Town of Lovettsville

Fiscal Policy

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Table of Contents

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WHY WE ADOPTED A FISCAL POLICY ?

As the Town nearly tripled in size from 2000 to 2018, the responsibilities of Town Government has grown. The increase in operational service capacity and capital needs resulted in larger sums 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 Policy was adopted in October 2015. The policy has been reviewed and the Town Manager has recommended that the Policy be revised and approved by Town Council, the effect of which will be to simplify and modify the language consistent with actions taken by the Town Council over the past several months. When first adopted in FY16, the following was true:

- 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 situation has changed and has improved immeasurably. Starting in FY16, the prior Town Manager instituted measures which had the effect of improving the financial situation. The FY 16 budget and later budget amendments 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. However, the FY16 Approved Budget was unable to 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 Reserves, by earmarking all economic development revenues for Debt Service, Repairs and Maintenance and New Capital.

The FY18 Approved Budget and the recently Approved FY19 Budget continued to recognize the need for sound fiscal policy, and in so doing set aside funds to meet the current and future financial needs of the Town in order to continue efficient service delivery for Town residents and business. Both in FY18 and FY19, substantial funds have been set aside in Reserve Accounts for Debt Service, 3RM, New Capital, as well as for cash flow management, rainy day, and future water and sewer capacity. The Town Council has confirmed that economic development revenue should be earmarked specifically for debt service payments as a priority, and then to 3RM and new capital. As a result, the financial outlook looks optimistic. Notwithstanding prior efforts, it is critical that the Town continue to adhere to strict fiscal actions in accordance with this Policy.

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 was that the organization was 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 in the past, the continual spending of reserves resulted in the lack of sufficient funding for retiring debt, and making necessary repairs and maintenance and providing for new capital. In addition, the Town Council approves and authorizes the Town Manager to make contributions to Reserves in accordance with the Town Council Approved FY Budget.

Furthermore, all transfers to and from Reserves must be approved by the Town Council including reinvestment of funds with the purpose of achieving higher yields and maintaining or lowering risk.

General Fund Debt Retirement

The Town Manager is required to present Annual Budgets that includes the necessary funding to meet debt service requirements. In addition, the Debt Retirement Reserve Fund is funded from surplus funds with the intent of building a reserve for debt retirement large enough to retire the town's debt after dedicated revenues are applied. At present, dedicated revenues in the General Fund from economic development fees

and taxes are earmarked debt service retirement. Current General Fund debt is for repayment of the loan on the Phase I Broad Way Improvement Project.

Combined old and new debt liability in the General Fund shall not exceed 10% of the total General Fund budget in any given year.

Water and Sewer Availability Fee Reserve Funds

In the Utility Fund, Water and Sewer Availability Fees pay for capacity driven utility projects such as Water and Sewer Plant expansion. There are two separate Reserve Funds on the Utility side where Availability Fees are transferred from Utility Operating Revenue into Reserves; Water Availability Fee Reserve Fund, and Sewer Availability Fee Reserve Fund.

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. This Policy sets a goal of 8% of the General Fund Operating Budget. with the goal of reaching 10% by 2023 and a 5% of the utility Fund with a goal of 7.5% by 2023. The Town Manager is required to present annual budgets that to the extent possible, fully fund or builds towards the Rainy Day Fund goal.

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 will work towards an increasing this fund to a 90 Day Cash on Hand by FY 2023. In addition the Town Manager is required to present annual budgets that to the extent possible, fully fund the 30-Day Cash on Hand Fund goal and builds towards the 90-Day Cash on Hand Fund goal.

Operating Cash Funds

The Operating Cash Fund enables the Town 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 Budgets. The Town Manager is required to present annual budgets that to the extent possible, fully fund or builds towards the Operating Cash Fund goal.

Human Resources Funds

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 as a goal the fund level to 10% of the Personnel Budget by FY2020. The Town Manager is required to present Annual Budgets that to the extent possible, fully fund or build towards the Human Resources Fund goal.

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 have a goal of earmarking 20% of all economic development related revenues including sales tax revenue, after annual debt payments, to the 3RM Fund.

New Capital Reserve Fund

This fund is intended to cover unbudgeted project overruns, down payments on new capital projects identified in the CIP, and/or fully funding CIP approved Capital Projects without borrowing.

In the General Fund, the Town shall earmark Economic Development revenues for making annual debt payments, contributions to the New Capital Fund, and to the 3RM Fund. Notwithstanding, Meals Tax Revenue shall be earmarked for streetscape and pedestrian safety projects for the purpose of encouraging Economic Development.

In the Utility Fund, surplus revenue from the Utility Operating Budget should be earmarked for transfer into the New Capital Fund as necessary to fund Utility Capital Projects identified in the CIP. UF Capital Projects that are to be funded from New Capital Fund shall be used specifically to fund non-capacity driven utility projects. Additionally, the Utility New Capital Reserve Fund shall be used for funding capacity driven projects or parts thereof, when there are insufficient funds available in the Water and Sewer Availability Fee Reserves Fund.

DEBT POLICY

New Debt

The Town will seek to use debt financing to fund in part, new capital and capacity driven projects where the total borrowing exceeds $100K and are the projects are identified in the Approved Capital Improvement Plan (CIP) All borrowing on behalf of the Town, for any purpose whatsoever, must be approved by the Town Council.

Debt Retirement

As described above, the Town has established reserves for the purpose of retiring debt in both the General Fund and the Utility Funds. The Town Manager is required to present a plan for ensuring that the debt retirement funds are 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. The Town Council must approve all refinancing of existing debt prior to making application to financing institutions.

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 <u>all</u> Economic Development revenues (Meals, Cigarette, Sales, 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).

The Town will vigorously pursue various external funding sources to accomplish support of funding capital projects 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 revenue can yield a lower tax burden on residents.

The Utility Fund is set up to manage revenue and costs to operate the Town's Water and Sewer Facilities. Cost of increasing capacity in either plant is paid from Availability Fees paid by developers. As a result, the Town will earmark at least 50% of its availability fee revenues for retirement of existing capacity driven debt (unless all

capacity driven new capital needs have been satisfied at which point 100% of availability fee revenues would be sent to the debt retirement Reserve Fund). In other cases where there is a need to construct or repair utility facilities (that are not capacity driven) funds will be used from either the Operating Fund or 3RM or New Capital Reserves. The Town Council shall approve all transfer of funds from any Reserve Fund for purposes of funding projects.

CAPITAL PROGRAM / CAPITALBUDGET/ CIP

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 the current year of the Five Year CIP (the first FY column of the Capital Investment Plan).

During the FY, if a project faces overruns and there is no New Capital funds available, or if the Town Council decides to implement a project that was not budgeted the Town Manager is required to present to Town Council options for funding the overrun by either identifying new sources of funding or cutting expenditures 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.

PROGRAM BUDGETING

The Town Manager was directed by Council to transform the historically pure line-item budget into a Program Budget in FY 17. In FY 18 and FY19 a section of the Budget was organized by Program Categories. 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.

In FY 19, the Town Manager developed the Program Budget in the General Fund which identified Expenditure levels for eight (8) Town Programs, including Administration, Capital and Engineering, Public Works and Related Activities, Planning and Zoning, Events and Tourism, Debt Payments, Transfers to Reserves. In the Utility Fund, the expenditure levels are Administration, GF Overhead, Utility Operations, Utility Supplies and Equipment, Utility Operations Repairs and Maintenance, Contract Support Services, Debt Service, Transfers Out to Reserves. Revenue is also separated into program areas in both the General and Utility Budgets. Budget Totals for both Expenditures and Revenues in the Program Budget, are simply another way of presenting Budget information, are equal to the Budget Totals found in the Operating Line Item Budgets.

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. The Town Council will set Priorities for the upcoming Fiscal Year not later than October since the County will be undertaking Billing on behalf of the Towns, and will require Towns having to approve Budgets and the Ad Valorum Tax Rate in April, as opposed to June when Tax Rates were previously set. The Town Manager as part of his/her Work Plan approved by Town Council, evaluates the service level requirements and determines in the Town Manager's Recommended Budget the funding necessary to implement the Town Council's Approved Priorities. If current service capacity does not match current service level requirements and there is not enough revenue to increase capacity, the Town Manager must then 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 Manager to the Town Council and the Town Council shall approve new revenue sources, spending cuts, or a mix of both for funding new service level requirements.

During the FY, the Town Manager is required to provide Quarterly Financial Reports including an explanation of variances in the Budget, as well as Income Statements that describe the economic and financial status of the Town's Finances and Reserves.. The Town Manager is expected to provide alternative solutions as how to resolve any expenditure overages or revenue shortfalls. In addition, the Town Council approves an outside auditing firm to undertake a complete audit on an annual basis and report both financial as well as management and administrative discrepancies to both the Town Manager and the Town Council.

During the fiscal year, no funds shall be transferred from any one Program Account to any other Program Account without the prior, express consent of the Town Council. When required or appropriate, such consent may be provided only after notice and

public hearing in accordance with the provisions of Va. Code section 15.2-2507. The approved budget shall be the standing will of the Town Council, subject to change only by an affirmative vote of the Town Council in a duly convened session.

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 downturn potentially decreasing the amount of Real Estate Property Tax Revenue) and to decrease dependence on Real Estate Property Taxes as the main source of revenue. The FY19 Budget indicates that Residential Real Estate Tax Assessment is 93.99 percent of all Tax Assessed Property in the Town down only slightly from FY 18 level of 94.03 percent, suggesting that the non- Residential Tax base has only slightly increased. Revenue from non-residential Tax on real estate increase slightly over the prior year from $34,080 to $36,480 or 7.04 percent. On the other hand, total revenue generated from all non-residential uses is $280,980 or approximately 7 times the revenue generated from the real estate portion of the revenue. This indicates that there are far greater benefits from continuing to seek business or economic development in the Town.

The Town Manager believes that economic development initiatives are by far the most efficient approach to generating additional revenue and diversifying revenue opportunities. The goal should be to increase the percentage of non-residential assessed value to residential assessed value to almost 10 percent over the course of the next five years from the current 6 percent level. The Town Manager is authorized to review marketing and land use strategies in order to increase the percentage of non-residential development. The Town Council shall approve those initiatives, if shown by the Town Manager that such initiatives will achieve the long term goals for revenue diversity and value appreciation.