CARFAC Special Report: Financial Metrics, Financial Position and Bond Issuance

At the Board of Commissioner meeting on November 23, 2015, CARFAC was asked to respond to two separate requests from Commissioners: (1) To identify metrics that determine if the Township's financial position is better today versus prior years with an emphasis on the amount of debt being carried by the Township. (2) To recommend if bonds are the most appropriate mechanism to raise the capital needed to complete the various improvements included under Park | Trail | Library bond ordinance. CARFAC held a special working-group meeting on December 3, 2015 and developed this special report.

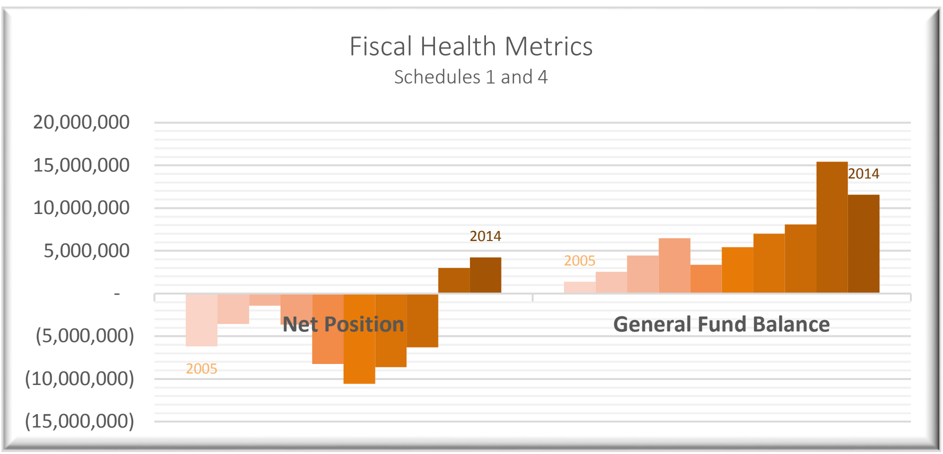
1 Identifying Metrics to Determine Fiscal Health and Debt Load

CARFAC has come to the conclusion that when you look at the significant metrics, the Township is clearly improving its financial picture. Net position is improving, General Fund balance is improving, indebtedness has been steadily decreasing each year since the Township hit the highest debt levels in 2007, and the Township's margin of debt to revenue has been steadily improving. Conceding that the Township is spending more today than in prior years, the metrics identified demonstrate that the spending has been used to improve financial position.

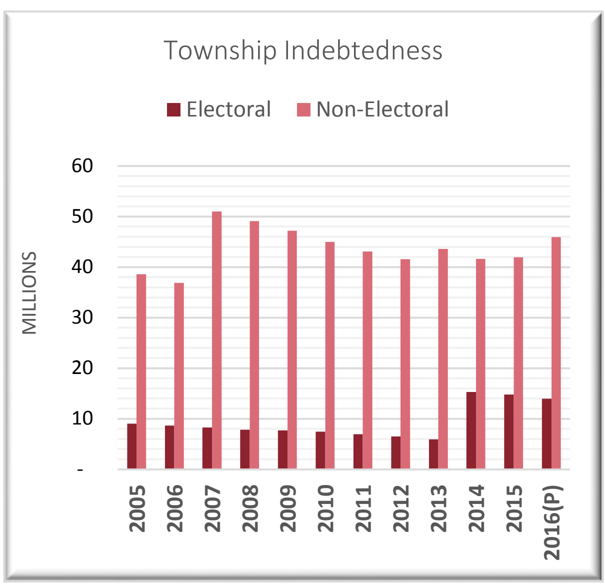
The Governmental Accounting Standards Board (GASB) and Government Finance Officers Association (GFOA) have developed a comprehensive reporting model called the Comprehensive Annual Financial Report (CAFR). Radnor Township has adopted this reporting model and has, according to Township Staff, published a CAFR each year going back to [at least] 1995, with exceptions in 2008, 2009 and 2010 when the Township only did basic financial statements. The relevance to the issue at hand is that the CAFR includes a statistical section that provides various metrics for determining fiscal health. Even more, the statistical section provides these metrics that span a period of time; in most cases, ten years. So trends can be identified and quantified. In determining which metrics provide the answer to the Commissioner's question, CARFAC recommends that looking at Schedule's 1, 4, 13 and 15 together provide a comprehensive review of the Township fiscal direction and debt load. The recommendation is based on the following:

- Metrics to determine fiscal health:
  - Schedule 4 – Fund Balances, Governmental Funds: Provides the reader with a precise measure of the Township's bottom line (versus Schedule 1 below), by only including governmental funds and by only looking at fund balance. When reviewed in conjunction with the Net Position, the reader can determine if the governmental fund balances are moving in the same direction as on the overall net position. CARFAC recommends focusing on the General Fund balance since the General Fund is primarily responsible for the township operations and capital funding.
  - Schedule 1 – Net Position by Component Unit: The Net Position is the "bottom line" for the Township. It includes all aspects of the Township in accordance with Generally Accepted Accounting Principles. Therefore, by looking at the ten year history, the reader can determine whether overall fiscal health is improving or worsening.

- Metrics to determine indebtedness:
  - Schedule 13 – Net General Bonded Debt Outstanding[1]: Provides the reader with the annual amount of electoral and non-electoral debt outstanding for the Township over a ten year period. Then, the schedule applies that total against demographics such as taxable assessed value and per capita. Each metric provides useful insight: Taxable assessed value demonstrates the outstanding debt as a percentage of the overall value of the Township. Personal Income demonstrates the outstanding debt as a percentage of the residents' income. Finally, the per capita amount shows the level of outstanding debt per resident.
  - Schedule 15 – Legal Debt Margin Information: Provides the reader with the total outstanding non-electoral debt as a percentage of the total debt allowed under State Law. State law sets the limit at 250% of the borrowing base, which is a three year average of total revenues (less enterprise fund revenues, interest, grants and proceeds from the sale of assets or loan proceeds).



	Schedule 1	Schedule 4
	Net Position	GF Balance
2005	$(6,184,710)	$1,380,425
2006	(3,546,093)	2,546,603
2007	(1,423,445)	4,460,316
2008	(3,637,355)	6,474,263
2009	(8,232,027)	3,368,119
2010	(10,584,071)	5,414,283
2011	(8,611,015)	6,988,851
2012	(6,293,337)	8,096,582
2013	2,984,876	15,407,783
2014	4,229,511	11,581,210



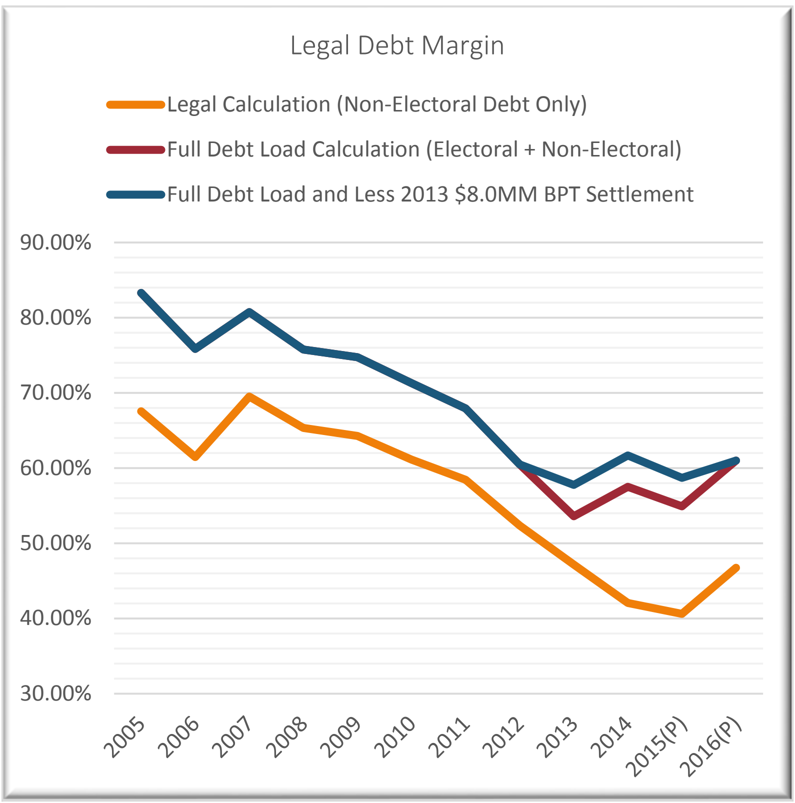
Schedule 13 | General Obligation ("GO") Bonds

(In 1,000's)	Electoral	Non-Electoral	Total	Change	% of Taxable Value[2]	Net GO Bonds per capita[3]
2005	$9,005	$38,595	$47,600	n/a	1.57%	1,542
2006	8,630	36,860	45,490	$(2,110)	1.47%	1,473
2007	8,240	50,980	59,220	13,730	1.91%	1,918
2008	7,835	49,130	56,965	(2,255)	1.83%	1,845
2009	7,695	47,225	54,920	(2,045)	1.75%	1,779
2010	7,465	44,965	52,430	(2,490)	1.67%	1,663
2011	6,970	43,055	50,025	(2,405)	1.60%	1,587
2012	6,465	41,575	48,040	(1,985)	1.53%	1,524
2013	5,955	43,570	49,525	1,485	1.56%	1,571
2014	15,310	41,605	56,915	7,390	1.79%	1,805
2015(p)	14,785	41,920	56,705	(210)	1.79%	1,798
2016(p)	13,975	45,905	59,880	3,175	1.89%	1,899

[1] Schedule 13 in the CAFR is titled, "Ratio of Net General Bonded Debt Outstanding"
[2] The 2016 "% of Taxable Value" is based on the 2015 Taxable Assessment which is the latest available
[3] The 2015 and 2016 Net GO Bonds per Capita are based on the latest population data from the US Census

As the data in the preceding tables reflects, the Township's overall Net Position and General Fund balance have been improving since the recession, which hit the floor in 2010 and began recovering starting in 2011. At the same time, up until the Township elected to issue bonds for the Library | Parks | Trails, the non-electoral debt had been steadily declining from the peak in 2007. Even when the new Library | Parks | Trails bonds are incurred, the total non-electoral debt will be less than it was in 2007. The "Change" column in the Schedule 13 table above demonstrates an important point: Each year, the Township is paying down approximately $2.2 million in principal. Those pay downs still occurred in 2013, 2014 and 2015, but were offset by other increases including the swap termination in 2013, the open space bonds in 2014, the library bonds in 2015, and the Park | Trail bonds anticipated to be issued in 2016.

The final metric recommended is the Legal Debt Margin[4], which is included on Schedule 15 of the statistical section in the Township's annual financial report. The graph and table below show the LDM under three difference scenarios:



Schedule 15 | Legal Debt Margin

		Information beyond the legal requirement and different than what is reported in the CAFR	
	Legal Calculation of the Legal Debt Margin	Full Debt Load	Full Debt Load and Less 2013 $8MM BPT Settlement
2005	67.56%	83.32%	83.32%
2006	61.45%	75.84%	75.84%
2007	69.53%	80.77%	80.77%
2008	65.35%	75.77%	75.77%
2009	64.29%	74.77%	74.77%
2010	61.15%	71.31%	71.31%
2011	58.46%	67.92%	67.92%
2012	52.35%	60.49%	60.49%
2013	47.15%	53.60%	57.76%
2014	42.06%	57.53%	61.69%
2015(p)	40.61%	54.93%	58.72%
2016(p)	46.76%	61.00%	61.00%

The first scenario, "Non-Electoral Debt Only" represents the state's legal calculation as defined in the Unit Debt Act. The Unit Debt Act only requires that non-electoral debt be included in the calculation. The second scenario uses the same calculation, but it adds the Township's electoral debt. Finally, the third scenario uses the

[4] The Legal Debt Margin Calculation: Three Year Average Township Revenues x 2.5 = Legal Debt Limit – Total net debt applicable to limit (Non-Electoral Debt) = Legal Debt Margin. Then, the Legal Debt Margin is represented as a percentage of net debt applicable to the limit by Total Net Debt Applicable to Limit / Legal Debt Limit. See Schedule 15 in the Township's CAFR, Statistical Section for details.

Township's full debt load, both electoral and non-electoral debt, and it removes the $8 million BPT settlement from the revenue total in 2013, which impacts the 2013, 2014 and 2015 margins. The second and third scenario were calculated to show the total debt picture and to remove extreme revenue variations that could skew the three year revenue average. In all cases, the Township's margin has been improving steadily since 2007. This is the result of improving revenues, coupled with the fact that the Township has not issued large amounts of debt since 2007 (until 2014).

To conclude, when you look at all the metrics, the Township is clearly improving its financial picture. As stated, net position is improving, General Fund balance is improving, indebtedness has been steadily decreasing each year since the Township hit the highest debt levels in 2007, and the Township's margin of debt to revenue has been steadily improving. In discussing the reasons why these metrics are showing improvement, the following decisions made by the Board, with recommendations from CARFAC and the Administration were identified:

- Adopting the OPEB Funding plan which as accumulated more than $4,454,000 in assets since 2012
- Utilizing excess fund balances to help address the unfunded liabilities in the pension plans. To-date, more than $3,205,000 in excess balances have helped reduce the unfunded liability
- Adopting an improved fund balance policy to increase the requirement to 25% which improves fund balance and reduces revenue risk
- Creating and using a five year financial forecast into the annual budgeting process
- Terminating the SWAP Agreement in 2013
- Refunding bonds to take advantage of the interest rate environment and reduce debt service cost
- Eliminating the practice of issuing long-term bonds for short term assets (a practice that occurred from at least 1991 – 2007)
- Providing the fire companies with consistent, annual capital contributions rather than providing large, lump sums at the time new equipment is purchased
- Beginning to finance portions of the moving fleet with short-term leasing which has improved cash flow and assisted in refreshing the aging fleet (thus; no longer needing large, long-term bonds to buy these assets)
- Beginning to adjust benefit levels in the collective bargaining agreements to stabilize the Township's liability exposure over the long-term
- Establishing CARFAC to assist in the review of these major policies and make recommendations that have helped improve the Township's overall financial position

2 TO RECOMMEND IF BONDS ARE THE MOST APPROPRIATE MECHANISM TO RAISE THE CAPITAL NEEDED TO COMPLETE THE VARIOUS IMPROVEMENTS INCLUDED UNDER THE PARK | TRAIL | LIBRARY BOND ORDINANCE

CARFAC addressed this question by first discussing what the alternatives could be, and then agreed on a series of reasons that support the bond issue. It's important to note that CARFAC was not asked to determine the need for the improvements, but rather, to focus on the method of financing. Therefore, the scope of this response is specific to the method of financing. CARFAC's response is broken into three categories: Alternatives, technical thoughts, and subjective thoughts. CARFAC has come to the conclusion that when all the facts are evaluated, along with the fact that the Township's financial position is improving, the issuance of bonds to fund long-term capital assets is appropriate and recommended.

- Alternatives: In this case, the Township is using a hybrid approach where some township cash is being used, grant funds are being used, and the project funding is completed through the issuance of bonds. Besides issuing bonds, other alternatives that are available could include the use of additional cash through reserves, dedicated capital revenue (not currently on the books), excess fund balances, shorter-term bank loans, or by cutting other areas of the budget. Other options include selling or leasing assets, or reconsidering the cell tower installations. Another alternative altogether would be to not do the projects and remove the aging park infrastructure and scale back the park programming. CARFAC is not advocating for the removal of park improvements, but listing it as an option is appropriate.

  Each alternative to bonds carries some negative benefit, opportunity cost, or has been eliminated as an option by prior decisions from the Board. For example, cash reserves have been established for the specific reason of building financial solvency and mitigating revenue risk. Next, excess revenues have a greater benefit when used to fund pension liabilities, and, according to other capital discussions, the Board has not seemed interested in raising taxes for a specific dedicated capital revenue. Finally, the Board has eliminated cell towers from being considered and selling land assets is legally difficult and/or has been eliminated from consideration by the Board during past discussions.

- Technical Reasons Why Issuing Bonds is Appropriate:
  - Issuing bonds to fund capital improvements is an appropriate method provided several factors are met:
    1) That the Township is legally able to issue new non-electoral debt pursuant to the State's Unit Debt Act, and
    2) That the Township has matched the useful lives of the assets being improved with the maturities of the bonds, and
    3) That the Township provides a method of paying for the bonds at the time the bonds are contemplated.

    First, as noted earlier in the report, the Township's legal debt margin has been improving annually since it hit its highest mark in 2007. The 2014 legal debt margin was at 42.06%, meaning that the

Township has 58% capacity remaining. Clearly, the Township meets the legal ability to issue bonds. Second, the improvements identified have the same useful life as the 20 year bonds being issued to finance them. Finally, the Board of Commissioners have proposed a millage increase dedicated to the repayment of the bonds which satisfies the recommendation to provide a funding source of the bonds. While a millage increase is not the only way to achieve this recommendation, it will provide the following benefits: (1) while the value of the Township continues to grow over the life of the bonds, the millage necessary to generate the tax to make the annual debt payment will go down. So over the life of the bonds, the tax rate will decrease, and (2) a dedicated millage will ensure that future fluctuations in other areas of the Township's budget will not impact its ability to pay for these bonds. At the same time, the requirement to pay for these bonds will not impact other areas of the Township's budget. In other words, if the Board is satisfied with the current level of services and the costs to provide those services, a dedicated millage for these improvements will ensure that the two will not conflict with one another if revenues were to fall in the future.

- Subjective Thoughts CARFAC thinks are important to consider for this matter:
  - The three "F's": Separate from the technical aspects of the decision, CARFAC suggests that issuing bonds for these improvements meets the "three F's" test; Fairness, flexibility, and financing affordability. During the discussion, the issue of fairness was emphasized as follows; by using bonds, those residents that will benefit from the improvements will also have the responsibility for paying for them. Using cash doesn't achieve the same fairness test. Next, bonds provide additional financial flexibility by allowing the Township to hold its excess cash or invest that cash in more beneficial areas (i.e. unfunded liabilities), and the bonds are more affordable given today's interest rate environment.
  - Issuing Bonds is not a new concept for municipalities in general, or, to Radnor Township. It may seem that this is a new concept since the Township has not issued bonds for its capital program since 2007, but here is evidence that this practice dates as far back as 1991:

Year	New Money Type	Term	Amount	Purpose
1991	Non-Electoral	15 Years	4,000,000	1992-'93 capital program, add'l $1.690M to refinance 1986 bonds
1994	Non-Electoral	30 Years	7,900,000	1994-'96 capital program, $3M for PW Garage, $1.1M for vehicles/ equipment, and other capital program items.
1996	Electoral	30 Years	7,500,000	Electoral – Nov. 1994: Open Space Acquisition
1997	Non-Electoral	20 Years	7,650,000	1997-'01 capital program, completion of PW Garage, vehicles/ equip.
2000	Non-Electoral	15 Years	8,500,000	2000-'04 capital program, vehicles, equipment, fire protection
2002	Electoral	15 Years	2,500,000	Electoral – Nov. 1994: Open Space Acquisition
2004	Non-Electoral	30 Years	17,195,000	$1M Art Center, $500K for library, $2.05M to redeem note, fund Township Building, and other capital program items
2005	SWAP Agreement	Varied	1,050,000	Capital Program
2007	Non-Electoral	30 Years	15,910,000	2007-'09 capital program, township building, flood control, capitalized interest

- Moody's Report: In its most recent report, Moody's states that, "The Aa1 rating reflects the township's moderately-sized and affluent tax base in suburban Philadelphia (A2 stable); a strong financial position featuring above average reserves and a solid trend in tax receipts; and a moderate debt and pension burden." Moody's goes on to identify the Township's financial strengths as "Strong management committed to increasing funding for long-term liabilities", "Solid reserve levels", "Positive tax receipt trend," "ample liquidity," and "debt burden is expected to remain manageable." Moody's also emphasizes the benefits of adopting the policies that have helped stabilize the Township's finances including the OPEB funding plan, the fund balance policy and the five-year forecast. While Moody's does not provide an opinion on the decision to issue bonds, they conduct a full review of the Township's finances that includes a comparison of how Radnor compares to similarly sized municipalities. Such a comparison provides compelling information, and CARFAC holds the Moody's report in high regard.
- Invest into pension: It has been documented that directing excess revenues to fund pension provides two benefits: (1) The influx of cash immediately improves the funding status of the pension funds and (2) any funding above the MMO provides an actuarial gain, which helps reduce future MMO expenses. As MMO expenses decrease, more operating funds are made available which provide greater financial flexibility to the Board in making future tax decisions.
- Future Capital Planning: In reviewing the Township's five-year capital plan, the Township is not anticipating needing any additional major general obligation bonds for, at least, the next three years beyond the issuance of the 2016 Park | Trail bonds. Further, in reviewing the financial forecast, the debt service expense will drop by approximately $500,000 per year in 2019, freeing up capacity for the capital program (in one form or another).

We hope that this information provides the Board of Commissioners with answers to their questions. As always, if further information is needed by the Board or if additional clarification in needed, please do not hesitate to ask.

Respectfully,
Members of CARFAC