Town of Lovettsville

Fiscal Policy

Adopted 10-22-2015

Revised 06-23-2016

Town of Lovettsville – Fiscal Policy

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WHY WE ADOPTED A FISCAL POLICY

As the Town nearly tripled in size from 2000 to 2015, the responsibilities of Town Government grew. The increase in operational service capacity and capital needs resulted in larger amounts of money for the town to manage. With this expanded scope and responsibilities, it became 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 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 obligations 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 and beyond.

- 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 addressed this shortfall by building in structural surpluses to allocate to Capital, by earmarking all economic development revenues for Capital, and by setting a policy for increased revenues equivalent to $4.6M over 30 years as discussed below in the Budget Surplus and Deficit Section and the Revenue Diversification Section of this Policy.

To ensure that the strategies for FY 16 and FY 17 are codified as town policy moving forward, the Town Council has instructed the Town Manager to draft and update this 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 historically 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 could lead to 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 revenues are applied - economic development revenues for the GF, and Water and Sewer Availability Fees for the UF. For more information about revenue sources for this fund, please reference the Debt Policy Section below.

Rainy Day Fund
To counter the negative effects associated with the national business cycle (i.e. decreased revenues to the town during recessions) 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 target.

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 of 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 target.

Operating Cash Fund
The Operating Cash Fund enables the Town to never have to 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 this reserve 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 target.

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 target.

3RM Fund
This fund is for the Repair, Renewal, Replacement, and Maintenance of 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. In the interim, the Town will earmark 20% of remaining economic development revenues, after annual debt payments, to the 3RM Fund (see below for more detail).

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, the town will earmark all Economic Development revenues (Meals, Cigarette, Commercial/Light Industrial Property, and Business License Revenues) for making annual debt payments, and for contributions to the New Capital Fund (80% of remaining funds after debt), and 3RM Fund (20% of remaining funds after debt).

Police Force Fund

This fund is intended to build up the needed cash to finance the creation of a Lovettsville Police Force. For the FY 21 Budget (or prior to this if the situation requires), the Town Council will evaluate if the Town is in need of a Police Department based on criteria to be established in FY 17 and monitored annually until FY 21. Example criteria could include population growth, resident demand, county response time averages, 9-11 call volumes, and crime statistics. If the Town Council determines that a Police Department is not needed, the Town Council will close this fund and shift the available revenue over to another Reserve Fund (e.g. Capital or Rainy Day Fund) and/or to other Staff Support needs. The Town Council could also decide to push the decision back another 5-10 years when the town is almost completely built out and more information is available. In the interim, the Town Council will begin making annual contributions of $20K a year to the Police Force Fund beginning in FY 19.

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 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, historically the Town has earmarked Meals Tax and Cigarette Tax revenues for annual debt payments. Since these revenue sources were not sufficient, the Town pulled from its general fund cash reserve account to make up the difference. In FY 16, the Town established a Debt Retirement Fund to safeguard enough cash to be able to make annual contributions for debt payments to cover the shortfall from debt payments being more than the amount of revenue generated from Meals and Cigarette taxes. As of FY 17, the Town began to earmark all Economic Development revenues (Meals, Cigarette, Commercial/Light Industrial Property, and Business License Revenues) for making annual debt payments, and for contributions to the New Capital Fund (80% of remaining funds after debt), and 3RM Fund (20% of remaining funds after debt). The annual difference between debt payments and meals and cigarette tax revenues will determine the amount to be pulled from the debt retirement fund to contribute to the operating budget for cash equalization purposes (i.e. to cover the shift away from using economic development revenues for general operating purposes). By FY 19, the amount of surplus revenue generated in the Program Budget (see Program Budget Section below for more detail) will exceed the amount of previously planned allocated cash from the Debt Retirement fund for that FY. Thus, in FY 19 the Town can begin moving cash from the Debt Retirement Fund to the New Capital Fund and for Staff Support Capacity in amounts equivalent to the planned annual Debt Retirement contribution schedule established in the FY 16 Budget (i.e. Debt Payments – Meals and Cigarette Tax Revenues). This approach will ensure that the Town maintains sufficient revenue in the Debt Retirement Fund to cover any economic development shortfall. If/when the Town achieves its economic development goals (i.e. building-out the Town Square, preserving/backfilling businesses on Broad Way, and developing the Engle Tract), the town can reassess the need for a debt retirement fund (e.g. the town can shift all of the revenue to other reserve funds due to a high level of economic development revenues).

The Town will vigorously pursue external funding sources to partner with internal revenues to accomplish our Capital Goals within a reasonable timeline. External Funding sources will include- Federal, Commonwealth, County, and Private Sector sources. Receiving substantial external funding support allows for project timelines to be moved up and when combined with Economic Development can yield a lower tax burden on residents.

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 but instead is 3RM'ed, the town began making annual operating budget contributions of $100K in FY 16, increasing by $5K per year, out to 2030.

CAPITAL PROGRAM BUDGET

The Town's Capital Program will consist of three parts: 1. Debt Retirement Plan (out to the last year that existing debt is retired), 2. Capital Investment Plan, and 3. Capital Budget (i.e. the FY Capital Budget). The Debt Retirement Plan is a long-range plan that 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 needed/used for debt payments for each FY to cover revenue shortfalls, and how much operating budget cash is needed to cover any remaining shortfalls. The Capital Investment Plan is a multi-year Capital Budget that shows all available revenue (reserves, annual operating contributions, borrowed cash, etc.) and all planned projects with forecasted costs and timelines for project execution. 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 FY column of the Capital Investment Plan but with only the rows displayed for those projects being implemented in the upcoming Budget FY.

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.

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.

In the FY 17 Budget process, the Town Manager, via a Program Budget (see below for more details), built in long-term structural surpluses out to 2046 to provide a decision point to Council for investing in Capital, Staff Support, and/or Police. The Town Council decided on June 16, 2016 to allocate these forecasted surpluses to both Capital and Staff Support Capacity, with the decision to begin making contributions to a Police Fund in FY 19.

Furthermore, the Town Council decided to increase new revenues with a target of $4.6M over 30 years to finance additional Capital projects and Staff Capacity (technology, consulting, personnel, and market pay) and to enable CIP projects and staff investments to occur sooner:

	Staff support + Capital						
	Timeline for Project Initiation (breaking ground, not just design or other prep)						
Increase in revenues (over 30 years)	$0	$1M	$2M	$3.6M	$4.6M	$6M	$9M
Project or Spending Item:							
Staff Support (Begin Significant Investments)	2020	2020	2019	2018	2017	2017	2017
EDA Support	2020	2020	2019	2019	2019	2018	2018
Broad Way 2A	2031	2031	2025	2025	2023	2021	2019
Broad Way 2B	2036	2036	2031	2031	2026	2024	2022
N. Berlin Path	>2046	>2046	2035	2035	2030	2029	2027
S. Loudoun Streetscape	>2046	>2046	>2046	>2046	>2046	2044	2040
New Town Hall	>2046	>2046	>2046	>2046	>2046	>2046	2045
Parks	2040	2040	2038	2036	2038	2036	2034
S. Church Street Streetscape	>2046	>2046	>2046	>2046	>2046	>2046	>2046

The new revenues are discussed in the Revenue Diversification Section below. With the selected Budget Option combined with achieving Economic Development Goals, the Town is hoping to be able to finance our Capital Program within the following timeline:

Budget Option Selected

Via Achieving Economic Development Goals

Staff Support + Capital							
	Timeline for Project Initiation (breaking ground, not just design or other prep)						
Increase in revenues (over 30 years)	$0	$1M	$2M	$3.6M	$4.6M	$6M	$9M
Project or Spending Item:							
Staff Support (Begin Investments)	2020	2020	2019	2018	2017	2017	2017
EDA Support	2020	2020	2019	2019	2019	2018	2018
Broad Way 2A	2031	2031	2025	2025	2023	2021	2019
Broad Way 2B	2036	2036	2031	2031	2026	2024	2022
N. Berlin Path	>2046	>2046	2035	2035	2030	2029	2027
S. Loudoun Streetscape	>2046	>2046	>2046	>2046	>2046	2044	2040
New Town Hall	>2046	>2046	>2046	>2046	>2046	>2046	2045
Parks	2040	2040	2038	2036	2038	2036	2034
S. Church Street Streetscape	>2046	>2046	>2046	>2046	>2046	>2046	>2046

PROGRAM AND PERFORMANCE BUDGETING

The Town Manager was directed by Council to transform the historically pure line-item budget into a Program/Performance Budget in FY 17 (Program Budget) and FY 20 (Performance Budget). 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. The Program Budget also forecasts revenue and expenditure growth over a 10 Year period by Program in order to determine whether or not the Town is facing structural surpluses or deficits. Structural Surpluses provide Council with decision points for where to allocate these surpluses as they arise (e.g. Capital, existing Program, new Program, Reserve Funds, and/or Tax Cuts). Structural Deficits, as existed prior to FY 16, provide Council with decision points for how to address these shortfalls prior to their onset (e.g. program cuts, new revenues, transformation of services, and/or all of the above). 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 (efficiency) and how much output is achieved with each dollar spent (productivity). 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 (e.g. Council will know how service levels will be impacted through a 5% increase of decrease in spending for a particular program).

In FY 17, the Town Manager developed the Program Budget which identified expenditure levels (both direct and overhead) for eight (8) Town Programs- Administration, Capital, Public Works, Utilities, Planning and Zoning, Economic Development, Events and Tourism, Public Safety, and Miscellaneous. The Program Budget identified that the Town was facing Structural Surpluses (all else being equal) based on the existing policies and strategy of the town per the FY 16 Budget. The Town Manager presented the Town Council with eight (8) options for managing the long-term Program and Capital Budget based on the Town Council's goals and the surplus reality. As previously discussed, the Town Council decided to invest the surplus in Capital and Staff/ Staff Support Capacity, along with generating new revenues (target of $4.6M over 30 Years) to be able to accomplish more and in a timelier fashion.

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.

REVENUE DIVERSIFICATION

The Town will seek opportunities to diversify their revenue sources in order to cushion budgets from shocks to one source of revenue (e.g. a Real Estate market crash dramatically decreasing the amount of Real Estate Property Tax revenues that the Town collects) and to decrease dependence on one source of revenue (i.e. the Real

Estate Property Tax will grow at a different rate than others). New Revenue Sources that the Town identified in the FY 17 Budget process for enactment in future Budget Years starting in FY 18 include the Trash Fee user charge and the Personal Property Tax. In the FY 17 Budget process, the Town decided to adopt a new revenue approach to diversification in order to generate $4.6M in new revenue over 30 years. The revenue breakdown includes:

Trash User Fee- Currently, the Town provides 100% subsidized trash services to residents. The perception (although there is no policy establishing this) is that a portion of Real Estate Property taxes are linked to the financing of trash services. Unfortunately, while Trash costs continue to rise by 3% per unit, there is no guarantee (or tax rate adjustments made) that property values will rise by 3% every year. In fact, during this last recession (FY 09), Real estate Values plummeted and just returned to pre-recession values in FY 16:

Trash*	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Total**
	3%	3.09%	3.18%	3.28%	3.38%	3.48%	3.58%	3.69%	3.80%	**30%**
RE Average Assessment		2008	$315,423	2016	$ 329,658				**% Increase-**	**4.51%**
*Increases 3% every year which is compounded								**Summary-**	**30%>4.51%**	

In the long run, this relationship is not sustainable. As part of the FY 18 Budget, the Town will evaluate decreasing the subsidy percentage in order to contribute to the $4.6M new revenue goal over 30 years. The Town will not lower the subsidy to 0% as there is a benefit to the town contributing to public sanitation and health. A 50% subsidy, would result in residents paying roughly $7.50+ per month for trash and would generate an estimated $3.6M over 30 years (all else being equal and with current housing development forecast coming to fruition). The average trash bill nationally is between $12-$20 per month per National Solid Waste Management Association. Thus, residents would still be paying far below the national average for trash, while the town would diversify its revenues, address this unsustainable relationship of property taxes paying for trash, and would yield nearly 80% of the new revenue goal.

Personal Property Tax- Since housing and vehicle values are not necessarily correlated, and since every town in the County has the Personal Property Tax (minus Middleburg with its over $1M in annual Economic Development revenues), this source of revenue is a good candidate for the Town to consider adopting. This is also a good candidate since it is a potential source of new revenue that would come from the Commonwealth instead of residents via the Personal Property Relief Act. Unfortunately, in 2006 the Commonwealth capped contributions to those jurisdictions that had the tax in 2004. To receive Commonwealth dollars, the Town would need to gain General Assembly action to add Lovettsville to the annual contributions. If the Town is able to acquire Commonwealth relief, then the town will pursue this source of new revenue in FY 18. If not, the Town will eye FY 19 or 20 for instituting this new revenue source. Adopting the Personal Property Tax Rate at $1.05 per $100 of assessed value would generate $4.6M over 30 years. The Town will work with its Delegate and Senator in FY 17 to determine if the Town can get Property Tax Relief.

Real Estate Property Tax- If the Town only adopts the Trash Fee and not the personal property tax, it would need to raise the Real Estate Property Tax Rate by 1cent from 21cents per $100 of assessed value to 22cents per $100 of assessed value in order to generate the remaining $1M requirement (Trash $3.6M + RE Tax $1M = $4.6M goal). If the Personal Property Tax is also adopted at a $1.05 per $100 of assess value along with the Trash Fee, the Real Estate Property Tax Rate could be reduced by 3.5 Cents per $100 of assessed value (from $0.21/$100 to $0.18/$100).

Finally, the Town will pursue an aggressive strategy to achieve economic development goals as outlined in the Town of Lovettsville Economic Development Strategy (as adopted in FY 17) in order to diversify and decrease dependence on residential taxes and to be able to implement Capital Program Goals in a timelier fashion. In the long run, as the Town accomplishes its Capital Program Goals, increased Economic Development Revenues could permit the reduction in tax rates.