of what has been done in other states will now be presented to illustrate the variety of approaches that have been taken.

#### Ohio

The Ohio legislature enacted local financial emergency legislation in 1979, the year after the Cleveland default. Under the terms of the legislation, the state auditor determines if a city [locality] is experiencing a financial emergency. The Mayor, the City Council, or the County Budget Commission may solicit the decision, or the state auditor may make the decision himself.

Any of five conditions lead to the declaration of a local financial emergency: default on a debt obligation for more than 30 days; failure to pay employees; an increase in the city's taxes that raises the total price (rate) payable by the locality's taxpayers above the legal limit; the existence of a deficit at the end of the fiscal year; or unpaid accounts from the fiscal year of more than one-twelfth of that fiscal year's general fund budget.

If a local government financial emergency is declared, a financial planning and supervision commission is appointed for the locality. Members of the panel are: the State Treasurer, the Director of the State Office of Management and Budget, the Mayor, the City Council Chairman, and three members appointed by the Governor who have been nominated by city presidents. The Commission is required by law to hire a financial advisor for the city.

Local officials must provide the Commission with a workable financial plan, subject to the Commission's approval. The issuance of debt under the emergency conditions is stringently regulated by statute.

It is the state auditor, by unilateral action or upon request of the city, the Governor, or the financial supervision commission, who decides when the financial emergency has ended. He does so after determining that the city has enacted an effective financial plan, complete with an accounting and reporting mechanism, and has remedied the original emergency conditions.

Since the passage of the legislation, six small cities in Ohio have been deemed to be experiencing financial emergencies. (Cleveland was also declared, but its serious problems had been known about since 1971.) Most of the problems can be traced to Ohio's recession-ridden economy. Because still other cities are considered to be facing serious fiscal difficulties, amended legislation is being proposed which would establish more specific requirements for preventing financial emergencies. The new requirements would be steps taken by the locality to avoid future deficits; a balanced local budget; and the repayment of any debt.

Those supervising local finances would also be required to make a quarterly review of local receipts to ensure that revenue estimates are accurate. If they are not, the local governing body must either cut spending for the remainder of the fiscal year or raise new revenues.

### New Jersey

New Jersey has had state regulation of local finances in some form since the depression, when 30 percent of its local governments defaulted on their debts. To avoid further local defaults, a comprehensive regulatory mechanism was adopted which covers long-term debt; the preparation, adoption, and operation of budgets; short-term borrowing; accounting, auditing and financial reporting; and the local governments' purchases of

goods and services. The regulatory mechanism is overseen by the Division of Local Government Services, with that body's director being appointed by the Commissioner of Community Affairs and the State Treasurer. The Director chairs the State Finance Board, the Division's policy-making body.

It is the Board's statutory responsibility to determine whether a city is in "unsound financial condition." Circumstances which may lead to that determination are: default on bond or note payments; failure to make required payments to the state, county, or school district for the year just ended; the previous year's budgeting of more than 4 percent of city tax revenues by the city to eliminate the preceding year's deficit; budgeting more than 25 percent of the city's total appropriations to pay back its bonded debt; or failure by the city to collect a determinate percentage of the year's real and personal property taxes.

After a local government financial emergency is proclaimed, the Board can revise revenue administration procedures to the degree necessary to bring city tax collections up to the proper standard. Under a 1947 law, the Board is also empowered to recommend that the city have a local financial officer. The affected locality is required to submit its budget to the Board for approval each year and remains under state oversight until it has operated for three consecutive years without running a deficit of more than 5 percent of total property taxes.

In 1981, the New Jersey Legislature amended the 1947 statute by tightening the trigger for the act and giving the Director of Local Government Services and the State Finance Board more power to address local government financial emergencies. The reason for the Legislature's action was the City of Camden's fiscal problems.

The new triggering mechanism is "a judicial determination of gross failure to comply with [the state's local finance laws] which substantially jeopardizes the fiscal integrity of the municipality." The amount allowed to be budgeted for the past year's deficit was lowered from 5 percent of property taxes to 4 percent. The Board may now also bring local expenditures under control by instructing the Director of Local Government Services (who has now acquired many of the functions of the Fiscal Control Officer) to review collective bargaining agreements, save those stemming from arbitration. If so directed by the Board, the Director may hire and fire managers and regulate hours and employment terms for city workers.

The Board may instruct a city to devise a plan for liquidating or refinancing its obligations as well. If such action is taken, the locality will be under Board supervision as long as it is in effect. The Board may end state oversight if there is no plan; if the statutorily delineated emergency conditions are no longer present; if the city has not run a cash deficit during the last fiscal year; and if the Board's resolution proclaiming a local government financial emergency is

not renewed each year and approved by at least two of the following state cabinet officers - the Commissioner of Community Affairs, the State Treasurer, and the Attorney General.

### Nevada

Like Florida, Nevada has a flexible mechanism for dealing with local government financial emergencies. In Nevada it is the State Department of Taxation, under the guidance of the State Finance Board, which works with local governments experiencing financial distress. The Department has several statutorily defined means to provide assistance. It may require the local government to submit a financing plan, hire financial advisors, and prepare reports; it may demand that local expenditures be adjusted by restraining capital outlays, hiring, and issuance of bonded indebtedness; it may exercise its rights of approval of contracts, fund transfers, and collective bargaining agreements entered into by the local government.

The State Board of Finance may ask the Department of Taxation to undertake one or more of the above corrective actions after a hearing with local officials. A hearing will be called if the Department discovers that the local government has defaulted on bond payments or short-term financing, has not met its payroll, has frequently relied upon short-term financing to offset revenue-expenditure indebtedness, is subjected to serious local management problems, or that the local government frequently does not file required reports with the Department.

It is the State Board of Finance which calls an end to corrective action. Termination may be decided upon at the Board's initiative or upon request of the local government.

### Illinois

Chicago's school district is a prime example of the fact that jurisdictions other than cities and counties can experience fiscal difficulties. The Chicago school district's problem was whether it could prepare and adopt a budget so that the schools could operate in 1980 and open in 1981.

To avoid similar problems in other school districts, the Illinois General Assembly passed legislation in 1981 empowering the State Board of Education to determine whether school districts are in fiscal trouble and to require those that are to devise plans for remedying their problems. Districts may be proclaimed to be experiencing a financial emergency if they owe tuition or money to other districts; are in default on debt instruments; fail to pay teacher salaries; contract loans not authorized by law; adopt deficit budgets for two consecutive years; or issue tax anticipation warrants backed by the forthcoming year's taxes when warrants backed by the present year's taxes are still unpaid.

The Board is required to provide any district it declares to be experiencing a financial emergency with guidelines for



preparing a financial plan; the plan must be presented to the board 45 days after the declaration. There are no statutory guidelines for ending state oversight.

### Florida

Florida is a state that decided to take action before an actual local government financial emergency occurred. Its 1979 legislation gives the Governor fairly broad authority to resolve local government financial emergencies and to initiate state oversight at the appropriate time. It is the responsibility of the local governments, however, to inform the state that a statutorily defined emergency situation has been reached.

Similar to other states, a local government financial emergency exists in Florida if a local government fails to meet debt service payments; fails to repay short-term loans during the fiscal year in which they fall due; is unable to meet wage payments or retirement benefits; fails to transfer taxes withheld from employee wages, Social Security taxes, or pension contributions to the appropriate agency; runs a budget deficit for two consecutive years; or has a retirement system which fails to meet legally defined actuarial conditions.

The preparation of a local financial plan is one of several non-required means to address a local financial emergency. A financial board to supervise local operations is similarly available on a non-required basis. The Governor appoints a chairman and the other board members, and the board is empowered to review local records and actions and to confer with local officials. The board then makes recommendations based on its findings and submits them to the Governor for action.

The Governor is entitled to proscribe the affected local government from issuing debt, and he can also authorize state loans to the locality. Implicitly, however, there appears to be a role for the Legislature in appropriating the loan funds.

The Governor makes the decision to terminate state oversight. However, the Governor must have determined that the local government "is operating an effective financial accounting and reporting system," that the statutorily defined emergency conditions have been remedied, and that no new difficulties have surfaced.

### Michigan

Michigan is a state especially hard hit by economic developments, primarily because of the depressed state of the automobile industry. Michigan has not, however, addressed the threat of local financial emergencies with legislation similar to that enacted in Ohio and New Jersey. In 1980, the Michigan Legislature did take action to make state and local governments cognizant of local financial conditions and to make emergency loans available to localities which have been severely hurt by economic downturns. The central feature of the new legislation

is a "carrot-and-stick" use of state revenue sharing funds and a requirement that local governments create workable financial plans. If such plans are not created, revenue sharing payments are withheld. If a local government ends the fiscal year with a deficit, state law also now permits state administrators to withhold one quarter of the locality's revenue sharing funds until it devises a financial plan which erases the deficit. The State Treasury may assist the local government in developing the financial plan, and it must approve the plan before it becomes effective.

An emergency loan fund was adopted by the 1980 Legislature as well. Here, financial planning also plays a major role for local governments must submit a long-range plan for balancing revenues and expenditures. If a loan is approved, the local government must submit biannual progress reports for as long as the loan is undischarged. If a local government applies for additional loans, a progress report describing improvements in financial management must be submitted.

Eligibility requirements for a loan which must be met by the local government are: an indication that the maximum property tax millage permitted by law is being levied; a projection of a general fund deficit for the present fiscal year; an application to the state Municipal Finance Commission for permission to issue tax or revenue sharing anticipation notes; and an indication of unsound fiscal health due to low income tax revenue and tax base growth rates and declining property values. When the loan has been granted, the locality must hire a full-time professional administrator and submit quarterly progress reports to the Emergency Financial Assistance Loan Board. The locality's general appropriations act, proposed budget changes, and the proposed budget for the upcoming fiscal year must also be submitted.

#### RECENT LOCAL FINANCIAL EMERGENCIES IN VIRGINIA

Although there has not been a default in a local unit of government in Virginia in modern times, other states have experienced them. Virginia has indeed been fortunate, but the possibility of a local default does exist in the Commonwealth as it does in her sister states. In 1982, for example, several localities in Virginia experienced financial emergencies of varying degrees. Several of the "crises" were minor and not indicative of financial deterioration, but Brunswick County and the Stafford Sanitary Districts were fortunate to have escaped actual defaults. To provide insight into the clear and present possibility of financial emergencies and defaults occurring in local units of government right here in Virginia, the case studies of the Town of Boydton, the Stafford Sanitary Districts, the Town of Occoquan, and Brunswick County deserve study.

## Town of Boydton

In 1979, the Department of Highways and Transportation began plans to construct a bypass around Boydton, running along the north side of the town. To accommodate future development and avoid having to tunnel under the highway at a later date, the Town decided to install water and sewer lines prior to construction of the highway. When it learned of the Town's plans to install the water and sewer lines, the Department of Highways and Transportation suggested that the project be incorporated into and placed for bid as part of the overall bypass construction project undertaken by the state.

Problems arose when the Department informed the Town that the cost of joining the state project would approximate \$160,000. Relying on a prior estimate made by a professional consulting engineer, Boydton was proceeding on the basis of \$80,000 in cost. The Department of Highways and Transportation insisted, however, that the Town accept the terms offered for the overall project. Boydton was thus faced with paying \$80,000 more than it expected, or, according to local officials, was capable of paying (the population of Boydton is only 498), or even was ethically required to pay since it was the Department of Highways and Transportation that refused to allow the acceptance of the expected low bid.

Initially, the Department of Highways and Transportation intended to seek legal redress against Boydton to collect the \$80,000 which the Town refused to pay. At this time, however, the Department has decided to delay any legal proceedings until April, 1984, in the event the General Assembly desires to provide financial assistance to Boydton.

This Boydton case, arguably, should be considered as an intergovernmental misunderstanding, not a financial emergency. The Town's finances and credit will not be imperiled if this single problem with the Commonwealth is solved. The case is included here because it received publicity as a crisis and does illustrate one kind of problem a local government cannot solve on its own.

## Stafford Sanitary Districts

This case study demonstrates how financial difficulties can arise in localities for a mixture of reasons, including some over which local officials may not have complete control. The case study involves two sanitary districts which provided water and sewerage services and existed as separate legal entities but were governed by the Board of Supervisors.

To finance the expense of improving the sanitary districts' facilities, the Stafford County Board issued bond anticipation notes and left them outstanding for almost all of the statutory maximum of five years before trying to sell long-term bonds. During this period, interest rates went steadily higher, political problems on the Board intensified, and relationships

with financial institutions on which the County depended deteriorated. The County was nearly blocked from the credit markets, and it was necessary to make repeated attempts to have a county-wide referendum to authorize county general obligation bonds to replace the authorized, but unissued, sanitary district bonds which were considered by the financial community to be unmarketable in mid-1982.

Before successfully issuing long-term debt, however, the County had to negotiate several extensions of the districts' bond anticipation notes, and at one point a default appeared imminent because of the deterioration of the County's bank relations and local political uncertainties.

Finally, on June 15, 1982, Stafford County voters approved a referendum which allowed general obligation bonds to be issued instead of sanitary district bonds, and added general obligation backing to all the sanitary districts' previously issued debt. The Circuit Court then abolished the sanitary districts--a formality once the County assumed the debt of the sanitary districts. Despite Stafford County's credit rating, the period in which it was forced to go to the credit market was the worst in the nation's history. Thus, the County issued general obligation bonds at 13% (which, although high, was lower than the estimated 15% the sanitary districts would have paid).

The relatively high interest rate on the general obligation bonds and the associated high taxes and water and sewer rates needed to finance the bonds put the county under fiscal stress. However, according to its County Administrator, Stafford County is in relatively good shape. The County may one day refinance the bonds to lower its interest costs, but the financial emergency has been dealt with for the present time.

Stafford County is a classic example of a rapidly growing, urbanizing county with deep political cleavages between growth and "no growth" factions. During the emergency, there was less question about its "ability to pay" than about its political "willingness to pay."

#### Town of Occoquan

The Town of Occoquan, in Prince William County, encountered financial problems in 1982 due to a decrease in its population as reported by the Census Bureau and the resulting cuts in revenues received from the state and federal government. The population of Occoquan decreased drastically because of a coding error that was made by the Census in 1970 and continued in subsequent population estimates for 1976 and 1977. The error was not corrected until the 1980 Census. Listed below are the population figures for Occoquan as reported by the Census Bureau.

<u>Year</u>	<u>Population</u>
1970 Census	975
1976 Estimated	1,554
1977 Estimated	1,609
1980 Census	241

There are two programs in which the amount of state funds disbursed is significantly affected by population estimates: state law enforcement assistance and ABC funds. Population also affects a locality's federal revenue sharing allotment.

The Mayor of Occoquan requested \$20,840 in emergency funding from the state to cover the decrease in funds received by Occoquan. Below are figures provided by the Mayor to support his request for emergency funding.

	<u>1980-82</u>	<u>1982-84</u>
Police Grant (State)	\$13,102.00	\$ 2,274.00
Revenue Sharing (Federal)	5,912.00	(453.00)
ABC Profits (State)	4,727.00	1,338.00
Utilities Taxes (Local)	<u>10,835.00</u>	<u>10,577.00</u>
	<u>\$34,576.00</u>	<u>\$13,736.00</u>

Due to the five percent reduction in the Commonwealth's budget for the 1982-84 biennium and existing obligations against the Executive Discretionary Appropriation of the Governor's Office, the Governor decided that he could not grant emergency relief to Occoquan.

Following discussions with state officials, the Mayor of Occoquan asked the state legislators who represent Occoquan to develop appropriate relief legislation to address Occoquan's losses. Legislation requesting \$24,000 was introduced (SB 102), but it was not reported by the Senate Finance Committee.

The General Assembly, however, did agree to set aside \$2,000 for a special census to remedy disputed claims between Occoquan and the Census Bureau as to the actual population of the Town. But since the General Assembly's action would require Occoquan to pay for the special census through a reduction in general revenue sharing or a direct payback and because the special census would take longer to implement than Occoquan wanted, the Town decided to forego the special census and wait for the 1990 Census to settle the dispute.

As of June 10, 1983, the Town had solved its financial problems on its own. It did so by increasing business license taxes and by renting the upstairs portion of the town hall.

Manifestly, Occoquan's problem was unusual and minor, but it did bring this locality to state officials and then the General Assembly for counsel and financial assistance.

### Brunswick County

Brunswick County got into severe financial difficulty partly as a result of the recession and a high unemployment rate but mostly as a result of expenditures which exceeded revenues for several years. Brunswick's problems did constitute a fairly deep emergency and were caused by the types of mismanagement and overspending that have accounted for emergencies in many states.

The Brunswick County Board of Supervisors was faced by two critical financial problems in developing its budget for fiscal 1983:

1. The county general fund had a deficit balance of \$921,000 at June 30, 1981. Despite a real property tax increase for FY 1982 from \$3.50 to \$4.05 per \$100 of value (assessment ratio approximately 10%), the fund deficit from June 30, 1982, increased significantly--to \$1,700,000.
2. Under Court Order to improve jail facilities, the voters approved, at an election in November 1981, the issuance of \$2,185,000 in general obligation bonds to build a new jail. The County's poor financial condition obviously made it more difficult to sell these bonds at a reasonable rate.

A variety of capital improvement projects also contributed to the acute nature of the County's financial difficulties. These projects included the county jail, an industrial park under development, an access road to the new Brunswick Medium Security State Prison, and water and sewer line extensions to the prison and industrial park from a system owned by the Town of Lawrenceville (the county seat).

Temporary financing for the operating deficit was provided both by publicly offered tax anticipation notes and loans of \$1,100,000 from two banks. The crisis reached its most serious stage in February, 1983, when the larger of the two banks informed Brunswick County that it would make no further loans to the County.

When the Secretary of Administration and Finance was informed of the problem in Brunswick County, he investigated ways by which the Commonwealth could assist the County to prevent a default, but he could not identify any means adequate to assist with an emergency of this magnitude. A bill calling for \$1.6 million in relief for Brunswick County was therefore introduced in the House of Delegates (HB 186) by the Delegate from the area, but the bill was not reported by the Committee on Claims. Fortunately, a crisis was averted when a third bank agreed to

step in and assist Brunswick County in its loan program through December 31, 1983. If this bank had not intervened, the County would have been unable to meet its payroll. The bank did set conditions for making the loan: the County had to provide documentation of its cash flow for the 1982-83 fiscal year, and it needed to provide some indication of fiscal planning for future years.

It will probably take three to five years for Brunswick to overcome its financial problems. In order to do so, four things must happen:

1. Local officials must continue to demonstrate their commitment to addressing the County's financial difficulties in a responsible fashion;
2. Responsibility for capital budgeting needs to be clarified;
3. The County needs three or four years of operating budget surpluses in the range of \$250,000 to pay off the accumulated deficit; and finally,
4. Brunswick needs to hire a County Administrator. In the past, the County has been without a County Administrator because of concern for the money required to pay the position's salary. Clearly, however, the administrative competence which a qualified administrator would bring to the County is needed.

The Board of Supervisors is acutely aware of the County's financial difficulties and has agreed to address the problem in a realistic manner. The Board has also agreed to restrain expenditures as much as possible; the budget for fiscal 1983 estimates that revenues will exceed operating expenditures by \$600,000. The tax levy has been increased as well, with real estate taxes raised from \$4.20 to 4.70 per \$100 of valuation. And perhaps most important in the long run, Brunswick County has committed itself to hiring a full-time County Administrator starting in January.

On October 27, 1983, Brunswick's financial consultant reported that the County had been able, in fiscal 1983, to cut its cumulative \$1.7 million deficit in half, primarily due to the recovery from the Town of Lawrenceville of the County's investment in the Town's water system. The consultant believes the County will have a fund surplus some time during fiscal 1985.

#### Earlier Financial Emergencies

From inquiries of state financial officials serving at the time, we could only identify one or two earlier financial emergencies that have occurred in local communities during the past fifteen years or so, and they were dealt with by actions of the local government and banks. Hence, the number of emergencies in 1982 was unusual and hopefully will not occur again soon.

1982 was marked by the deepest recession in 50 years, but recession was not the primary cause of any of the emergencies described in the foregoing case studies.

#### CURRENT POWERS OF THE COMMONWEALTH TO ASSIST LOCAL GOVERNMENTS

In 1982, state officials who conferred and attempted to assist those local governments that were experiencing financial emergencies took various steps to inventory what powers the Commonwealth has to assist such local governments. The following questions and answers will describe both what powers the Commonwealth does have to assist and what powers it does not have.

##### Does the Commonwealth Have Power to Loan Money to Local Governments?

A number of state officials and bodies, including the state treasurer, other treasurers of state instrumentalities, and the Virginia Supplemental Retirement System, have authority to purchase, as investments, the general obligation securities issued by local governments -- tax anticipation notes, revenue anticipation notes, bond anticipation notes, bonds, and so forth. (See Code Section 2.1-327.)

However, a local government experiencing a financial emergency may have exhausted its power to issue such securities or may not have taken, on a timely basis, the legally required steps to position itself to sell such securities. The state officials and boards, in any case, are obligated to invest prudently, which means that they typically limit their purchases of securities to those of high grades and low risk. Moreover, they usually invest in taxable securities offering higher yields than the tax exempt securities issued by Virginia's local governments. The tax exemption is of no value to state entities which have no tax liability. The Virginia Supplemental Retirement System in earlier times bought considerable amounts of tax exempt securities but has discontinued this practice for the reason stated.

As a practical matter, then, the state's authority to purchase securities from a local government experiencing a financial emergency is not a lending method that is designed to be used in emergencies and that will always be open in each emergency situation. There, of course, could be a factual situation where the state's power to purchase securities could be employed, but the state official or body involved might be obligated to negotiate a rate of interest competitive with taxable securities of the same risk.

Sections 15.1-224 and 225 of the Code of Virginia require the Governor to withhold state funds from any local until that defaults. State entities that would purchase such securities, therefore, are assured eventual repayment and could take this into account in deciding if they could assist a local unit



experiencing an emergency. Withholding state funds to secure repayment could, of course, precipitate a new emergency.

It is noteworthy that state purchase of local securities was not proposed in any of the four financial emergencies experienced during 1982.

The Commonwealth has no other type of lending authority that can be tapped to help a local government in trouble. The Commonwealth is not authorized to be a "lender of last resort."

#### Does the Commonwealth Have Power to Assume Local Debts?

Article 10, Section 10 of the Constitution of Virginia addresses the issue of local debt. Upon examining this section it is discovered that Virginia, like almost half of her sister states, has a constitutional prohibition against state assumption of local debt. That constitutional prohibition, however, does not apply to the assumption of local debt for state purposes by an agency of the state or under statutory authority. (See Board of Supervisors v. Bibb, 129 VA 638; Harrison v. Day 200 VA 750; Buttor v. Day 203 VA 687). Thus, according to Professor A. E. Dick Howard, of the University of Virginia School of Law, Virginia seems to have decided that "the state may assume local debts when incurred for state purposes . . . (but the case involved is cryptic - see Board of Supervisors v. Bibb 129 VA 638.)"

Professor Howard, in concluding his examination of Article 10, Section 10, contends that "how narrowly the local debt clause will be read is a function of how generously the Court views the concept of public purpose or governmental function."<sup>1</sup>

The question boils down to whether the default of a locality could affect the state interest. Many knowledgeable in finance argue that a local default could have such an effect. Since a local financial emergency threatens the health, safety, and welfare of the local citizens, Harrison v. Day, 200 VA 750, seems to support this belief. (Here we are not even considering the effect on the state's credit rating.) In Harrison, the Supreme Court of Virginia held that to promote the interest of the Commonwealth and "the health, safety, welfare, convenience, and prosperity of the inhabitants thereof represent the exercise of governmental functions." The issue, however, will probably need to be addressed by the Supreme Court of Virginia once again.

If the Commonwealth had power to assume local debts, this capability would certainly be useful in certain types of

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<sup>1</sup>This discussion is taken from A. E. Dick Howard's Commentaries on the Constitution of Virginia, Vol. 2, p. 1134. Can Counties Make Loans to Local Governments Within Their Boundaries?

financial emergencies, but a state would need some more tools in addition to debt assumption.

When this question was put to the Attorney General in connection with the Town of Occoquan's emergency, he informed us that "this Office has previously opined, applying Dillon's Rule," that a county does not have the authority to lend money to a town." 1980-1981 Report of the Attorney General at 121.

#### Does the Commonwealth Have Any Other Power to Assist?

A number of additional avenues were explored in an effort to assist Brunswick County. They included a literary fund loan and acceleration or advances of state aid or other payments to the County. This search uncovered no means of assisting them that were of any consequence.

In summary, the Commonwealth, in the interim between legislative sessions, has limited power to assist one of its local governments in countering a financial emergency. In past emergencies, the Commonwealth has provided financial advice and has assisted the local unit in its efforts to secure bank loans or loan extensions. The state has evidenced its clear interest and has provided moral support but has not considered itself able to do much more. The General Assembly, of course, does have the power to make grants or loans to local governments in trouble, and bills to assist Brunswick County and the Town of Occoquan were considered during the 1983 Session.

#### ALTERNATIVE WAYS TO STRENGTHEN VIRGINIA'S CAPACITY TO ASSIST IN FINANCIAL EMERGENCIES

By describing three alternative ways to strengthen Virginia's capacity to assist local governments in financial emergencies, the range of approaches from strongest to weakest can be illustrated.

#### The ACIR Model Financial Emergencies Law

Earlier in this report the ACIR Model Financial Emergencies Law (Attachment I) was described, and it was indicated that this model law derived from a national study of past financial emergencies and their causes. This model law establishes or designates an Emergency Financial Control Board for the prevention and handling of local government financial emergencies, provides standards for the declaration of a financial emergency, empowers the Board to take various actions to cope with the emergency, and specifies conditions under which the emergency shall be declared to have ceased.

The model law would not require a great deal of adaptation to fit Virginia's needs. Perhaps the largest decision to be made would pertain to creating or designating an agency of the Commonwealth to be vested with responsibility and authority for action in emergencies.

Creating a new Emergency Financial Control Board seems unnecessary and unwise for several reasons. Emergencies have occurred very rarely in the past and hopefully will not occur often in the future. If a board existed solely to deal with emergencies, it would not have anything to do for years at a time, would not garner much experience, and would not "hit the street running" when it was needed. It seems preferable to entrust the financial emergencies responsibility to some standing body with other functions that is continuously involved in state and local finance.

The standing bodies that could be considered for this duty include the Treasury Board, the Commission on Local Debt, and the Local Government Advisory Council.

The Local Government Advisory Council does not appear to be a good choice. With its 26 members, it is too large; it is advisory, not administrative; and its appointment provisions do not assure that substantial financial expertise will reside on the Council at any given time.

Either the Treasury Board or the Commission on Local Debt would be a good choice. Their compositions overlap. The State Treasurer, the State Comptroller, the Tax Commissioner, and the Assistant Secretary for Financial Policy serve on both of these bodies. The Treasury Board has a fifth member appointed by the Governor and confirmed by the General Assembly, who is currently a private citizen from the investment banking community. The Commission on Local Debt has three additional members, making seven in all. These three members are the Auditor of Public Accounts and two private citizens.

Regardless of whether the Treasury Board or the Commission on Local Debt is selected to carry the financial emergencies task, any local government experiencing an emergency should be authorized to name its representative who would sit as a voting member for purposes of acting on that unit's emergency. Presumably, the member named would be the local government's chief executive, finance officer, or financial consultant, or the chairman or a member of its legislative body.

#### "Lender of Last Resort" Authority

As a simpler, more modest way to strengthen Virginia's capacity to assist in financial emergencies, the General Assembly might consider giving "lender of last resort" authority to an established state body. The Treasury Board or Commission on Local Debt, for example, might be authorized to make loans up to a certain amount or up to a certain percentage of the local unit's budget or tax levy. The loans could be straight treasury loans repayable within one year, or a loan pool could be established so as to more sharply segregate this activity from the General Fund. The Governor's approval for any such loans could be required.

When you think through how the designated body would proceed in an emergency, you quickly conclude that they would need criteria for determining whether an emergency existed, that they would need powers beyond lending authority to play an appropriate role and to ensure repayment of any loans they made, and that it would be well for them to operate under statutory direction concerning cessation of the emergency. Some of these needs could be met by administrative action, but statutory action would be required or preferable with reference to other components. These observations lead to the conclusion that the ACIR Model Law is a more complete and satisfactory approach. It also seems preferable that local governments and the financial community be provided with this type of clear and continuing statutory description of the state role and intentions in the event of a financial emergency.

#### Issuance of Bonds to Finance Cumulative Deficits

As a longer-term way to authorize local governments to deal themselves with financial emergencies, it has been suggested that the Constitution and the Public Finance Act could be amended to permit the issuance of bonded debt to finance cumulative operating deficits. While borrowing to fund deficits by the local governments themselves or by financial control bodies is authorized in some other states, such borrowing would seem to be a dubious practice at best in the Commonwealth of Virginia which has long prided itself on prudent, conservative financial management. It also seems doubtful that Virginia's voters would be willing to pass a constitutional amendment to authorize such borrowing.

#### DISCUSSION OF THE ALTERNATIVES AND RECOMMENDATION

The first question that is likely to occur to anyone concerning local government financial emergencies in Virginia is whether it is necessary to do anything. Emergencies have been rare, and even in 1982 when several fairly serious ones occurred, each local government involved somehow muddled through and avoided defaults. Banks seemingly have extended themselves to assist such local governments as they work their way back to financial health. State laws restricting temporary borrowing and requiring financial reporting and a post audit offer some measure of prevention. Moreover, while opinion varies, there is reason to believe that a debt default by a small unit of government does not have an adverse effect on the credit of the state and other local governments in it. Hence, it can be argued that Virginia would not be living dangerously if it did not strengthen its capability to assist local governments in trouble.

Looking at the other side of this matter, we were very fortunate in 1982 that we reached the end of the year without a genuine emergency and default in one or more of the local units involved. Brunswick and Stafford Counties are both substantial units of government, and they came much too close for comfort. The various state controls on borrowing, reporting, and auditing

assist in preventing emergencies but do not provide prevention or early warning for every type of emergency, especially sudden emergencies due to causes such as loss of a major industry or Occoquan's freakish population drop.

Whether a default in a small unit of government would hurt the state and its other local governments is probably the most crucial question. Actually, the question should not be limited to small units of local government. Emergencies certainly could occur in larger units, but cities and counties of 50,000, 100,000 and above in Virginia do enjoy well above average management and competence in financial administration, and their economies are fairly well diversified. These factors do not offer overwhelming protection against emergencies, but Virginia's exposure does appear to be primarily with reference to smaller units.

Virginia's tradition of prudent, conservative financial management and its continuing determination to safeguard its AAA credit rating and reputation seem to call for a particular posture toward financial emergencies. We simply should not want to find out if an emergency and default in a local government of any size would hurt the state and its other local governments. The Commonwealth should provide itself with additional and sure means to prevent defaults.

If the Commonwealth were to provide itself with financial emergency machinery and "lender of last resort" authority, would local governments become less self-reliant and more inclined to look to the state for assistance over rough spots? Would banks be inclined to withdraw from lending where risks were high and where they could depart knowing that the state would step in as the lender of last resort? With reference to local governments, the answer should be that the arrangements under which the state would assist would not be at all inviting to a local government; the state would necessarily make certain decisions and oversee other decisions with the result that the local government would lose part of the control over its own affairs during the emergency period. Loans, moreover, would be repayable and would not be forgiven. With reference to banks, our best judgment is that they would continue to play their present role, would continue to be motivated by the desire to serve a community over a long period, and would, in fact, feel somewhat more secure about making loans in an emergency situation because of the knowledge that the state would be present as the "lender of last resort" if the finances of that unit worsened.

#### Recommendation

It is recommended that the General Assembly consider adoption of the ACIR Model Financial Emergency Law with appropriate adaptations to Virginia. This study, however, has not included adequate consultation with local governments, banks, other interested financial institutions, or private municipal financial professionals. It is therefore recommended that the Joint Subcommittee, established by HJR 65, or some other appropriate instrumentality of the General Assembly hold hearings

concerning the adaptation and desirability of enacting the ACIR  
Model Financial Emergency Law.

[AN ACT TO PROVIDE FOR  
PREVENTION AND CONTROL OF  
LOCAL GOVERNMENT FINANCIAL EMERGENCIES]

(Be it enacted, etc.)

1 SECTION 1. *Short Title.* This act may be cited as the "Prevention and Control of Local Govern-  
2 ment Financial Emergencies Act."

3 SECTION 2. *Purpose.* This law is enacted to preserve and protect the fiscal solvency of local gov-  
4 ernments because the failure of a local government to meet its obligations would endanger the public  
5 health, safety, and welfare of its inhabitants, and would affect the state's own ability to raise funds in  
6 the public market, as well as that of all other local governments in the state. It is in the public interest,  
7 and is the policy of this state to assist local governments in providing their essential services without in-  
8 terruption, and in meeting their financial obligations.

9 SECTION 3. *Definition.* As used in this act "local government" means a county, city, town, town-  
10 ship, borough, school district, authority, or other special district.

11 SECTION 4. *Declaration of Financial Emergency.*

12 (a) A local government shall be in a state of financial emergency and thereby subject to the pro-  
13 visions of this act when either of the following two conditions occurs:

14 (1) A local government determines that it is unable to finance the ordinary needs of govern-  
15 ment, or will not be able to meet outstanding or maturing obligations, and is, or may become un-  
16 able to borrow through the ordinary banking channels or through the sale of bonds and notes suffi-  
17 cient money to meet such governmental needs, or to meet outstanding or maturing obligations; and it  
18 applies to the Governor for assistance under this act; and the Governor determines assistance is neces-  
19 sary.

20 (2) The Governor finds, after notice and hearing conducted by the Governor or his designate,  
21 that one or more of the following conditions have occurred, or will occur within [90] days, if state  
22 action is not taken to assist the local government:

23 (i) Failure, within the same fiscal year in which a loan or debt service payment is due, to  
24 pay loans from banks or principal or interest due on notes or bonded debt in full within [28] days of  
25 the due date.

26 (ii) Failure for a period of [28] days or more to transfer to the appropriate agency:

27 (A) taxes withheld on the income of employees; or

28 (B) employer and employee contributions for:

- 1 (1) federal Social Security; or
- 2 (2) any pension, retirement, or benefit plan of an employee.
- 3 (iii) Failure for a period of [28] days to pay:
  - 4 (A) wages and salaries owed to employees; or
  - 5 (B) pension and retirement benefits owed to former employees.
- 6 (iv) The total amount of all forms of nonbonded debts, issued for other than capital spend-  
7 ing, of the unit of local government due and payable at the end of the fiscal year, less reserves for pay-  
8 ment of same, is in excess of [10%] of the total expenditures of the unit of local government in that  
9 fiscal year.
- 10 (v) Failure to fund any pension program in accordance with state law or with its plan  
11 adopted by law.

12 (b) After either of the two occurrences above, the Governor shall declare that the local government  
13 is in a state of financial emergency, that it is subject to the provisions of this act, and he shall appoint an  
14 [emergency financial control board] for the local government.

15 SECTION 5. [Emergency Financial Control Board.]

- 16 (a) The membership of the [board] shall be:
  - 17 (1) the Governor, or his designate,
  - 18 (2) the [state auditor], or his designate,
  - 19 (3) the [chief executive finance officer] of the local government,
  - 20 (4) the [chairman] of the legislative authority of the local government, and
  - 21 (5) [three] members appointed by the Governor, [at least one of whom shall be a represen-  
22 tative of the labor force of the government].
- 23 (b) The appointed members shall serve at the pleasure of the Governor.
- 24 (c) The Governor shall be the [chairman of the board] and the Governor or his designate shall  
25 preside over all meetings of the [board]. The [board] shall act by majority vote of the entire  
26 [board], and shall maintain a record of its proceedings.
- 27 (d) Appointed members of the [board] shall be entitled to reimbursement for actual and nec-  
28 essary expenses.

29 (e) In addition to staff otherwise authorized by law, the [state auditor] is authorized to appoint  
30 such additional staff as may be needed by the [board].

31 SECTION 6. Powers of [Board]. The [board] shall issue to the appropriate officials of the  
32 local government such orders as it deems necessary to accomplish the purposes of this act, including but  
33 not limited to timely and satisfactory implementation of an approved financial plan. Any order so is-  
34 sued shall be binding upon the official to whom it is issued.

35 SECTION 7. Development of a Financial Plan.



1 (a) The [board], in conjunction with the local government, shall develop, and may from time  
2 to time amend, a financial plan for the local government. Such plan shall provide:

3 (1) that operations of the local government will be conducted within the cash resources avail-  
4 able according to the [board's] revenue estimate;

5 (2) for the payment in full of the debt service requirements on all bonds and notes of the local  
6 government and all other legal obligations.

7 (b) After the initial adoption of a financial plan, the plan shall be regularly re-examined by the  
8 [board] in consultation with the local government, and, in the event of reductions in revenue esti-  
9 mates, the [board] shall modify the financial plan to effect such reductions in total expenditures as  
10 may be necessary to conform to such revised revenue estimates.

11 (c) The financial plan shall be in such form and shall contain such information for each year dur-  
12 ing which the financial plan is in effect as the [board] may specify.

13 SECTION 8. *Additional Powers of the [Board].*

14 (a) Any [board] created pursuant to Section 4 is authorized to take any of the following addi-  
15 tional actions with respect to the unit of local government in which a financial emergency has been  
16 declared:

17 (1) to make an analysis of all factors and circumstances contributing to the financial condi-  
18 tion of the unit and to recommend steps to be taken to correct such conditions;

19 (2) to amend, revise, approve or disapprove the budget of the unit, and to limit the total  
20 amount appropriated or expended during the balance of the fiscal period and during the balance of the  
21 financial emergency;

22 (3) to require and to approve or disapprove, or to amend or revise a plan for liquidating cur-  
23 rent debt;

24 (4) to require and prescribe the form of special reports to be made by the finance officer of  
25 the unit to the governing body, the creditors, the [board], or the public;

26 (5) to have access to all records and books of account, and to require under the procedures of  
27 [applicable state law] the attendance of witnesses and the production of books, papers, contracts, and  
28 other documents relevant to an analysis of the financial condition of the local unit;

29 (6) to approve or disapprove any appropriation, contract, expenditure, or loan, the creation  
30 of any new position, or the filling of any vacancy in a permanent position by any appointing authority;

31 (7) to approve or disapprove payrolls or other claims against the unit prior to payment;

32 (8) to act as an agent of the unit in collective bargaining with employees or representatives and  
33 to approve any agreement prior to its becoming effective;

34 (9) to appoint a local [administrator of finance] to exercise the authority of the [board]  
35 with respect to the unit and to perform duties under the general supervision of the [board].

1 (10) to employ or contract for, at the expense of the unit of local government, such auditors  
2 and other personnel as may be necessary to carry out the provisions of this act;

3 (11) to require compliance with orders of the [board] by court action if necessary.

4 SECTION 9. *Loans by the [Board].*

5 (a) The [board] is authorized, after having taken over the administration of government and con-  
6 trol of the financial affairs of any local government, to:

7 (1) issue negotiable board certificates, such certificates to be preferred claims against all the  
8 assets of said local government; and

9 (2) borrow from the state if necessary, in a sufficient amount to pay the expenses of the  
10 [board], and for other lawful purposes.

11 (b) All certificates approved by the [board] are to be issued in the same manner and form as  
12 provided by law for other local government debt, upon the terms to be determined by the [board],  
13 and to thereby become valid debt of such local government. Such debt shall be considered reasonable,  
14 prudent, proper, and legal investments for state-administered retirement, insurance, or other funds and  
15 no state officer with custody or responsibility for investing such funds shall incur or suffer any liability  
16 by reason of investing such funds in said obligations.

17 (c) In issuing temporary board certificates, the [board] shall have the same authority as is vested  
18 in the local government officers and shall further have the right to issue the same as if authorized by the  
19 vote of the inhabitants of any such local government at an election.

20 (d) The [board] shall have the authority to levy taxes authorized by law in said local govern-  
21 ment and to collect the same for the purpose of paying deficiencies and amounts previously contracted  
22 by said local government, as well as to meet all current obligations.

23 (e) The [board] shall have the power to sell, mortgage, or otherwise use the assets of the local  
24 government to meet past or current obligations, provided the use of such assets for this purpose does not  
25 endanger public health, safety, or welfare.

26 (f) Whenever the [board] finds it necessary to issue negotiable [board] certificates, it may  
27 employ such bond experts, counsel, and other assistants and incur such other expenses as it deems nec-  
28 essary. A sum sufficient to cover such expenses shall be appropriated and paid by the local govern-  
29 ment upon order of the [board].

30 SECTION 10. *Cessation of Local Financial Emergency.*

31 (a) The declaration of a local financial emergency in a unit of local government shall be withdrawn  
32 and revoked, when the local government completes [two] fiscal years in which none of the conditions  
33 in Section 3 (a) (2) exists.

34 (b) The Governor shall determine that the conditions for revoking the declaration have been met,  
35 after receiving a recommendation from the [board].

1           **SECTION 11. *Authority for Local Government to File Petition Under Federal Statute.*** A local  
2 government [or the *[board]* acting on its behalf] may file any petition with any United States Dis-  
3 trict Court or court of bankruptcy under the provision of the laws of the United States, now or hereaf-  
4 ter in effect, for the composition or adjustment of municipal indebtedness.

5           **SECTION 12. *Separability.*** *[Insert separability clause.]*

6           **SECTION 13. *Effective Date.*** *[Insert effective date.]*

LD9116426

HOUSE JOINT RESOLUTION NO. 65

Offered January 24, 1983

*Establishing a joint subcommittee to study the feasibility of vesting an agency of the Commonwealth with the responsibility and necessary authority to deal with financial emergencies arising in Virginia's local units of government.*

Patrons—Brickley, Bagley, F. C., Keating, Manning, and Parrish

Referred to the Committee on Rules

WHEREAS, several local governments in Virginia faced financial emergencies in 1982 or are experiencing financial difficulties currently; and

WHEREAS, the Commonwealth of Virginia is concerned with, and potentially is affected by the financial condition of its local governments; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That a joint subcommittee is established to study the feasibility of vesting an agency of the Commonwealth with the responsibility and necessary authority to deal with local financial emergencies arising in Virginia's cities, counties, towns, and other local governmental units. The joint subcommittee shall consist of eight members as follows: one member each from the House Appropriations Committee, the House Finance Committee, and the House Committee on Counties, Cities and Towns, to be appointed by the Chairman of their respective committees; one member each from the Senate Finance Committee and the Senate Committee on Local Government, to be appointed by the Senate Committee on Privileges and Elections; one member each from the Virginia Municipal League and the Virginia Association of Counties, to be appointed by the Speaker of the House of Delegates; and the Secretary of Administration and Finance, or his designee.

The joint subcommittee shall complete its work in time to make any recommendations it deems appropriate to the General Assembly by July 1, 1983.

The cost of conducting this study shall not exceed \$3,000.

Official Use By Clerks	
<p style="text-align: center;">Agreed to By The House of Delegates</p> <p>without amendment <input type="checkbox"/></p> <p>with amendment <input type="checkbox"/></p> <p>substitute <input type="checkbox"/></p> <p>substitute w/amdt <input type="checkbox"/></p>	<p style="text-align: center;">Agreed to By The Senate</p> <p>without amendment <input type="checkbox"/></p> <p>with amendment <input type="checkbox"/></p> <p>substitute <input type="checkbox"/></p> <p>substitute w/amdt <input type="checkbox"/></p>
Date: _____	Date: _____
Clerk of the House of Delegates	Clerk of the Senate