Town
of
Lovettsville

Fiscal Policy

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Town of Lovettsville – Fiscal Policy

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WHY WE ADOPTED A FISCAL POLICY

As the Town has nearly tripled in size the last 15 years, the responsibilities of town government have grown. The increase in operational service capacity and capital needs has resulted in larger amounts of money that the town manages. With this expanded scope and responsibilities it is now time for the Town to adopt a fiscal policy to properly manage its revenues and expenditures. This fiscal policy is Town Council's mechanism for guiding the Town Staff towards responsible fiscal management. The FY 2016 budget established the framework for this fiscal policy in response to fiscal challenges that were facing the town including:

- A declining cash reserve due to a lack of delineation of reserves and debt management strategy. General Fund (GF) cash reserves were declining by $200K+ per year since 2010 with reserves running out by 2021 despite debt obligations continuing out to 2031. Utility Fund (UF) cash reserves were declining by nearly $300K per year since 2010 with reserves being depleted between 2020 and 2023 despite debt obligation continuing out to 2030.

- A Long-term Debt shortfall of $1.7M combined GF and UF.

- When factoring in debt and reserve financing, the town was facing $200K+ structural budget deficits for FY 16.

- If the town delineated its reserves and were to properly build them, the town would be $868K short.

The FY 2016 budget and later budget amendment pulled the town out of structural deficits (through a mix of significant spending cuts, increased water and sewer rates, and the delineation of a debt retirement fund), defined and set a path for funding reserves, set the path for managing and retiring debt, and improved service-level capacity. Unfortunately the budget did not address the inability of the GF to finance new capital projects. The FY 17 budget will work to address this and will require an update to this document.

To ensure that the strategy for FY 16, and eventually the FY 17 strategy, is codified as town policy moving forward the Town Council has instructed the Town Manager to draft a fiscal policy for Town Council's approval. Future changes to budget strategies would require Town Council amendment to the fiscal policy. This extra-step will force future Town Managers and Town Councils to think hard about making any adjustments to the budget strategy to prevent fiscally irresponsible actions.

RESERVE POLICY

The Need For Reserves

The town has had one cash reserve account for the GF and one for the UF. The challenge with having one cash reserve fund is that the organization is unable to determine how much of these reserves are encumbered for debt retirement, how much is for capital investments, how much is for operating cash or emergency cash, etc. With this lack of understanding and transparency, the continual spending of reserves results in the lack of sufficient funding for retiring debt and potential bankruptcy.

In FY 16, the Town adopted the lower percentage band for funding its reserves. It is the goal of the Town Council that once Economic Development picks up in the town and key capital projects are implemented, such as Broadway Streetscape Phase II and S. Loudoun Streetscape, the town will move towards the higher recommended percentage bands.

Debt Retirement Fund

The Town Manager is required to present annual budgets that have or build towards a debt retirement fund large enough to retire the town's debt after dedicated (meals and cigarette tax revenues for the GF and Water and Sewer Availability Fees for the UF) revenues are applied. For the GF, the town currently set a Debt Retirement Fund large enough to retire the debt assuming a 3% rise in meals tax revenues per year and a flat cigarette tax revenue. However, for the UF, the town is required to make operating budget contributions of $100K in FY 16 and increasing by $5K per year out to 2030 as a result of insufficient availability fee revenues and capital project financing where availability fee revenues cannot be utilized.

Rainy Day Fund

To counter the negative effects associated with the national business cycle (i.e. decreased revenues to the town) the town will maintain a Rainy Day Fund to sustain deficit spending during recessions in a fiscally responsible manner. During non-recession periods it is expected that the town will rebuild the Rainy Day Fund. The Rainy Day Fund should be sized at 5-10% of the Operating Budget. The Town has adopted a strategy of 5% as of the FY 16 Budget. The Town Manager is required to present annual budgets that fully funds or builds towards the Rainy Day Fund.

30-Day Cash on Hand Fund

Ideally an organization would build a 90-Day Cash on Hand Fund to be able to resolve unexpected emergencies such as a breakdown on a town asset, the collapse of an expected revenue source, etc. However, the town has decided during the FY 16 Budget that a 30-Day Cash on Hand Fund would be sufficient at this time. The Town Manager is required to present annual budgets that fully funds or builds towards the 30-Day Cash on Hand Fund.

Operating Cash Fund

The Operating Cash Fund enables the Town to never have borrow funds during the FY when revenues have not caught up to spending, but are projected to do so (i.e. the revenue will arrive by the end of the FY). An example would be a delay in the receipt of Sales Taxes or Property Tax Revenues from the County. The town has set the fund level to 10% of the Operating Budget. The Town Manager is required to present annual budgets that fully funds or builds towards the Operating Cash Fund.

Human Resources Fund

The HR Fund enables the Town to withstand expenditure shocks from personnel actions including: short-term disability funding requirements, turnover (needing to pay out vacation time, hire interim replacement, and search and hire new replacement for potentially more pay), extended leave (requiring a temporary fill-in), and funding for needed surge capacity (when a requirement has overwhelmed staff capacity). The HR Fund should be sized at 10-20% of the Personnel Budget. The town has set the fund level to 10% of the Personnel Budget. The Town Manager is required to present annual budgets that fully funds or builds towards the Human Resources Fund.

3RM Fund

This fund is for the Repair, Renewal, Replacement, and Maintenance of the Town Assets including facilities, vehicles, IT systems, etc. The Town will seek to develop an Asset Management Plan that will inventory town assets and set schedules for 3RM for these assets. That will determine how much the Town will need to contribute to the 3RM Fund. This document will need to be updated once the asset management plan is completed.

New Capital Fund

This fund is intended to cover unbudgeted project overruns, down payments on new capital projects, and/or fully fund capital projects without borrowing. On the UF side, this

Fund is comprised of Availability Fee Revenue not earmarked for debt retirement. For FY 16 and beyond (or until all new capital requirements are financed), the Town will be allocating 50% of availability fee revenues for this New Capital Fund and the remaining 50% to the debt retirement fund in order to be able to finance required capital projects (e.g. WWTP fixes). On the GF side, there is no dedicated revenue source for building this fund up. The town will need to make a decision in FY 17 and beyond for how much of the town's current revenues should be earmarked for building up this fund for new Capital projects.

DEBT POLICY

New Debt

The Town will seek to use debt financing to fund new capital projects that are both over $100K and provide intergenerational benefits in order to ensure that most residents who receive the benefit of the project will be part of paying for it (e.g. a new waterline).

Debt Retirement

As described above, the Town has established a debt retirement fund. The Town Manager is required to present a plan for ensuring that the debt retirement fund is solvent. When new Capital Projects are proposed, the Town Manager will be required to provide options to the Town Council for ensuring that the Debt Retirement Fund will be built up to be able to retire the new debt. Town Council will vote on revenue measures for ensuring that the debt retirement fund will be built up to be able to retire the new debt.

Debt Refinancing

When interest rates are low, the Town Manager is expected to vigorously pursue refinancing opportunities where the refinancing will result in net savings of at least $10,000 to the town. The Town Manager can recommend waiting to refinance if interest rates are forecasted to decline further.

Revenue Sources

For the GF, the town will earmark all meals tax and cigarette tax revenues to the Debt Retirement Fund or to the New Capital Fund if Debt has been retired. Since these sources of revenue are not sufficient for funding existing debt, let alone new debt, the Town will explore other options in the FY 17 Budget and beyond. For the UF, the town will earmark at least 50% of its availability fee revenues for retirement of existing debt (unless all new capital needs have been satisfied at which point 100% of availability fee revenues would be sent to the debt retirement account). Since this availability fee revenue is not enough alone for debt retirement and cannot be used for capital projects where new capacity is not built, the town is required to make operating budget contributions of $100K in FY 16 and increasing by $5K per year out to 2030.

Budget Surpluses and Deficits

The Town Manager is required to present a balanced budget to Town Council on an annual basis. However, during economic recessions, the Town Manager can request use of Rainy Day Funds to cover recession related deficits. Likewise, during strong economic growth periods, it is expected that the Town Manager will recommend adding surplus revenue towards the Rainy Day Fund to strengthen it or rebuild it if it was used during a recession.

Program and Performance Budgeting

The Town Manager is expected to transform the current pure line-item budget into a Program/Performance Budget within the next two Fiscal Years (FY 17 and FY 18). The Program Budget defines the key programs or services offered by the town. It then uses activity based costing to allocate overhead and direct costs to these programs so that Town Council and Town residents can see how much the Town spends for specific services. Performance budgeting takes these programs and defines the service output levels for each. This way Town Council and Town residents will not only see how much the town spends on each service offering, but what output is achieved from this spending (productivity) and how much output is achieved with each dollar spent (efficiency). Town Council, residents, and the Town Manager will then be able to monitor performance improvements and will better understand the repercussions of cutting or increasing spending (i.e. Council will know how service levels will be impacted through a 5% increase of decrease in spending for a particular program).

Capital Program Budget

The Town's Capital Program will consist of three parts: 1. Long-term Debt Retirement Plan (out to the last year that existing debt is retired), 2. Medium Term Capital Investment Plan, and 3. Short-term Capital Budget (i.e. the FY Capital Budget). The Long-term Debt Retirement Plan must show debt payments for each FY out to retirement, a table that forecasts dedicated revenue sources for debt retirement, a column displaying the amount of reserve funds used for debt payments for each FY, and how much operating budget cash is needed to cover any shortfall. The Medium Term Capital Investment Plan is a 5-15 year Capital Budget that shows all available revenue (reserves, annual operating contributions, borrowed cash, etc.) and all planned projects with forecasted costs. The Net Value (Revenue minus Costs) for each Fund (GF and UF) will determine how much revenue is needed via borrowing, new revenues, and/or grant money. The Capital Budget is simply the first column of the Medium Term Capital Investment Plan but with only the rows displayed for those projects being implemented in the FY Capital Budget.

During the FY, if a project faces overruns and there is no available New Capital Spending Fund dollars available, or if the Town Council decides to implement a project that was not budgeted for, the Town Manager is required to present to Town Council options for coming up with new revenues, cutting spending in other area(s), or a mix of both.

OPERATIONAL BUDGET

The Town Manager is required to continuously seek to cut spending that is no longer needed, identify program reforms or innovations that result in efficiency savings, present the budget in a transparent and comprehensive manner, and present base budgets that fund current service level requirements. If current service capacity does not match current service level requirements and there is not enough revenue to increase capacity, the Town Manager must present options to Town Council for new revenues, service level reductions, or a mix of both. Finally, the decision to increase service level requirements can be presented as options by the Town Council and/or the Town Manager. However, new revenue sources, spending cuts, or a mix of both must be identified for funding new service level requirements.

During the FY, if the town seeks to spend more money than was budgeted for a specific item in the budget, or if the town wants to spend money on a new requirement that was not budgeted for, the Town Manager is required to present to Town Council options for coming up with new revenues, cutting spending in other area(s), or a mix of both.

During the FY, the Town Manager is required to hold quarterly budget execution meetings where the Town Manager works with the Town Treasurer and Staff to review the status of the current FY budget, gain a better understanding of cost drivers, control spending that is reaching ceiling levels, and identify potential savings.