

TAB 2

Point Paper
Financial Polices
Fund Balance and Debt
May 5, 2008 Workshop

Problem: The City does not currently have a fund balance or debt policy.

Background: Based on prior discussions with Commission, staff committed to bring forward new financial polices related to fund balance and debt before the 2008/09 budget year. Both of these policies will help staff and Commission ensure the financial goals of the City with respect to these areas are known and we have benchmarks to guide decisions. The attached draft fund balance and debt policies have been created based on personal knowledge, comparative polices of other cities and discussions with our financial advisor RBC Dain. Staff would like to review each of the respective policies with Commission and obtain any feedback before we move forward to finalize the policies. Based on discussions today, staff will confer with our consultants to develop a final version of each policy, which will be brought back to Commission as an ordinance. Staff hopes to bring both polices back to Commission during the 2nd meeting in May or early June for 1st reading and Public Hearing.

Alternatives:

- Discussion of debt and fund balance policies as presented

Recommendation:

- Provide staff with authorization to move forward and finalize policies

Budget Impact:

- None. The proposed polices will guide future decision making with respect to fund balance and debt.

Draft Fund Balance Policy

WHEREAS, the City Commission, in and for the City of Palmetto, Florida, hereinafter referred to as Commission, endorses sound financial policies and practices; and

WHEREAS, the Commission has determined that a fund balance/retained earnings reserve policy tailored to the particular needs of the City is the most responsible way to insure against unanticipated events which would adversely affect the financial condition of the City and jeopardize the continuation of necessary public services; and.

WHEREAS, it is essential that the Commission maintain adequate fund balances/retained earnings and reserves in its various operating funds to provide the capacity to: (1) provide sufficient cash flow for daily financial needs, (2) offset significant economic downturns or revenue shortfalls, and (3) provide funds for unforeseen expenditures related to emergencies.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COMMISSION OF THE CITY OF PALMETTO:

SECTION 1. Financial Policy:

The annual operating budget of the City balances the public service needs of the community with the fiscal resources of the city. It is intended to achieve the goals and objectives set by City Commission for the sound administration of the City's finances and continued financial health. The City Commission places special emphasis on maintaining the City in a strong financial condition to ensure public safety, environmental health, physical appearance and quality of life while maintaining a friendly neighborhood atmosphere.

Financial condition may be defined in a variety of ways. For purposes of this policy, financial condition refers to the city's ability to provide services at the level and quality required to maintain the health, safety, and welfare of the community and its citizens. Financial indicators, as set forth by the Auditor General of the State of Florida, will be reviewed at the end of each fiscal year, and discussed with the external auditors and the City's Financial Advisor. If, at such time, the indicators reveal a deteriorating financial condition, appropriate steps will be taken to alleviate the condition.

SECTION 2. Fund Balance/Retained Earnings Reserves

There is hereby created, in each of the various governmental fund types (general fund, special revenue fund, debt service fund, and capital projects fund) and proprietary fund type (enterprise funds only), funds of the City, a reservation of fund balance or retained earnings equal to the following:

- A. General Fund – In the general fund, there shall be created a reservation in fund balance (Stabilization Reserve) equal to 3 months of the current fiscal year expense budget, or 15% (you might consider a range of between 10% and 25% - this gives the City Manager a little more flexibility) of budgeted revenues whichever is greater. For the purposes of this calculation, the current fiscal year budget shall be the budget as originally adopted by Resolution of the City Commission. This reserve shall be in addition to all other reserves or designations of fund balance, including but not limited to reservations for Building Department, encumbrances, inventory, Law Enforcement and reservations of funds which have expenditure authority limited to specific purposes. The Fund Balance in the Trailer Park Trust fund will be included in the calculation of the General Fund fund balance and may be allocated as Reserves. In any fiscal year when the City is unable to create the reservation of fund balance required by this section, the City shall not utilize any amount of fund balance for the purpose of balancing the subsequent fiscal year budget.
- B. Special Revenue Funds – (I would not specifically identify funds the City already has – keep it broad) By definition, special revenue funds are created to account for the proceeds of specific revenue sources (other than expendable trusts or for major capital projects) that are legally restricted to expenditure for specified purposes. There shall be created a reservation in fund balance (Stabilization Reserve) equal to 3 months of the current fiscal year expense budget, or 15% (again you might do 10-25%) of budgeted revenues whichever is greater.
- C. Capital Projects Fund – The capital projects funds (Governmental CIP fund) were created to account for resources (CIP project expenses) designated to construct, acquire or maintain general fixed assets and major improvements and are typically listed as reserved for such purposes. In the Governmental CIP Fund, these projects may extend beyond a single fiscal year. Therefore, although no specific reserve requirement is established for the capital projects funds. The fiscal year end fund balance, coupled with estimated revenues for the ensuing fiscal year, must be sufficient to fund all outstanding fund obligations.
- D. Enterprise Funds – In each of the enterprise funds now or hereafter created by the Commission, there shall be created a reservation of retained earnings equal to four months of the current fiscal year budget for that fund or 25% (10-25%) of budgeted revenues, whichever is greater. For the purposes of this calculation, the current fiscal year budget shall be the total budget as originally adopted by Resolution of the City Commission. This reserve shall be in addition to all other reserves or designations of fund balance/retained earnings, including but not limited to reservations for Impact Fees and encumbrances and reservations of funds which have expenditure authority limited to specific purposes. In any fiscal year when the City is unable to create the reservation of retained earnings required by this section, the City shall not utilize any amount of fund balance for the purpose of balancing the subsequent fiscal year budget.

SECTION 3. Utilization of Surplus Reserves

In the event that the unreserved undesignated fund balance or unreserved retained earnings balance exceeds the amounts set forth above, the excess may be utilized for any lawful purpose. Nevertheless, it is recommended that first priority be given to utilizing the excess within the fund in which it was generated. In order to minimize the long term effect of such use, it is also recommended that any such excess be used to fund one time expenditures or expenses which do not result in recurring operating costs or other one time costs including the establishment of or increase in legitimate reservations or designations of fund balance or reservations of retained earnings.

SECTION 4. Replenishment of Reserve Deficits

If, there are insufficient fund balance/retained earnings, subsequent budgets will provide for a three year repair plan. The required amount will be calculated and the shortfall determined. Then each of the subsequent three years will fund 1/3 of the shortfall until the required reserve is obtained. If this is financially unfeasible, a written plan shall be forwarded by the City Clerk to the Commission for approval in order to restore the unreserved and undesignated fund balance to an amount within the range within a reasonable time frame. This plan may require reduction of services, increases in taxes, fees, or rates, or some combination thereof.

SECTION 5. Annual Reporting and Periodic Review

Annually, after the completion of the City's Comprehensive Annual Financial Report, the Deputy Clerk – Finance shall prepare a Reserve Level Status Report as part of the City's Annual Budget Process to be approved by the City Clerk. At least every five years, the City Commission will be required to affirm or revise the Policy including the percentage range established by the category described herein.

Draft Debt Policy

WHEREAS, the City Commission, in and for the City of Palmetto, Florida, hereinafter referred to as Commission, endorses sound financial policies and practices; and

WHEREAS, the Commission has determined that a debt policy tailored to the particular needs of the City is the most responsible way to provide guidelines for the issuance and management of the debt of the City and to maintain the financial strength and provide for the timely repayment of all debt; and.

WHEREAS, it is essential that the Commission establish a policy to provide guidelines for the (1) conditions for issuing debt, (2) project life, type, and management of debt, (3) and restrictions on debt issuance, service and outstanding debt.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COMMISSION OF THE CITY OF PALMETTO:

SECTION 1. PURPOSE

The purpose of this policy is to establish guidelines for the issuance and management of the debt of the City of Palmetto, Florida (hereafter referred to as the "City"). The City is committed to consistent, best practices in financial management, including maintaining the financial strength and flexibility of the City and the full and timely repayment of all debt.

SECTION 2. CONDITIONS FOR ISSUING DEBT

A. Purposes and uses of debt

Under the governance and guidance of Federal and State laws and the City's Charter, ordinances and resolutions, the City may periodically enter into debt obligations to finance the construction or acquisition of infrastructure and other assets and equipment or to refinance existing debt for the purpose of meeting its governmental obligation to its residents. It is the City's desire and direction to assure that such debt obligations are issued and administered in such fashion as to obtain the best long-term financial advantage to the City and its residents, while making every effort to maintain and improve the City's credit ratings and reputation in the investment community.

The City may also desire to issue debt obligations on behalf of external agencies or authorities for the purpose of constructing facilities or assets which further the goals and objectives of City government, while not placing additional liabilities on the City (conduit debt). In such case, the City shall take reasonable steps to confirm the

financial feasibility of the project and the financial solvency of the borrower; and, take all reasonable precautions to ensure the public purpose and financial viability of such transactions.

The City shall not issue debt obligations or utilize debt proceeds to finance current operations of the City Government.

B. Project Life and Types of Debt

Long-term debt will be used to finance essential capital projects and certain equipment where it is cost effective, prudent or otherwise determined to be in the best interest of the City. Long-term debt, which includes capital lease financings, should not be used to fund the City's operations, provided that the City may issue long-term debt to finance pension or other post employment benefit obligations in the event that it is financially prudent to do so. Capital improvements financed through the issuance of debt will be financed for a period not to exceed the useful life of the facilities or equipment.

The City may issue debt in the form of capital leases, bank qualified loans, general obligation or revenue bonds, and state issued loans. These debt instruments may be issued through a bank, bond pool, underwriter, State of Florida or Florida League of Cities financing. The feasibility of issuance, type of debt and method of issuance will be determined by the City's Finance Team to include the City Clerk, Deputy Clerk of Finance, and the City's Financial Advisor. The Finance Team will consider debt coverage, net debt per capita, interest costs, and other items as deemed necessary by the team to determine the feasibility of issuing debt and the type and method of issuance. Once the determination is made, the team will make a recommendation to the City Commission for final approval.

The City shall seek to finance the capital needs of its revenue producing enterprise activities through the issuance of revenue-secured debt obligations. Prior to issuing revenue-secured debt obligations, City departments, in consultation with the Deputy Clerk-Finance, will develop financial plans and projections showing the feasibility of the planned financing, required rates and charges needed to support the planned financing, and the impact of the planned financing on ratepayers, property owners, City departments, and other affected parties.

Capital leases will only be issued on equipment with a minimum useful life of four years and a minimum item or group cost of \$10,000. The maturity of a capital lease will be the lesser of the asset's useful life (4 years minimum) and ten years and will be grouped together with like assets to obtain the maximum financial benefit.

All debt obligations, other than capital leases, shall have a maximum maturity of the earlier of (i) the estimated useful life of the capital improvement being financed; or, (ii) thirty years; or, (iii) in the event they are being issued to refinance outstanding

debt obligations the final maturity of the debt obligations being refinanced, unless a longer term is deemed financially necessary.

Whenever possible, the City will utilize bank qualified loans totaling a maximum of \$10 million per calendar year, inclusive of capital leases and conduit debt. In the event that the Financing Team determines that the issuance of bonds is in the best interest of the City, the issuance of revenue bonds is preferable to general obligation bonds. Per Florida Statutes, general obligation bonds will be issued only through a referendum of the voters of the City of Palmetto and will be backed by the full faith and credit of the City.

Where their use is judged by the Clerk and Deputy Clerk -Finance to be prudent and advantageous to the City, the City has the power to enter into agreements with commercial banks or other financial entities for purposes of acquiring lines or letters of credit that shall provide the City with access to credit under terms and conditions as specified in such agreements. Before entering into any such agreements, takeout financing for such lines or letters of credit must be planned for and determined to be feasible by the City's Financing Team. Any agreements with financial institutions for the acquisition of lines or letters of credit shall be approved by the City Commission.

The City may issue variable rate debt in amounts and in proportion to its fixed rate debt that the City's Financing Team determines are appropriate to achieve the City's goals with respect to its credit rating, risk management, debt management flexibility and debt service costs. The specific amount of variable rate obligations permitted will be set considering cash reserves, market conditions, matching of current and future assets and liabilities, budget procedures and other factors deemed relevant by the City and Financing Team.

The City may choose to enter into contracts and financing agreements involving interest rate swaps, floating/fixed rate auction, or other forms of debt bearing synthetically determined interest rates as authorized under Florida statutes. The Financing Team will fully understand the implications and risks of employing derivatives, such as interest rate swaps, prior to entering into these agreements and will not enter such agreements without full understanding. Before entering into such contracts or agreements, the Financing Team shall review the risks and benefits of such financing techniques and expected impacts on the City's long-term financial operations and credit ratings with the City Commission.

The City shall seek to use credit enhancement (letters of credit, bond insurance, surety bonds, etc.) when such credit enhancement proves cost-effective. Selection of credit enhancement providers shall be subject to a competitive bid process developed by the City's Financing Team, except in such situations where the service or product being offered is unique to a single provider, or provides a clear benefit to the City not available elsewhere. Credit enhancement may be used to improve or establish a credit rating on a City debt obligation even if such credit enhancement is not cost

effective if, in the opinion of the Financing Team, the use of such credit enhancement meets the City's debt financing goals and objectives.

C. Debt Refunding and Restructuring

The City will monitor outstanding debt in relation to existing conditions in the debt market and may refund bonds or refinance any outstanding debt when sufficient cost savings can be realized. Refunding/refinancing outstanding debt may be considered when the net present value savings between the outstanding debt and the refunding/refinancing debt is equal to or greater than 3% or when the Financing Team determines it to be in the best financial interest to the City. The City may also refund existing debt for the purpose of revising debt covenants to meet particular organizational and/or strategic needs of the City.

SECTION 3. RESTRICTIONS ON DEBT ISSUANCE, SERVICE AND OUTSTANDING DEBT

The City hereby establishes the following policies concerning the issuance and management of debt:

- A. The City will not issue debt obligations or use debt proceeds to finance current operations.
- B. The City will utilize debt obligations only for acquisition, construction or remodeling of capital improvement projects that cannot be funded from current revenue sources, or in such cases wherein it is more equitable to the users of the project to finance the project over its useful life.
- C. The City shall engage independent auditors to complete an annual audit of the City. An Independent Auditors' Report is part of the Comprehensive Annual Financial Report (CAFR) of the City. The annual audit of the City shall include all funds and fund balances established as part of any direct debt financing of the City. The audit shall identify any debt covenants that were not satisfied and will follow a policy of "full disclosure" in its CAFR.
- D. The City will measure the impact of debt service requirements of outstanding and proposed debt obligations prior to the issuance of debt.
- E. The City will strive to establish and maintain a credit rating acceptable to Rating Agencies to receive a minimum rating of A1 (Moody Rating Service) for its obligations, which will facilitate favorable interest costs.
- F. In the event the City determines it is best to issue bonds, a bond team will be assembled to include: City Clerk, Deputy Clerk of Finance, Financial Advisor, Bond Counsel, Underwriters and any other expert deemed necessary by the Financial Advisor. Outside experts will be chosen through the issuance of a Request for Proposal (RFP).
- G. The City's debt capacity shall be maintained within the following generally accepted benchmarks as determined by the City's latest completed CAFR:
 - Net debt per capita should remain under nine-hundred dollars (\$900).

- Net debt as a percentage of estimated assessed value of taxable property should not exceed three percent (3%).
 - The debt per capita as a percentage of income per capita should not exceed five percent (5%).
 - Debt Service Coverage Ratio for each fund should be a minimum of 110% of maximum combined debt service. The calculation shall not include impact fees or the associated expenses.
- H. The City will include the appropriations necessary to make the required debt service payment in its annual budget.

SECTION 4 METHOD OF DEBT ISSUANCE

When determined appropriate by the Deputy Clerk of Finance and the City Clerk, in consultation with the Financial Advisor, the City may elect to sell its debt obligations through either a competitive sale, negotiated sale or private placement. Such determination may be made on an issue by issue basis, for a series of issues, or for part or all of a specific financing program. Selection of the underwriting team shall be made pursuant to selection procedures set forth in these Debt Policies, consistent with City Code.

SECTION 5 – REPORTING AND COMPLIANCE

The City shall establish a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code, or accomplish the same through a third party source. This effort shall include tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the City's outstanding debt issues. Additionally, general financial reporting and certification requirements embodied in bond covenants shall be monitored to ensure that all covenants are complied with.

An Independent Auditors' Report is part of the Comprehensive Annual Financial Report (CAFR) of the City. The annual audit of the City shall include all funds and fund balances established as part of any direct debt financing of the City. The audit shall identify any bond covenants that were not satisfied.

The Deputy Clerk - Finance shall be responsible for providing ongoing disclosure information to established national information repositories and for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies.

DEFINITIONS

Amortization: The process of paying the principal amount of an issue of debt by periodic payments either directly to bondholders, bank or debt issuing body. Payments are usually calculated

to include interest in addition to a partial payment of the original principal amount.

Assessed value:	A valuation set upon real estate or other personal property by a government as a basis of levying taxes. The assessed value in the City of Palmetto is set by the Manatee County Property Appraiser.
Capital project:	Any improvement or acquisition of major capital: facilities, roads, bridges, buildings, utilities or land with a useful life of at least five years.
Conduit financing:	Debt issued by a governmental unit to finance a project to be used primarily by a third party, usually a corporation engaged in private enterprise. The security for such bonds is the credit of the private user rather than the governmental issuer. Generally such bonds do not constitute obligations of the issuer because the corporate obligor is liable for generating the pledged revenues.
Debt:	Bonds, notes, loans, capital leases, or lines of credit issued against a pledge of a specific revenue source or sources with proceeds used to fund a project providing for a public benefit.
Debt Service Coverage Ratio:	Net revenues divided by required debt service (principal and interest payments). This is stated as a percentage and should be 110% of the required debt service or greater.
Gross revenue and income:	Operating revenue plus non-operating revenue
Net revenues:	Gross revenue (not including impact fees) and income less operating and maintenance expenses.
Operating and maintenance expenses:	Operating and maintenance expenses net of depreciation, amortization, and interest requirements.
Required debt service:	Principal and interest payments per the amortization schedule of outstanding debt plus any projected principal and interest payments for proposed debt.