Taxation, Revenue and Utilization of Expenditures (TRUE) Commission

Wes Benwick, Chair

TRUE Commission
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BANKING FUND COMMITTEE MEETING MINUTES
October 13, 2010
3:00 p.m.

Location: City Council Conference Room B, Suite 425, City Hall

Attendance: Commissioners Marc El Hassan (Chair), Tom Martin, Ryan Jones, Gamal Lyons, Joe Andrews, Ernest McDuffie, Mike McCollum
Excused: Marcella Lowe
Guest: Mike Givens, City Treasurer

Meeting convened: 3:00 p.m.

Chairman El Hassan convened the meeting and introduced City Treasurer Mike Givens to discuss the City's Banking Fund.

Mr. Givens began his overview of City borrowing by stating that the City has three basic revenue streams to pledge for repayment of borrowing: 1) General Fund covenant pledge (promise to pay from any available General Fund revenues); 2) particular pledged revenue streams (i.e. excise tax, utility service tax); and 3) local option sales tax (Better Jacksonville Plan transportation tax and infrastructure tax). The City has adopted a debt management policy and makes several annual reports on debt and borrowing that Mr. Givens recommended the committee members read to familiarize themselves with the City's borrowing policies and procedures. The policies and reports are available on the City's Investor Relations web site at http://www.coj.net/Departments/Finance/Treasury/Investor+Relations/default.htm.

The focus of the City's borrowing policies is on the capacity to repay (what can we afford) rather than the capacity to borrow (what's the maximum amount that we could borrow). Five parameters have been adopted by the City Council to govern the City's borrowing practices: 1) ratio of overall debt to market value of property; 2) debt service as a percentage of General Fund expenditures; 3) unreserved fund balance as a percentage of General Fund revenues; 4) ten year principal pay-down; and 5) amount of debt per capita.

The Banking Fund is part of the General Fund covenant pledge borrowing pool. It is treated for accounting purposes as an internal service fund of the City (similar to the Information Technology Department or Fleet Management), but is different from the other internal service funds in that it is not used as a cost allocation mechanism to distribute the expenses of the fund across all City agencies. Two types of borrowing are excluded from incorporation into the Banking Fund: any debt that pre-existed the creation of the Banking Fund, and any debt with a dedicated repayment source (i.e. BJP bonds or stormwater utility fee revenues).

The object of the Banking Fund is to “disconnect” internal and external borrowing and repayments so as to externally borrow funds for periods that do not exceed the maximum time allowed under IRS regulations (125% of the normal life of the asset being purchased), loan the money to a City department for that capital purpose, then recoup the loan through accelerated repayments so that the money can be re-loaned for another internal use and repaid a second time before the original external debt instrument has to be repaid. The City is not yet at the point of being able to disconnect the two amortizations because the current budget pressures don’t allow for accelerated internal repayments. The real worth of the Banking Fund’s ability to disconnect the internal and external amortizations would be illustrated if and when the City budget allowed for accelerated repayment on a long-term (20 – 25 year) bond issue for a large, expensive asset like a building. Recouping tens of millions of dollars of internal repayments 10 or 12 years before the external debt instrument had to be repaid would allow for a substantial re-use of the funds. The disconnected amortization model is not particularly beneficial for small, short term borrowing (e.g. to purchase fleet vehicles).

In response to a question about why the Banking Fund authorization cap has been growing steadily over the past several years, Mr. Givens explained that it is a result of the accumulation of multiple years of Banking Fund allocations for projects listed in the 5-year Capital Improvement Plan, some of which carry over from year to year. If a Banking Fund allocation to a project is authorized in one fiscal year but the debt to fund the project is not issued until a succeeding year, then a “double counting” occurs in the subsequent years as the unissued debt allocation from the previous year is added to the new allocation authorized in succeeding years. Recognizing this problem, the system was changed for FY10-11 to recognize a category of “authorized but not issued” debt capacity in order to clarify what’s happening.

Mr. Givens explained that the City used to use single-purpose “theme” borrowing to fund its capital needs – periodic large scale bond issues for recreation or road paving or drainage. Now the City utilizes blended borrowing with multiple types of capital projects grouped into borrowings with multiple maturities reflecting the varied life spans of the assets being procured. In response to a question about pay-as-you-go borrowing Mr. Givens agreed that in ideal circumstances that’s the best way to do capital projects, but the reality of difficult budget times is that pay-as-you-go capital projects are one of the easiest targets when it comes to budget cutting. Chief Financial Officer Mickey Miller has advocated that a city of Jacksonville’s size should annually devote the equivalent of 1 mill of property taxes (approximately $50 million for Jacksonville) to pay-as-you-go capital projects.

In response to a question about whether the Banking Fund is really achieving its purpose given the current budget restraints and when and how a decision might be made to discontinue the experiment, Mr. Givens indicated that the fund needs the opportunity to prove its worth in better financial times and with the large scale projects that provide a better prospect for loan recapture and reuse before a decision can be made about whether the model makes sense or not. If it becomes apparent that tight budgets and an inability to speed up loan recapture and reuse is a permanent condition, then the potential advantages of an internal banking program might go unrealized. In response to a question about whether the scope or use of the Banking Fund has changed over the years, Mr. Givens stated that it had not. The fund is an accounting mechanism and borrowing mechanism, designed to provide financing for approved capital projects. The number, nature and funding sources of projects have not changed, they’re just being grouped and tracked and paid off in a slightly different manner. The internal loan repayments and the external bond payments are not directly connected on a project basis. Computer programs track the inflow and outflow of borrowings and repayments to ensure that there are always sufficient reserves in the City’s coffers to make payments on bonds or commercial paper borrowing whenever necessary. There is not a built-in cushion or reserve fund in the Banking Fund to protect against non-payment from the City’s other funds, and the City does not ever borrow to pay off previous borrowing through the Banking Fund. Banking

Fund borrowed proceeds are pooled with all of the City's other cash for investment purposes and each contributing fund receives a proportional share of the interest earnings.

Mr. Givens responded to several questions about the transparency of project funding and repayment through the Banking Fund. He suggested that the Comprehensive Annual Financial Report is a good source for information on the City's borrowing and repayment programs, particularly the column entitled Internal Service Fund. The Banking Fund is audited as part of the City's annual external audit, but he is unsure to what extent the auditor (for many years, Ernst & Young, beginning this year, McGladrey & Pullen) has closely examined the internal repayment function of the Banking Fund. The auditors are primarily concerned with the repayment of the external borrowing.

Mr. Givens explained the conditions under which voter referenda are required before issuing debt, the primary one being that a pledge of property tax revenue to debt always requires referendum approval. Pledges of any other revenue source can be done by Council ordinance, although for other reasons there may be consideration given to using citizen referenda to gauge public approval of certain projects or types of borrowing. Banking Fund borrowing does not require referendum approval because non-property tax revenues are being pledged and the City meets the 35% and 45% anti-dilution tests. In response to another question he stated that the Police and Fire Pension Fund does not hold any Banking Fund debt. IRS regulations prohibit an entity holding its own debt.

As a general trend, the City has moved from specific pledged revenues to covenant pledges to back its bonds, but recently Moody's Investor Services, one of the three major bond rating agencies, has indicated that it is going to look more closely at the ratings on covenant pledge debt because of the pressures on ad valorem property tax revenue being felt by cities and counties across the country. If property tax revenue is stagnant or falling, then local governments will need to turn to non-ad valorem revenues to balance their budgets and that may pose problems for bond repayments and therefore bond ratings.

In response to a question about the City's borrowing capacity Mr. Givens cited two measures. With regard to the 35% anti-dilution test, the City is at 80% of its borrowing capacity. With regard to the five City debt management policies cited earlier, the current levels of debt are well within the guidelines and the City ranks well on the national median rankings published by Moody's.

In response to a question about how the City would deal with a spike in interest rates from the current historic lows to double digit rates, Mr. Givens stated that the City closely tracks interest rates and converts variable rate to fixed rate debt whenever the conditions indicate the wisdom of doing so. There really is no easy solution if interest rates spike; the City will continue to make all its payments when they come due and the pain will have to be absorbed in the budget. He discussed the healthy tension in the City's fiscal planning between the Treasury and Budget offices with regard to interest rate projections, length of debt amortization, what sources to pledge to debt repayment, etc. Revenues are clearly limited and the amount of funding needed to set aside loan repayment reserves and plan prudently for possible interest rate hikes takes away funding that could be used for operational purposes. He also noted that substantial capital projects (particularly new buildings, new parks and the like) can substantially increase operational costs in subsequent years for staffing, utilities, maintenance, etc.

The committee thanked Mr. Givens for his most informative presentation. Copies of the various debt management policies mentioned at the beginning of the meeting will be sent to the committee members for review.

Meeting adjourned: 5:08 p.m.

Minutes: Jeff Clements, Council Research
10.15.10 Posted 5:00 p.m.

Recording: Legislative Services Division
10.15.10

Materials: Legislative Services Division
10.15.10

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