To Synchronize or Not to Synchronize, and What is Our Debt Capacity Anyways?

First, What is EP's Debt Capacity?

• Debt Limit per State Law	$120,157,716
• City/School Outstanding Debt	36,467,690
• Available Debt Capacity	$ 83,690,026

Who Borrowed the Outstanding Debt

• City Borrowings	$14,813,690
• School Borrowings	21,654,000
• Total	$36,467,690

How Much Will New Debt Cost the City?

- Municipal 20 Year Interest Rates are Trending Upward and Now Range between 3.75% to 4.25%. If the Fed Raises Rates This Year – Who Knows?
- Interest Rates are Tied to Bond Ratings which Reflect a Municipalities' Fiscal Health. The spreads between AA rated Municipalities and those lower are about 40 basis points, or .40%.
- East Providence has Investment Grade Ratings from both Moody's (A2) and S&P (AA). EP Should Get a Favorable Interest Rate Should It Go Out to Bond, but It Probably Will End Up in the 4.0% range.

What Does This Mean in Dollars (Approx.)?

- A $25mm, 4%, 20 Year Bond will Cost -- $36.6 mm ($11.5mm Int.)

  Annual Int. & Prin. Payments = $1.8 mm

. A $25mm, 4%, 25 Year Bond will Cost -- $39.8 mm ($14.8mm Int.)

  Annual Int. & Prin. Payments = $1.6 mm

. A $25mm, 4%, 15 Year Bond will Cost --$33.5 mm ($ 8.5mm Int.)

  Annual Int. & Prin. Payments = $2.2 mm

How Much Tax Capacity Does the City Have?

- The State Caps Tax Increases at 4% of Levy.
- For EP that is about $4.2mm, or about 4.2%.
- The Charter caps annual tax increases at 3.5% over the Prior Year's Tax Rate.
- You may not want all tax categories to have proportional rate increases. That is residential, commercial, tangible and excise may be increased differently.
- Tax caps can only be exceeded with legislative/voter approval.
- Remember debt service will not be your only increased cost. New union contracts and normal City expenditures also need additional tax dollars.

What is this synchronization issue?

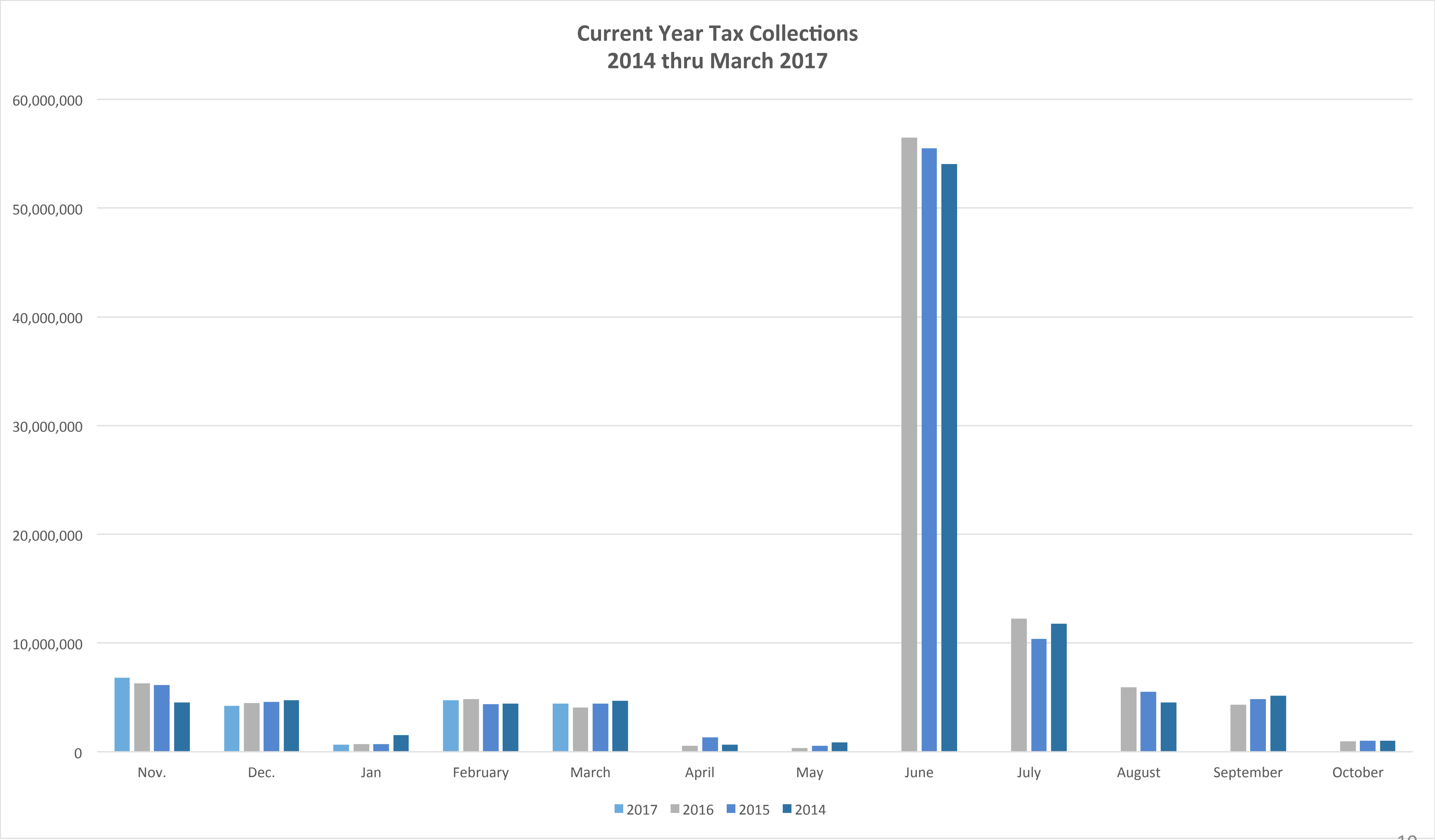
- East Providence's **fiscal year-end** is 10/31.
- East Providence is one of two municipalities (Scituate) in Rhode Island with a fiscal year-end that is not 6/30.
- The State of Rhode Island has a 6/30 year-end.
- East Providence maintains a **tax year** starting 7/1 and ending 6/30.
- Its **tax year** is out-of-synch with its **fiscal year,** that is tax year assessments are collected over **two** fiscal years, and each fiscal year collects revenues based on **two** different tax assessment years.

Why is Synchronization an Issue (part 1)?

- East Providence is out-of-synch with state reporting, especially for grants, that requires data as of 6/30.
- For such reporting, EP provides either old data or estimated data.
- The East Providence School Department is especially out-of-synch with RIDE reporting that is due 6/30. The EPSD hates our fiscal year.
- Banks and bond rating agencies are used to dealing with municipalities that end their fiscal year on 6/30. Municipal audits are normally completed by 12/31. EP's audit is normally not complete until May.

Why is it an Synchronization an Issue (part 2)?

- The big budget problem on the City with different fiscal and tax years is estimating the amount of property taxes that will be collected in any fiscal year.
- East Providence residents have the option of prepaying property taxes by 7/1 to collect an early pay discount that currently stands at 1.5%. Many exercise this option (escrows – approx $29 mm have to), but is it a big deal if they do not? Yes!
- Over 68% of current year tax revenues (approx. $69mm) are collected prior to 7/30.
- Current year tax collections have the **potential** to differ either way from year-to-year by several percentage points (each % point is approx. $1.0 mm of revenue), **however**, they have been remarkably consistent over the years.


Current Year Tax Collections
2014 thru March 2017
60,000,000
50,000,000
40,000,000
30,000,000
20,000,000
10,000,000
0
Nov.
Dec.
Jan
February
March
April
May
June
July
August
September
October
2017
2016
2015
2014

Why Care about the Early Tax Payments?

- About 50% of what is not paid early will likely flow into the next fiscal year. If prepayment estimates are short by $3.0 mm, about $1.5 mm of revenue expected in the current fiscal year will be booked in the next fiscal year (Dec. & March qtly. payments).
- Every dollar missed in forecasting revenue hits the bottom line during that fiscal year.
- Missing a fiscal year revenue forecast because of timing of tax year payments could result in an unplanned budget deficit or surplus, in one year, and if not immediately recognized as such, a corresponding budget surplus/deficit in the next.
- Budgets can be missed, not due to poor management, but to the timing of tax payments.
- Worse, you may not recognize a revenue budget shortfall until it is too late to do anything on the expenditure side to offset it.
- In order to prevent a fiscal year deficit due to tax collection timing, it is always wise for EP to “conservatively forecast” revenues.

Reasons Not to Synchronize

- State funding for municipalities and schools is not final until budget enactment, usually during July or August.
- Most fiscal 6/30 municipalities submit preliminary budgets by May, and approve them well before final state funding is known. They depend on the governor's "first look" budgets for state funding information:

Year	First Look Budget	Enacted Budget
2017	Feb-2	Sept – 1
2016	Mar-12	Aug-12
2015	Jan-15	June-13
2014	Mar-7	Aug-26
2013	Feb-7	Jul-18
2012	Mar-10	Aug-10
2011	Feb-2	Jun-9

Can you Rely on First Look Estimates? Variance Between Enacted & First Look

Year	School Aid
2017	$94K
2016	($ 58k)
2015	NA
2014	($159K)
2013	$40K
2012	$94K

Main Reason to Synchronize: EP has a Perpetual Cash Flow Issue from January Through June.

. Uneven revenue and expense cash flows **always** results in EP running out of cash sometimes in January. This cash deficit increases until June and then changes to a cash surplus when prepayments for the upcoming tax year starting 7/1 are received.

. Cash flow borrowing via Tax Anticipation Notes (TANS) is required to cover the cash deficits. TANS represent short-term borrowing because they require full repayment prior to the end of EP's fiscal year. Interest rates on TANS typically run 1.0 – 2.0 percentage points less than longer term debt.

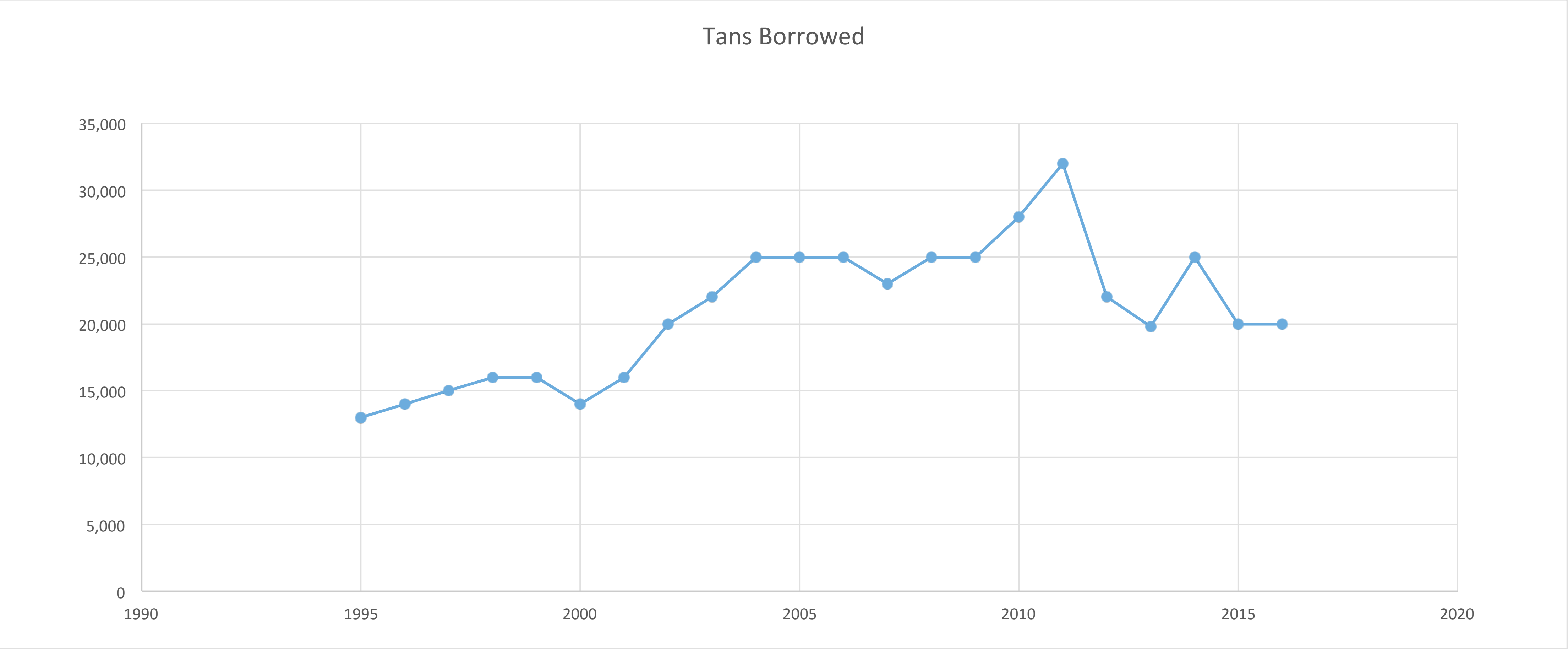
. Over the past 10 years, the amount of TANS required by EP has ranged from a $19.8 mm low in 2013 to a $32 mm high in 2011.

. For 2017, EP has received $20mm in TANS.

. By the first week of July 2017, all TANS should be repaid.

. **In an unsynchronized world, it is a cycle that annually repeats itself.**

TANS Have Been Around in EP for a Long Time



Problems with Cash Flow Borrowings (TANS)

- TANS relief depends on: A) a willing lender, and B) strong fiscal EP performance and a high bond rating.
- TANS may be difficult to get in any one year if A) The City or the School Department has a run a deficit; B) other municipalities in RI are having financial difficulties; C) banks are having financial difficulties; D) the State is having issues balancing its budget or E) EP's debt capacity is tapped out.
- TANS Interest Rates could fluctuate and be greater or less than what we put in our annual Budget by a few hundred thousand dollars.
- Without TANS, EP could not pay its bills for January through June, and essentially would be insolvent.

East Providence Experienced The Perfect Storm that Brought the Budget Commission

- The aftermath of the Great Recession
- Banks have pulled back on lending
- Central Falls filed bankruptcy
- The EP School Department continued to run a large deficit
- The City seemed powerless to reverse it
- The EP School Department had large outstanding bills
- Moody's downgraded EP below investment grade
- The City was running out of cash – Like it always does
- No bank wanted to lend EP TANS
- The Budget Commission entered in 2011

Is Synchronization the Answer?
This is How You Would Do It

Step One:

- First you commit to end your "pre-synch" fiscal year at 6/30. The most logical way to accomplish this is to elect for a short "pre-synch" fiscal year which is 9 months (10/1/2017 – 6/30/2018).
- EP budgets for a 9 month "stub" fiscal year, and audited financial statements would reflect that 9 month period.

Step 2:

- Tax bills for the synchronized year starting 7/1/18 are sent out in late May-2018, and collections for that tax year begins in June-2018. All June 2018 collections will count as revenue for the new synchronized year, not for the 9 month stub year.
- We accomplish this by "accounting-wise" taking the revenues that we collected in June out of the stub fiscal year that ended 6/30/2018, and putting them (accruing) in the new fiscal year beginning 7/01/2018.
- Through the **magic** of accrual accounting, we have aligned, or **synchronized**, our fiscal revenue reporting with our tax assessment year.

East Providence – We Have a Problem!!!

Hypothetical Financials – 6/30/2018 Year-end (9 months)

Beg Year Synch Reserve 11/01/2017	$11,180,000
Revenues 11/01/17 - 6/30/2018	45,000,000
Revenues Collected in June/July (now recorded in year starting 7/01/2018)	
Expenditures (11/1 – 6/30)	(95,180,000)
Ending Loss fiscal 6/30/2018	($40,000,000)

The Problem Synchronization Brings & How to Fix It

. Per State Law – We cannot end a fiscal year with a deficit.

. A $40.0 million deficit for the stub fiscal year ended 6/30/2018 is a really **big** deficit.

. We fix this "Accounting" problem by borrowing $40 million.

. Borrowed funds received during the fiscal year ended 6/30/2018 will count as revenue for that year.

. The "Synchronization Bond" will move fiscal year-ended 6/30/2018 into a balanced status.

Synchronization Bond to the Rescue

Hypothetical Financials – Synchronized 6/30/2018 Year-end (9 months) with $40 Million Synchronization Bond

Beg Year Synch Surplus 11/01/2017	$11,000,000
Revenues for 10/1 – 6/30	45,000,000
Revenues Collected in June/July	0
(now in fiscal year starting 7/01/2018)	
Expenditures (11/1 – 6/30)	(96,000,000)
Bond Proceeds	40,000,000
Ending 6/30/2018 F/S	0

Bond Givith – Bond Takith

- The Synchronization Bond has to be paid back, interest and principal.
- Municipal Accounting rules mandate that repayment of debt be recorded as an expenditure in the year paid.
- Every year for the life of the bond, EP will have to cover the entire amount of debt repayment through its annual budget.

- The Synchronization Bond can be paid back in as little as 10 years, or as many as 20 years.
- The term of the bond will determine how much EP will have to allocate in its budget for annual bond repayment.

How Can Synchronization Be Funded?

Highest Bond Payment Amount (10 years) $5,207

Allocate & Maintain Current "Synchronization" funding	$2,296
End Most of Early Pay Discount	1,300
Interest on Unused Bond Proceeds	200
Other (taxes)	1,411
Total	$5,207

Reasons not to Synchronize

. The annual cost to repay the bond over 10 years is high ($5.2 mm).

. The City will have little financial flexibility to fund other projects. It will be possible, but will require fiscal discipline.

. Annual bond repayment costs over a 15 year ($4.0 million) or a 20 year ($3.4 million) period, will give the City fewer year-to-year budget constraints, but will result in a higher cumulative interest burden ($10 mm vs. $18 mm vs. $27 mm) over the life of the bond. The longer EP pays off the bond, the more interest is involved.

. Synchronization essentially wipes out $40 mm of EP's existing debt capacity.

Reasons not to Synchronize

. In synchronization, the City requires a $40 million loan to balance its short-year, 6/30/2018 books. It does not, however, require $40 mm of cash. The projected near-term, annual cash shortfall/requirement will be $25mm to $30mm for a 6 – 7 month period of time.

. The City will have excess cash of $10 mm to $15 million at all times, and a full $40 mm of excess cash for 5 – 6 months.

. Depending on the length of the bond, and interest rates, the City will annually pay between $400K and $700K in interest for cash that it does not need.

Synchronization Does Have Fiscal Benefits After a Number of Years

In 13 Years Cumulative Synch Interest = TANs

20 YEAR COMPARISON OF INTEREST												
TANS INTEREST PROJECTIONS								SYNC BOND	DIFFERENCE			
YEAR		2% increase 2% TAN	Interest rates from Frist Southwest	COI	Interest + COI	ANNUAL TAN INTEREST		SYNC BOND INTEREST	YEARLY DIFFERENCE	TOTAL DIFFERENCE	FISCAL YEAR	YEAR #
2014	Actual	12,500,000	2.35%	17,800	121,858							
2014	Actual	12,500,000	2.35%	17,800	178,348	335,806					2014	
2015	Estimate	12,750,000	2.43%	17,800	128,526							
2015	Estimate	12,750,000	2.43%	17,800	188,108	352,234	3,398,534	692,737	(340,503)	(340,503)	2015	Yr 1
2016	Estimate	13,005,000	2.99%	17,800	161,308							
2016	Estimate	13,005,000	2.99%	17,800	236,087	432,996	5,204,750	1,060,905	(627,910)	(968,412)	2016	Yr 2
2017	Estimate	13,265,100	3.83%	17,800	210,758							
2017	Estimate	13,265,100	3.83%	17,800	308,461	554,819	5,207,000	1,061,364	(506,545)	(1,474,957)	2017	Yr 3
2018	Estimate	13,530,402	4.56%	17,800	255,948							
2018	Estimate	13,530,402	4.56%	17,800	374,599	666,146	5,205,750	1,061,109	(394,963)	(1,869,920)	2018	Yr 4
2019	Estimate	13,801,010	5.01%	17,800	286,830							
2019	Estimate	13,801,010	5.01%	17,800	419,797	742,227	5,205,750	1,061,109	(318,882)	(2,188,802)	2019	Yr 5
2020	Estimate	14,077,030	5.33%	17,800	311,253							
2020	Estimate	14,077,030	5.33%	17,800	455,543	802,396	5,206,500	1,061,262	(258,866)	(2,447,669)	2020	Yr 6
2021	Estimate	14,358,571	5.52%	17,800	328,795							
2021	Estimate	14,358,571	5.52%	17,800	481,217	845,613	5,202,500	1,060,447	(214,834)	(2,662,503)	2021	Yr 7
2022	Estimate	14,645,742	5.57%	17,800	338,409							
2022	Estimate	14,645,742	5.57%	17,800	495,288	869,297	5,203,500	1,060,651	(191,354)	(2,853,856)	2022	Yr 8
2023	Estimate	14,938,657	5.82%	17,800	360,670							
2023	Estimate	14,938,657	5.82%	17,800	527,868	924,138	5,203,750	1,060,702	(136,563)	(2,990,420)	2023	Yr 9
2024	Estimate	15,237,430	5.96%	17,800	376,733							
2024	Estimate	15,237,430	5.96%	17,800	551,377	963,710	5,202,750	1,060,498	(96,788)	(3,087,207)	2024	Yr 10
2025	Estimate	15,542,179	6.01%	17,800	387,491							
2025	Estimate	15,542,179	6.01%	17,800	567,123	990,214			990,214	(2,096,993)	2025	Yr 11
2026	Estimate	15,853,022	6.09%	17,800	400,502							
2026	Estimate	15,853,022	6.09%	17,800	586,166	1,022,268			1,022,268	(1,074,725)	2026	Yr 12
2027	Estimate	16,170,083	6.12%	17,800	410,525							
2027	Estimate	16,170,083	6.12%	17,800	600,834	1,046,959			1,046,959	(27,767)	2027	Yr 13

After 13 Years – EP Saves With Synchronization

20 YEAR COMPARISON OF INTEREST												
TANS INTEREST PROJECTIONS								SYNC BOND	DIFFERENCE			
YEAR		2% increase 2% TAN	Interest rates from Frist Southwest	COI	Interest + COI	ANNUAL TAN INTEREST		SYNC BOND INTEREST	YEARLY DIFFERENCE	TOTAL DIFFERENCE	FISCAL YEAR	YEAR #
2027	Estimate	16,170,083	6.12%	17,800	410,525							
2027	Estimate	16,170,083	6.12%	17,800	600,834	1,046,959			1,046,959	(27,767)	2027	Yr 13
2028	Estimate	16,493,485	6.23%	17,800	426,261							
2028	Estimate	16,493,485	6.23%	17,800	623,866	1,085,727			1,085,727	1,057,961	2028	Yr 14
2029	Estimate	16,823,354	6.20%	17,800	432,693							
2029	Estimate	16,823,354	6.20%	17,800	633,279	1,101,572			1,101,572	2,159,533	2029	Yr 15
2030	Estimate	17,159,821	6.16%	17,800	438,499							
2030	Estimate	17,159,821	6.16%	17,800	641,777	1,115,877			1,115,877	3,275,410	2030	Yr 16
2031	Estimate	17,503,018	6.20%	17,800	450,174							
2031	Estimate	17,503,018	6.20%	17,800	658,864	1,144,637			1,144,637	4,420,047	2031	Yr 17
2032	Estimate	17,853,078	6.24%	17,800	462,140							
2032	Estimate	17,853,078	6.24%	17,800	676,377	1,174,116			1,174,116	5,594,163	2032	Yr 18
2033	Estimate	18,210,140	6.25%	17,800	472,138							
2033	Estimate	18,210,140	6.25%	17,800	691,010	1,198,748			1,198,748	6,792,911	2033	Yr 19
2034	Estimate	18,574,342	6.18%	17,800	476,187							
2034	Estimate	18,574,342	6.18%	17,800	696,936	1,208,723			1,208,723	8,001,634	2034	Yr 20
						18,242,418		10,240,784	8,001,634	8,001,634		
							50,240,784					

What if You Do Not Synchronize?

- Remember you will always need TANS, so you need a willing lender.
- No ongoing deficits for the City or the School.
- Pay all bills on time.
- Maintain “Rainy Day” fund.
- Keep some unrestricted surplus for flexibility.
- Do not over-extend on long-term debt – have adequate debt capacity to meet future needs. Do not end up “tapped-out” on the ability to borrow.
- Make sure your bond ratings remain strong.
- Stay under the tax cap.

What Can Come to the Rescue of a Missed Revenue Budget?

- EP now has an approx. $11.0 mm “Rainy Day Fund”.
- Missed revenue budgets due to timing of collections from having to deal with a non-synchronized year would be an acceptable reason to utilize it.
- The “Rainy Day Fund” can help resolve an annual deficit due to tax collection shortfalls, state funding shortfalls, and dramatic increases to healthcare (which has a 6/30 year-end).
- Synchronization may not be as crucial now as it was before the “Rainy Day Fund”.