CITY OF MCMINNVILLE
AUDIT COMMITTEE MEETING AGENDA
8/05/2020
9:00 a.m.
Zoom Meeting

https://mcminnvilleoregon.zoom.us/j/96469669540?pwd=VDNwS0FQNFR0RytwYnNjQWoyNkJIZz09

Meeting ID: 964 6966 9540   Password: 372809

1. Consider approval of the Minutes 7/14/2020 Audit Committee Meeting

2. Discussion on Reserve as a Component of Financial Health
   40 mins

3. Components of Reserve Presentation and Discussion with Council
   15 mins
   - Deliverables for next meeting

4. Next steps
   5 mins
   - Need a third meeting? Proposed Agenda items?

Documents and Resources – previous packet

PFM's 7/14/2020 presentation was distributed to Audit Committee members

Documents and Resources – current packet

City of McMinnville
City Council Audit Committee
Meeting Minutes

Date: July 14, 2020, 11:00 a.m.

Audit Committee: Scott Hill, Mayor
Kellie Menke, City Councilor
Peter Hofstetter, Budget Committee member

Municipal Advisor: Duncan Brown, PFM
Maggie Marshal, PFM

Staff: Jeff Towery, City Manager
Jennifer Cuellar-Smith, Finance Director
Ronda Gretzon, Senior Accountant
Dewey Burchell, Accountant II

Handouts: March 10, 2020 Audit Committee Meeting Minutes
City of McMinnville Reserve Trend, Budget to Actual data compiled by Jennifer Cuellar-Smith
Moody's July 18, 2019 Annual Comment on McMinnville including Moody's Local Government Debt Rating Methodology
Government Finance Officers Association's Best Practice statement regarding Fund Balance Guidelines for the General Fund
Governing Magazine, "10 Policies and Practices that Promote Financial Health"
Municipal Research and Services Center's guidance on Fund Balances and Reserve Policies
City of McMinnville's Fund Balance Policy for the General Fund and adopting Resolution No. 2011-30

Minutes from March 10, 2020 meeting

The minutes from March 10, 2020 were presented for approval. Mayor Hill mentioned that he was listed as City Councilor and that the minutes should be revised to reflect that he is the Mayor. The Committee was in agreement and Kellie Motioned to approve the March 10, 2020 minutes as amended; Scott seconded. Motion passed as amended.

City of McMinnville Reserve Trends, Budget to Actual

Jennifer gave a brief overview of the meeting's agenda and went over the City of McMinnville Reserve Trend, Budget to Actual data found in the Audit Committee Packet. Jennifer drew the Committee's attention to the trend of budgeting a decrease in the reserve level that started in Fiscal Year 2014-15 and has continued through the current year's budget. She also drew attention to the fact that the budget since fiscal year 2012-13 included a negative current net revenue of at least $500,000 that had increased to over $3,000,000 in the fiscal year 2019-20. She mentioned that fiscal year 2019-20's budget included negative current net revenues that were an increase even from fiscal years 2017-18 and 2018-19 which came in just over $2,500,000 as shown on page 6. She also brought their attention to the actual data and pointed out that the actual negative current net revenues in fiscal year 2019-20 were a significant increase from any of the prior years, all of which had actuals coming in significantly better than budget.

Peter mentioned that he felt the graphs presented in the packet were backwards showing the current year on the left and fiscal year 2012-13 on the far right. The general consensus was that when this is brought to the City Council the graphs should be displayed from least to most current fiscal year end. Peter mentioned that the percentage graphs were helpful to put the numerical graphs into perspective, stating that he really appreciated the extra time it took and benefit of the increase in comparative metrics used in the presentation. Kellie brought up the fact that the Budget Committee and City Council would often say they were being very pessimistic in their budgetary projections, but based on data shown here they might actually have been more optimistic than they might have realized. Scott suggested that a real careful discussion needed to happen at both the Budget Committee and City Council regarding what the City's reserve should look like, rather than just understating estimated revenues, overstating estimated expenses and hoping for the best at year end.

Jennifer comment that it was clear to her from this discussion and the data presented that there had been a decision made at some point between fiscal year end 2014-15 and 2015-16 to spend down a percentage of the reserve as it related to Actual Expenditures from July to October closer to or even below the 25% threshold in Resolution 2011-30. She stated that despite the Budgeted Negative Current Net Reserve of $1,500,000 to $2,500,000 from Fiscal Year 2014-15 through Fiscal Year 2018-19, the Actual Current Net Revenue had not come close to that level of a deficit in the Budgeted Current Net Revenue until the current fiscal year end where the Budgeted amount was negative $3,140,990 and the Actual Current Net Revenue was negative $2,276,472.

Jennifer stated that this discussion was helpful for her as the Finance Director to understand where the Audit Committee stood in terms of the overall Reserve Trends, and Budget to Actual numbers over the past seven fiscal years. Jennifer mentioned that the current discussion had already gone a little over time allotted in the Agenda and she wanted to ensure that Duncan Brown from PFM had enough time to complete his presentation as well as answer any questions the Committee had. She then turned the meeting over to Duncan.

<u>Presentation by Duncan Brown on Credit Ratings, Debt Market and the impact of reserves</u>

Duncan started the presentation with an overview of the three major rating agencies, (Moody's Investor Services, S&P Global Ratings and Fitch Ratings) and what a credit rating is. The presentation continued with and overview of the Hierarchy of Credit Ratings with a focus on Moody's Investor Services used by the City of McMinnville and most municipal governments. Duncan mentioned that under Moody's Hierarchy with investment-grade ratings ranging from Aaa down to Baa3, most cities carried a rating of A3 or higher (the seventh of ten on a scale of one to ten) and McMinnville was currently rated Aa3, (or fourth out of ten).

Duncan continued by referencing Moody's Local Government Rating Scorecard, indicating that Moody's Investor Services (Moody's) had developed a more transparent form or rating in prior years following the credit bubble and subsequent collapse of the securities market, by moving to this scorecard format. Duncan continued by explaining to the Committee that this scorecard is updated over time and that PFM is able to come close to calculating what Moody's credit rating will be based on the high level of detail and transparency included in the scorecard. He indicated that there are several factors that are out of the City Management's control (i.e. Tax Base, Institutional Framework, and Pension Liability) and others the City Management might have more direct control over, (i.e. Fund Balances, Operating History, and Debt).

Duncan transitioned to an overview of the City of McMinnville's Rating by Moody's, on February 2018 at the last debt issuance by the City. He informed the Committee that the annual comment in July 2019 was all that Moody's was required to do annually unless there was a major change to the City that would trigger a full revaluation. Duncan also mentioned that city is due for its next annual comment this year and would likely see the results of the annual comment in the coming months.

Duncan continued the presentation by informing the Committee that Moody's "Operating Available Fund Balance" was one area that was still unclear to those outside of the agency and was not calculated using just the "General Fund Balance". He indicated that along with the General Fund, Moody's would pull out other undesignated funds that could be used for debt payments by a municipality. Duncan suggested that if it were not for this and a few other grey areas PFM and others would be capable of calculating a rating for any municipality. He stated that the General Fund was typically the majority share of this "Operating Available Fund Balance" and the focus in most available funds policy.

Duncan transitioned to the "Operating Available Fund Balance" trend, informing the Committee that the City's "Operating Available Fund Balance" in 2014 was much higher than the US Cities Median. He continued by stating that in 2019 the City's "Operating Available Fund Balance" was below the US Cities Median, but to remember that this is not an all-encompassing part of what determines actual discount rates. The "Operating Available Fund Balance" is rather, a general means for calculating the City's ability to make payments on and retire debt. He continued by informing the Committee that the Credit Spreads based on credit ratings over last 10 years averaged about 0.38% between singe A and double A and is currently 0.24%.

Peter inquired in regards to the downward trend of "Operating Available Fund Balance" and how long it would take for this to impact the City's credit rating. Duncan responded, that based on the scorecard provided by Moody's it is more of the magnitude of the changes over time, than just the downward or upward trend. He indicated that the City of McMinnville was near the bottom of the double A rated cities in Oregon in regards to the "Operating Available Fund Balance" as a percentage of "Operating Revenues" in 2019, but he did not feel that they were in danger of being downgraded at this time as long as they had a plan in place to begin replenishing the reserve.

Jennifer inquired about possible precursors to a rating change by Moody's. She indicated that it was her understanding that a downgrade typically happened after a negative annual comment was issued. She continued by mentioning that the City did not receive a negative annual comment in 2019 and so she had not been worried about the possibility of the City's rating moving down to A1. Duncan responded that Moody's will not take action during an annual comment, so unless the City received communication from Moody's informing them of a formal review, the City was not in danger of having their credit rating downgraded to A1. He continued by indicating the pattern he had observed was Moody's launching a formal review that could result in action being taken (change in credit rating), after consecutive years with either a negative or positive annual comment.

Kellie asked for clarification on exactly what would trigger a formal review by Moody's. Duncan clarified that "general borrowing" for example from another government entity or bank would not trigger a formal review, only a new public offering would require formal review. He did mention that if the City was involved in a lot of "general borrowing" and their debt level was higher that it could reflect poorly on their formal review when a new public offering was done. He mentioned that these types of "general borrowing" affected the City's ability to make payments and retire debt as much as the "Operating Available Fund Balance".

Jeff inquired regarding the impact of McMinnville Urban Renewal Agency (MURA) on the City's credit rating. Duncan responded that MURA and even other taxes or assessments such as Transient Lodging Tax (TLT), are heavily restricted and do not often impact the City's credit rating. Jeff asked for clarification on the TLT revenues, commenting that the City has been discussing the use of a portion of the TLT revenues for other qualified expenses and expressed his and the City Councils concern regarding the volatility of these revenues. Duncan responded, that he would need to have a more in-depth discussion with the rating agency on this as the City does not currently use TLT as a major source of revenue.

Scott voiced his concern about being at the bottom of the double A rating and wanted to know how close the City may be to Moody's taking action and downgrading the City to A1. He also inquired of Duncan and Jennifer regarding the historical trend data on both TLT and General Fund revenues as a whole. Scott indicated that he was concerned about the trend total revenues had on "Moody's Local Government Rating Scorecard". Duncan responded by bringing it to the Committee's attention that the City has had a double A rating for a substantial period of time. He explained that in his professional opinion a formal review would only be triggered by a new public offering at this time. He further informed the Committee that the rating agencies were busy and they did not typically preform formal reviews of municipalities unless required to do so by policy or law.

Scott inquired about the timing the City should be looking at for increasing the reserve balance. Duncan responded, by informing the committee of the importance of having a plan of action. He indicated that seeing changes in one direction or the other over time, rather than a one or two year period which averaged itself out over a five or ten year span prior to a public offering made a big difference. Duncan explained that in his professional opinion having a formal plan of action that was in place AND working for either increasing OR keeping the reserve at a steady level would be the most impactful form of action the City could take in keeping the City's double A rating at the next public offering. Jennifer expressed her sincere gratitude for Duncan's timely and helpful information. She indicated that as the City continued to look at facility maintenance and other possibly expensive projects in the near future likely to require a public offering to fund, that Duncan and PFM's guidance and suggestions were much appreciated.

Scott asked Duncan what he felt would be an appropriate level of reserve for the City considering the City had been at or above the undocumented target of 30% of July through October operating expenses and had passed Resolution No. 2011-30 requiring a target of 25%. Kellie and Jeff also voiced their concern with the estimated reserve level coming in under 25% this year and the high possibility of a $60,000,000 bond measure being needed in 2021-2022 fiscal year. Jeff also added that he would like clarification on how the reserve amount or percentage would be affected by the current five year forecast and if they should institute a formal plan of action to increase the amount of the reserve over the next ten fifteen or even twenty five years.

Duncan responded to the Committee's questions, stating that any forecasting or reserve timelines longer than five years were not typically valid or credible. He made the point that even at four or five years the forecasted numbers are marginal at best. He indicated that a five year plan should be in place as soon as possible if the City was looking to make a public offering of that size in the next 24 months. He responded to the reserve level inquiry by stating that the GFOA (Government Finance Officers Association's) suggested the General Fund reserve be 17% of Expenses for the months of July through October. He continued that 20% is a common target for cities and suggested level by other professional organizations. He did point out that higher reserve amounts were always better, but targeting that area would be his professional suggestion. Duncan further stated that reserve plans, policies and formal resolutions along with timing are all important, however results are the most impactful to a rating agency.

Best Practices Discussion on Reserve as a Component of Financial Health

The Committee transitioned into a more discussion based format amongst themselves regarding the reserve policy and possible changes that would be needed. Peter began by stating that some tough decisions would need to be made in an attempt to cut back expenses as well as increase revenues to begin raising the reserve level back to the 25% target set by Resolution No. 2011-30. Scott and Kellie both agreed with this statement and Scott suggested that a starting point or points should be identified along with suggestions on how to achieve this goal should be identified prior to the discussion at a City Council meeting.

Jennifer brought to the Committee's attention that time was running out and asked if the Committee would prefer to schedule another meeting or extend the current meeting. Scott mentioned that there was already another meeting scheduled in August where the Committee would have some time to sit on the information provided by Duncan and continue the discussion. Jennifer commented that her vision for the August meeting was to include and go over possible options. She indicated that the Committee might like to have a further discussion prior to the meeting to better understand the Committee's view of best practices on the reserve as a component of the City's financial health. The Committee decided to extend the current meeting until they had agreed on parameters for possible action plans to be discussed during the Meeting in August.

The discussion by the Committee transitioned to an appropriate starting point for the reserve level. The target starting point of 15% was agreed to and the committee asked Jeff if he felt comfortable with this as a starting point or if they should shoot for something higher. Jeff responded that he felt a stable 15% sounded like a reasonable starting point, but added that the Committee also needed to consider the microeconomic uncertainty the City faced. He pointed out that the City was running out of land for expansion and the uncertainty regarding COVID-19. The Committee further discussed a 15% reserve target, where cuts might be made, and other possible options to stabilize the reserve and build it back up without a definitive consensus. Discussion also circled back to COVID-19 and how that might impact policy making across Yamhill County, the State of Oregon, and at the national level. The Committee members all voiced concern about the possible impacts these might have on the City's financial state and their goal of achieving a 15% reserve mark.

Jennifer offered the suggestion of reversing the budget process. She explained that if the City were to reverse its current format by starting off the budget process with bare minimum operating expenses only and then incorporating in a targeted increase in the General Fund reserve they could then build up from that point. She continued that the current starting point of general operating costs and a wish list of items from each department at the first level of the budget process forced the City and its management team to make tough decisions during the whole budget process by making cuts to balance the budget at every level. Finance Department then goes through steps to complete the balancing process and often requires further wish list items to be cut by departments. She stated that she felt working to build up from the base operational cost and adding in prioritized projects and expenses might keep expenses lower and that cutting expenses was the easiest way to build a reserve back up. This transitioned the Committee to possible scenarios being laid out in the August meeting for how the City might build the reserve within reason. There was a general consensus that both the desire and need of the City Officials is to build up the General Fund reserve.

The Committee discussion shifted to possibility of and uncertainty around the formation of a Fire District and how that might impact the City. The Committee decided that they would like to have some core services information to be available at the next meeting with possible soft spots in the current budget. Jeff wanted to be clear that it would be difficult to obtain information regarding the possible Fire District prior to the feasibility study being completed. He also mentioned that there were other factors surrounding public safety as a whole that might affect the City's forecast. Further discussion was focused on other unknowns, such as affordable housing, homelessness, and both State and Federal funding sources.

The Committee began to wrap up the current conversation as Scott asked Jennifer if she remembered the date and time of the Committee's next meeting. Jennifer said that she thought it was the first week of August, but she would double check the date for everyone. Scott also asked if Jennifer would send out the presentation by PFM for the Committee to use as reference when preparing for the August meeting, indicating that he had been very helpful and included relevant information to the City's reserve policy. Jennifer stated that she would email the information out along with the meeting's minutes and confirmed that the meeting in August was to be on August 5^{th}.

The Committee thanked Duncan, Maggie, and PFM for their time and information provided.

There being no further comments to come before the Committee, the meeting was adjourned at 12:26 PM.