To:	Mayor Miro Weinberger
From:	Beth Anderson, Interim Chief Administrative Officer
	Richard Goodwin, Director of Financial Operations
Re:	Fiscal Health Report
Date:	March 13, 2019

With the FY18 audit complete, and the FY20 budget process underway, it is again time to provide you with a broader financial update regarding the City's finances. Following on last year's change from reporting on the Fiscal Stability Bond, this report provides a broader overview of the City's overall fiscal health.

Context

The City has continued to realize significant improvement in its overall financial condition as a result of the Administration and Council's commitment to improving the City's financial position. This report provides information about the steps that have been taken to improve the City's overall financial standing and the impacts of those efforts over the last five years.

A direct result of the City's continued and focused efforts on improving its financial position since 2012 has been a series of rating upgrades of the City's general obligation debt (GO) by Moody's. The most impactful result of a rating increase is the ability to borrow money at a lower interest rate due to lower risk associated with lending to a more stable entity. Therefore, the recent upgrades have translated into significant savings for every taxpayer and ratepayer through decreased costs of debt service. For borrowing since 2014, following issuance of the Fiscal Stability Bond (FSB), the City's improved GO credit ratings have resulted in total net present value savings estimated at approximately $17,024,540 in current dollars[1] (or $25,043,840 in gross dollars) over the terms of the bonds relative to what the bonds are estimated to have cost at the City's 2012 Baa3 rating. The gross savings are as follows: $13,719,913 for general City debt, $6,936,587 for Burlington Electric Department borrowing, and $4,387,341 for Burlington School District borrowing.

Fiscal Stability Bonds

Between 2010 and 2012, the City's credit was downgraded six steps in three separate actions by Moody's, from a high of Aa3 in 2009 to a low of BAA3 in 2012 -- only one step from junk bond status. Moody's cited the Burlington Telecom liability and advances to other enterprise funds, increasing reliance on Tax Anticipation Notes (TANs), and multiple years of operating deficits as key reasons for the downgrades. Further, in FY 2012 the Management Letter from the City's auditor stated the City was "at risk as it is overly reliant on borrowing from financial institutions to provide overall City short-term cash requirements."

In response, and as a foundation for continued steps to be taken toward improving the City's fiscal picture, the Mayor and City Council sought and received voter approval to issue $9 million in Fiscal Stability Bonds in 2013. The bond proceeds resulted in an improvement of the City's liquidity and deficit balance, and eliminated short-term TAN borrowing. The State Treasurer identified the resulting liquidity and stability as one of the reasons the Vermont Municipal Bond Bank (VMBB) was willing to fund some of the City's debt, the first time they were willing since the downgrade, which offered a far

[1] Cash flows are discounted using the Arbitrage Yield of each issue.

better interest rate to the City and resulted in debt service savings. This shift set the stage for continued improvements to the City's financial management policies and practices, and overall fiscal health.

Upgrades to Credit Rating Resulting from Improved Financial Condition

Since the June 2012 downgrade and the 2013 Fiscal Stability Bond issuance, the City has been upgraded four steps in three credit actions by Moody's, with the most recent upgrade to A2 being received in November 2017. Moody's has pointed to the strong management team, operating surpluses, elimination of short-term TAN borrowing, creation of a fund balance policy and its early achievement, and development of a multi-year capital improvement program as reasons for the improving outlook.

In the most recent upgrade, Moody's specifically pointed to the following as reasons for the improved rating:

- Sound reserves following four years of operating surpluses;
- Continued prudent and conservative management of expenses;
- Strength as the economic center of the State; and
- Low other post-employment benefits (OPEB) liability.

Moody's specified that operating deficits leading to reduced reserves, increased reliance on cash flow borrowing, or a material increase in the debt burden, as well as retention of liabilities related to Burlington Telecom, could result in a downgrade.

As Moody's identified, the City's operating surpluses have been an important factor in the improvements. These surpluses have been a result of strong fiscal management, improved financial reporting, reduction in support for enterprise funds, identification of new and expansion of existing revenue sources, a continued city-wide focus on cutting expenses and collecting receivables, and conservative budgeting that included working toward a surplus and ensuring contingencies for unexpected expenses. Further, the City has continued to put means in place to help better manage unexpected or uncontrollable irregular expenses. In addition to the reserves previously created to support the cost of a Citywide reappraisal, unusually high winter salt usage, and rising fuel costs, at the end of FY18 the City created a new reserve fund to address extraordinary health care claims, and another to absorb any large workers' compensation costs.

Realized Savings

As mentioned, a result of the City's prudent fiscal behavior over the last five years has been an estimated savings of approximately $17,024,540 in current dollars, which is a direct saving for each taxpayer and ratepayer. This represents $25,043,840 in total dollars, not discounted to current value. These savings are estimated by comparing the actual cost of debt service for all bonds issued after the Fiscal Stability Bond to what those bonds would have cost if they had been issued at the Baa3 negative outlook bond rating[2]. Please note that we want to make clear that while the Fiscal Stability Bond is not the only reason for the creation of these savings, it was the first key step in this process.

FY18 and the Unassigned Fund Balance

FY18 resulted in an estimated $1.3 million increase to the fund balance, which was $9.7 million at fiscal year-end. This was approximately $1 million higher than what was anticipated, as a result of audit adjustments. Those adjustments were largely due to reclassification of previously restricted funds, as

[2] The estimated savings are detailed in the attached spreadsheets, which include the borrowing terms of each bond issued during the timeframe, and the discount rate used to estimate current savings.

well as health care costs being significantly under budget for the year. The adjustments were one-time adjustments, and are not anticipated to occur in future years.

Maintaining a strong fund balance is important to continue to display the City's financial health, and ensure we have the appropriate liquidity to support operations, cover our debt service obligations, and respond to unforeseen events. Further, fund balance is a direct component of Moody's rating model. Therefore, we believe it will be important to ensure we maintain the fund balance within the range set by the City's Fund Balance Policy. That range is 10-15% of the City's General Fund Operating Expenses, which were approximately $59.4 million for FY18.

The health of the fund balance is also important as we expect coming general fund operating budgets to have much smaller surpluses as a result of: 1) the City's limited opportunity to raise revenues; 2) our expectation that we have exhausted many of the more straightforward opportunities to cut costs; and 3) operating costs continuing to rise.

The FY19 budget was developed with fewer contingencies for unexpected expenses, and approximately $875 thousand in use of surplus funds from FY18 (for appropriate one-time expenses, such as investments that should help reduce future costs). To realize future budget surpluses, we believe it will be necessary to more actively invest monies into activities or initiatives that will result in ongoing benefits to the City's finances, through developing additional revenue sources or identify means to decrease operating expenses.

Looking forward

Burlington is still two notches below the City's 2009 Moody's rating of Aa3. Returning to that level would lead to additional significant future savings on debt service, both as a result of the opportunity to borrow at lower costs as well as the possibility of refinancing existing debt at lower rates. The November 2017 Moody's report suggested that "continued surplus operations and material growth in reserves and liquidity" could lead to a ratings increase. The City's FY18 budget performance achieved that, and the City remains focused on continuing that success.

As part of last year's report, at the Mayor's request, our financial advisors assessed the City's financial status and recommended a number of steps for us to take to help achieve additional ratings increases.[3] Those recommendations, and an update on each, follows:

- Settle on a final favorable resolution to the BT case
    - Following execution of an Asset Purchase Agreement for the sale of Burlington Telecom to a local subsidiary of Schurz Communications, Champlain Broadband, in December 2017, the City, Champlain Broadband, and Blue Water Holdings submitted a petition to the Vermont Public Utility Commission seeking a Certificate of Public Good for Champlain Broadband to own and operate Burlington Telecom. A decision is expected in early 2019, after which the transaction will be completed. The City expects to receive proceeds of over $7 million after settlement of all outstanding liabilities and costs.
- Continue to minimize enterprise risk through satisfactory management operations and fiscal performance of the City enterprise funds which will insulate the General Fund from any exposure

[3] See PFM memo dated December 12, 2017

    - The Administration and leadership team continue to focus on sound budgeting and financial performance across all City departments, including enterprise funds and special revenue funds.
    - Burlington International Airport received a rating upgrade from Moody's in May 2018 to Baa2 and Fitch in September 2018 to BBB.
    - In March 2018, Moody's issued a Credit Opinion that highlighted the Water Resources Division's "sound financial metrics, including healthy debt service coverage and improving liquidity."
- Consider adopting a Debt Policy & Capacity Model that would outline acceptable thresholds, ratios & target levels
    - In September 2019, after months of work with the Administration and the Board of Finance, and in collaboration with Burlington School Department, the City Council approved a Debt Policy that sets limits for the amount and type of debt the City can undertake to ensure the responsible management of debt and its impact on taxpayers.
- Analyze the economic benefits of refunding/defeasing the City's 2013 Stabilization bonds
    - This was explored with our financial advisor, and found to not be a cost effective action at current market rates.
- Develop a special capital reserve fund for planned infrastructure needs that could leverage existing fund balance allocations and reduce the City's overall debt burden
    - The City is discussing taking a small step toward this goal, exploring the opportunity to create a dedicated fund to support investments required in existing City facilities.
- Formulate a Balanced Budget Policy
    - This will be explored with the Administration and Board of Finance in the next fiscal year.
- Initiate annual Benchmarking and Peer Group analysis
    - The Clerk Treasurer's Office has started some preliminary benchmarking with our financial advisor, and will bring a more formal update in the coming months.

In summary, the City has continued to achieve significant savings as a result of its improved fiscal management and health. These savings are a direct result of the commitment and leadership of the Mayor, and the City Council, as well as the continued efforts of all of the City departments and the continued focus of the Clerk Treasurer Office working under their charge, to improve the City's finances. We believe that through continued responsible financial management, maintaining the unassigned fund balance, and identifying new sources of efficiencies, we can achieve further rating upgrades and realize additional reductions in our debt service costs.

We look forward to answering your questions.