To:	Mayor Miro Weinberger
From:	Beth Anderson, Interim Chief Administrative Officer
	Richard Goodwin, Director of Financial Operations
Re:	Fiscal Health Report
Date:	January 5, 2018

With the draft Management Letter now before the Board of Finance, as well as the scheduled discussion of the Moody's report and discussions in the coming months regarding the fiscal year 2019 (FY19) budget, it is an appropriate time to provide you with a broader financial update regarding the City's finances. Such an update has been request by City Council resolution in the past. Unlike prior financial reports, which focused on the positive impact of the Fiscal Stability Bond approved by the voters in 2012, this report provides a broader overview of the City's overall fiscal health.

Context

The City has realized significant improvement in its overall financial condition as a result of the Administration's and Council's commitment to improving the City's financial position. We have developed this new financial health report to provide some information about the steps that have been taken and the impacts of that hard work. Though one of the first key steps toward this turnaround was the issuance of the Fiscal Stability Bonds in 2013, prior reports have focused on that action. Therefore this report considers the improvements in the City's overall financial standing that have resulted from all of the City's efforts of 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 ratings upgrades. Those 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 credit ratings have resulted in total net present value savings estimated at approximately $12,601,825 in current dollars[1] (or $18,954,990 in gross dollars) over the terms of the bonds relative to what the bonds would have cost at the City's 2012 Baa3 rating.

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, which offered a far better interest rate to the City and resulted in debt

[1] Cash flows are discounted using the True Interest Cost (TIC) of each issue, which represents the total cost of bonding, including interest, fees, and issuance costs.

service savings. This was the first time VMBB allowed Burlington to borrow under their auspices. 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 seen three credit rating upgrades and two improvements in outlook 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 for the last five years were 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 put means in place to help better manage unexpected or uncontrollable irregular expenses, such as creating a reappraisal fund to pay for an upcoming reappraisal, a salt fund to cover unusually high salt usage during tougher winters, and a fuel fund to help manage rises in fuel costs.

Realized Savings
As mentioned, a result of the City's prudent fiscal behavior over the last five years has been a savings of approximately $12,601,825 in current dollars, which is a direct saving for each taxpayer and rate payer. This represents $18,954,990 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 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.

FY17 and the Unassigned Fund Balance
FY17 resulted in an estimated $1.9 million increase to the fund balance. This was approximately $900k higher than what was anticipated, as a result of audit adjustments. Those adjustments were due to

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[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.

reclassification of funds, including a reduction of prepayments and inventory and reductions in accounts receivable as a result of focused work by the Clerk-Treasurer's Office. These adjustments were one-time adjustments, and are not anticipated to occur in future years.

We believe it will be important to ensure we maintain, and possibly grow, our fund balance to ensure we have the appropriate liquidity to cover our debt service obligations and respond to unforeseen events.

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; and 2) our expectation that we have exhausted many of the more straight-forward opportunities to cut costs and that future efficiencies may require investment to be able to realize benefits.

The FY18 budget was developed with a much smaller anticipated surplus, fewer contingencies for unexpected expenses, and approximately $2.6 million in use of funds from FY17 (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 ongoing benefits to the City's finances, through additional revenue or decreased operating expenses.

Looking forward

Burlington is still two steps 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 suggests one significant factor that could lead to a ratings increase:

- Continued surplus operations and material growth in reserves and liquidity.

Further, at the Mayor's request following the most recent upgrade, PFM, our financial advisors, have assessed the City's financial status and recommended the following steps for us to take to help achieve additional ratings increases:[3]

- Settle on a final favorable resolution to the BT case;
- 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;
- Consider adopting a Debt Policy & Capacity Model that would outline acceptable thresholds, ratios & target levels;
- Formulate a Balanced Budget Policy;
- Initiate annual Benchmarking and Peer Group analysis;
- Analyze the economic benefits of refunding/defeasing the City's 2013 Stabilization bonds;
- 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.

[3] See PFM memo dated December 12, 2017

The City can successfully achieve many of these steps. As part of the FY ’19 budget process the CAO’s office will consider PFM’s recommendations and develop a plan for pursuing further ratings upgrades for Board of Finance review.

In summary, the City has achieved 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. Moreover, this plan has succeeded because Burlington voters have consistently supported this focus with multiple votes over the last six years. We believe that through continued responsible financial management, maintaining the unassigned fund balance, and identifying new sources of efficiencies, we can achieve further upgrades and additional reductions in our debt service costs.

We look forward to answering your questions.