

James F. Gilley

From: James F Gilley, Jr
Sent: Wednesday, December 6, 2017 5:17 PM
To: Amber Lewis
Cc: Gavin Massingill; Roxanne McKee; financdept@cityofrollingwood.com; Jim Gilley; David Holland
Subject: RE: Budget Review Policy
Attachments: S&P Rating Report Final_2 26 15.pdf; S&P Credit Estimator - City of Rollingwood (12-6-17).pdf

Amber,

I apologize for my delayed response. After reviewing the Budget Review Policy I would say it is a very well-written policy and certainly might provide a benefit to the City to adopt such a policy. One consideration with respect to Section IV is that, in the course of the City conducting a quarterly Budget Review, a discrepancy might be revealed that needs to be addressed. If, for example, YTD revenues or expenditures are not tracking as originally budgeted, the City may need to consider a Budget Amendment. In that case you may consider adding language to Section IV to the effect of: "If, in the course of a Quarterly Budget Review, it is determined that the Original Budget, as adopted, may require revision in order to maintain balanced operations, such revisions will be subject to the regular Budget Amendment process as set forth in Section III of the Budget Management and Review Policy". Furthermore, you might consider adding language to Section IV that permits the City, as needed and at the discretion of the Administrator, Mayor, or Council, to require an official 'special' Budget Review at a time other than the mandatory quarterly review date.

You might also consider adding language that describes the method by which the City develops revenue and expenditures assumptions (e.g. 3 year historical review and 3 year future forecasting). One final thought on the Budget Policy relates to the last sentence of Section I, Introduction. You might consider adding language to the effect of: "to meet the City's Mission and Strategic plan, notwithstanding that the City's reserves shall be maintained in accordance with the City's Official Reserve Policy, as adopted."

With respect to your question about whether the City could ever attain a 'AAA' rating, it is a difficult question to answer directly. As we have previously discussed in the last rating report (attached) issued by Standard & Poor's, the rating agency highlighted the following factors as the City's greatest strengths (bulleted on page 2 of the attached report):

- Very strong economy (the City participates in and benefits from the robust Austin-area economy)
- Very strong budgetary flexibility (available fund balance as a % of expenditures)
- Very strong liquidity (available cash as a % of expenditures)
- Strong budgetary performance (revenues over expenditures as a % of expenditures)
- Strong institutional framework (governmental statutes regulating the City's ability to raise revenues)

Two factors that were not listed as "strong" or "very strong" were the City's management practices (adequate) and the City's debt and contingent liability position (very weak). Management practices are those items that we have previously discussed and some of which you are currently working to improve: formal reserve policy, practices for developing budget, formal budget policy, formal long-term financial plan (a subset of which is a long-term capital improvement plan), and a formal debt management policy.

The second attachment ("S&P Credit Estimator") is a tool S&P provides to run scenarios on possible credit ratings. I've entered in various metrics relating to the City's finances in this "credit calculator" and the attachment is the resulting summary page. The seven factors shown are the same seven factors highlighted above and these are the

factors S&P reviews to quantitatively arrive at a rating. In their modelling, a score of “1” represents the highest and best credit factor while a “5” represents the lowest or worst credit factor. The left side of the page lists the % Weight S&P assigns to each category (as you can see, the Economy is the most significant factor at 30% weight).

By working to develop and formally adopt the policies we have been discussing over the past several months, you are taking steps to improve the Management Practices factor in the eyes of S&P. Furthermore by striving for balanced financial operations, this would also help to improve the City’s “score” within the Budgetary Performance category. Improving these scores could allow the City to improve its rating, subject to any additional positive or negative considerations made by S&P. The weakest factor of Debt & Contingent Liability takes into account the net debt (or debt attributable to governmental activities) in addition to contingent liabilities such as the City’s pension fund. Based on interfund transfers cited in the City’s 2016 audit, it appears as though the governmental funds are supporting a portion of debt attributable to the water and sewer system (although I could very well be misreading these transfers and would certainly like clarification if I am incorrect). This may contribute to the ‘weak’ assessment by S&P.

It could be possible for the City to attain a ‘AAA’ rating, however I would strongly emphasize that I cannot say that with any certainty. Often times rating agencies will “cap” the rating of smaller issuers, such as Rollingwood, due to resources that are limited in comparison with larger issuers. Furthermore it is difficult to have rating agencies explain how an issuer might improve their rating since they are reluctant to provide any information that could be construed as coaching. We can, however, infer from their rating methodologies which certain practices might improve the issuer’s credit in their eyes.

This is a large amount of information to take in and it is certainly a challenge to relate via email. I would be happy to go over this with you in person, and I think it might even be helpful for us to work through this ‘rating estimator’ together. If we are able to set up a meeting in the next few weeks as proposed, perhaps we can take some time before or after to go over this in more detail.

I hope this helps. Please feel free to call with any questions.

Thank you,
James

James Gilley, Jr.
U.S. Capital Advisors LLC
300 W 6th St, Suite 1900
Austin, TX 78701
Direct 512.813.1110
Internal Extension 110
Toll Free 888.635.USCA
Cell 713.516.8804
Fax 512.605.3848
www.uscallc.com

From: Amber Lewis [mailto:administrator@cityofrollingwood.com]
Sent: Monday, December 04, 2017 2:19 PM
To: James F Gilley, Jr <jfgilley@uscallc.com>; Jim Gilley <jgilley@uscallc.com>
Cc: Gavin Massingill <gavinmassingill@cityofrollingwood.com>; Roxanne McKee <mayormckee@cityofrollingwood.com>; financedept@cityofrollingwood.com
Subject: Budget Review Policy

Hi James and Jim,

Attached is a draft of the budget review policy. I wasn't able to locate a police that was already written, so here's what I came up with. Will you please let me know if this process will meet with S&P ratings expectations to increase our rating? Is Rollingwood too small to ever get to AAA?

Thanks!

Amber



Amber Lewis

City Administrator,
City of Rollingwood
403 Nixon Drive
Rollingwood, Texas 78746

administrator@cityofrollingwood.com

Office 512-327-1838

Fax 512-327-1869

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