2013-049

# Financial Policy

***For:***

# Town of Clayton, North Carolina

*Adopted 9/8/2009; Amended 11/04/2013*

# FINANCIAL POLICY
**Town of Clayton, North Carolina**
**Goals and Standards**

## TABLE OF CONTENTS

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## FINANCIAL POLICY – PREAMBLE

The Town of Clayton establishes this comprehensive financial policy to manage its General Fund and Enterprise Funds in conjunction with facilitating and enhancing its credit rating. Furthermore, the Town acknowledges the existence of the fundamental and operational differences between these funds, which is attributable to the primary revenue sources that support each fund's activities. As such, the Town intends to utilize the same financial policy goals and standards where appropriate or relevant and establish separate benchmarks and other criteria as financial indicators to evaluate the performance and financial condition of these funds independently from each other.

## FINANCIAL POLICY – OBJECTIVES

This financial policy is a statement of the goals and standards that will guide the financial management practices of the Town of Clayton, North Carolina. A financial policy that is adopted, adhered to, and regularly reviewed is recognized as the cornerstone of sound financial management. Effective financial policy:

- Contributes significantly to the Town's ability to insulate itself from fiscal crisis,
- Enhances both short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible,
- Promotes long-term financial stability by establishing clear and consistent guidelines,
- Directs attention to the total financial picture of the Town rather than single issue areas,
- Promotes the view of linking long-term financial planning with day to day operations, and
- Provides the Town Staff, the Town Council and the Town citizens a framework for measuring the fiscal strength of government finances against established parameters and benchmarks.

To these ends, the following financial policy statements are presented.

## CAPITAL IMPROVEMENT BUDGET POLICIES

1. The Town will consider all capital improvements in accordance with an adopted capital improvement program.

2. The Town will develop a five-year Capital Improvement Program and review and update the plan periodically.

3. The Town will enact an annual capital budget based on the five-year capital improvement plan. Future capital expenditures necessitated by changes in population, changes in real estate development, or changes in economic base will be calculated and included in capital budget projections.

4. The Town will coordinate development of the capital improvement budget with development of the operating budget. Future operating costs associated with new capital improvements will be projected and included in operating budget forecasts.

5. When the Town utilizes intergovernmental assistance to finance capital improvements, those projects will be consistent with the capital improvement plan and Town priorities, and with future operating and maintenance costs included in operating budget forecasts.

6. The Town will maintain all its assets at a level adequate to protect the Town's capital investment and to minimize future maintenance and replacement costs.

7. The Town will project its equipment replacement and maintenance needs for the next several years and will update this projection each year. From this projection a maintenance and replacement schedule will be developed and followed.

8. The Town will identify the estimated costs and potential funding sources for each capital project proposal before it is submitted for approval.

9. The Town will attempt to determine the least costly and most flexible financing method for all new projects.

## FINANCIAL MANAGEMENT PERFORMANCE EXPECTATIONS

In addition to the policies established on pages 4-5 of this document, the Town also wishes to articulate certain financial management performance expectations for fund balance reserves, debt service expenditures, and liquidity. These expectations are intended to illustrate typical performance in normal conditions and are intended as internal performance benchmarks. The Town shall most commonly expect to operate within the following prescribed expectations:

General Fund:

Unassigned fund balance as a percentage of net expenditures: at least 30%

Tax supported debt service as a percentage of total governmental expenditures less capital outlay not more than 13%

Enterprise Funds:

Debt service coverage ratio for all indebtedness: at least 1.50

Equity funding of the system's capital improvement program: at least 25%

Operating days cash on hand:

Water and Sewer Enterprise Fund: at least 200.75 days

Electric Enterprise Fund: at least 98.55 days

In conjunction with the key ratios established by the financial policy guidelines, the Local Government Commission (LGC) also monitors similar key ratios and compares these ratios to the Town's peer group (similarly positioned municipalities) as benchmarks. If the Town deviates materially below the peer group benchmarks, then the Town will formulate and execute a multi-year plan to reestablish and sustain itself among leaders in its peer group.

State oversight via the LGC also provides the Town's residents, taxpayers, and the investment community with an additional layer of risk management expertise. The Town shall perform such that inquiries and admonitions from the LGC shall be avoided and in the event of LGC comment or inquiry the Town shall take immediate action to respond and affirmatively address the matter of interest. This approach will prevent broad swings in key indicators, even those within acceptable parameters, on a year to year basis.

## DEBT POLICIES

1. The Town will confine long-term borrowing to capital improvements or projects that cannot be financed from current revenues except where approved justification is provided.

2. When assessing capital project funding approaches and the issuance of debt, the Town will conduct a series of financial analyses to demonstrate each Fund's financial ability to incur such debt under its current rate structure, and to determine if, when and to what degree rate structures need to be adjusted in the event that the current rate structure is not able to accommodate new additional debt.

3. The Town will review each Fund's current debt structure periodically as interest rates fluctuate and optional bond redemption dates arise for refunding or advance refunding opportunities. Refinancing opportunities that produce a net present value savings of 3% or greater will be considered as beneficial to the Funds, although other factors can be taken into account when assessing the feasibility of a refunding transaction.

4. The Town will take a balanced approach to capital funding utilizing debt financing, draws on capital reserves and/or fund balances in excess of policy targets, and pay-as-you go funding. Each Enterprise Fund will target a minimum amount of equity funding equal to 20% of the system's capital improvement program.

5. The Town will set rates and charges for each Enterprise Fund so as to achieve a debt service coverage ratio of 1.25 times or greater for all indebtedness. All indebtedness includes both parity and subordinate debt obligations of each fund. In the absence of a specific debt ratio calculation required by a debt covenant, the debt coverage ratio will be calculated in accordance with the following example:

| | |
|---|---|
| A. Operating Revenues | $7,822,484 |
| B. Operating Expenses* | $6,413,900 |
| Less: Depreciation and Amortization | 947,560 |
| Net Expenses | $5,466,340 |
| C. Net Revenue Available for Debt Service (A minus B) | $2,356,144 |
| D. Debt Service (Principal and Interest) | $1,762,023 |
| E. Debt Coverage Ratio (C divided by D) | 1.34 |

*Operating expenses include support service charges and tax reimbursements to the General Fund.

The debt coverage ratios will be calculated and tracked annually for each Enterprise Fund separately and will be measured independently from the other and from the Town's General Fund.

6. When the Town finances capital improvements or other projects by issuing bonds or entering into capital leases, it will repay the debt within a period not to exceed the expected useful life of the project.

7. Where feasible, the Town will explore the usage of special assessment bonds, revenue bonds, or other self-supporting bonds instead of general obligation bonds.

8. The Town will retire tax anticipation debt, if any, annually and will retire bond anticipation debt within six months after completion of the project.

9. General Fund net debt as a percentage of estimated market value of taxable property shall not exceed 2.5%.

10. The ratio of debt service expenditures as a percent of total governmental fund expenditures shall not exceed 15.0%, with an aggregate ten-year principal payout ratio of 55%.

11. The Town recognizes the importance of underlying and overlapping debt in analyzing financial condition. The Town will regularly analyze total indebtedness including underlying and overlapping debt.

## RESERVE POLICIES AND STANDARDS

1. General Fund unassigned fund balance at the close of each fiscal year shall not be less than 20% of actual General Fund net expenditures without prior Town Council authorization.

2. The Town Council may, from time-to-time, utilize fund balances that will reduce the unassigned fund balance below the 20% policy for the purposes of a declared fiscal emergency, financial opportunity to enhance the well-being of the Town of Clayton or other such global purpose as to protect the long-term fiscal security of the Town of Clayton. In such circumstances, after unassigned fund balance has been calculated as part of closing-out a fiscal year, the Council will adopt a plan as part of the following year's budget process to restore the assigned fund balance to the policy level within 36 months from the date of the budget adoption. If restoration cannot be accomplished within such time period without severe hardship to the Town, then the Board will establish a different but appropriate time period.

3. Monies in excess of a 20% unassigned fund balance will be available for Appropriation, as deemed necessary and approved by the Council.

4. The Enterprise Funds will maintain the following minimum level of liquidity:
    a. Water and Sewer Fund – a minimum of 50% of Unrestricted Cash as a percentage of Operating Expenditures or 182.5 Days Cash on Hand.

    b. Electric Fund – a minimum of 25% of Unrestricted Cash as a percentage of Operating Expenditures or 91.25 Days Cash on Hand.

## BUDGET DEVELOPMENT POLICIES

1. The Town will develop the Annual Budget in conjunction with a stated program of performance objectives and measures with which to gauge progress toward meeting those objectives.

2. Water, sewer and electric rates will be established at the appropriate level to enable the related funds to be self-supporting.

3. One-time or other special revenues will not be used to finance continuing Town operations but instead will be used for funding special projects.

4. The Town will pursue an aggressive policy seeking the collection of delinquent utility, license, permit and other fees due to the Town.

5. The Town will make regular, quarterly reports to the Council on the status of actual revenues and expenditures as compared to the adopted budget.

## DEFINITIONS

1. Fund balance is defined as the difference between the assets and liabilities reported in a governmental fund. Unassigned fund balance in the General Fund is defined as the total fund balance in excess of what can be properly classified in one of the following four categories:

    a. Nonspendable fund balance is the portion of net resources that cannot be spent because of their form or because they must be maintained intact.

    b. Restricted fund balance is the portion of fund balance that reflects resources that are subject to externally enforceable legal restrictions, which are comprised of limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments or limitations imposed by law through constitutional provisions or enabling legislation.

    c. Committed fund balance is the portion of fund balance that represents resources whose use is constrained by limitations imposed by the Clayton Town Council upon the Town and will remain binding until formal action at the same level is taken to remove the self-imposed limitation.

    d. Assigned fund balance is the portion of fund balance that reflects the Town's intended use of resources established by the Clayton Town Council or by a body or an official with delegated authority and does not require formal action to remove the limitation of intended use.

2. Net expenditures are defined as actual expenditures plus transfers out minus capital lease proceeds.

3. Debt coverage ratio is defined as annual net pledged revenues to the related annual debt service payments.

4. Equity funding is defined as the utilization of the Town's cash to fund its capital improvement program.

5. Days cash on hand is defined as unrestricted cash divided by (Operating Expenditures/365).

6. Net debt is defined as any and all debt that is tax supported.

Duly adopted by the Clayton Town Council this 4th day of November 2013, while in regular session.

Jody L. McLeod,
Mayor

ATTEST:

Sherry L. Scoggins, MMC
Town Clerk