

**Minutes of the Fairhope Financial Advisory Committee
Regular Meeting**

November 9, 2017

The Fairhope Financial Advisory Committee met Thursday, November 9, 2017 at 4:00PM at the Nix Center, 1 Bayou Dr., Fairhope.

Members present: Will Newberry, Tim Rosson, Page Stalcup, and Charles Zunk; and Council liaison Robert Brown.

Presentation by Chairman Zunk: Chairman Zunk presented a draft report on the proposed FY2018 Budget. During discussion among the FAC members several modifications were made to that report.

Vote on the Budget Report: The FAC members voted unanimously to approve the modified report on the proposed FY2018, and to forward it to City Council and the Mayor. [See item attached]

Public Participation: The Chairman opened the floor for public participation.

Adjournment: After Public Participation the meeting was adjourned.

**FINAL REPORT – FY2018 PROPOSED BUDGET
PREPARED BY FAIRHOPE FINANCIAL ANALYSIS COMMITTEE
11-9-2017**

INTRODUCTION

The Fairhope Financial Analysis Committee (the “Committee”) has reviewed the written FY2018 Proposed Budget (the “Budget”), and conducted interviews and general discussion with Mayor Wilson and some of her staff. However, because of the late point in the Budget preparation cycle at which the Committee became involved, our comments in this report are necessarily focused only on large influences on the Budget and major changes from projected FY2017 actual performance.

In the context of this report nothing is “good” or “bad”. The relative merits of issues discussed in this report are strictly meant to make all the elected City officials aware of the financial impact of the Budget within the larger scheme of the City’s overall financial performance regarding operating income, balance sheet accounts, and cash flow. The elected officials are the decision makers of the final contents of the Budget.

CITY UTILITIES

In this report City Utilities means those business entities normally referred to as Gas, Electric, Water, and Sewer. In this report the term “ACUC” means all City Utilities, combined.

Comment 1

The Budget for ACUC appears to be trying to do too much by combining the regular annual budgeting process with a proposal for \$21 million in capital upgrades to the respective infrastructures of the four utilities. Without challenging the need for the \$21 million program, the Committee believes that the amount of time and study required to approve such a program with expenditures of this magnitude cannot reasonably be done in a timeframe consistent with approving the rest of the Budget. In other words, the Committee believes that – except for the \$21 million program – the Budget for ACUC can be approved (as-is or modified) in a relatively short period of

time, which is a very desirable outcome for all the parties; but the amount of time required to gain approval for the capital spending, rate increases, and debt financing required for the \$21 million program will likely take much longer. Therefore the Committee recommends severing the \$21 million program from the Budget and moving ahead on two separate tracks simultaneously... 1) to gain rapid approval of a budget for FY2018 taking into consideration the comments to follow, and 2) to start the process for gaining approval for making major capital improvements in the infrastructure for ACUC – such as fleshing out the details of the \$21 million projects and preparing a capital budget including pro forma P&Ls, Balance Sheets and Cash Flows by Utility.

Referring specifically to Tab 8 in the Budget Book, the Budget contains \$2.1 million of projected rate increases directly related to the \$21 million program, and \$1.4 million of projected debt service payments on the assumption that all \$21 million would be borrowed. But, none of the capital spending strictly related to the \$21 million program is included in the Budget. Removing these proposals from the Cash Flow Statement for ACUC as presented on the bottom of the first page in Tab 8 of the Budget Book would reduce Excess Cash Flow for ACUC by \$0.7 million, from \$3.65 million to \$2.95 million.

Comment 2

The Water and Sewer Utilities each have proposed rate increases imbedded in their respective FY2018 projected revenues that are not associated with the \$21 million program. They are large enough to be material to the overall cash flows, and if adopted as-is in the Budget by Council will require prompt action by Council to implement those rate increases. If on the other hand Council does not anticipate approving such rate increases, reductions in projected spending should be considered to maintain projected net income and cash flow.

CITY GOVERNMENT

In this report City Government means those activities of the City other than the Utilities. Sometimes referred to as the General Fund, a summary of the Budget for City Government is in Tab 1 of the Budget Book. The accounting method for the City Government is different from that used for ACUC in that it does not generally use accrual-based expenses as is done for ACUC; generally speaking, with some exceptions, all items spent for City Government are fully expensed – even large capital items with a long useful life – which means that expenses may vary significantly from year to year depending on the spending cycle for large capital items.

Comment 3

The first spreadsheet in Tab 1 illustrates that the Budget for City Government before use of \$2.03 million of cash reserves is a deficit of \$2.0 million compared to Budget revenues, and a deficit of \$3.1 million compared to the projected actual for FY2017. Given that Budget revenues of \$26.8 million are approximately equal to projections for FY2017 of \$26.9 million, the deficit is based on an increase in spending, not a loss of income.

Comment 4

Two of the significant increases in the Budget for City Government expenses are additional personnel and capital projects. The Committee recognizes that there are varying estimates of the total dollar effect of year-over-year personnel increases, but in any event we present here our own opinion, keeping in mind as we stated in the Introduction that there is no connotation of “good” or “bad” in this analysis.

We start with a supplemental spreadsheet we received about October 18th titled “New Positions 2018 Budget”. The spreadsheet shows a net salary increase of \$540M, but that net number includes assumptions of overtime reduction of \$482M meaning that the gross increase is \$1,022M. But this total does not include any salary benefits or burden which we estimate at 40% giving a new total of \$1,431M. Factoring back the allowance for overtime reduction which we discount by 50% based on our own prior experiences, we come to an approximate increase in year-over-year gross salaries of \$1,190M. Even admitted the possibility of a large margin of error

in this estimate it is clear that one major contributor to the Budget deficit is the increase in headcount.

It's important to point out that the total headcount numbers include both City Government and ACUC. But in either case these expenses affect the overall amount of money available to the City.

Comment 5

Also related to salary expense is an assumption in the Budget that employees in City Government and ACUC will have salary increases of \$255M, which is about 2%. If the Council intends to change the amount or timing of this increase the effect on the Budget should be taken into account.

Comment 6

As noted in Comment 3 the City Government Budget includes use of a \$2.03 million "Cash Reserve". However, based upon page 81 [attached] of the FY2016 CAFR there is no such reserve account unless one includes the \$7 million "Rainy Day Fund" the use of which is at the discretion of the Council. The only unrestricted account in the General fund is the Operating Account, which the CAFR shows has been (at fiscal year-end) about \$3.5 +/- million for the past five years. This account fluctuates greatly during the fiscal year depending on the timing of large one-time receipts such as property taxes and large expenses such as capital items. We believe it is not intended as a reserve account in the sense it is used in the Budget, so the \$2.03 million will need to come from elsewhere. There are four major options, and they are not mutually exclusive: 1) reduce the need for reserves by cutting other expenditures in the Budget; 2) increase the transfer from ACUC to the General Fund – City Government; 3) "borrow" from the Rainy Day Fund with a pledge to pay it back next year; and 4) borrow short-term from a bank with a pledge to pay it back next year. The fifth option – to accept the deficit as is and reduce the Operating Account Balance – is not sustainable in the long run.

Comment 7

The Budget contains no allocation of funds from Sales Tax Revenue to make any early repayment of debt, nor does it include any proposal to increase the

Rainy Day Fund for City Government (or to start one for ACUC). In other words, 100% of Sales Tax Revenue is planned to be spent in the Budget.

Comment 8

A \$3.00 per month per customer rate increase is proposed in the Budget for Sanitation (Solid Waste). The increase will reduce the deficit for providing this service and make available funds to keep the fleet up to date. Given that even after the rate increase the City's new rate would still be a little under market compared to other municipalities it is likely that it will be included in the final Budget. However, if Council has another view about the timing or size of the rate increase then comparable reductions in spending should be planned.

Comment 9

Donations for Community Development are increasing 13% in the Budget compared to last year's budget for a total of \$639,500.

Comment 10

The Police Department at about \$6 million in annual expenses continues to put pressure on the Budget because of population growth and the large size of its jurisdiction. This pressure will continue to increase in future years, but especially so if large population growth occurs inside the jurisdiction but outside of the City. Whether or not the Mayor and Council decide to shrink the Police Jurisdiction, all parties should confront this issue sooner rather than later because of the large amounts of money involved.

Comment 11

Spending of \$1.1 million from the Impact Fee Fund in the Budget is up by \$0.7 million from FY2017 projected actual of \$0.4 million.

**** END OF COMMENTS ****

Attached: Page 81 of FY2016 CAFR

CITY OF FAIRHOPE, ALABAMA
 FUND BALANCES OF GOVERNMENTAL FUNDS
 (modified accrual basis of accounting)

| | Fiscal Year | | | | | | | | | | |
|---|---------------------|---------------------|---------------------|---------------------|---------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | |
| General fund | \$ - | \$ - | \$ 501,932 | \$ 2,723,595 | \$ 5,014,205 | \$ 7,000,000 | \$ 7,000,000 | \$ 7,000,000 | \$ 7,000,000 | \$ 7,000,000 | \$ 7,000,000 |
| Restricted | 1,703,619 | 1,083,383 | 1,574,743 | 1,985,914 | 2,145,950 | 3,295,547 | 3,447,451 | 3,449,523 | 3,992,803 | 3,629,943 | 3,629,943 |
| Unassigned | \$ 1,703,619 | \$ 1,083,383 | \$ 2,076,675 | \$ 4,709,509 | \$ 7,160,155 | \$ 10,295,547 | \$ 10,447,451 | \$ 10,449,523 | \$ 10,992,803 | \$ 10,629,943 | \$ 10,629,943 |
| Total general fund | \$ 1,703,619 | \$ 1,083,383 | \$ 2,076,675 | \$ 4,709,509 | \$ 7,160,155 | \$ 10,295,547 | \$ 10,447,451 | \$ 10,449,523 | \$ 10,992,803 | \$ 10,629,943 | \$ 10,629,943 |
| All other governmental funds | | | | | | | | | | | |
| Restricted | | | | | | | | | | | |
| Debt Service - Other Gov. Funds | \$ 456,957 | \$ 470,671 | \$ 350,987 | \$ 351,008 | \$ 350,020 | \$ 325,214 | \$ 339,308 | \$ 357,156 | \$ 348,720 | \$ 516,120 | \$ 516,120 |
| Road Maint & Const. - Other Gov. Funds | - | - | - | - | - | - | 274,746 | 46,007 | 105,947 | 35,936 | 35,936 |
| Construction - Capital Projects | - | - | - | - | - | - | 1,154,000 | 1,154,000 | 1,154,000 | 1,154,000 | 1,154,000 |
| Assigned, reported in: | | | | | | | | | | | |
| Other Governmental Funds | 311,553 | 66,907 | 59,142 | 127,419 | 167,786 | 1,029,075 | 1,252,213 | 851,448 | 826,435 | 1,478,912 | 1,478,912 |
| Capital Projects Funds | 3,892,524 | 2,070,337 | 550,369 | 362,354 | 675,799 | - | 58,625 | 1,956,986 | 4,398,406 | 1,364,704 | 1,364,704 |
| Unassigned | - | - | - | - | - | - | - | - | - | - | - |
| Capital projects funds | - | - | - | - | - | (1,069,424) | 181,085 | - | - | - | - |
| Total all other governmental funds | \$ 4,661,034 | \$ 2,607,915 | \$ 960,498 | \$ 840,781 | \$ 1,193,605 | \$ 284,865 | \$ 3,259,977 | \$ 4,365,597 | \$ 6,833,508 | \$ 4,549,672 | \$ 4,549,672 |

The City implemented GASB Statement number 54 fiscal year 2011. This statement replaces the previous classifications of reserved, unreserved, designated and undesignated fund balances.