Town of Orleans

19 School Road Orleans Massachusetts 02653-3699

Telephone (508) 240-3700 – Fax (508) 240-3388

Director of Municipal Finance
Cathy L. Doane, CPA

To: Board of Selectmen
From: Cathy L. Doane
Date: May 1, 2020
Subject: Fiscal Stability

For the past few years I have been talking to you about the declining position of local receipts and our excess levy capacity that, without budget reductions, could result in the need of securing a General Operating Override to maintain our current level of services.

The declining revenue projections is further exacerbated by the financial effects of the COVID-19 pandemic. We have no idea at this point how long this is going to last and what the financial impact on our local receipts (including Beach revenues, Meals tax receipts and general town fees, etc.) will be. Furthermore, it is uncertain how State Aid may be impacted by the reduction in revenue at the State and Federal levels.

With all this uncertainty, I have recently expressed concerns to you regarding our ability to maintain our financial reserves while weathering this storm.

For the past several months, I have been researching viable alternatives and have been working with our financial advisor, Hilltop Securities, to put together a financial strategy that would attempt to do the following:

1. Protect the Town's Credit Rating of AAA
2. Reduce reliance on Free Cash to offset the operating budget
3. Provide the Town with flexibility to weather the economic fallout of COVID-19 into FY 22 and perhaps beyond.
4. Preserve the Town's financial reserves.

Below is an excerpt from an email I received from Cinder McNerney, Regional Managing Director of Hilltop Securities Inc. in Boston:

"Hi Cathy. I share your concerns. After reviewing what you sent, as well as S&P's most recent credit report and the Town's most recent disclosure, if the Town can tighten its belt in FY 2021 and not use free cash the way it has, or reduce that amount, would be ideal from the perspective of protecting the credit rating and as important, providing the Town flexibility to weather the economic fallout of COVID-19 into FY 2022 and perhaps beyond. Using the unused levy capacity, reducing reliance on free cash to balance the budget at least partially, tightening your belts in anticipation of FY 2022, are all good measures, and reflect a balancing effort, probably reflecting the very strong management view of the Town. That said, the rating agencies view the coronavirus as both a health crisis and a financial crisis. There are concerns it will become a credit crisis. There is some expectation that rainy day funds will be used as it's raining. But, if you read S&P's report, a deterioration in the Town's flexibility, i.e., available fund balance, could pressure the rating given that debt and contingent liabilities are large. That's offset by the Town's wealth and lack of reliance on state aid, and that its budget is mostly supported with property taxes. Already the rating agency gives credit for the unused levy capacity, but if that's used ahead of reserves, it would protect the reserve position to weather the fact that operating surpluses will be less likely going forward. The Town's fee cash policy looks like it hasn't been reviewed in some years and did not anticipate the event of perhaps multiple years of not being regenerated. We think it should be reviewed in light of current

expectations, and in light of what the Town reasonably expects revenue losses will be in each of the next 3 years, as any draw on reserves may not only be difficult to restore, but simply postpone the inevitability of making the same difficult decisions only a year later, when the reserve position is diminished. Generally, we would advise a balanced approach to the use of reserves, if any, that would allow for the use only as part of a multi-year plan that reflects it can ultimately be rebuilt and restored. Liquidity is the focus of the rating agencies these days, and the Town is viewed as having very strong liquidity. Using reserves to balance the budget, if not restored, would also start to undermine that component of the Town's strength, another reason to be very cautious about drawing down on reserves heading into all the uncertainty of the next couple of years in terms of the economic impact of the coronavirus."

"The Town should consider maintaining reserves in the 13% to 15% as a range….I think that way you can meet your minimum, but strive to something that provides the Town more flexibility relative to events like reduced local receipts and new growth." (At the end of FY 19, our reserves were 13%.)

"Generally the rating agencies, regarding the policy for reserves, is focused on free cash and stabilization together, and they usually look at unassigned and total fund balance as a percent of total expenditures, or revenues, on a GAAP basis. So the Town might want to consider where it's at now, under GAAP, and can you maintain that as a percent of revs/exps."

"What the rating agencies want to see is that whatever your choices are, that they fit into a plan to get through coronavirus in a sustainable way. The Town is so well managed, I don't see this as compromising your AAA but I do think, as you started out this conversation, that every effort should be made to maintain or return unassigned fund balance and total fund balance percentages at current levels that support the AAA."

"With regard to a policy, I agree that perhaps develop more of a policy of how much free cash is to be transferred to stabilization. Stabilization is considered as part of your flexibility."

The above comments by Cinder reinforce what I have been saying to you all along. Therefore, I propose the following for consideration of how we need to proceed:

<u>Steps for FY 21</u>:

1. Reduce reliance on free cash to balance the budget and instead utilize excess levy capacity.
2. Adopt new financial reserves policy.
3. Evaluate actual revenue vs. projections during the summer months and make adjustments to FY21 budget at the October STM to offset any shortfall
4. Conduct BOS work sessions on the future need for general operating override. Consideration to include possibility of reducing services and increasing fee-based revenue. Work sessions should commence early FY 21 in preparation for the FY 22 budget process.

<u>Steps for FY 22 – FY 25 projections</u>:

1. Based on FY 21 adjustments and work sessions, amend projections for revenue and operating budgets.

Thank you for your consideration.

cc: John Kelly