

# Staff Memorandum

Business Meeting– 01/17/2018

REISSUED – 01/31/2018



**Overview:** The Town's Comprehensive Annual Financial Report (CAFR) for the period ended June 30, 2017 (FY17) has been distributed and is available on the Town's website. Among other things, the CAFR is a record of the Town's financial performance for the fiscal year and a snapshot of the Town's fiscal condition. The information in the Town's CAFR provides important indicators of the Town's financial health that are used by a variety of outside stakeholders, including investors, bond rating agencies, state and federal agencies.



## **Recommendations:**

*Staff Recommendation:* That Council receive this report on the Town's CAFR for FY17 and financial update presentation.

## **FY2016-17 CAFR**

As has been the case in previous years, the Town has received an unqualified or "clean" opinion from the independent auditors attesting to the fact that the Town's financial statements fairly represent the Town's financial condition in all material respects.

For the period there was one reportable condition in the Single Audit Section. This condition was a non-compliance issue related to the investment of funds held in trust for Other Post Employment Benefits (OPEB). The OPEB Trust funds were invested in securities that were not authorized by the Local Government Commission. We have corrected this finding by moving the OPEB Trust funds to investments specifically authorized in G.S. 159-30.

## **The CAFR Document**

The CAFR has four major sections, each with a specific purpose as described below:

1. **Introduction Section:** This section contains the transmittal letter from the manager and the Finance Officer, the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting, Organizational Chart and a listing of the members of the governing body.
2. **Financial Section**
  - a. Auditors opinion on the Town's Financial Statements
  - b. Manager's Discussion and Analysis (MD&A): Includes a discussion of the structure of the Town's Financial Statements, highlights and analysis of the various Town funds
  - c. Government Wide-Statements: These statements aggregate the activities, assets and liabilities of all funds and show enterprise-wide financial position and results
  - d. Fund Financial Statements: Individual financial statements for all of the Town's major funds
  - e. Notes to the Financial Statements: Additional information essential to the full understanding of the government-wide and fund financial statements

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- f. Required Supplementary information: Includes required information regarding the Town's progressing funding its obligations to provide separation allowance for law enforcement officers and other postemployment benefits
  - g. Combining Statements: Facilitate comparison and present information at the individual fund level demonstrating how they are combined to accumulate totals used in the fund financial statements.
  - h. Budgetary Statements: The budgetary statements demonstrate compliance with the budget ordinance and are presented using the same format, language and classifications.
  - i. Other Supplementary Information: Schedule of taxes receivable and the current tax levy.
3. **Statistical Section:** Presents multi-year schedules that help to identify trends and provide indicators of the Town's overall financial health. These schedules include financial trends, revenue capacity, debt capacity, demographic, economic and operating information.
4. **Single Audit Section:** This section contains the auditor's reports on internal controls and compliance for major federal and state grant programs and a schedule of expenditures for federal and state awards.

## Results for FY2016-17

**Governmental Funds** – This fund type uses the current financial resource management focus and the modified accrual basis of accounting (see CAFR page 42 for information on the basis of accounting for Town funds).

- General Fund – Overall fund balance is down \$8.2 million and undesignated fund balance is down \$2.4 million. Undesignated fund balance as of 6/30/17 was 20.2% of expenditures, which is \$1.3 million less than the 22% undesignated fund balance target. Fund balance has been stable over the past 6 years, averaging about 24%. The reduction in fund balance is due to several one-time transactions, including the purchase of the American Legion Property.
- Debt Management Fund – For the year, revenues and transfers into the Debt Fund exceeded expenditures by \$433,013, adding to the total fund balance, which finished the year at \$7,048,523. Due to the accounting for future debt obligations, the fund shows a negative unassigned fund balance, signifying that future debt obligations exceed currently available funds.
- Capital Project Funds – Capital Project revenues and proceeds from the issuance of debt exceeded capital expenditures by \$1,904,347 for the year, increasing the Capital Project fund balance. This increased balance will be spent down rapidly as we continue to make progress on major capital projects.

**Enterprise Funds** - This fund type uses the economic resource focus and the accrual basis of accounting (see CAFR page 42).

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- Transit Fund – Net assets in the Transit Fund were down about \$2.3 million for the year. This reflects depreciation charges and investment in capital assets (buses) during the period. The fund finished the year with \$1.8 million in unrestricted net assets (8.9% of operating budget), down \$5.1 million from the prior year.
- Parking Fund – The fund finished the year with expenditures exceeding revenues by \$196,249. Given the Parking Fund's high fixed costs and faltering revenues, it is unlikely that the fund will be able to continue operations without a significant subsidy or restructuring.
- Housing Fund – Net assets decreased for the year by \$555,719 as expenses exceeded revenues due in part to planned capital maintenance. The fund finished the year with unrestricted net assets of \$2,192,817, which is about 89% of the annual operating budget.
- Stormwater Fund – The fund finished FY17 with an increase in net assets of about \$121,774 and a decrease in unrestricted net assets of \$564,758. This decrease reflects an investment in capital improvements during the year.

## Trends and Analysis:

### General Fund

- Due in large part to the planned spend-down of fund balance for the purchase of the American Legion Property and several one-time transactions, fund balance dropped below the 22% target. Personnel savings remain a major component of the annual budgetary savings. At any given time the Town has 50-70 vacant positions. The Town acknowledges the expected personnel savings from vacancies and to a lesser extent savings in other cost categories created by conservative budgeting practices, by budgeted lapsed salaries and appropriating fund balance to balance the initial budget. In most years, the savings from vacancies eliminates the need to use the appropriated fund balance, thereby keeping fund balance levels stable. While this strategy has worked well in the past, our margin of error is getting smaller as we increase the amount of budgeted lapsed salaries and fund balance appropriations to balance budgets.
- The Town's property tax base is growing slowly, averaging 1.39% annual growth over the last 7 years. While there has been strong building permit activity in both residential and commercial areas during that time, with a \$7.8 billion tax base, the amount of growth needed to "move the needle" is huge. For instance, to raise the property tax base one percent would require the addition of the equivalent commercial space of two new University Place Malls. Increases in the Town's operating costs (over 3% per year over the last seven years) outpace this slow growth rate.
- The Town's investment in economic development projects also slows the realization of tax revenues from tax base growth. The tax revenue impacts of developments in the Blue Hill District, Caraway Village and Wegmans are delayed as we use those tax revenues for public improvements and economic incentives that helped facilitate those projects.
- Sales and other economy driven taxes, including occupancy tax and utility franchise taxes, have helped keep us keep pace with costs as they have increased steadily since FY11. While most forecasts show continued steady growth, we remain cautious due to

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the potential for unexpected changes in economic climate and/or changes in how the state and County choose to distribute these revenues.

## Transit Fund

- Investment in capital assets (buses) and depreciation expenses significantly reduced the Transit Funds unrestricted net assets. While this was expected due to the need to invest in renewing the bus fleet, this is not a sustainable result. As federal funds for bus replacement have disappeared in the last few years, we have devised other means of replacing buses, including borrowing and using excess fund balance. This change in strategy adds a significant layer of cost that was not contemplated when the Chapel Hill Transit System was developed. Ensuring the long-term financial sustainability of the system, as the long-term prospect for federal bus replacement funds remains bleak, will be a continuing challenge.

## Parking Fund

- After breaking even in FY16 for the first time since FY11, the fund had a setback as revenues declined and costs continued to increase in FY17. Given the need for capital maintenance of parking structures, it is doubtful that the fund can survive another year in its current configuration. If operating results do not improve in FY18, , The Parking Fund will need a subsidy from the General Fund to keep the fund solvent.

## Housing Fund

- The fund has a healthy level of unrestricted net assets that is offset, in part, by the ongoing need for capital improvements. Due to the age of the complexes, major capital improvements are needed on an annual basis, which will spend down the level of net assets over time. The Housing Fund is dependent on Federal Operating Assistance grants; the sharp reduction in the amount of the FY17 grant is problematic for the sustainability of the Housing Fund as it is currently structured.

## Stormwater Fund

- Unrestricted net assets were \$1.6 million at year-end (67.4% of the operating budget). Some of these funds, along with debt proceeds from the issuance of the authorized \$5.9 million of Stormwater referendum bonds, to fund major stormwater improvement projects identified in the sub-watershed study. The FY18 Budget included a \$6.00 per ERU increase in the Stormwater fee in anticipation of issuing approximately \$3 million of Stormwater Bonds in the third quarter of FY18.

## Summary

The Town's overall financial condition remains strong, but there are signs that sustaining this condition will require adjustments. The General Fund continues to see expenditures consistently out-pacing its largest revenue source (property taxes). Our reliance on fund balance and lapsed salaries and sales tax revenues to balance our budget has grown to an uncomfortable level and we need to reexamine the means by which we balance our budget during the next budget cycle.

Three of the Town's four enterprise funds are facing sustainability challenges due either to the loss of federal funding and/or major capital needs. The exception is the Stormwater Fund, which

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can regulate its cash flows by increasing the dedicated stormwater fee. The Parking and Housing funds have limits to their revenue raising abilities, while the “fare free” Transit System is reliant on its funding partner financial model and state and federal funding for support. We will continue to monitor these funds and work with stakeholders on strategies to improve prospects for long-term sustainability.