TOWN OF PARADISE VALLEY

Financial Policies - Reserves

Reserves – the cornerstone of financial flexibility

- Provides options to respond to unexpected issues
- Buffer against shocks and risk

Considerations

- Policy level: minimum/maximum fund balance and goal
- Ratings agency perspectives
- Use and replenishment
- Long range forecasting

Government Finance Officers Association

GFOA Sources:

“A Risk-Based Analysis of General Fund Reserve Requirements”

Best Practices:

- Appropriate Level of Unrestricted Fund Balance in the General Fund
- Adopting Financial Policies
- Ensuring Other Postemployment Benefits (OPEB) Sustainability
- Long Term Financial Planning
- Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits (OPEB)

GFOA Best Practices – Minimum Fund Balance

- No “one-size-fits-all”
- Minimum recommended under any circumstance is 60 days
- Adjust for local conditions/risks
  - Revenue volatility
  - Infrastructure upkeep
  - Vulnerability to extreme events/public safety concerns
  - Leverage
  - Expenditure volatility
  - Liquidity/cash flow
  - Growth of the community (resorts and/or service needs)

Accounting for Uncertainty – The "Triple-A" Approach

Sizing a reserve requires estimating highly uncertain events, like natural disasters and economic downturns. To develop an adequate response, the GFOA used the "Triple-A" approach:

- **Accept**. First, we must accept that we are subject to uncertainty, including events that we haven't even imagined.
- **Assess**. Next, we must assess the potential impact of the uncertainty. Historical reference cases are a useful baseline.
- **Augment**. The range of uncertainty we really face will almost always be greater than we assess it to be, so we should augment that range. Historical reference cases provide a baseline, but that baseline may not be adequate to account for all future possibilities.

Ratings agencies –
Our financial report card and litmus test

Moody's Issuer Comments

- **Reserves:** "The financial position of the town is robust and is comparable to the assigned rating of Aaa. The fund balance as a percent of operating revenues (127.2%) is far stronger than the US median and increased between 2012 and 2015. In addition, Paradise Valley's cash balance as a percent of revenues (124.2%) is far superior to other Moody's-rated cities nationwide."
- **Liabilities:** "The town's net direct debt to full value (0.1%) is materially lower than the US median. However, the Moody's-adjusted net pension liability to operating revenues (1.8x) is above the US median and rose from 2012 to 2015. [Thus] they are slightly weak in comparison to the assigned rating of Aaa."

Use of Fund Balance

- Emergencies
- Opportunities
- Planned drawdowns

When is using fund balance in the **long term** *best interest of the Town?*

Replenishment

- Use of fund balance below goal should be accompanied by plan to restore
- Below minimum should be restored within 1-3 years
- Often by nonrecurring revenues or specific allocations for defined time period

Considerations

- Policy level: minimum/maximum fund balance and goal
  - Current policy: 90-110% of annual operating expenses
- Ratings agency perspectives
  - Retain Aaa rating by
    - Maintaining Aaa level reserves
    - Reducing unfunded liabilities
    - Balancing long term financial plan; identifying funding for capital needs
- Use and replenishment
  - Identify and implement reasonable strategy
- Long range forecasting

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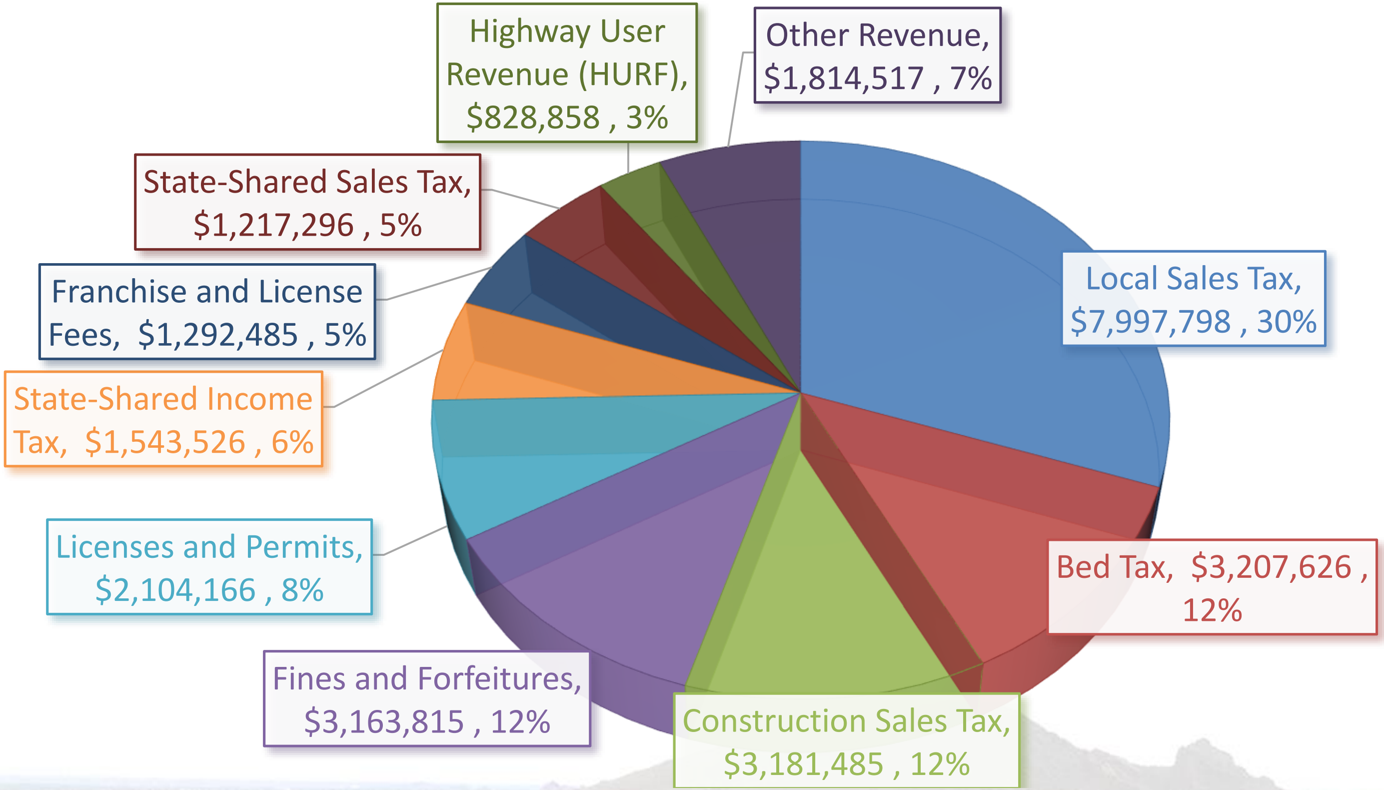
FY 2016 General Operating Revenues



Historic Volatility

Revenue Type	Volatility	Variance in $	% of Operating
State-shared sales & income tax	Medium	$1,300,000	5%
HURF	High	$ 800,000	3%
Local sales tax	Medium	$1,000,000	4%
Construction sales tax	High	$1,500,000	6%
Bed tax	High	$2,000,000	8%
Fines	Low financially; high politically	$500,000; $3,000,000	12%
		$9,600,000	**38%**

Policy Recommendation

- Establish a logical “true minimum” as well as a higher “target”
- Eliminate maximum threshold; address policy issues instead
  - Are we accumulating funds for a specific purpose?
    - Capital projects
    - Repair and replacement funds
      - Fleet, facilities, streets, rights-of-way
  - Are there opportunities to lower rates?
- Define appropriate uses and address corresponding restoration of fund balance

Recommendation

Current policy:

– A reserve equal to at least 90%, but not more than 110%, of the annual operating budget (General and HURF funds) operating expenditures will be maintained. The amount will be calculated using the budgeted expenses for the following year. The reserve is to be used for unforeseen emergencies, such as a significant loss of revenues or catastrophic impacts on the Town. At the time the Town Council approves the use of the reserve below 90%, it will also identify the time period over which the reserve will be replenished.

Recommended policy:

– The Town maintains a target operating fund balance of 75% of annual operating expenditures (General Fund and HURF). The use of these reserves shall be limited to anticipated or unanticipated non-recurring needs. Except in temporary emergent situations, fund balances shall not be used for normal or recurring annual operating expenditures. In no circumstance but a declared emergency shall the operating reserve balance drop below 50% of the Town's annual operating expenditures. Fund balances in excess of 110% that have not been accumulated for a specific future purpose will be considered in rate and fee studies. Use of fund balance below targeted levels will be accompanied by a plan to restore the fund to target within a reasonable time period. Emergency use below 50% must be accompanied by a strategy to restore fund balance above the minimum in less than three (3) years.

PSPRS Unfunded Liability

- Long term substantial liability to Town
- 8% annual assessment on outstanding balance

PSPRS Current Schedule – 22 Year Pay Off

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Additional assessment after 5 years
Beginning Balance	$ 18,828,141	$ 17,736,481	$ 16,708,116	$ 15,739,376	$ 14,826,804	
Required Liability Payment	2,405,473	2,266,003	2,134,620	2,010,854	1,894,264	
Additional Payment						
Assessed 8% (Anticipated rate of return)	1,313,813	1,237,638	1,165,880	1,098,282	1,034,603	$5,850,216
Ending Balance	$ 17,736,481	$ 16,708,116	$ 15,739,376	$ 14,826,804	$ 13,967,142	

- Total 8% assessment paid next 10 years: $10,190,039
- Total scheduled 8% assessment remaining life: $13,308,701

PSPRS – Pay off in 10 years

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Additional assessment after 5 years
Beginning Balance	$ 18,828,141	$ 16,656,481	$ 14,329,935	$ 12,138,282	$ 10,073,702	
Required Liability Payment	2,405,473	2,128,023	1,830,785	1,550,780	1,287,011	
Additional Payment	1,000,000	1,260,000	1,260,000	1,260,000	1,260,000	
Assessed 8% (Anticipated rate of return)	1,233,813	1,061,477	899,132	746,200	602,135	$4,542,758
Ending Balance	$ 16,656,481	$ 14,329,935	$ 12,138,282	$ 10,073,702	$ 8,128,826	

- Total 8% assessment remaining life: $5,670,841
- Savings over current schedule: $7,637,860

PSPRS – Paid off in 3 years

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Additional assessment after 5 years
Beginning Balance	$ 18,828,141	$ 16,656,481	$ 10,290,735	$ 4,294,076	$ -	
Required Liability Payment	2,405,473	2,128,023	1,314,739	548,609	-	
Additional Payment	1,000,000	5,000,000	5,000,000	3,750,000	-	
Assessed 8% (Anticipated rate of return)	1,233,813	762,277	318,080	-	-	$2,314,170
Ending Balance	$ 16,656,481	$ 10,290,735	$ 4,294,076	$ -	$ -	

- Total 8% assessment remaining life: $ 2,314,170
- Savings over current schedule: $10,994,531

Impact to Fund Balance

If PSPRS unfunded liability is paid off in 3 years:

- Fund balance low at 58%
- Steady recovery to above 75% within following 5 years
- Includes:
  - Allowance for CIP
  - Repaving of Lincoln and Tatum
  - Vehicle replacement funding
  - Facilities repair and replacement funding

Any Questions?