Evaluating Your City's Financial Health

Iowa State University
Extension and Outreach

The PFM Group
Financial & Investment Advisors
40 Years of Independent Advice

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Agenda

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Sample Bio Page

Ms. Cindy Kendall, *Extension Specialist*

Iowa State University Extension & Outreach

Ms. Cindy Kendall is an Extension Specialist with Iowa State University Extension and Outreach, Director of the Municipal Professionals Institute and Academy and a resource to the Iowa League of Cities. She has been a City Clerk/Finance Director in Strawberry Point, Grundy Center and Marshalltown, Iowa. She served on the Board of Trustees for the Municipal Fire and Police Retirement System of Iowa, and the City Finance Committee. She received a Bachelor of Arts degree from Upper Iowa University, her Masters of Public Administration from Iowa State University, and designation as a Certified Municipal Finance Manager from the Association of Government Accountants.

Mr. Jon Burmeister, *Managing Director*

Public Financial Management, Inc.

Mr. Jon Burmeister, CFA is a Managing Director with Public Financial Management, Inc. located in Des Moines and currently heads PFM's Midwest Municipal Advisory practice. Mr. Burmeister has over eighteen years of public finance experience. Mr. Burmeister has provided municipal advisory services to governmental municipalities located throughout the Midwest including the planning and execution of all types of general obligation, education, utility and other enterprise fund debt issues. Mr. Burmeister received a Bachelor of Science degree in Accounting and Business Administration with honors from Mankato State University. Mr. Burmeister is a Certified Public Accountant (CPA inactive) and has earned his Chartered Financial Analyst ("CFA") designation from the CFA Institute.

Ms. Susanne Gerlach, *Senior Managing Consultant*

Public Financial Management, Inc.

Ms. Susanne Gerlach is a Senior Managing Consultant with Public Financial Management, Inc. located in Des Moines. Ms. Gerlach has over nine years of public finance experience. Ms. Gerlach currently serves as Municipal Advisor or co-manager for over twenty-five clients in the states of Iowa, including cities, school districts and utilities of all size and complexity. Ms. Gerlach earned a Bachelor of Arts degree in Marketing with honors from Simpson College located in Indianola, Iowa. Ms. Gerlach currently serves as President of the Simpson College Continuing and Graduate Education Alumni Board of Directors.

Iowa Government Finance Initiative

Purpose:

- To help city and county governments more easily access analyses of their financial situation.

Services:

- Free base financial condition and trend analysis report for cities in Iowa published every spring using historical annual financial data.
- Advanced financial planning that is an extension of the base reports to include two additional levels of detail:
  - Use of additional indicators as well as a selected peer city to provide more comprehensive fiscal condition report.
  - Use of data beyond the AFR to take stock of the financial condition and customize the report as requested by the partnering city.
- Fee-based product designed to provide educational programs to local governments including workshops and online webinars.
- Translating academic research conducted at ISU in Ames in the areas of local government finance and economic development into an easily understood format.

Annual Fiscal Conditions Report

- Iowa State University Extension and Outreach, in conjunction with the Iowa Department of Management, is collecting, analyzing and presenting the financial data included in the Annual Fiscal Conditions Report.
- The Annual Fiscal Conditions Report, in combination with educational workshops, is designed to provide an alternative perspective about the financial performance and health of Iowa cities.
- The Annual Fiscal Conditions Report includes all of the following:
  - Legislative updates
  - Financial health indicators
    - Socioeconomic conditions
    - Revenue
    - Expenditure
  - Implications and discussion

igfi.extension.iastate.edu

Financial Health Indicators & Rating Considerations

- The financial health indicators included in the Annual Fiscal Conditions Report are also relevant to bond ratings.
- These same financial health indicators are included in the scorecard methodologies employed by both Moody's Investors Service and Standard & Poor's and can be used to estimate a city's initial bond ratings or to identify potential changes to a city's existing bond rating.
- In the following slides, as we discuss each financial health indicator in more detail, we will also discuss the potential rating implications for each financial health indicator.

Financial Health Indicators & Rating Considerations: Socioeconomic Conditions

- Socioeconomic indicators are closely tied to the health of local government finance.
- An examination of the following indicators reveals the connection between the changes taking place and their impact on the financial health of the city government:
  - Population
  - Median age
  - Gender Ratio
  - Age distribution
  - Commuting patterns
  - Income distribution
  - Poverty rate
  - Education
  - Housing

Financial Health Indicators & Rating Considerations: Socioeconomic Conditions

- Current Moody's Investor Service general obligation rating methodology includes the following socioeconomic indicators in their scorecard, which, when combined with a city's 100% valuation information, represent 30% of a city's initial scorecard rating outcome.
  - 10% for tax base size (100% valuation)
  - 10% for 100% value per capita
  - 10% for median family income

Factor 1: Economy/Tax Base (30%)							
	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Tax Base Size: Full Value	> $12B	$12B ≥ n > $1.4B	$1.4B ≥ n > $240M	$240M ≥ n > $120M	$120M ≥ n > $60M	≤ $60M	10%
Full Value Per Capita	> $150,000	$150,000 ≥ n > $65,000	$65,000 ≥ n > $35,000	$35,000 ≥ n > $20,000	$20,000 ≥ n > $10,000	≤ $10,000	10%
Socioeconomic Indices: Median Family Income	> 150% of US median	150% to 90% of US median	90% to 75% of US median	75% to 50% of US median	50% to 40% of US median	≤ 40% of US median	10%

Financial Health Indicators & Rating Considerations: Socioeconomic Conditions

- Current Standard & Poor's general obligation rating methodology includes socioeconomic indicators in their Economic Score, which represents 30% of a city's initial scorecard rating outcome.
  - Assessment of the Economic Score is a sliding scale that measures total market value per capita against the projected per capita effective buying income ("EBI") as a % of U.S. projected per capita EBI.

Assessing The Economic Score (30%)					
	Total Market Value Per Capita				
Projected per capita effective buying income as a % of U.S. projected per capita EBI	> $195,000	$100,000 to $195,000	$80,000 to $100,000	$55,000 to $80,000	< $55,000
>150	1	1.5	2	2.5	3
110 to 150	1.5	2	2.5	3	3.5
85 to 110	2	2.5	3	3.5	4
70 to 85	2.5	3	3.5	4	4.5
≤ 70	3	3.5	4	4.5	5
A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak and very weak, respectively.					

Financial Health Indicators & Rating Considerations: Revenues

- In general, a local government should rely on a revenue mix that provides adequate, stable funding and distributes the burden equally among all groups.
- There is no prescribed mix that is considered ideal, so the local government should take into consideration local needs, preferences, and resources when evaluating local revenue sources.
- The following criteria are usually recommended:
  - **Adequacy**: Is the revenue source regular, reliable, and not susceptible to economic change?
  - **Adaptability**: Can rates be easily adjusted to meet changing needs and avoid shortfalls?
  - **Administrative ease and economy**: Is it simple and inexpensive to administer?
  - **Economic effects**: How does it affect local resource use and growth?
  - **Social acceptability**: How do citizens and businesses perceive the tax?
  - **Fairness**: Does it treat people uniformly and conform to social definitions of fairness, such as the ability to pay? Do those who benefit the most pay the most?

Financial Health Indicators & Rating Considerations: Revenues

- A local government's fiscal position determines its cushion against the unexpected, its ability to meet existing financial obligations, and its flexibility to adjust to new ones.
- Financial structure reflects how well a local government's ability to extract predictable revenues adequate for its operational needs are matched to its economic base.
- Current Moody's Investors Service general obligation rating methodology includes the following financial metrics in their scorecard, which, when combined with a city's ending fund/cash balances, represent 30% of a city's initial scorecard rating outcome.
- The Finances category comprises two major components:
  - Cash reserves and other liquid resources
  - The financial trend, which reflects on the quality of financial operations, the local government's ability to adjust to changing circumstances, and the potential for future stability or instability

Factor 2: Finances (30%)							
	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Fund Balance as % of Revenues	> 30%	30% ≥ n > 15%	15% ≥ n > 5%	5% ≥ n > 0%	0% ≥ n > -2.5%	≤ -2.5%	10%
5-Year Dollar Change in Fund Balance as % of Revenues	> 25%	25% ≥ n > 10%	10% ≥ n > 0%	0% ≥ n > -10%	-10% ≥ n > -18%	≤ -18%	5%
Cash Balance as % of Revenues	> 25%	25% ≥ n > 10%	10% ≥ n > 5%	5% ≥ n > 0%	0% ≥ n > -2.5%	≤ -2.5%	10%
5-Year Dollar Change in Cash Balance as % of Revenues	> 25%	25% ≥ n > 10%	10% ≥ n > 0%	0% ≥ n > -10%	-10% ≥ n > -18%	≤ -18%	5%

Financial Health Indicators & Rating Considerations: Revenues

- Standard & Poor's measures Budgetary Flexibility, which is a score intended to measure the degree to which a local government can look to additional financial flexibility in times of stress.
  - This includes a local government's capacity to raise additional revenue in times of fiscal distress including the ability to tap available unreserved fund balance as well as additional capacity in the existing tax rate structure.
  - This also takes into account reliance on questionable or risky revenue streams (i.e. gaming revenues, receivables due from funds with deficit balances, etc.)
- The Budgetary Flexibility Score is one of three components that make up the Financial Measure component included in the Standard & Poor's general obligation rating methodology, which when combined, represents 30% of a city's initial scorecard rating outcome.
  - 10% - Budgetary Flexibility
  - 10% - Budgetary Performance (will be discussed in more detail with expenditures)
  - 10% - Liquidity (will be discussed in more detail with expenditures)

Assessing The Budgetary Flexibility Score (10%)					
	Available Fund Balance as a % of Expenditures				
%	> 15%	8% - 15%	4% - 8%	1% - 4%	≤ 1%
Score	1	2	3	4	5
A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak and very weak, respectively.					

GASB 54: Fund Balance Classifications

GASB 54 includes a prescribed hierarchy based on the extent to which a city is bound by constraints for the use of the funds reported in governmental funds. GASB 54 provides the classification as non-spendable, restricted, committed, assigned and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. The following definitions are provided in GASB 54:

- **Non-spendable:** These funds are not available for expenditures based on legal or contractual requirements. An example might be the principal of an endowment or perpetual care cemetery funds.
- **Restricted:** These funds are governed by externally enforceable restrictions. In this category, one would see restricted purpose grant funds, Road Use Taxes or Local Option Sales Taxes.
- **Committed:** Fund balances in this category are limited by the government's highest level of decision making (in this case the City Council). Any changes of this designation must be done in the same manner that it was implemented. For example, if funds are committed by resolution, the commitment could only be released with another resolution.
- **Assigned:** For funds to be assigned, there must be an intended use which can be established by the city council or an official delegated by the council, such as a city administrator or finance director. For example, during the budget process, the council decided to use some existing fund balance to support activities in the upcoming year.
- **Unassigned:** This classification is the default for all funds that do not fit into the other categories. This, however, should not be a negative number for the General Fund. If it is, the assigned fund balance must be adjusted.

Financial Health Indicators & Rating Considerations: Expenditures

- Keeping per capita expenditures low allows local governments to keep local taxes low and ensure the delivery of services at the least cost possible.
- Given the general increase in prices, it is expected that the cost of services provided will continue to trend upward.
- Local governments also tend to increase user charges to compensate for any type of revenue shortfall.
- Both of these factors usually play a role in a general increase in local government expenditures.
- Expectedly, any increase in population also translates to higher dollar amounts spent by the local government to meet the additional needs of its residents.
- Measuring total expenditures per capita provides a financial health indicator that can be measured against peer cities.

Financial Health Indicators & Rating Considerations: Expenditures

- Current Moody's Investor Service general obligation rating methodology includes expenditures as part of the calculation of operating history (annual surpluses or deficits).
- When combined with Institutional framework, this represents 20% of a city's initial scorecard rating outcome.
  - 10% Institutional framework
    - Is a measure of an entities legal ability to match resources with spending
    - Institutional framework for Iowa cities is rated Aaa by Moody's Investors Service.
  - 10% for Operational History
    - Is a 5-year average of operating revenues divided by operating expenditures.

Factor 3: Management (20%)							
	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Institutional Framework	Very strong legal ability to match resources with spending	Strong legal ability to match resources with spending	Moderate legal ability to match resources with spending	Limited legal ability to match resources with spending	Poor legal ability to match resources with spending	Very poor or no legal ability to match resources with spending	10%
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	> 1.05x	1.05x ≥ n > 1.02x	1.02x ≥ n > 0.98x	0.98x ≥ n > 0.95x	0.95x ≥ n > 0.92x	≤ 0.92x	10%

Financial Health Indicators & Rating Considerations: Expenditures

- Current Moody's Investors Service general obligation rating methodology includes the following debt expenditure metrics in their scorecard, which, when combined with net pension liability, represents 20% of a city's initial scorecard rating outcome.
- The debt category is comprised of two major components:
  - 10% direct debt
    - 5% Debt to Full Value
    - 5% Debt to Revenue
  - 10% adjusted net pension liabilities
    - 5% Moody's-adjusted Net Pension Liability (3-year average) to Full Value
    - 5% Moody's-adjusted Net Pension Liability (3-year average) to Revenue

Factor 4: Debt/Pensions (20%)							
	Aaa	Aa	A	Baa	Ba	B & Below	Weight
Net Direct Debt / Full Value	< 0.75%	0.75% ≤ n < 1.75%	1.75% ≤ n < 4%	4% ≤ n < 10%	10% ≤ n < 15.%	> 15%	5%
Net Direct Debt / Operating Revenues	< 0.33x	0.33x ≤ n < 0.67x	0.67x ≤ n < 3x	3x ≤ n < 5x	5x ≤ n < 7x	> 7x	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value	< 0.9%	0.9% ≤ n < 2.1%	2.1% ≤ n < 4.8%	4.8% ≤ n < 12%	12% ≤ n < 18%	> 18%	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues	< 0.4x	0.4x ≤ n < 0.8x	0.8x ≤ n < 3.6x	3.6x ≤ n < 6x	6x ≤ n < 8.4x	> 8.4x	5%

Financial Health Indicators & Rating Considerations: Expenditures

- The Budgetary Performance Score (10%) is a measure of the current fiscal balance of the government, both from a general fund and total government funds perspective.
  - This takes into account significant historic volatility in performance due to reliance on cyclical revenues or exposure to event-related risks.

Assessing The Budgetary Performance Score (10%)					
	Total Government Funds Net Results (%)				
General Fund Net Result (%)	> -1%	-1% to -5%	-5% to -10%	-10% to -15%	≤ -15%
(>5%)	1	2	3	3	4
(-1% to 5%)	2	3	3	4	5
≤ -1%	3	4	4	5	5
A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak and very weak, respectively.					

- The Liquidity Score (10%) is a measure of the available cash and cash equivalents to service both debt and other expenditures.
  - This takes into account access to external liquidity, the stability of internal cash flow generation, aggressive use of investments and exposure to non-remote contingent liability risk.

Assessing The Liquidity Score (10%)					
	Total Government Available Cash as a % of Total Government Funds Debt Service				
Total Government Available Cash as a % of Total Governmental Funds Expenditures	>120%	100% to 120%	80% to 100%	40% to 80%	≤ 40%
>15%	1	2	3	4	5
8% to 15%	2	2	3	4	5
4% to 8%	3	3	3	4	5
1% to 4%	4	4	4	4	5
<1%	5	5	5	5	5
A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak and very weak, respectively.					

Financial Health Indicators & Rating Considerations: Expenditures

- Standard & Poor's includes a Debt and Contingent Liability Score as part of its general obligation rating methodology, which represents 10% of a city's initial scorecard rating outcome.
- The Debt and Contingent Liability Score is a measure of the total governmental funds expenditures and net direct debt as a percentage of total governmental funds revenues.
  - Debt service as a percentage of expenditures measure the annual fixed-cost burden that debt places on the government.
  - Debt to revenues measures the total debt burden on the government's revenue position rather than the annual cost of the debt.

Assessing The Debt and Contingent Liability Score (10%)					
	Net Direct Debt as a % of Total Governmental Funds Revenue				
Total Governmental Funds Debt Services as a % of Total Governmental Funds Expenditures	< 30%	30% to 60%	60% to 120%	120% to 180%	≥ 180%
> 8%	1	2	3	4	5
8% to 15%	2	3	4	4	5
15% to 25%	3	4	5	5	5
25% to 35%	4	4	5	5	5
≥ 35%	4	5	5	5	5
A score of '1', '2', '3', '4' and '5' means very strong, strong, adequate, weak and very weak, respectively.					

Other Rating Considerations

- Other rating considerations not previously discussed:
  - Institutional Framework
    - Moody's Investors Service: Iowa cities rated Aaa
      - Represents 10% of a city's initial scorecard rating outcome
    - Standard & Poor's: Iowa cities rated 2 (strong)
      - Represents 10% of a city's initial scorecard rating outcome
  - Management
    - Moody's Investors Service:
      - Included only as a notching factor, not included in initial scorecard rating outcome.
    - Standard & Poor's:
      - Based on a government's ability to implement timely and sound financial and operational decisions
      - Represents 20% of a city's initial scorecard rating outcome
  - Notching factors are qualitative outliers that move an initial scorecard rating upwards or downwards in half-step increments.
    - Moody's Investors Service: Unlimited Notching Factors
    - Standard & Poor's: 1 notch maximum movement (upwards or downwards)

Other Rating Considerations

- GASB 68: Pension and OPEB reporting requirements
  - Both rating agencies adjust an issuer's GASB 68 reported liabilities based on different internal rating criteria assumptions to generate an adjusted net pension liability that can be up the three times greater that the reported GASB 68 liabilities in an issuers audited financial statements.

- Comprehensive Rating Presentation
  - PFM recommends that issuers utilize a Comprehensive Rating Presentation as the foundation for each rating discussion.
  - One of the best ways to demonstrate strong management is by taking control of the rating dialogue.
  - The increased transparency of the scorecards provides an excellent opportunity to provide the rating agencies the information you know they will request.
  - Benefits of utilizing a Comprehensive Rating Presentation include:
    - Allows the issuer to control the tone and pace of the rating discussion and address rating challenges head on.
    - Creates an open dialog between the issuer and their Municipal Advisor during the credit presentation preparation process.
    - Brings to light rating challenges during the preparing process, allowing issuer to prepare answers to questions related to those issues BEFORE the rating call begins.
    - Identifies notching factor opportunities to enhanced the final rating outcome.
    - For new staff or new issuers requesting an initial rating, provides an opportunity to talk through the important points of each slide prior to the rating call.
  - Examples of Comprehensive Rating Presentations are available upon request.

Other Rating Considerations

Excerpts from Standard & Poor's Rating Commentary:

"The Top 10 Management Characteristics of Highly Rated U.S. Public Finance Issuers"

1. Focus on structural balance.
2. Strong liquidity management.
3. Regular economic and revenue updates to identify shortfalls early.
4. An established rainy day/budget stabilization reserve.
5. Prioritized spending plans and established contingency plans for operating budgets.
6. Strong long-term and contingent liability management.
7. A multiyear financial plan in place that considers the affordability of actions or plans before they are part of the annual budget.
8. A formal debt management policy in place to evaluate future debt profile.
9. A pay-as-you-go financing strategy as part of the operating and capital budget.
10. A well-defined and coordinated economic development strategy.

Based on the Rating Commentary originally published on July 23, 2012.

Moody's Investors Service Rating Medians

Moody's
INVESTORS SERVICE

MEDIANS FOR IOWA CITIES	RATING CATEGORIES		
	Aaa	**Aa**	**A**
Number of Cities Currently Rated:	*2*	*32*	*30*
Debt Statistics & Ratios			
Direct Net Debt as % of Full Value	1.50	2.30	2.70
Direct Net Debt per Capita ($)	1,283.00	1,467.00	1,504.00
Debt Burden (Overall Net Debt as % Full Value)	2.60	3.80	4.00
Overall Net Debt per Capita ($)	2,408.00	2,309.00	2,290.00
Debt Service as % of Operating Expenditures	28.60	28.70	29.30
Debt Paid Out within the next 10 Years (%)	96.60	89.30	86.70
Demographic Statistics			
Population 2010 Census	54,312.00	23,917.00	5,872.00
Per Cap Inc as % of U.S. (2010 Census)	119.70	91.00	83.50
Med Fam Inc as % of U.S. (2010 Census)	128.10	106.30	89.70
Population Change 2000-2010 (%)	15.50	6.10	(0.40)
Median Home Value (2010 Census)	134,450.00	99,150.00	72,100.00
Poverty Rate (%) (2010 Census)	13.10	7.40	8.10
Financial Statistics & Ratios			
Total General Fund Revenue ($000)	55,514.00	14,413.00	3,416.00
General Fund Balances as % of Revenues	61.50	39.00	33.60
Unrserved General Fund Balance as % of Revenue	36.20	31.00	29.00
Unreserved, Unrestricted Gen Fund Bal % of Rev	36.20	27.30	27.90
Tax Base Statistics & Ratios			
Total Full Value ($000)	5,437,286.00	1,479,461.00	390,986.00
Full Value Per Capita ($)	85,421.00	67,179.00	51,393.00
Average Annual Increase in Full Value (%)	2.40	1.90	2.20
Top Ten Taxpayers as % of Total Taxable Value	11.60	13.20	17.30

Standard & Poor's Rating Medians

General Obligation Medians For Municipalities										
Rating	**No.**	**MVPC**	**Proj PC EBI**	**FB/exp**	**GF op res**	**TGF op res**	**TG cash/exp**	**TG cash/DS**	**Net DD/rev**	**TGF DS/exp**
AAA	327	$289,586	174%	47%	4%	4%	84%	2,234%	91%	9%
AA	1,944	$134,207	110%	45%	4%	3%	88%	2,610%	121%	11%
A	913	$55,001	82%	38%	3%	2%	82%	2,310%	154%	12%
BBB and low er	103	$83,230	80%	5%	0%	0%	45%	3,893%	169%	12%

- **MVPC:** Total market value per capita
- **Proj PC EBI:** Projected per capita effective buying income as a % of U.S. projected per capita EBI
- **FB/exp:** Available fund balance as a % of expenditures
- **GF op res:** General fund net result
- **TGF op res:** Total governmental funds net result
- **TG cash/exp:** Total government available cash as % of total governmental funds expenditures
- **TG cash/DS:** Total government available cash as % of total governmental funds debt service
- **Net DD/rev:** Net direct debt as % of total governmental funds revenue
- **TGF DS/exp:** Total governmental funds debt service as a % of total governmental funds expenditures

GFOA Best Practices

- Government Finance Officers Association offers recommendations for Best Practices to local governments in many areas.
- GFOA Best Practices identify specific policies and procedures as contributing to improved government management and aims to promote and facilitate positive change rather than merely to codify current accepted practice.
  - A few Best Practice reports relevant to our discussion today is:
    - *Determining the Appropriate Level of Unrestricted Fund Balance In the General Fund* (CAAFR, Budget) (2015)
    - *Adopting Financial Policies*
  - This report provides guidance on how to determine the appropriate fund balance for each city.
- In addition, GFOA offers case studies and other valuable resources that would beneficial in determining a city's financial health.

Additional Resources

- Iowa Government Finance Initiative
  - http://igfi.extension.iastate.edu/

- Moody's Investors Service General Obligation Rating Methodology
  - www.moodys.com
    - For rating methodology:
      - Research & Ratings/Rating Methodologies
      - Market segment: U.S. Public Finance/Local Government

- Standard & Poor's General Obligation Rating Methodology
  - www.standardandpoors.com
    - For rating methodology:
      - Actions & Criteria/Ratings Criteria
      - Market segment: Governments/U.S. Public Finance

- GFOA Best Practices
  - http://www.gfoa.org/best-practices

Questions?

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