Minutes
Finance Committee Meeting
3:30pm, 10/23/12
First Floor-North Conference Room, City Hall

Present: Vice Mayor Esther Manheimer, Chair; Councilman Chris Pelly, Councilman Marc Hunt

Staff: Lauren Bradley, Gary Jackson, Jeff Richardson, Steve Shoaf, Tony McDowell, John Sanchez, Cheryl Heywood

Approval of Minutes

Councilman Hunt made a motion to approve the 9/25/2012 minutes and this motion was seconded by Councilman Pelly and unanimously approved by the committee.

1. **Fiscal Year 2012 Audit Update**
   Ms. Bradley told the committee that we are on target with the deadline for the annual financial audit which is due to the Local Government Commission (LGC) on 10/31/12. Staff is finishing up the financial statements and the analysis that goes with it. Our fund balance is above our policy target but is slightly lower than anticipated; with a fund balance that will come in at around seven hundred and sixty thousand dollars. There is no expectation that there will be any audit findings and we will have a clean opinion for the audit. Council will be given a full staff report about our year-end numbers and fund balance at the 11/13/12 council meeting. Recommendations for appropriating any one-time fund balance and capital savings will be discussed at the 11/27/12 council meeting, Vice Mayor Manheimer asked if the reserves in the water fund for capital projects were also going to be discussed at that meeting. Ms. Bradley said yes, the water reserves would be discussed at that meeting.

2. **Financial Policy Update**

   Water Fund Policies
   Ms. Bradley said that the advantage of having a formally adopted policy gives us a consistent guide about how to set rates and budget for capital. In addition, rating agencies typically ask if you have a formal policy that has this information included in that document.

   Ms. Bradley said that Section H of the Financial Policy draft are the additions being proposed on the water utility. The metrics for the water fund model that were discussed with council in small group meetings have been incorporated into the financial policy and staff is asking that they be formally adopted by council.

Councilman Hunt said that item number five, under service affordability, which states that "the City of Asheville's percent MHI, the average annual residential bill divided by real median household income, shall be equal or less than 1.5 percent" on service could potentially come into conflict with some of our other policies. Ms Bradley said she is personally very comfortable with this number because even with the model where we are showing the fifty million dollar transmission line in the second five years of the capital plan, we are still at or below this ratio. That is a pretty significant cost increase that we factored into the plan, so even with the worst case scenario, we are still within that threshold and we can manage that. If metrics, standards, or something in the management of the water utility changes, we can always revisit the policy.

Internal Service Fund Policies

Ms. Bradley began by saying that the internal service fund actually has three sub-funds; 1) health care, 2) workers compensation and 3) property casualty and liability. Staff would like to set policies that establish how we set rates for health care and how we budget for claims costs, workers compensation and liability. Ms. Bradley said that the draft policy given to the committees for review addressed only the health fund, but staff would take the same policy and mirror it for workers compensation and liability.

The policy outlines that we will set a budget for health care claims at an amount that looks at our past history, health care inflation trends, and includes a five percent risk corridor buffer above what we estimate our health care claims to actually be. The reserve requirement for the health care fund will be thirty percent of incurred but not reported claims, and reported but not yet computed claims. This means that there will be an actuarial analysis that goes back and reviews that information. This is significant because in the current year, when we got through year-end, used the data from last year, and looked at what was budgeted for this year, we budgeted too much in the health care fund for claims. Staff realized that we need to define how we budget and what our reserve requirement should be so we are budgeting what we need and not more than that. Staff will come back to city council with a budget amendment for the health care fund to adjust that budget down by approximately five hundred thousand dollars. On the risk management and workers compensation and liability budget, we need to make an adjustment based on how those costs are being allocated. The general fund needs to pay a larger portion of those claims than our enterprise funds but their portion should be less The budget amendment of five hundred thousand dollars coming out of the health care fund will be moved to step up the general funds portion of the risk management's responsibilities of workers comp and property casualty. Ms. Bradley said that a formalized policy would give consistency in how the budgets for these funds are calculated.

Councilman Hunt said the policy refers to regulatory fees but asked for an example of regulatory versus non regulatory fees. Ms. Bradley said that a regulatory fee would be something like fire inspection or building permit fees, and non-regulatory fee would be privilege license fees.

Councilman Hunt said there is provision in the policy that states that debt service shall be no more than fifteen percent of the general fund budget and asked if we are anywhere near that amount. Mr. McDowell, the budget manager, said that the pay-go capital and the debt equal approximately eight percent. Ms. Bradley said that we would not ever want to reach the fifteen percent limit.

Councilman Hunt said when we retire our general obligation bonds and issue new bonds we would be paying mostly interest and very little principal. He asked if we risk violating the provision that states "the pay out of aggregate principal outstanding shall be no less than fifty percent paid within ten years"? Ms. Bradley said that we are nowhere close to that cap.

Councilman Hunt asked if there was a need to include a policy related to the post employment benefit clause. Ms. Bradley said that we are participating in the State Treasurer's Other Post Employee Benefits (OPEB) Trust and we sent over 3 million dollars to that trust to fund our OPEB liability. Where we are falling short on OPEB is the annual required contribution, and we have put in place a 4 year step up plan, to be increased by two hundred thousand dollars each year. Ms. Bradley said that we can look at a formalized policy that would outline our commitment to meeting the OPEB obligation if that is a concern. Councilman Hunt said that perhaps a formal policy should be included in the financial policy but would leave that up to staff.

Ms. Bradley said that the revised financial policy, the budget amendments, and internal service fund will go to full council at the 11/13 or 11/2712 meeting.

3. **The Next Community Crossroads: Whitepaper Update and Staff conference**

Mr. Jackson said that this draft is a current financial assessment of the financial challenges and the structural issues that prevent us from fully implementing council's long range plans, or capital improvements. The theme of the paper remains the same. We need to continue to be frugal, diversify our revenue base, manage expectations and communicate more and better both with our citizens and potential partners. Staff is in the process of expanding upon the outline by updating such facts as the financial and legislative information and development trends. We are revisiting the demands on our system in the daytime population, tourism, and updating sales tax statistics. One change in theme is the inclusion of the information that municipalities are not in a position to do city initiated annexation. It also underscores the importance of sustainability, affordable housing, and the need to take advantage of infill development, the growing tax base in the river, downtown, and commercial corridors. Mr. Jackson concluded by saying that the report is not just a revenue management strategy it is a land use and community development strategy as well. Staff anticipates that council will find that information helpful during the strategic planning process in January.

Ms. Bradley said one of the most significant additions to the paper is the chart outlining the structural problem and what is causing it. That is, the rate of revenue growth is smaller than the rate of growth and expenditures. and we would see this phenomenon whether we were having a recession, or whether we had this daytime population strain or not the structural issue will continue to be remain. Those two items just exacerbate the problem. Revenues are growing at a rate of about one to two percent and expenditures are growing at a rate of four to six percent. We start the year with a balanced budget, where revenues equal expenditures and then in year two, expenditures are growing at a faster rate than revenues. This creates a gap. What we have done in the past few years to close the gap is to reduce expenditures. It is then necessary to either continue to cut expenditures each year, or raise revenue each year to keep up with the structural problem.

Councilman Pelly asked what the amount of the gap was. Ms. Bradley said that it is about a five percent gap.

Vice Mayor Manheimer said that the gap is not unique to Asheville, it is a reality for all cities when you are dealing with health care costs and if you don't adjust your revenue there will be a gap.

Water Rate Model

Ms. Bradley said that the water rate model goes hand in hand with the water financial policy. Staff is continuing to work on the water financial forecast and the rate model as part of the capital planning and budget cycle. Staff received feedback that the main transmission line needed to be taken out of the model. The study on that line is not completed and the scope of the work is unknown at this point. That project has been removed from the model so we could see what our rate structure would look like without it. The water rate of increase is much lower without the project included. In fiscal year 2013-14, we are showing a one percent increase for CIP, single family, multi-family and for commercial and a three percent increase for large commercial class of customer. Ms.

Bradley concluded by saying that when you remove the transmission line project, it has a

big impact on rates. This model also brings the debt ratio more in line with the ratio we want to achieve with this model. The other key difference in this model is that staff adjusted some of the expenditure assumptions. In the original model, which included the transmission line, expenditures were growing at a rate of approximately three percent across the board , so we adjusted health care, fuel, utilities, and those that we have seen growing at a faster rate than three percent, we adjusted up.

Vice Mayor asked if we have identified which projects the CIP will cover. Ms. Bradley said that in the first five years, it is project specific, and in the second five years, it is more broadly categorized because when you go ten years out, projects have not been specifically identified. Staff is currently working on identifying specific projects for the full ten years.

Ms. Bradley said that this item will move to full council for a recommendation during the budget process.

Vice-Mayor Manheimer adjourned the meeting at 4:30 p.m.