Budget, Finance & Economic Development

August 28, 2018

Summary and Motions

Chair Stinnett called the meeting to order at 1:04 p.m. Committee members Moloney, Evans, Farmer, Kay, J. Brown, and Bledsoe were in attendance. Committee members F. Brown, Mossotti, and Lamb were absent. Council Members Smith and Plomin were in attendance as nonvoting members.

I. Approval of March 20, 2018 Committee Summary

A motion was made by CM Evans to approve the March 20, 2018 Budget, Finance & Economic Development Committee Summary, seconded by VM Kay. The motion passed without dissent.

II. Financials Update – July 2018

Bill O'Mara, Commissioner of Finance, presented the item. He reviewed comparative unemployment rates, pointing out the most recent information available is from June, and said the U.S. is at 4.0, Kentucky at 4.2, Lexington MSA at 4.1 and Lexington at 4.0. In May, the rates were 3.8, 4.1, 3.3, and 3.2, respectively. He said you can see a seasonality in June and July numbers that has more people going to the labor markets in the summer months pointing out what's distinctive this year is the larger jump of 0.7 or 0.8. O'Mara reviewed the economic indicators comparing June of last year to this year, highlighting the unemployment rate is lower, the number of permits issued is up by over 400, the number of business licenses is slightly lower, home sales are down and the number of foreclosures seems to be stuck in the low twenties for the last few months. When reviewing the top four revenue sources he pointed out the difference in variances between 2018 and 2017, which is because we received payments from large payers earlier last year than this year, relative to the July 31 due date.

CM Moloney referenced the lawsuit that the school won, which our Lexington legislators supported, and how that might impact or take away the pension phase-in plan. He said that communities who have connections with Frankfort's leadership are coming up with a backup plan in case the phase-in is taken away and asked if Lexington has a backup plan. O'Mara clarified the lawsuit that CM Moloney referred to is about pension reform legislation and that is going through the process now. He said the phase-in, which outlines a maximum of 12 percent per year, is a separate law and not part of the lawsuit. He explained that the administration does not feel the phase-in is in jeopardy at this point, however last fall, the Council adopted a $10M budget stabilization assignment as the city's backup plan, which represents the additional amount the state's pension reform plan would require from Lexington for one year. Moloney pointed out that this backup plan is for one year and the backup plan should consider the following few years.

Melissa Lueker, Director of Budgeting, continued the presentation reviewing the other revenue streams and cash flow, pointing out that insurance and investment income are the only categories we collected more than what was budgeted. When reviewing the expenses, she said that overall we are at budget, highlighting the 0.7 percent variance for personnel being excellent and a total variance in fund balance of $2.1M. She reviewed revenues and expenses comparing this year to last year.

CM Evans asked why we have transfers only one month in. Lueker said we do them for many reasons and that some are done once a year and some throughout the year. She will send a list of the transfers. CM Stinnett mentioned that everyone should have received a copy of the urban services funds for information only.

No further comment or action was taken on this item.

July 2018 YTD Actual Compared to Adopted Budget:

Revenue Category	Actual	Budget	Variance	%Var
OLT- Employee Withholding	7,770,767	7,777,745	(6,977)	-0.1%
OLT - Net Profit	596,340	708,033	(111,694)	-15.8%
Insurance	3,397,415	3,322,542	74,873	2.3%
Franchise Fees	2,358,572	2,367,270	(8,698)	-0.4%
TOTALS	14,123,094	14,175,590	(52,496)	-0.4%

2019 Fiscal Year – Cash Flow Variance Revenue (Actual to Budget):

For the one month ended July 31, 2018				
	Actuals	Budget	Variance	% Var
Revenue				
Payroll Withholding	7,770,767	7,777,745	(6,977)	-0.1%
Net Profit	596,340	708,033	(111,692)	-15.8%
Insurance	3,397,415	3,322,542	74,873	2.3%
Franchise Fees	2,358,572	2,367,270	(8,698)	-0.4%
Other Licenses & Permits	85,509	289,625	(204,116)	-70.5%
Property Tax Accounts	(6,243)	2,000	(8,243)	-412.2%
Services	1,762,930	1,824,463	(61,533)	-3.4%
Fines and Forfeitures	17,908	19,917	(2,008)	-10.1%
Intergovernmental Revenue	8,845	12,664	(3,819)	-30.2%
Property Sales	4,521	20,833	(16,312)	-78.3%
Investment Income	59,821	39,084	20,737	53.1%
Other Income	182,460	235,622	(53,162)	-22.6%
Total Revenues	**$16,238,846**	**$16,619,797**	**($380,951)**	**-2.3%**

2019 Fiscal Year – Cash Flow Variance Expense (Actual to Budget):

For the one month ended July 31, 2018				
	Actuals	Budget	Variance	% Var
Expense				
Personnel	14,093,666	14,186,624	92,958	0.7%
Operating	2,695,010	4,931,991	2,236,981	45.4%
Insurance Expense	936,562	1,018,728	82,166	8.1%
Debt Service	3,755,609	3,756,776	1,167	0.0%
Partner Agencies	1,451,205	1,546,829	95,624	6.2%
Capital	637	80,063	79,426	99.2%
Total Expenses	**$22,932,688**	**$25,521,011**	**$2,588,322**	**10.1%**
Transfers	**423,338**	**395,183**	**(28,155)**	**-7.1%**
Change in Fund Balance	**($7,117,181)**	**($9,296,397)**	**$2,179,216**	

Comparison of Economic Indicators 2017/2018:

Comparison of Economic Indicators

Economic Indicators		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fayette County	2016	4.2%	4.3%	4.1%	3.3%	3.6%	3.9%	3.8%	3.3%	3.4%	3.3%	2.9%	3.1%
Unemployment Rate	2017	4.0%	3.9%	3.9%	3.6%	3.6%	4.4%	4.5%	3.9%	3.2%	3.2%	3.1%	2.8%
	2018	3.0%	3.5%	3.4%	3.0%	3.2%	4.0%						
Quarterly Fayette County	2016	-	-	188,039	-	-	192,063	-	-	194,300	-	-	196,500
Employment	2017	-	-	191,760	-	-	193,695	-	-	195,800	-	-	199,800
	2018	-	-	N/A	-	-	N/A	-	-	N/A	-	-	N/A
Fayette County Permits Issued	2016	937	1,206	1,510	1,631	1,453	2,071	1,042	744	860	737	742	721
	2017	876	739	924	899	1,357	995	1,207	1,283	1,054	1,053	994	965
	2018	914	927	979	993	1,547	1,432						
Fayette County New Business	2016	203	248	445	564	658	299	173	260	219	231	211	153
Business Licenses	2017	201	253	418	468	621	328	206	281	205	247	213	140
	2018	219	250	379	751	535	286						
Home Sales (MSA)	2016	640	773	950	1,139	1,313	1,419	1,230	1,338	1,155	1,050	1,012	1,081
	2017	776	794	1,060	1,067	1,411	1,428	1,353	1,311	1,084	1,115	951	1,000
	2018	728	700	1,042	1,085	1,281	-						
Fayette County	2016	22	36	25	27	31	21	26	40	14	31	31	16
Foreclosures	2017	27	17	16	19	16	17	20	22	19	16	26	16
	2018	21	0	22	21	21	22						

N/A indicates information not available.
BLS Release Dates for Fayette Co. Quarterly Employment - 6 months after quarter end

FY19 Code Enforcement Nuisance Abatement/Lien Collections:

Code Enforcement Lien Collections

Month	Administrative Collection Fees		Miscellaneous		Penalty & Interest		Total Collections	
	FY 2019	FY 2018	FY 2019	FY 2018	FY 2019	FY 2018	FY 2019	FY 2018
July	675	825	1,430	603	15,407	6,936	17,512	8,364
Totals	6,699	825	15,278	603	517,156	6,936	539,132	8,364

III. Exaction Program Review

CM Stinnett explained the exactions program started in 1996 during the last urban services boundary expansion and how the Commissioner of Planning, Preservation and Development, Derek Paulsen, has spent the last year conducting a review and overhaul of the program to get it back on track after a variety of issues. Paulsen presented the item, providing an overview of the program. He said the goal of the program is to provide an equitable means of allocating a fair share of the cost of capital facilities, which are needed to serve new growth and development. He identified the three expansion areas the exactions program applies to and highlighted the types of facilities it was designed to pay for. Paulsen explained how exaction rates are set, how different expansion areas have different rates and how they are paid. He reviewed the city’s divisions that are involved with exactions and how the program is being managed. He highlighted ongoing work, including a new database, a rate table update and the importance of updating the cost estimates for remaining improvements. He concluded the presentation by reviewing the accounting of credits and the reserve account, pointing out that the city is not meant to make any money off of the program.

CM Farmer asked if the expansion areas are able to receive sewer infrastructure, which Paulsen said they are all in the urban services boundary and therefore it is a matter of timing when the infrastructure comes online. CM Farmer asked if the rate table will change. Paulsen explained the rate table is required by ordinance to be updated and how the rates impact the cost developers’ associate with the land. He said the rates will change and that they hope to bring updated rates to the council for approval before the end of the calendar year.

VM Kay asked about the history of exactions, what we know from what has been completed and if they were adequate for the work that was done. Paulsen said there was an estimate of how much everything would cost when the expansion area was created and that's what drives the rates now. He said they now have some close out data but that there are many variables in addition to that information that determines potential cost. He pointed out that the city of Lexington last updated its rates in March 2010 but has not updated it since then. VM Kay asked how the 2010 update was handled and Paulsen explained money was not returned, though reimbursements can be granted, instead it changed the amounts being collected going forward. VM Kay asked how the city determines if the fees were accurate. Paulsen said they do not go back and check but overall the rates should go down; he added that it would not be easy to determine if refunds are necessary until everything is developed.

CM J. Brown clarified that the fees are based on rate table per acreage so there is no additional charge just a percentage of what the projected cost of infrastructure will cost. Paulsen explained the breakdown by land use and expansion area and the different zones, or uses, relative to the different impacts on infrastructure. CM J. Brown asked who has the right to transfer credits and Paulsen said the developer, the group who actually builds the infrastructure, receives the credits when it is complete. CM J. Brown asked if the rates are affected if a development falls within a consent decree area. Paulsen explained that the expansion area master plan and that the infrastructure is laid out with the costs associated with that plan. CM J. Brown asked about the balance in the exactions reserve account. O'Mara explained with an example of a developer receiving credits for putting in a major road, then a small builder buys a lot from the developer and pays the exactions upon getting their permit and money then goes into the reserve account. He said if the developer did not use all their credits, then money in the reserve account (i.e. exactions paid by the small builder) could pay back the developer's credits. It was clarified that the developer would have to request reimbursement.

CM Stinnett pointed out the added cost exactions amount to relative to the scarcity of developable land in Lexington and the impact that has on development. He asked if there is a list of improvements that still need to be built in the expansion areas and if that included public parks. Paulsen said there is a list and that there are some parks laid out in the master plan, particularly one in Expansion Area 2a. CM Stinnett asked how much is in the reserve account; Paulsen responded $7.2M and explained that the developer would likely not build the park but instead receive credits for contributing the land. It was clarified that updating the rate table is done to apply an updated costs associated for the remaining infrastructure to be built. CM Stinnett asked why we would continue this program, particularly if the accounting is off, mentioning Expansion Area 1, which has seen no development. Paulsen said it would be very difficult to halt the program in Expansion Areas 2 and 3. Paulsen explained the goal for exactions are to remain an equitable payment for infrastructure so no one party, the city or individual developers, is overburdened with the cost. He said the city does need to look at whether there is a less complex way to do this in the future and pointed out the possibility to do that for Expansion Area 1.

CM Moloney said he was told it would be eight to 12 years before Expansion Area 1 would receive sewer infrastructure and how that is the real reason that property has not been developed. He asked how the Planning Commission and the Council will be informed on information such as this. Paulsen explained how the readiness for development from the owners/developers impacts the prioritization of sewer infrastructure and how it could not have been predicted, when the program was created, that it would take 30 years for sewer to reach Expansion Area 1.

VM Kay explained his understanding that part of the rationale for the implementation of the exactions program in 1996 came from the debate to expand the urban services boundary and the conclusion that if the city did expand it should not be at the expense of the entire county, instead the costs should be borne by the developer and the people who purchase the land. He argued that if we decide to expand in the future this same conclusion be considered going forward but that we need a simpler system to reach this goal.

<u>No further comment or action was taken on this item.</u>

IV. LFUCG Debt Profile: General Fund and Sanitary Sewer System

O'Mara presented the item and discussed the debt profile for the City of Lexington. He reported the total general fund outstanding debt in fiscal year 2019 at $515,797,581 with debt service payment of $42,622,176, which is about 11.58 percent of revenue. He demonstrated how our debt diminishes over the course of 20 years, as well as debt service, with payments peaking in 2021. He reviewed the 20 year schedule that show the waterfall as we pay down various bond issues. He pointed out pension bonds 2009B, 2010D that was refinanced into 2017B, and 2012A. He reviewed graphs of the 20 year schedule, and what the anticipated new annual debt might look like with a three percent growth factor. He said our credit ratings have a stable outlook and highlighted the factors that could lead to an upgrade or downgrade in credit rating. O'Mara shifted to sanitary sewer bonds, which are separate from general fund bonds and rated separately. He said they are fully supported by the sewer user fee and reviewed the credit ratings and the factors that affect the ratings. He explained how the sewer bonds are through Kentucky Infrastructure Authority (KIA) and their funding mechanisms, which are very favorable for Lexington. He said these loans operate similar to a construction loan, where you draw down on the loan as needed and said the total sanitary sewer system outstanding debt is $139,939,436. He reported there is $4.9M outstanding debt in a stormwater KIA loan with $350,000 annual debt service.

CM F. Brown asked what the highest rating you can get from Moody's credit rating and O'Mara said AAA. It was noted that the city's Moody's credit rating is two steps below the highest possible rating and that the S&P rating is only one step below the highest. CM F. Brown asked how AAA would affect our borrowing rates. O'Mara said they would be lower but that all the rates are very compressed right now and he would have to follow up with a number. CM F. Brown said that our general fund outstanding debt keeps getting bigger, discrediting the commonly used argument that we are taking on more revenue and pointed out the 20 years we have to pay down our existing debt. He said we need a bond management plan to put a dent in the $515M that we owe. He said that he is not against bonding and that he is supportive of bonding infrastructure, especially paving.

CM Bledsoe highlighted the categorical shifts every five to six years in the general fund outstanding debt by fiscal year chart, which are due to bond issues rolling off. She asked if we were running the same amount of debt in the previous 10 years and if this debt is consistent historically. O'Mara said he could provide similar information looking at the last 10 years but he said we have remained a little over 10 percent for the last 10 years.

CM Moloney asked about the city's lowest rating and O'Mara explained that we have gone up and down in the AA category and that this is not the lowest rating the city has had historically. CM Moloney expressed concern about being financially stable in the future and said he wants to see the city go below 10 percent. He pointed out the Town Branch Commons project and that construction projects sometimes require additional funding after they get started. He asked if bonds can roll over, stretching longer than what was outlined when the bond was originally issued and O'Mara said they never lengthen the maturity of the bond and clarified that refunding a bond would only be done to lower the interest rate.

VM Kay asked CM F. Brown why bonding for road paving is okay but bonding other projects is not. CM F. Brown said paving is important infrastructure, an absolute necessity, that people pay taxes for but projects such as Town Branch Commons or the historic courthouse are not directly benefiting the tax payer. He said he ultimately would prefer not to bond paving but said you can't do that with the size of debt service Lexington has. He emphasized we are not putting nearly enough money in infrastructure and said he thinks people would understand bonding infrastructure before some of the other projects. VM Kay said bonding is one tool for being fiscally responsible and that tool is used for what the council thinks would be useful for the community to have. He explained that includes the basics, like roads, as well as other projects, like the historic courthouse and Town Branch Commons, which may not provide a benefit for everyone in the community but that are a part of quality of life, economic development, what attracts people here, and what keeps Lexington going. He argued these other projects are just as important as infrastructure. He emphasized why bonding projects now is sometimes more fiscally responsible than delaying a project, when the cost may be greater in the future, and said it is the council's decision each year through the adoption of the budget on what and how much to bond.

CM Evans said council should have this discussion before budget season. She suggested working with core staff to set this up. She asked about factors that lead to downgrades in credit ratings such as failure to adopt timely rate increases and the time frame to facilitate that conversation, before rate increases become critical. O'Mara said we look at these figures every four months for the sanitary sewer program and capital spend, studying projected cash flow 36 months out and actual spend, to make sure we can afford the EPA consent decree. He said part of that study is examining how to pay for it, through bonding and projected rate increases, so they always try to look forward. He referenced how they typically ask the council to adopt sanitary sewer rates in February/March and the property tax rates are considered in August.

CM Stinnett commented on the changes over the last 20 years relative to the history of total outstanding debt and how the city did not have a $32M rainy day fund 20 years ago. He said he could argue against bonding paving projects because it is a deteriorating asset. He emphasized that low interest rates are critical when utilizing bonds and pointed out the difference one year can have. CM Stinnett referenced years 2021 and 2022 when debt service payments drop, and how bonding a new city hall ourselves ($6.9M debt service going forward), versus P3 financing, would be included in the city's total outstanding debt. He asked if the P3 debt service would count towards the city's outstanding debt obligation. O'Mara said it would be considered an operating expense in the budget and listed as an asset and liability on our balance sheet. CM Stinnett emphasized the importance of where the expense falls when considering big projects, relative to the city bonding themselves versus a P3 option.

CM Bledsoe agreed with CM Stinnett. She said it is imperative to have a retreat to discuss specific budget priorities, what the council is willing to bond and how we are willing to spend our resources; and to have this retreat in January before the mayor sets the agenda. She said she did not support the public art fund because she thinks those decisions need to be made on a project by project basis. She commented about the idea of borrowing to save money and the city's mentality to spend money when we have it and to borrow it when we don't. She said historically decisions are made to delay maintenance needs because there is no money and those needs are delayed so long that the cost to replace it entirely becomes cheaper. She explained that maintenance needs are not the types of projects that are popular compared to, for example, a new park and that the P3 financing model takes the risk, which is a future lack of commitment to maintenance needs, out of it. She concluded the P3 model makes more sense because it saves the city more money in operating cost. O'Mara said if there are critical needs then there would be a savings of cash flow, meaning if you assume the downtown campus of buildings will require additional money to be spent on critical needs then there would be a savings in cash flow by going with a lease-certain option for new building compared to the cash required to maintain the those buildings over the next 10 to 20 years.

CM Farmer asked if the forecast for bonding $30M per year was based on history or a feel for upcoming needs and O'Mara said it's a little of both, highlighting the city's bonds for regular CIP, excluding special projects, is about $25M to $30M each year. CM Farmer asked, if the council set a goal to bond less than $30M for the next few years, if that is attainable. O'Mara said this would require a "diet" and the council would have to be comfortable with certain priorities getting delayed; he compared it to personally financing and needs versus wants.

CM F. Brown said we have a budget for the community and we have balanced that budget on the back of bonds. He asked when the last time we balanced the budget without borrowing money was. O'Mara said it was 2005 because of the city's inability to produce the CAFR.

CM Plomin said she agrees we need to have a conversation and discuss our priorities. VM Kay said the conversation on priorities should be had at the beginning of the year with the administration. He said he is not in favor of an arbitrary cap on bonding, instead we need to look at the budget and the priorities each year to make bonding decisions.

<u>No further comment or action was taken on this item.</u>

III. Items Referred to Committee

A motion by CM J. Brown to remove *long-time resident property tax assistance (RTO)* from committee, seconded by CM Bledsoe, the motion passed without dissent.

A motion by CM Farmer to adjourn, seconded by CM Bledsoe, the motion passed without dissent.

The meeting was adjourned at 2:49 p.m.

K.T. and H.A.
9.10.18