Mayor's Semi-annual Financial Condition Statement to Council

Oct 1, 2022 – March 31, 2023

OVERVIEW

Section 11-43-84, Code of Alabama 1975, requires the mayor to present a semi-annual written statement to the Council of the City's financial condition and show all temporary floating indebtedness, for what created, and the steps he/she will take to protect the credit of the City.

The following report covers the first six months of FY 2023.

2023 FYTD BUDGET PERFORMANCE

Council approved an FY23 budget that assumed ~$14.1M in revenue, cash and carryover funds against anticipated expenses of ~$12.8M.

The $14.1M in budgeted revenue represents $9.6M in FY23 receipts, $2.3M in prior year funds, and a $2.2M beginning cash balance.

Included in FY23 estimated receipts is ~$4.8M in taxes and fees, ~$1.9M from various grants, ~$400k in proprietary user fees, and the remainder from a variety of sources including facility rentals and investment income.

Section 11-43-57, Code of Alabama 1975, permits "*the council to appropriate the sums necessary for the operation of city departments and for the interest on its bonded and other indebtedness, not exceeding in the aggregate within 10 percent of its estimated revenue*". In other words, anticipated expenses should not exceed 90% of expected revenue. For FY23 Columbiana budgeted anticipated expenses approximately 90.6% of estimated funds available forecasting a surplus of $1,317,173.

	Feb			Mar			FY 2023		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	FYTD Actual	FYTD Remain
GF Cum Revenue	$ 2,222,819	$2,745,590	$ 522,771	$ 2,667,383	$3,106,663	$ 439,281	**$ 5,334,765**	**$ 3,106,663**	**$ (2,228,102)**
GF Cum Expense	$ 2,863,677	$2,275,371	$ 588,306	$ 3,436,413	$2,891,168	$ 545,245	**$ 6,872,825**	**$ 2,891,168**	**$ 3,981,657**
GF Cash	$ 2,249,110	$1,983,832	$ (265,278)	$ 2,249,110	$1,479,732	$ (769,378)	**$ 2,249,110**	**$ 1,479,732**	**$ (769,378)**
GF Net Surplus (Deficit)	**$ 1,608,252**	**$2,454,051**	**$ 845,799**	**$ 1,480,080**	**$1,695,228**	**$ 215,148**	**$ 711,050**	**$ 1,695,228**	**$ 984,178**
Cum Revenue + ΔCash	$ 7,206,939	$5,987,382	$(1,219,557)	$ 8,198,505	$6,353,069	$(1,845,436)	**$14,147,900**	**$ 6,353,069**	**$ (7,794,831)**
Cum Expense	$ 5,346,136	$3,245,190	$ 2,100,946	$ 6,415,364	$4,477,525	$ 1,937,839	**$12,830,727**	**$ 4,477,525**	**$ 8,353,202**
Net Surplus (Deficit)	**$ 1,860,803**	**$2,742,192**	**$ 881,389**	**$ 1,783,142**	**$1,875,545**	**$ 92,403**	**$ 1,317,173**	**$ 1,875,545**	**$ 558,372**

As of March 31, 2023, General Fund (GF) revenues were slightly above plan while GF expenses were below plan leaving a GF net surplus of $1.7M which is approximately $215k greater than anticipated.

Cumulative revenue from all funds, plus cash, as of March 31, 2023, is approximately 22% below plan. Similarly, expenses are approximately 30% below plan. This leaves a net surplus of ~$1.9M against a planned surplus of ~$1.8M. The revenue and expense variances are driven, primarily, by the timing of certain expenses and revenues. Net-net, both the GF net surplus and the net surplus of all funds is tracking closely to plan indicating that FY 2023 budget assumptions are reasonable and the City is managing within its planned budget.

It is important to note that the City budgets on a cash basis and, for the most part, monitors its performance against the budget on a cash basis. The City's audited financial statements are prepared in accordance with rules established by the Government Accounting Standards Board (GASB) that requires accounting on a modified accrual basis. Therefore, for "cash" budget management purposes, we must make some assumptions based on comparisons or similarities. One of those would be to consider budgeted General Fund expenses as a proxy for the City's operating budget. When considering reserves (net surplus) a common rule of thumb is to maintain a net surplus equivalent to two months operating expenses. For FY23 that would be approximately $1.1M. We budgeted a Net Surplus of $1.3M.

The FYTD budget, however, is not without its challenges. These are driven primarily by unanticipated street paving cost. The City may likely cover these excess costs, most of which are yet to be incurred, by dipping into its GF surplus. If that occurs, the City's surplus would be approximately $300k below plan and $100k below the $1.1M guideline or "rule of thumb".

DEBT

The table, below, summarizes the City's outstanding long-term debt.

	Interest Rate *	Opening Balance	Balance As of: 31 Mar 2023	FY23 Annualized Debt Service	Maturity Date
General Obligation Warrants 2020 (OMS)	1.45%-3.0%	$ 2,595,000	$ 2,390,833	$ 133,030	5/1/2048
General Obligation Warrants 2021	0.42%-2.9%	$ 3,650,000	$ 3,634,479	$ 190,359	5/1/2048
Coop Dist Revenue Bonds 2021 (OMS)	0.27%-2.9%	$ 8,765,000	$ 8,397,500	$ 418,011	5/1/2048
Totals		**$ 15,010,000**	**$ 14,422,813**	**$ 741,400**	

*Note: Interest rates increase each subsequent year in which bonds/warrants mature.

** Note: Balances and debt service are estimates based on maturity and payment schedules.

FY23 debt service ~15.7% of recurring taxes and fees (excluding proprietary fund user fees).

The percentage of recurring taxes and fees consumed by debt service is an important metric in that the more consumed by debt, the less available to provide other essential services to the community. Municipal and other government bonds are considered low risk investments due to the taxing authority of the government entities that ensure its ability to service its debt; however, at the municipal level, we have very limited taxing authority and generally rely on the State for distribution of tax revenues.

A rule of thumb used by some municipalities is that the sum of capital investment and debt service should be between 25 – 30% of these taxes and fees. This should exclude capital investment funded by grants or other sources of revenue.

FY24 debt service will increase to $766K due to the maturation of lower interest rate warrants and revenue bonds. Additionally, debt service for existing warrants and revenue bonds will increase annually to approximately $800k in FY27 and remain relatively constant (slight annual fluctuations) until the maturation of those bonds in May 2048.

In August 2022, the City received a 50/50 combination grant and loan of $5.525M for urgent repairs/upgrades to the City's waste water sewage treatment facility. Half of the grant/loan is funded by federal ARPA funds and the remainder will be funded by a 20 year, 1.99% loan from the State Revolving Fund (SRF). The City will not likely begin drawing upon the loan until FY24 at which time the City's debt service will increase an estimated $135k annually. Assuming modest increases in tax revenue, the City's debt service should remain relatively constant as a percentage of recurring taxes and fees.

Constitutional Debt Limit

Constitutional Debt Limit—General. The City's present constitutional debt limit is based on two provisions of the Alabama Constitution of 1901, namely, Section 225 of the Alabama Constitution of 1901 and Amendment No. 772 to the Alabama Constitution of 1901. Obligations chargeable against debt limit for purposes of Section 225 of the Alabama Constitution of 1901 are not chargeable against debt limit for purposes of Amendment No. 772 to the Alabama Constitution of 1901, and obligations chargeable against debt limit for purposes of Amendment No. 772 to the Alabama Constitution of 1901 are not chargeable against debt limit for purposes of Section 225 of the Alabama Constitution of 1901.

Constitutional Debt Limit—Section 225. Under Section 225 of the Alabama Constitution of 1901, the City's present constitutional debt limit is an amount equal to ***20% of the assessed value of the taxable property located within its corporate limits*** (additional indebtedness not exceeding three percent (3%) may be created for the following: obligations issued for the purpose of constructing or acquiring waterworks, gas or electric lighting plants, or sewerage, or for improvements of streets; subject to certain conditions, tax anticipation notes; certain lease obligations; certain obligations to make contributions towards the debt service of other public entities; and revenue securities issued for the purpose of extending, enlarging or improving water, electric, gas or sewer systems and payable solely from the revenues of one or more of such systems); however, under existing law, ***the following are not chargeable against the City's constitutional debt limit: (1) obligations chargeable against debt limit for purposes of Amendment No. 772 to the Alabama Constitution of 1901***; (2) tax anticipation notes payable within one year and not exceeding one-fourth of general revenues; (3) revenue securities payable solely from the revenues of water, sewer, gas or electric systems; and (4) capitalized lease obligations that are funded on a "year-to-year basis".

City of Columbiana
Statement of Legal Debt Margin—Section 225

Assessed value of taxable property (including motor vehicles) (as of September 30, 2021)		$48,835,962
Basic debt limit (20% of assessed value)		$9,767,192
Total indebtedness: (Mar 31,2023)		
General obligation indebtedness	$14,422,813	
Less indebtedness not chargeable to debt limit[(2)]	($10,788,333)	
Total indebtedness chargeable against debt limit		($3,634,480)
Legal debt margin		**$6,132,712**

Constitutional Debt Limit—Amendment No. 772. Under Amendment No. 772 to the Alabama Constitution of 1901, the City may become indebted and issue bonds, warrants which may be payable from funds to be realized in future years, notes, or other obligations, or evidences of indebtedness to a principal amount ***not exceeding 50% of the assessed value of the taxable property located within its corporate limits in order to secure funds for any of the economic and industrial development*** powers or authorities granted in such amendment; however, under existing law, obligations chargeable against debt limit for purposes of Section 225 of the Alabama Constitution of 1901 are not chargeable against the City's constitutional debt limit.

City of Columbiana
Statement of Legal Debt Margin—Amendment No. 772

Assessed value of taxable property (including motor vehicles) (as of September 30, 2022)	$48,835,962
Basic debt limit (50% of assessed value)	$24,471,981
Total indebtedness chargeable against debt limit (as of Mar 31, 2023)	($10,788,333)
Legal debt margin	**$13,629,648**

The bulk of the City's debt (~$10.8M) was secured under the criteria established by Amendment No. 772 for the purpose of economic development.

Based upon the criteria established under Section 225 and Amendment No. 772, as of March 3 1, 2023, the City of Columbiana has additional statutory borrowing authority of up to $19.8M.

PROTECTION OF THE CITY'S CREDIT

Columbiana's municipal credit rating was last updated by S & P Global (Standard and Poor's credit rating service) in June 2021. The rating was "AA - very strong capacity to meet financial commitments".

Customarily, municipalities do not seek an updated credit rating unless seeking material financing or refunding existing municipal bonds.

According to Fidelity Investments, 15% of municipal bonds are rated AAA, 52% AA, and 33% A. By comparison, only 10% of the Corporate bond market is rated above AA.

Notwithstanding the City's excellent credit rating and its statutory authority to borrow more, the decision to do so cannot be taken lightly. It is our moral and legal fiduciary responsibility to ensure that the City's finances and taxpayer dollars are managed responsibly for the benefit of the residents of Columbiana.

In order to protect the City's credit while providing necessary benefit to our residents it takes more than working within a budget. The City must have a thorough understanding of its financial condition. A decision to take on new debt must be accompanied by a thorough quantitative and qualitative analysis of the cost of such debt versus the benefit(s) it may provide. Most importantly, we must understand how we will repay it.

We service our debt from revenue generated by taxes and fees. Although there are no specific guidelines, comparison with other Cities might suggest that our debt service of 15.7% of recurring taxes and fees may be near the high end of generally accepted limits.

To help us determine how we "stack-up" financially and make prudent financial decisions, we have adopted a popular framework to evaluate local governments' financial condition known as the "*Ten Point Test*." It is comprised of ten key ratios that, when taken together, summarize a government's liquidity, profitability, and solvency. In the Ten Point Test framework a government earns "points" based on how its ratios compare to its peer governments. If its ratios are consistently better than its peers, it earns a higher score. If its ratios are consistently worse than its peers, it's scores are lower and in some instance negative.

The below table depicts results of the Ten Point analysis of our 2021 audited financial statements **(our most recent)** and an explanation of what the overall score means. You can see that Columbiana's score decreased in 2018 from being among the best of its peers to being better than most. This was the result of increased debt associated with the OMS project. Debt burden is Columbiana's only negative ratio among the 10 ratios evaluated.

CITY OF COLUMBIANA
TEN POINT TEST SCORE
SEPTEMBER 30, 2021

RATIO	2021 RATIO COMPUTED	2021 SCORE	2020 RATIO COMPUTED	2020 SCORE	2019 RATIO COMPUTED	2019 SCORE	2018 RATIO COMPUTED	2018 SCORE	2017 RATIO COMPUTED	2017 SCORE
LIQUIDITY RATIOS										
SHORT-RUN FINANICAL POSITION	43.01%	1	40.17%	1	31.16%	1	39.13%	1	46.68%	1
LIQUIDITY	226.00%	1	437.66%	0	168.83%	2	595.67%	2	659.27%	2
PROFITABILITY RATIOS										
NET ASSET GROWTH	1.07%	0	5.99%	2	8.06%	1	3.16%	1	5.70%	2
OPERATING MARGIN	62.01%	1	61.25%	0	64.39%	0	64.34%	0	55.46%	0
OWN-SOURCE REVENUES	9.80%	0	3.75%	1	3.14%	1	4.02%	1	3.34%	2
SOLVENCY RATIOS										
NEAR-TERM SOLVENCY	248.79%	0	238.66%	0	229.28%	0	239.76%	2	71.83%	2
DEBT BURDEN	3,329.84	-1	3,067.19	-1	2,507.68	-1	2,521.27	1	706.20	1
COVERAGE 1	16.88%	-1	10.00%	0	10.67%	-1	79.59%	-1	125.61%	-1
COVERAGE 2	902680	2	910093	2	811698	2	753592	2	708654	2
CAPITAL ASSET CONDITION	-0.95%	0	10.95%	2	90.99%	2	17.50%	2	5.77%	2
TOTAL SCORE		3		7		7		11		13

SCORE OF 10 OR GREATER	SUGGESTS A GOVERNMENT'S FINANCIAL POSITION IS "AMONG THE BEST" . IT CAN EASILY MEET ITS IMMEDIATE SPENDING NEEDS, IT HAS MORE-THAN-ADEQUATE RESERVES TO MITIGATE THE IMMEDIATE EFFECTS OF RECESSIONS, NATURAL DISASTERS, OR OTHER UNEXPECTED EVENTS, AND ITS HAS THE CAPACITY TO GENERATE ADEQUATE RESOURCES TO COVER ITS LONG-TERM SPENDING NEEDS. TO EARN THAT SCORE MOST OF ITS TEN RATIOS MUST BE AS GOOD AS OR BETTER THAN ITS PEER GOVERNMENTS.
SCORE BETWEEN 5 AND 9	MEANS THE GOVERNMENT IS "BETTER THAN MOST." MOST OF ITS RATIOS ARE BETTER THAN ITS PEER GOVERNMENTS, AND A FEW RATIOS ARE EQUAL TO ITS PEERS.
SCORE BTWEEN 1 AND 4	MEANS THE GOVERNMENT IS "AVERAGE". MOST OF ITS RATIOS EQUAL TO , OR WEAKER THAN ITS PEER GOVERNMENTS.
SCORE BETWEEN 0 AND -4	MEANS THE GOVERNMENT IS "WORSE THAN MOST". MOST OF ITS RATIOS ARE WEAKER THAN ITS PEER GOVERNMENTS.

The 10-point test compares Columbiana's key financial ratios to similarly sized cities. The small city peer group for Columbiana includes cities with populations less than 15,000.

The key ratios are divided into three categories as follows.

1. ***Liquidity*** measures the City's ability to meet its current financial obligations.

2. Although municipalities are not in the business of making a profit, ***Profitability*** looks at net assets, revenue margins over expenses, and the degree that the city funds its own operations (via taxes, fees, etc.) from revenue sources it controls versus dependency on grants and financing which may be out of the City's control.

3. ***Solvency*** looks at debt by comparing liabilities against revenues, assessing debt on a per capita basis and debt service as a percentage of total expenditures.

Each ratio is assigned a score from -1 to 2 based upon where its ratio ranks from the lowest to highest quartile of cities in its peer group. The City's overall score is simply the sum of the scores of the 10 ratios. Columbiana's 2021 score is 3, which is at the high end of the average range.

Columbiana's score has been declining over the past five years primarily due to debt associated with the Old Mill Square (OMS) project. In FY21, four ratios were primarily responsible for pushing the score down from 7 (better than most) to 3 (average). A discussion of those four ratios follows.

NET ASSET GROWTH

The *rate* of net asset growth declined in FY21, from 5.99 the prior year to 1.07, resulting in a smaller increase in net position than recent years. This was primarily due to three things.

1. Over the previous several years, based upon the stage of completion of the OMS project, Columbiana's asset base increased. In FY21, OMS was substantially complete so there was no associated increase in net assets.

2. As a result of debt refunding that occurred in FY21, long-term liabilities increased.

3. The City incurred a long-term liability associated with its ARPA grant. There is an obligation to repay the grant if it is not spent by 2024, hence, the liability. As funds are spent, the liability will decrease.

In short, assets increased at a lower rate than liabilities.

If one prefers to see the glass "half-full", OMS is becoming a well-known venue that brought approximately 50,000 visitors to Columbiana in 2021 and promises to become a key driver of future economic development.

Although refunding increased the principal balance of the City's long-term debt, lower interest rates allowed it to extract over $650k of refunding proceeds with no increase in debt service payments. This provided the City a significant amount of cash that was included in the FY22 budget for much needed capital infrastructure improvement.

Finally, the ARPA grant, from which there was a second tranche in July FY22, provides much needed funds to address storm water flooding issues.

OWN SOURCE REVENUES

Receipt of ARPA and other grants, essentially, punishes the City in this metric since a significant portion of primary government revenues came from grants rather than our "own sources" of funds (taxes and fees).

COVERAGE 1

Refunding the City's debt increased long-term principal and interest making it larger in proportion to the City's General Fund (GF) expenditures. Debt service did not increase. This metric looks at debt service as a percentage of General Fund expenditure. Over the next four years the City's debt service will increase slightly as higher interest bonds mature. Subsequently, the rates and associated debt service will stabilize. In the short term this may cause a deterioration in the Coverage 1 ratio. Additionally, General Fund expenditures may decline in the near future as Federal grant funds are depleted.

CAPITAL ASSET CONDITION

This is a metric where the City took a hit for good fiscal management. As indicated in the table, above, Columbiana's net capital asset balance declined in FY21. This was driven by disposal of excess, unused, assets and cleaning up the balance sheet by eliminating fully depreciated assets. Also, as stated earlier, the City did not get an "asset bump" due to OMS completion.

Finally, there are two important metrics that are not part of the 10-Point Test. These are liquidity metrics that assess the City's ability to meet near term obligations. These two metrics are the Current Ratio and the Quick Ratio.

Columbiana's Current Ratio in FY21 was 6.18. A Current Ratio of 2.0, or greater, indicates an entity is generally able to meet its short term obligations.

Columbiana's Quick Ratio in FY21 was 5.88. A Quick Ratio of 1.0, or greater, indicates an entity can pay its bills and meet its day to day operating expenses.

In summary, Columbiana enjoys excellent liquidity to ensure its ability to meet financial obligations and operating expenses. Additionally, Columbiana's budgeted net surplus slightly exceeds the generally recommended standard of two months operating expenses. Our largest burden is debt, primarily associated with the Old Mill Square project. Before incurring additional debt, the City should perform a thorough business case analysis and cost / benefit analysis, including pro forma financial statement and appropriate ratio analysis.