



# **A Comprehensive Review of Financial Policies: A Status Update #3 and Select Recommendations**

**Town Council Meeting**

**November 1, 2023**

# Prior and Upcoming Discussions

## 1. February 26, 2022

- Introduced Idea of Comprehensive Review

## 2. September 21, 2022

- Status Update #1

## 3. February 25, 2023

- Status Update #2

## 4. November 1, 2023

- Status Update #3
- Discuss Select Recommendations

## 5. February 24, 2024 (Strategic Planning Session)

- Status Update #4
- Finalize Select Recommendations



# Why Now?



- We Make Decisions Based on Long-Term Planning
- Financial Policies Are the Foundation of Long-Term Planning
- The Financial Complexity of the Town is Increasing as the Town Grows and Matures
- Our Financial Acumen Must Grow Accordingly
  - “What Does our Financial Future Look Like?”
- Maintain and Protect Our ‘AA+’ Bond Rating
- Allocating Financial Resources is Becoming More of a Challenge (Prioritizing Competing Interests)

# Competing Interests

Existing Service Levels

Cost Increases to Existing Service Levels

Service Level Increases

Construction of New Infrastructure

Debt Management

Replacement of Infrastructure

Reserves

# 'AA+' Bond Ratings

## 1. Revenues

- Continued Strong Revenue Growth
- Growing and Diverse Revenue Base
- Continued Strong Population Growth and Employment Gains Expected
- Maturing Bedroom Community with Increasing Commercial and Industrial Sectors
- Resilience Expected through Economic Cycles
- Infrastructure Plans Bode Well for Continued Economic Expansion
- Strong Arizona Economy and Connectivity to Phoenix-Metro Area



# 'AA+' Bond Ratings (continued)

## 2. Expenses / Long-Term Liabilities

- Pension Reserves Eliminate Unfunded Liabilities
- Manageable Pension Expenses
- Long-Term Liabilities Expected to Remain High but Manageable
- Adequate Debt to Pledge Revenue Coverage Ratio
- Debt Relates to Growth-Related Infrastructure Needs



# 'AA+' Bond Ratings (concluded)

## 3. Reserves

- Increasing Reserves
- Funded Pensions

## 4. Management

- Very Strong Financial Management Policies and Practices
- Favorable Budget to Actual Performance Results Historically



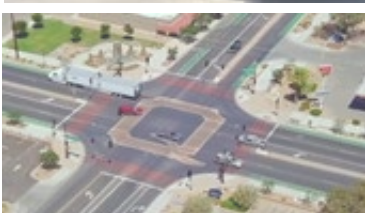
# Priority Financial Goals

1

- Maintain 'AA+' Bond Rating / Achieve 'AAA' Bond Rating (General Government)

2

- Receive Utility Bond Rating **by 2025** (Water and Wastewater)





# Immediate Objectives



## 1. Address General Government Infrastructure Needs

- Funding for \$265M of New Infrastructure (Police, Fire, Transportation, and Parks Land Acquisition)
- Impact Fee Update

## 2. Address Water and Wastewater Infrastructure Needs

- Permanent Infrastructure Financing by June, 2025
  - \$85M Interim Financing Expires
- Water Supply Acquisition (TBD)
- LGES Water Supply and Wastewater Treatment (TBD)
- Capacity Fee Update
- Rate Study Implementation

# Our Approach



1

- Review and Update Existing Policies

2

- Identify and Adopt New Policies

3

- Prioritize, Implement and Achieve Over Time

# Top Financial Goals

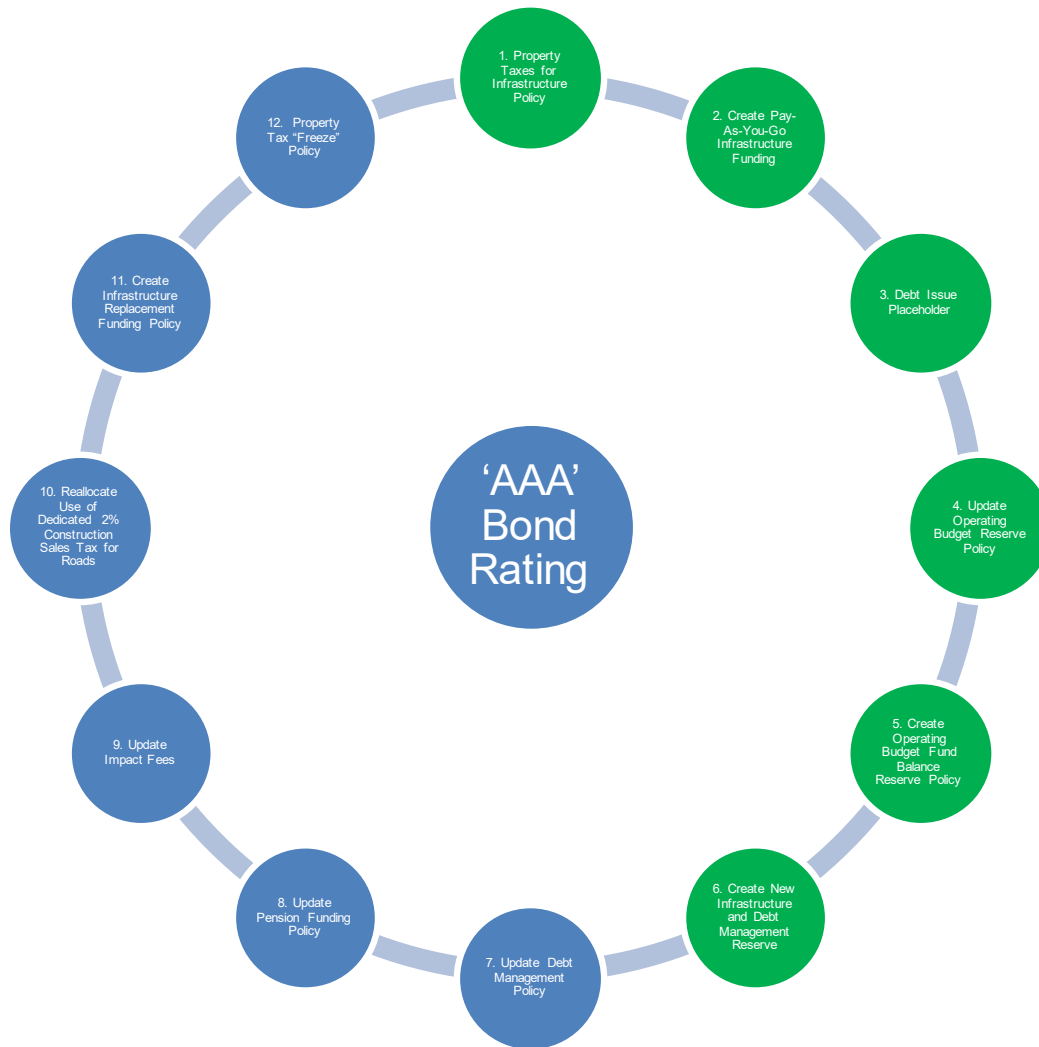
1

- Maintain 'AA+' Bond Rating / Achieve 'AAA' Bond Rating (General Government)

2

- Receive Utility Bond Rating by 2025 (Water and Wastewater)





# Achieve 'AAA' Bond Rating: Tonight's Recommendations

Goals and Policies	Recommendation / Result	Effective Date
<b><u>INCREASE FUNDING FOR INFRASTRUCTURE</u></b>		
1. Property Taxes for Infrastructure Policy	No Voter Approved Property Taxes for Infrastructure	FY 23-24
2. Create Pay-As-You-Go New Infrastructure Funding Policy	Annual Construction Sales Taxes In Excess of \$10M are Set Aside for New Infrastructure Costs 5-Year Cash Accumulation: \$18M	FY 23-24
3. Debt Issue Placeholder	Annual Placeholder in 5 <sup>th</sup> Year: \$7M Cash Accumulation: \$14M	FY 24-25
<b><u>SOLIDIFY / INCREASE RESERVES</u></b>		
4. Update Operating Budget Reserve Policy	Increase by \$16M (One Year's Debt Service)	TBD
5. Create Operating Budget Fund Balance Reserve Policy	Set at a Minimum of 100% of Recurring Expenses	FY 23-24
6. Create New Infrastructure and Debt Management Reserve	5-Year Cash Accumulation: \$32M	FY 23-24

# Achieve 'AAA' Bond Rating: Tonight's Recommendations

Goals and Policies	Recommendation / Result	Effective Date
<b><u>INCREASE FUNDING FOR INFRASTRUCTURE</u></b>		
1. Property Taxes for Infrastructure Policy	No Voter Approved Property Taxes for Infrastructure	FY 23-24
2. Create Pay-As-You-Go New Infrastructure Funding Policy	Annual Construction Sales Taxes In Excess of \$10M are Set Aside for New Infrastructure Costs 5-Year Cash Accumulation: \$18M	FY 23-24
3. Debt Issue Placeholder	Annual Placeholder in 5 <sup>th</sup> Year: \$7M Cash Accumulation: \$14M	FY 24-25
<b><u>SOLIDIFY / INCREASE RESERVES</u></b>		
4. Update Operating Budget Reserve Policy	Increase by \$16M (One Year's Debt Service)	TBD
5. Create Operating Budget Fund Balance Reserve Policy	Set at a Minimum of 100% of Recurring Expenses	FY 23-24
6. Create New Infrastructure and Debt Management Reserve	5-Year Cash Accumulation: \$32M	FY 23-24

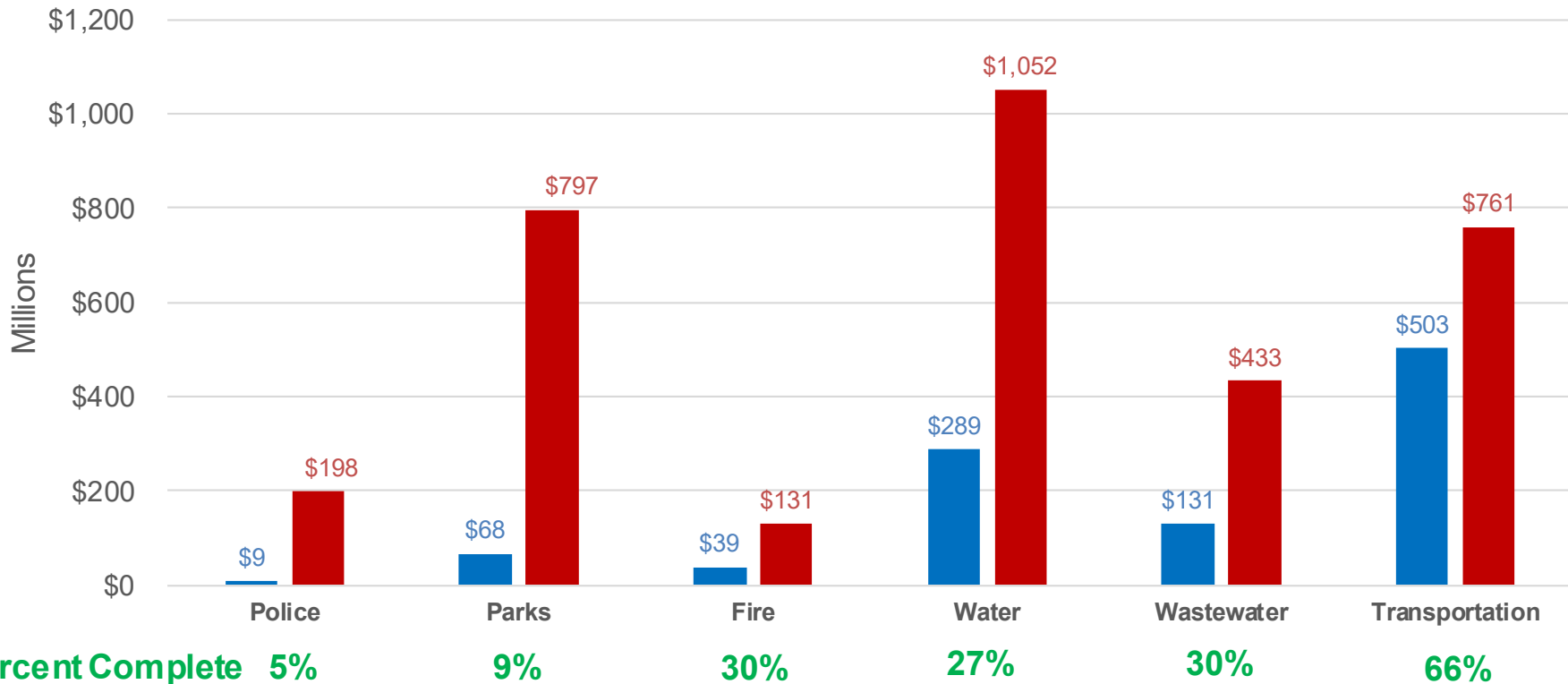
# Overview: Infrastructure

- Our Infrastructure is About 1/3 Complete of the Buildout Estimate
- Another \$2+B Remains to be Built
- Possible Sources to Pay for Infrastructure:
  - Reserves
  - Pay-As-You-Go Funding
  - Impact and Capacity Fees
  - 2% Dedicated Sales Tax for New Roads
  - Town Council Issued Debt
  - Voter Approved Property Taxes



# “Building a Town”

## Today’s Valuation (\$1B) vs. Buildout (\$3.3B)\*



\*Best Estimate Available



# New Infrastructure Estimate: \$2.3B\*



	Years 1 - 5	Thereafter	Total
Police	\$108M	\$81M	\$189M
Fire	\$38M	\$54M	\$92M
Transportation	\$258M	Pending Master Plan Update	\$258M
Parks	\$217M	\$512M	\$729M
Water	\$320M	\$443M	\$763M
Wastewater	<u>\$111M</u>	<u>\$191M</u>	<u>\$302M</u>
<b>Total</b>	<b>\$1.1B</b>	<b>\$1.3B</b>	<b>\$2.3B</b>

\*Best Estimate Available

# 1. No Property Taxes for Infrastructure Policy



## Purpose (New Policy)

- Communicates the Town Council's Position on Assessing a Property Tax to Pay for Infrastructure (Secondary Property Tax)

# 1. No Property Taxes for Infrastructure Policy

(continued)

## Background

- Known as a “Secondary Property Tax”
- Voters Approve Assessing Property Taxes for Infrastructure (New or Replacement)
  - Police, Fire, Roads, Parks and Recreation Facilities, All Other General Government Buildings
- Property Taxes are Levied Annually Equal to the Annual Debt Service Cost
- Property Taxes and Debt Costs Occur Outside the Operating Budget
  - General Taxes and Fees are **NOT Used to Pay the Debt**
- Most Cities and Towns in Metro Phoenix Have a Secondary Property Tax – QC Does Not



# 1. No Property Taxes for Infrastructure Policy

(continued)

## RECOMMENDATION

- The Town will Not Assess a Secondary Property Tax to Pay for Infrastructure
- Effective Date: FY 23-24 Budget

## Result of Recommendation

- Operating Budget Revenues to be Used to Partially Pay to Build and Replace Infrastructure
- Increases the Intensity of Competing Resources Within the Operating Budget
- Removes Voters from Infrastructure and Funding Decisions



# 1. No Property Taxes for Infrastructure Policy

(continued)

## An Example: If QC Had a Secondary Property Tax

- The Schedule Below Compares QC's Existing Primary Property Tax to a Secondary Property Tax Example

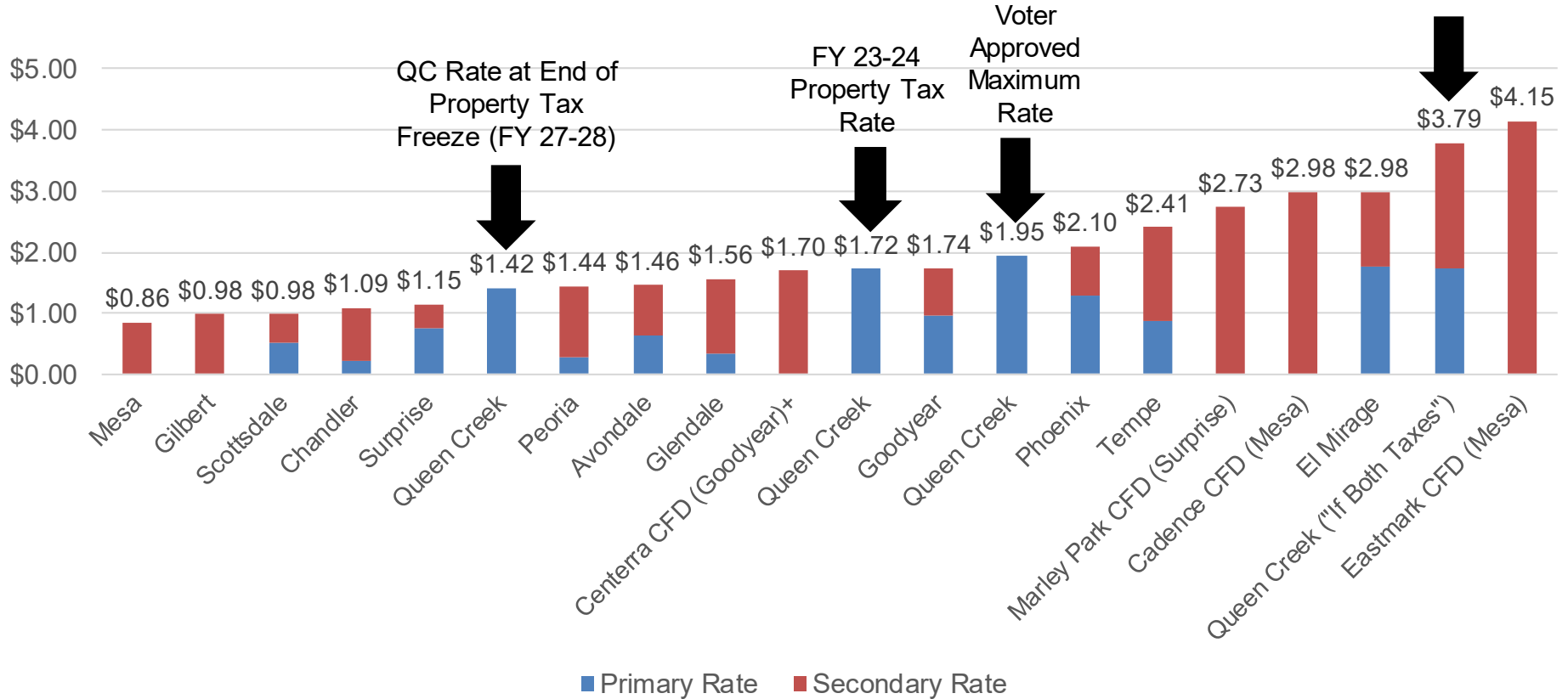
	Primary	Secondary	Total
Property Taxes	\$13.3M	\$16.0M*	\$29.3M
Property Tax Levy Rate (per \$100 of Assessed Valuation)	\$1.72	\$2.07	\$3.79
Property Tax per Median Value Home (\$256K)	\$441	\$531	\$972

\*Amount currently paid from Operating Budget.



# FY 23-24 Property Tax Comparisons

"If Both Taxes"



## 2. Pay-As-You-Go Infrastructure Funding

### Purpose (New Policy)

- Use a Portion of the Operating Budget's 2% Construction Sales Tax for Infrastructure Funding
- Prevents an Unsustainable Amount of One-Time Construction Sales Taxes from Being Used for Ongoing Operating Expenses
  - Potential Issue Given the Significant, Recent Growth of Construction Activity
- Reduces the Amount of Future Debt Issued for Infrastructure
- Helps Meet Debt Management Policy Objectives



Purpose	Sales Tax Rate
Operating Budget	2.0%
Police and Fire	0.25%
Construction Sales Tax for New Roads	<u>2.0%</u>
Total Tax Rate on Construction Activity	4.25%

## 2. Pay-As-You-Go Infrastructure Funding (continued)

### RECOMMENDATION

- Annual Cap of \$10M to Operating Budget, Excess to New Infrastructure and Debt Management Reserve
- Effective Date: FY 23-24 Budget
  - FY 23-24 Example: \$17M Annual Construction Sales Tax
    - Operating Budget: \$10M
    - New Infrastructure and Debt Management Reserve: \$7M

### EXPECTED RESULTS

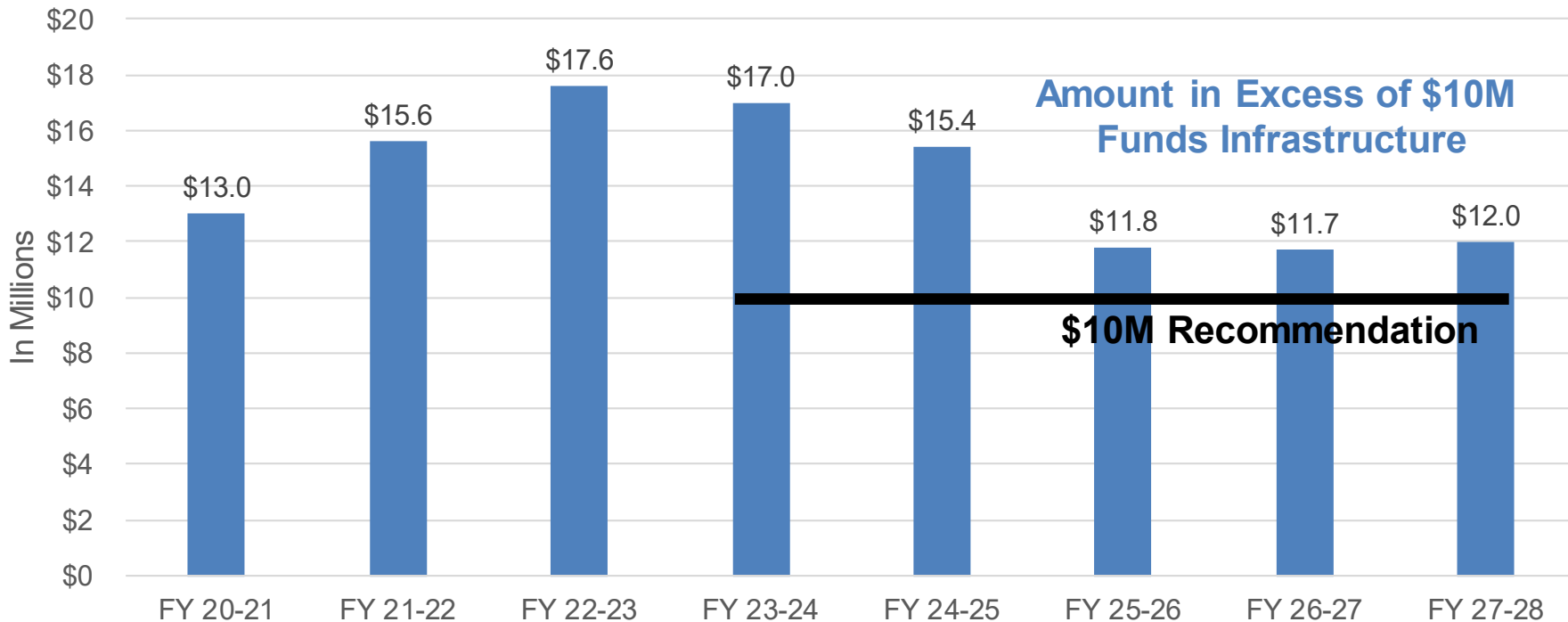
- Cash Accumulated After 5 Years: \$18M





## 2. Pay-As-You-Go Infrastructure Funding (concluded)

### 2% Construction Sales Taxes



### 3. Debt Issue Placeholder

#### Purpose (New Policy)

- Creates Expense Capacity in the Operating Budget for a Future Debt Issue
- Encourages Annual Prioritization Discussion About Operating Budget Expense Increases vs. Infrastructure Needs
- Eliminates the Full, New Debt Service Expense Increase in the Year the Bonds are Issued
- Accumulates Cash to Reduce the Amount of that Future Bond Issue



### 3. Debt Issue Placeholder (concluded)

## How is the Annual Amount Determined?

EXAMPLE	
Amount Needed in 5 Years	\$100M
Annual Debt Service (Placeholder Goal)	\$7M
Time Period to Achieve Placeholder	5 Years
Annual Placeholder Increase	\$1.4M
Accumulated Amount after 4 Years	\$14M



# Achieve 'AAA' Bond Rating

## Tonight's Recommendations

Goals and Policies	Recommendation / Result	Effective Date
<b><u>INCREASE FUNDING FOR INFRASTRUCTURE</u></b>		
1. Property Taxes for Infrastructure Policy	No Voter Approved Property Taxes for Infrastructure	FY 23-24
2. Create Pay-As-You-Go New Infrastructure Funding Policy	Annual Construction Sales Taxes In Excess of \$10M are Set Aside for New Infrastructure Costs 5-Year Cash Accumulation: \$18M	FY 23-24
3. Debt Issue Placeholder	Annual Placeholder in 5 <sup>th</sup> Year: \$7M Cash Accumulation: \$14M	FY 24-25
<b><u>SOLIDIFY / INCREASE RESERVES</u></b>		
4. Update Operating Budget Reserve Policy	Increase by \$16M (One Year's Debt Service)	TBD
5. Create Operating Budget Fund Balance Reserve Policy	Set at a Minimum of 100% of Recurring Expenses	FY 23-24
6. Create New Infrastructure and Debt Management Reserve	5-Year Cash Accumulation: \$32M	FY 23-24

# Operating Budget Fund Balance Defined

- Total Year-End Cash Balance
- Consists of 3 Components:
  1. Legally Restricted (State Law and Bond Documents)
    - Example: Unspent Gas Tax, Remaining Balances on Active Contracts
  2. Restricted by Town Council Policy
    - 25% Revenue Reserve, Pension Reserves
  3. Unrestricted (Available)



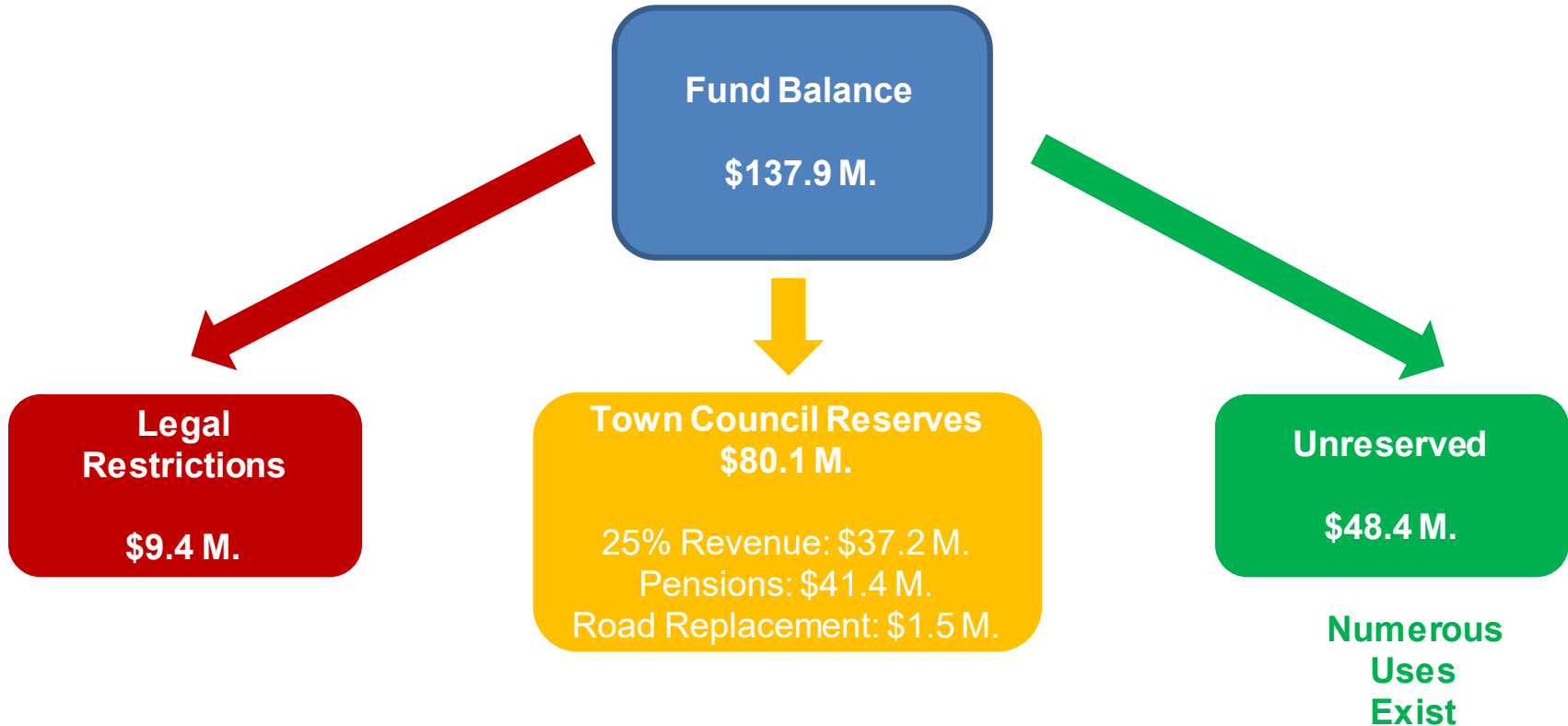
# Operating Fund Balance

## Role in Bond Ratings

- A Measurable Factor in a Bond Rating
- Rating Agencies Like High Fund Balances (for a Minimum of 3 years)
- Larger Reserves Have an Opportunity Cost
- Annual Discussion re. Balance Amount and Use Occurs During the Budget Development Process



# Operating Fund Balance: \$137.9M (June 30, 2023)



# 4. Operating Budget Reserve Policy

## Policy Elements

1. Why Have a Reserve?
2. What Should the Amount of the Reserve Be?
3. How is the Reserve Funded?
4. What Can the Reserve be Used For?







## 4. Operating Budget Reserve Policy (continued)

### 1. Why Have a Reserve?

- Create “Time to Recover” from Unplanned or Unavoidable Expenses or Revenue Interruptions



### 2. What Should the Amount of the Reserve Be?

- Existing Policy: \$37.2M
  - 25% of Next Fiscal Year’s Revenues



## RECOMMENDATION

- Increase by One Year’s Debt Service Payments (from Unreserved Fund Balance): +\$16M
- New Reserve Amount: \$53.2M
- Effective Date: TBD



## 4. Operating Budget Reserve Policy (continued)



### 3. How is the Reserve Funded?

- 25% of Next Year's Revenue Increase ("Taken Off the Top")
- Annual Debt Service Amount Remains Constant

### 4. When is the Reserve Used?

- Town Council Approval Required to Use
- Town Council Approved Plan to Replenish at the Time the Reserve is Used

# 5. Operating Budget Fund Balance Policy (Liquidity Ratio)

## Purpose (New Policy)

- Measures Resources Available to Pay for Operating Budget “Recurring Expenses”
- Used by the Bond Rating Agencies

## Liquidity Ratio Calculation

- Recurring Expenses Divided by Operating Budget Fund Balance
- Recurring Expenses are Operating Budget Expenses Excluding Capital Outlay, CIP Pay-As-You Go, Contingency and Funding of Reserves



# 5. Operating Budget Fund Balance Policy (Liquidity Ratio) (continued)

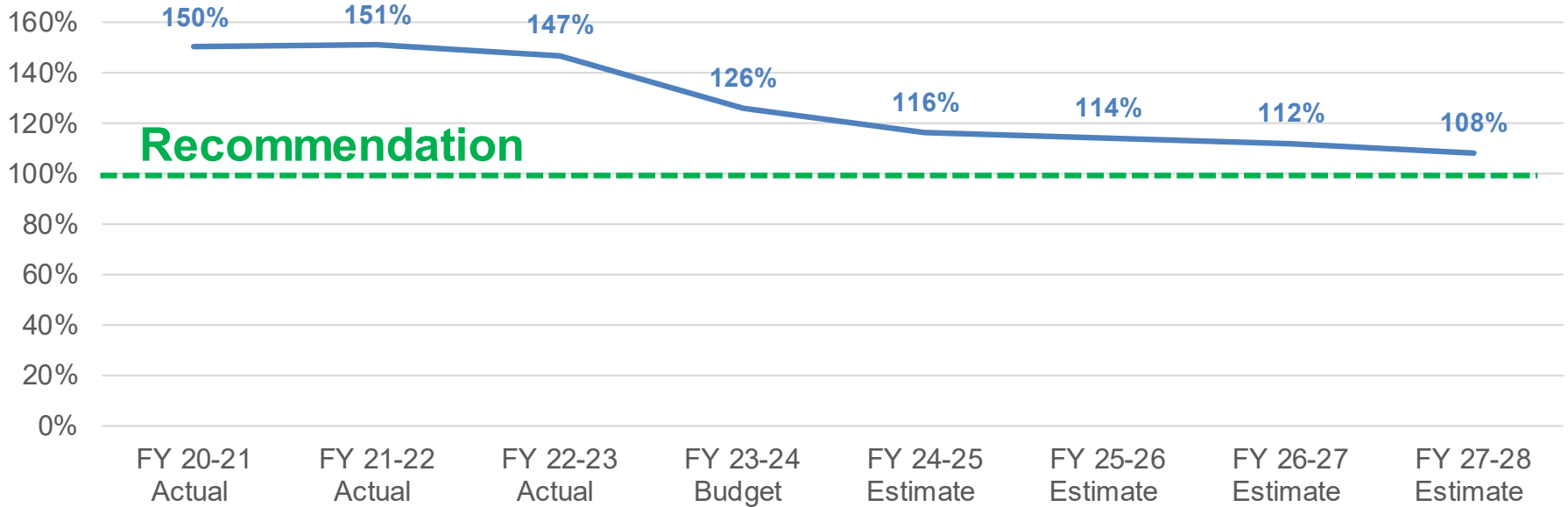
## RECOMMENDATION

- Fund Balance Should be at least 100% of Operating Budget Recurring Expenses for the Next 5 Years
- Effective Date: FY 23-24 Budget
- Will Limit the Amount of Unreserved Fund Balance that Can be Programmed for Expenses



# Operating Budget Fund Balance Liquidity Ratio

(concluded)



	FY 20-21	FY 21-22	FY 22-23	FY 23-24	FY 24-25	FY 25-26	FY 26-27	FY 27-28
Recurring Expenses	\$61.6 M	\$75.4M	\$93.6M	\$122.9M	\$137.1M	\$145.9M	\$155.0M	\$165.5M
Fund Balance	\$92.4M	\$114.1M	\$137.9M	\$154.6M	\$159.7M	\$166.0M	\$173.7M	\$179.3M
Liquidity Ratio	150%	151%	147%	126%	116%	114%	112%	108%

# 6. New Infrastructure and Debt Management Reserve

## Purpose (New Policy)

- Accumulate Cash in the Operating Budget to:
  1. Cash Fund a Portion of New Infrastructure
  2. Payoff Existing Debt
- Reduce the Amount of Future Debt Paid from Operating Budget
- Helps to Achieve Debt Management Policy Objectives
- Reviewed Annually During the Budget Development Process
- Town Council Approval Required to Use It

## RECOMMENDATION

- Effective Date: FY 23-24



## 6. New Infrastructure and Debt Management Reserve (concluded)

### How is the Reserve Funded?

- Funding Occurs from 2 Sources

	In 5 Years
1. Pay-As-You-Go New Infrastructure Funding	\$18M
2. Debt Issue Placeholder	<u>\$14M</u>
<b>Total Reserve Balance</b>	<b>\$32M</b>



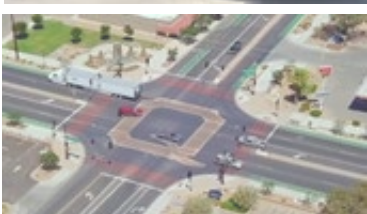
# Pulling It All Together: An Example



<b>\$200M New Infrastructure in 5 Years</b>	
Impact Fees (Assumption)	\$68M
New Infrastructure and Debt Management Reserve	\$18M (PAYGO) \$14M (Debt Placeholder)
Amount of Debt Issue	<u>\$100M*</u>
<b>New Infrastructure</b>	<b>\$200M</b>

\*\$7M Annual Cost Funded via Placeholder in 5<sup>th</sup> Year





# Debt Management Policy

# Debt Management Policy

- Debt is Only Used to Build Infrastructure
- Debt Accomplishes the Financial Objective of Spreading the Cost of Infrastructure over Multiple Generations of Taxpayers (Intergenerational Equity)
  - Public Finance is Different from Personal Finance
- Two Types of Debt
  1. General Government
  2. Water / Wastewater
- Debt is Paid Using Numerous Sources
  - Impact and Capacity Fees, Operating Budget, 2% Sales Tax Dedication for Transportation, and Water and Wastewater Rates



# Debt Management Policy (continued)



Purpose	Outstanding Amount 6/30/23	Annual Payment
General Government*	\$300.6M	\$21.0M
Water and Wastewater	<u>\$302.8M</u>	<u>\$15.3M</u>
<b>Total</b>	<b>\$603.4M</b>	<b>\$36.3M</b>

\*Police, Fire, Roads, Parks and Recreation Facilities, Horseshoe Park, and Other Buildings Infrastructure.

# Debt Management Policy (continued)

- Our Infrastructure is About 1/3 Complete – Another \$2+B Remains to be Built
- Additional Debt Will be Required to Build the Necessary Infrastructure to Meet Future Demands
  - New Infrastructure (Years 1 - 5): \$265M
  - New Infrastructure (Years 6 – 10): \$200M
- Managing Debt has Become More Important and More Complicated as the Town Grows and Matures



# Debt Management Policy (continued)

## Existing Policy

- Includes Definitions (i.e. Types of Debt, etc.) but Does Not Include Metrics and Guidelines re. How Much Debt is Appropriate
- A Much More Robust Policy is Recommended



# Debt Management Policy (concluded)

## RECOMMENDATION

- Update with “Best Practices”
- Focus on Ability to Pay and Affordability Metrics
- Include Bond Rating Agency Financial Metrics
- Develop Financial Metrics that are Appropriate and Unique to QC
  - QC Does Not Have a Secondary Property Tax
- Include an Investor Relations Program
- Improve Financial Disclosure
  - Annual Debt Report



# Top Financial Goals

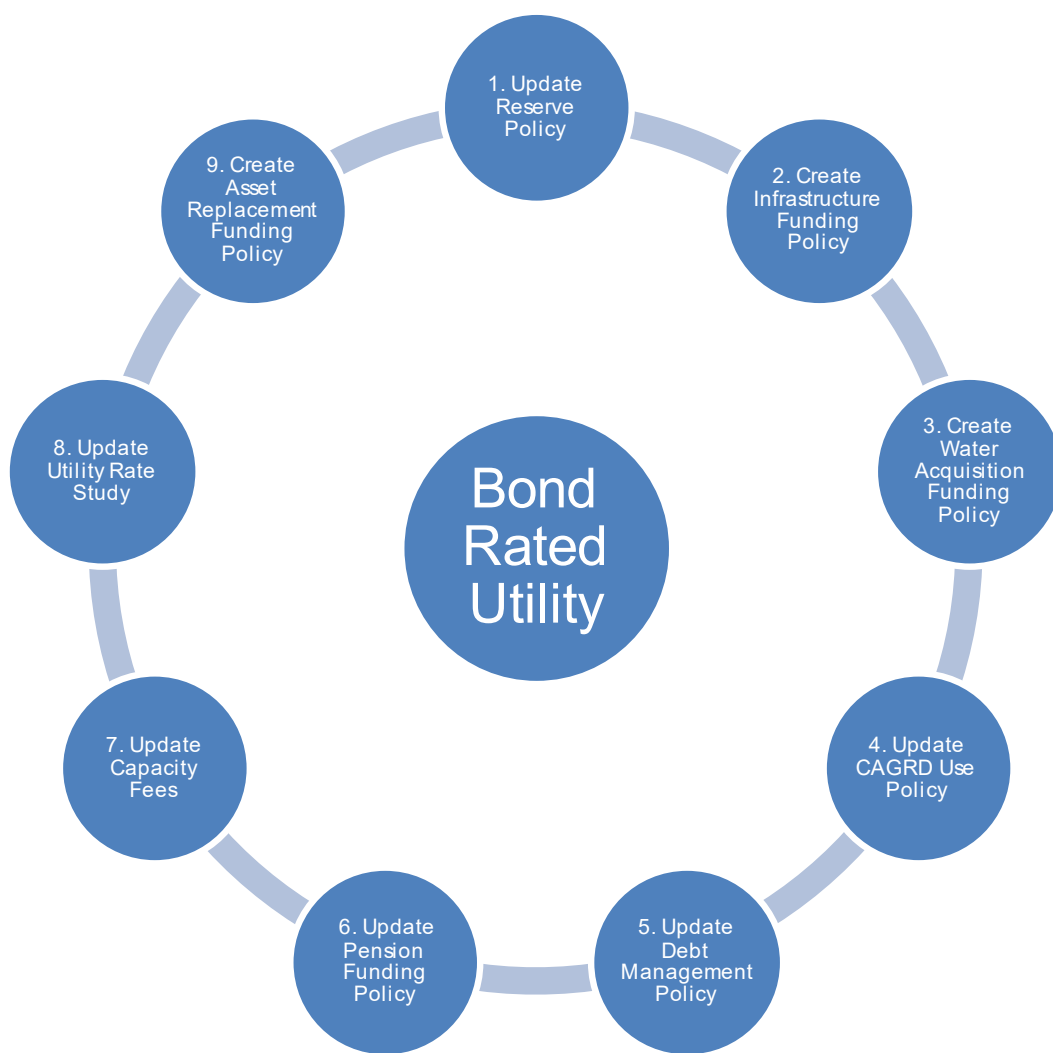


1

- Maintain 'AA+' Bond Rating / Achieve 'AAA' Bond Rating (General Government)

2

- Receive Utility Bond Rating **by 2025** (Water and Wastewater)







# Reaction, Questions, and Discussion