



FINANCIAL AND DEBT MANAGEMENT POLICIES

As instructed by the County Board at FY 2017 budget adoption, the County Manager was to provide an analysis of the County's various reserves and funding level; including criteria for utilization of certain reserves which would inform possible updates to the County's financial and debt management policies.

The County's financial advisor, PFM, has provided recommendations which will be discussed as part of the FY 2018 budget process. Underlined in the pages to follow are preliminary recommendations for changes to the financial and debt policies. The County Board will hold a work session with County staff and PFM to receive a presentation on the recommended changes prior to budget adoption in April 2017. The recommended changes below focus on utilization of the Economic and Revenue Stabilization Contingent, replenishment of certain reserves if utilized, and establishment of a reserve policy for the Ballston Garage.

Budgeting, Planning, and Reserves

Balanced Budget: Arlington County will adopt an annual General Fund budget in which the budgeted revenues and expenditures are equal (a balanced budget). Any one-time revenues will be used for one-time, non-recurring expenses such as capital, equipment, special studies, debt reduction, and reserve contributions.

Long-Term Financial Planning: The County will annually develop a six year forecast of General Fund revenues, expenditures and will maintain a biennially updated, ten-year Capital Improvement Plan (CIP). The ten-year forecast will incorporate projected reserve levels and impact of the CIP on the County's debt ratios.

General Fund Operating Reserve: An Operating Reserve will be maintained at no less than five percent of the County's General Fund budget. The Operating Reserve shall be shown as a designation of total General Fund balance. Appropriations from the Operating Reserve may only be made by a vote of the County Board to meet a critical, unpredictable financial need. Any draw on the operating reserve will be replenished within the subsequent three fiscal years.

Self-Insurance Reserve: The County will also maintain a self-insurance reserve equivalent to approximately one to two months' claim payments based on a five-year rolling average. Any draw on the self-insurance reserve will be replenished within the subsequent two fiscal years.

Budget, Economic & Revenue Stabilization Contingent: Consistent with past practice, the County will maintain an economic and revenue stabilization contingent to address unexpected events, such as major weather events or a local/regional emergency requiring immediate incurrence of cost in response; revenue declines and local or regional economic stress. Use of contingent monies will only be used at the recommendation of the County Manager and approval by the County Board. The minimum amount of the contingent will be ~~\$3 million~~ \$4 million and will be revisited annually as part of the budget process. Any draw on the economic and revenue stabilization contingent will be replenished within the subsequent two (2) fiscal years.

General Fund General Contingent: Each year's budget will include a General Fund General Contingent appropriation to be used to cover unforeseen expense items or new projects initiated

after a fiscal year has begun. Funding may be allocated from this contingent only with County Board approval.

Retirement System Funding: The County will use an actuarially accepted method of funding its pension system to maintain a fully-funded position. The County's contribution to employee retirement costs will be adjusted annually as necessary to maintain full funding. If the County reaches its actuarial-required contribution (defined as County and employee contributions that when expressed as a percent of annual covered payroll are sufficient to accumulate assets to pay benefits when due), the County may reduce its contribution provided that the amount reduced from the annual actuarial requirement will only be used for one-time, non-recurring expenses in order to provide the ability to increase contributions as may be required by future market conditions.

Other Post-Employment Benefits (OPEB) Funding: The County will use an actuarially accepted method of funding its other post-employment benefits to maintain a fully-funded position. The County's contribution to other post-employment benefit costs will be adjusted annually as necessary to maintain full funding. If the County reaches its actuarial-required contribution (defined as County and employee contributions that when expressed as a percent of annual covered payroll are sufficient to accumulate assets to pay benefits when due), the County may reduce its contribution provided that the amount reduced from the annual actuarial requirement will only be used for one-time, non-recurring expenses in order to provide the ability to increase contributions as may be required by future market conditions.

Capital Improvement Plan

1. The County Manager will biennially submit a ten year Capital Improvement Plan (CIP) to the County Board. The CIP will address all known facility and infrastructure needs of the County, including the needs of the Arlington County Public Schools.
2. The CIP shall include a detailed description of each capital project, identifying every source of funding, including pay-as-you-go (PAYG), bond financing, and master lease financing. The source of funding will largely be determined based on the useful life of the project. Bond-funded projects will typically have a useful life at least as long as the period over which the bonds will be repaid (generally twenty years). Master lease-financed projects will generally have useful lives of three to ten years and typically include furniture, equipment, rolling stock and technology purchases. PAYG funds provide greater flexibility and will be appropriated annually from general fund revenues.
3. Each project budget shall identify the financial impact on the operating budget, if any.
4. In general, capital projects estimated to cost \$100,000 or more should be included in the CIP, including technology and equipment purchases.
5. The County will balance the use of debt financing sources against the ability to utilize PAYG funding for capital projects. While major capital facility projects will generally be funded through bonds, the County will attempt to maintain an appropriate balance of PAYG versus debt, particularly in light of the County's debt capacity and analysis of maintenance capital needs. As part of each biennial CIP process, the County will conduct a comprehensive assessment of its maintenance capital needs.
6. The CIP will include an analysis of the impact the CIP has on the County's debt capacity, debt ratios and long-term financial plan.

7. Voter referenda to authorize general obligation bonds should only be presented to voters when the analysis of the County's debt capacity demonstrates the ability of the County to fund the debt service for the bonds based on the County's "Financial and Debt Service Policies." Absent a compelling reason to do otherwise, the County should have the capacity to initiate construction projects within the two-year period before the next bond referendum. There should also be a demonstrated capability for the County to complete any project approved by referendum within the eight-year time period mandated under state law for sale of authorized bonds. The term "County" in this specific policy includes the Arlington County Government and any entity that receives bond funding from the County (such as the Arlington County Public Schools and the Washington Metropolitan Area Transit Authority).
8. In the off-years of the biennial CIP process, the County will conduct a needs assessment that will reflect, as appropriate, existing master plans and assessments (e.g., the Master Transportation Plan and others.) Given the significant size and diversity of the County's infrastructure responsibilities, this assessment process will be implemented over the next four to six years.

Debt Management

The County will prudently use debt instruments, including general obligation bonds, revenue bonds, industrial development authority (IDA) revenue bonds, and master lease financing in order to provide re-investment in public infrastructure and to meet other public purposes, including inter-generational tax equity in capital investment. The County will adhere to the following debt affordability criteria (excluding overlapping and self-supporting debt).

1. The ratio of net tax-supported debt service to general expenditures should not exceed ten percent, within the ten-year projection.
2. The ratio of net tax-supported debt to full market value should not exceed three percent, within the ten-year projection.
3. The ratio of net tax-supported debt to income should not exceed six percent, within the ten-year projection.
4. Growth in debt service should be sustainable and consistent with the projected growth of revenues. Debt service growth over the ten year projection should not exceed the average ten year historical revenue growth.
5. The term and amortization structure of County debt will be based on an analysis of the useful life of the asset(s) being financed and the variability of the supporting revenue stream. The County will attempt to maximize the rapidity of principal repayment where possible. In no case will debt maturity exceed the useful life of the project.
6. The County will refund debt when it is in the best financial interest of the County to do so. When a refunding is undertaken to generate interest rate cost savings, the minimum aggregate present value savings will be three percent of the refunded bond principal amount.

Variable Rate Debt

1. Variable rate debt exposure should not exceed twenty percent of total outstanding debt.

2. Debt service on variable rate bonds will be budgeted at a conservative rate.
3. Before issuing variable rate bonds, the County will determine how potential spikes in the debt service will be funded.
4. Before issuing any variable rate bonds, the County will determine the impact of the bonds on the County's total debt capacity under various interest rate scenarios; evaluate the risk inherent in the County's capital structure, giving consideration to both the County's assets and its liabilities; and develop a method for budgeting for debt service.

Moral Obligation Debt or Support

On an infrequent basis, the County provides its "moral obligation" support for partners, including regional public safety agencies and affordable housing partners, among others. A moral obligation exists when the County Board has made a commitment to support the debt of another entity to prevent a potential default. The County's moral obligation will only be authorized after an evaluation of the risk to the County's balance sheet and stress testing of the financial assumptions underlying the proposed project.

Derivatives

Interest rate swaps and options (Swaps or Derivatives) are appropriate management tools that can help the County meet important financial objectives. Properly used, these instruments can help the County increase its financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help the County reduce its interest rate risk through better matching of assets and liabilities. The County must determine if the use of any Swap is appropriate and warranted given the potential benefit, risks, and objectives of the County.

1. The County may consider the use of a derivative product if it achieves one or more of the following objectives:
 - Provides a specific benefit not otherwise available;
 - Produces greater than expected interest rate savings or incremental yield over other market alternatives;
 - Results in an improved capital structure or better asset/liability matching.
2. The County will not use derivative products that are speculative or create extraordinary leverage or risk; lack adequate liquidity; provide insufficient price transparency; or are used as investments.
3. The County will only do business with highly rated counterparties or counterparties whose obligations are supported by highly rated parties.
4. Before utilizing a Swap, the County, its financial advisor and legal counsel shall review the proposed Swap and outline any associated considerations. Such review shall be provided to the Board and include analysis of potential savings and stress testing of the proposed transaction; fixed versus variable rate and swap exposure before and after the proposed transaction; maximum net termination exposure; and legal constraints.

5. Financial transactions using Swaps or other derivative products used in lieu of a fixed rate debt issue should generate greater projected savings than the typical structure used by the County for fixed rate debt.
6. The County will limit the total notional amount of derivatives to an amount not to exceed twenty percent of total outstanding debt.
7. All derivatives transactions will require County Board approval.

Special Revenue / Enterprise Funds

It is the general policy of the County to avoid designation of discretionary funds in order to maintain maximum financial flexibility. The County may, however, create dedicated funding sources when there are compelling reasons based on state law or policy objectives, as described below. The Utilities Fund was created as a self-sustaining, fee-based enterprise fund under state code to support and maintain development of the County's water and sewer infrastructure. The Transportation Capital Fund was adopted pursuant to state legislation for new transportation funding. The Stormwater Management Fund was adopted in lieu of a self-supporting, user fee-based enterprise fund. The CPHD Development Fund was created as a self-sustaining, fee-based enterprise fund. Tax Increment Funds were established to support redevelopment and preservation objectives associated with the County's adoption of master plans, (e.g., the Crystal City Sector Plan adopted in 2010 and the Columbia Pike Neighborhoods Plan adopted in 2013).

Utilities Fund

1. The County will annually develop a six year forecast of projected water consumption, revenue, operating expenditures, reserve requirements and capital needs for the Utilities Fund. The six year forecast will show projected water-sewer rate increases over the planning period.
2. The County will implement water-sewer rate increases in a gradual manner, avoiding spike increases whenever possible.
3. The County will meet or exceed all requirements of any financing agreements or trust indentures.
4. The Utilities Fund will maintain a reserve equivalent to three months' operations and maintenance expenses. The reserve may be used to address emergencies and unexpected declines in revenue. If utilized, the reserve will be replenished over a three year period to the minimum reserve level. This reserve is in addition to any financing agreement-required debt service reserve funds.
5. The Utilities Fund will maintain debt service coverage of at least 1.25 times on all debt service obligations.
6. The Utilities Fund will be self-supporting.

Transportation Capital Fund

1. New revenue shall not be used to supplant existing transportation funding commitments, and capital investments shall be compliant with state law restrictions on non-supplanting and maintenance of effort requirements.
2. Operating program enhancements (outside base program) that clearly document transportation benefits may be eligible for support from the Transportation Capital Fund.
3. No more than three to five percent of annual funding should be used for project administration, indirect & overhead costs to support capital projects.
4. A reserve equivalent of ten to twenty percent of annual budgeted revenue will be established.
5. A five to ten year financial plan and model will be developed that integrates project cashflow forecasts, revenue projections, and financial / debt management policies and will factor in other non-County funding sources, including federal, state, regional, and private funding.
6. The County will prudently balance the use of new transportation funding sources between pay-as-you-go funding and leveraging through new bond issuance. Use of leveraging will be dependent on project size, cash flow, and timing projections.
7. If the County chooses to issue debt supported by dedicated transportation funding sources, such debt will be structured to be self-supporting and will not count against the County's general tax supported obligation debt ratios or capacity. Debt service coverage on such debt will range from 1.10 to 1.50 times, depending on the type of debt issued. The term on such bonds will not exceed the average useful life of the assets financed, and amortization will be structured to match the supporting revenue stream.
8. The Transportation Capital Fund will be self-supporting.

Tax Increment Funds

1. The intended use of TIF monies will be specified at the time of TIF creation; changes or additional uses will be determined as part of the annual budget process.
2. The assessed value of TIF areas will not exceed 25 percent of the County's total assessed valuation. As of January 1, 2016, existing TIF assessed valuation totaled 20 percent of County-wide assessed valuation.
3. The percent of TIF revenue available for the intended uses within a TIF area will be established at the creation of the TIF and will be less than or equal to 40 percent. This percent will be evaluated annually as part of the budget process.
4. The County will prudently balance the use of PAYG funding and leveraging through TIF bond issuances. Use of leveraging will be dependent on project type, size, cashflow and timing projections. Leveraging will only be used for capital projects that meet useful life and other requirements for bond issuance.
5. If the County leverages TIF revenue on its own behalf, it will target a minimum debt service coverage ratio of 2.0 times and establish an appropriate level of debt service reserves and / or other contingencies.

6. The County will establish additional policies pertaining to the leverage of TIF revenue by a private development entity prior to any such issuance.
7. A reserve equivalent to ten percent of annual budgeted revenue will be established.

Stormwater Fund

1. The County will annually develop a six year projection of stormwater operating and capital expenses.
2. The County will prudently balance the use of new stormwater funding sources between pay-as-you-go funding and leveraging through new bond issuance. Use of leveraging will be dependent on project size, cashflow, and timing projections. If debt is issued for stormwater projects, it will generally follow the debt issuance guidelines contained in this policy.
3. The Stormwater Fund will maintain a reserve equivalent to three months' expenses.
4. Stormwater financial policies will be reviewed as part of the Municipal Separate Storm Sewer System (MS4) permit renewal cycle (every five years).
5. The Stormwater Fund will be self-supporting.

CPHD Development Fund

1. A contingent reserve will be established equivalent to thirty percent of the Fund's total operating budget based on the fiscal year. This amount is equivalent to three to four months of annual operating expenditures. The reserve may be used to address emergencies and unexpected declines in revenue only after authorization from the County Board.
2. The CPHD Development Fund will be self-supporting.

Ballston Garage and Ballston Garage 8th Level Funds

1. The County will annually develop a multi-year forecast of garage revenue, operating expenses, and capital maintenance costs to be updated with each County CIP cycle.
2. An economic stability reserve equivalent to 3 months of annual parking revenues will be established to address potential revenue variability, ramping up to this level over a four year period beginning in FY 2019. Any draws upon this reserve will be replenished within the subsequent three fiscal years.
3. A maintenance reserve will be established based on an assessment of expected capital renewal needs over a 10-year period.
4. A reserve will be established for the ensuing year of debt service on the Series 2016B Ballston Quarter CDA bonds allocable to garage improvements.

5. The County will meet or exceed all requirements of any financing agreements or trust indentures
6. The county will target self-sufficiency in consideration of limits imposed on parking user fee raising ability in the garage by the 1984 documents governing original and ongoing development of the garage.