



Lehi City 2020-2021 Fiscal Year Budget

Strategies and Tools for Weathering the COVID-19 Storm

In light of these uncertain times due to the COVID-19 pandemic, it is extremely important for Lehi City to budget in a way the city can adjust and react to changing conditions. Below is a summary of tools available to address financial stress as it may occur in the upcoming year. Following this summary is a detailed analysis of the general fund as well as the City's utility funds.

➤ **General Fund Reserves**

One way to deal with revenue shortfalls is through the use of reserves. Lehi has built healthy reserves during the recently strong economic times. These reserves could be called upon if needed to get through temporary declines in tax revenue.

Unassigned Fund Balance/Rainy Day Fund - **\$10.6 million**

Capital Project Reserves - **\$5.0 million**

➤ **Conservative Budgeting Practices**

The City has traditionally budgeted very conservatively when forecasting revenues. This strategy has generally led to surpluses, which are then used for capital projects. Since the City typically has revenue surpluses, a decline in revenues will not be as pronounced as it otherwise would.

➤ **Budget Implementation**

As actual data becomes available, Lehi could maintain flexibility and react to changing conditions by implementing new budgeted spending incrementally, rather than all on July 1, 2020.

➤ **Utility Funds**

Utility fund revenues are not as vulnerable to economic downturns as tax revenues. The ratios in the table below show overall strength and stability in our utilities and are manifest in strong bond ratings.

Lehi City Utility Fund Financial Ratios

	Culinary	Sewer	PI	Power	Drainage	Water Combined
Debt Service Coverage	12.85	N/A	0.49	3.62	2.20	3.11
Days Expenditures in Cash	1,088	310	50	245	1,207	552
Total Debt / Revenues	0.59	N/A	3.91	0.45	0.89	1.79

To Lehi City residents, employees, and elected officials:

In what has become an unprecedented budget year, I offer some insight into how this budget was prepared and what contingencies are in place to brace up the City in these difficult economic times. Lehi City will exercise fiscal responsibility by closing monitoring revenues and making reasonable adjustments to the budget, as needed.

When this budget process started in February, there were no indications of the economic uncertainty that lay ahead. Revenue growth was anticipated to increase at consistent levels. Lehi has historically budgeted revenues conservatively. This philosophy allows for flexibility in difficult times. Since general fund activities and utilities have different funding and economic models, I will discuss these activities separately.

General Fund

Let's address general fund activities first. These activities are primarily funded through taxes. 71 percent of general fund revenue comes from taxes, and 80 percent of those taxes are sales tax and property tax. So, I'm going to focus my remarks on these two revenue streams.

As I mention previously, Lehi has historically been conservative on forecasting revenues. This year was no exception. We were significantly ahead of sales tax projections as of January 2020. I anticipate February to be another positive month. Although there are anticipated to be significant shortfalls from March through June, Lehi may be in a little better position than other cities since our largest sales tax payers tend to be in categories of household necessity items such as grocery and other basic needs as opposed to discretionary items such as clothing and hospitality. Make no mistake that we will still see a significant drop off, but it may not be as severe as some cities. With current projections, I could see a shortfall in sales tax revenue of \$60,000 for the current fiscal year.

At current budgeted sales tax levels for the upcoming fiscal year, I would anticipate significant reductions of retail sales in the first half of the fiscal year (Jul – Dec) with a moderate recovery during the last half of the year (Jan – Jun). At these rates, I could see Lehi missing its revenue by \$250,000. This shortfall would not be insignificant but is also not overwhelming.

Property taxes for the current fiscal period are largely already collected. We have exceeded the yearly budget in revenues by \$600,000, which I believe will far exceed any anticipated shortfall in sales tax. Looking forward to next year, realize property tax revenue collected in November of 2020 is based on growth which occurred during calendar year 2019. Therefore, our property tax levies are based on economic growth prior to the covid environment.

However, although property tax levies should see significant growth, collection rates could suffer. During the 2009 recession, collection rates fell from 95% to around 88% at the low point. If collection rates fall to this level again, Lehi could see a shortfall of \$100,000 to \$200,000 for the year. We will eventually collect the delinquent taxes, but it could be 2-3 years in the future.

So, with some realistic projections, we could see a revenue shortfall of \$300,000 - \$500,000 in the upcoming year, with the knowledge that much of that will be recouped in future years as delinquent property taxes are paid. I want to emphasize that no one knows the extent of the current economic difficulties. This could be a 3-6 month period with a quick rebound or a 1-2 year recession that will be slow in rebounding. I wouldn't trust anyone who says they know when the recovery will begin or how quickly it will rebound.

Lehi can weather revenue shortfalls through reserves and budgeting practices. The City's general fund reserves as of June 30, 2019 are \$10.6 million. Additionally, approximately \$5.0 million has been set aside for future building projects. These funds could be made available by putting off these projects by 1-2 years. A shortfall of \$500,000 could be easily managed by using these resources.

The other tool we have to combat revenue shortfalls is in budget implementation. The tentative budget has several new positions as well as employee pay increases. If necessary, we could delay hiring these new positions and implement pay increases in steps as economic data becomes available and we have a better grasp on our financial condition. Further steps could be to hold vacant positions open for a period of time, to save money.

A brief discussion on development revenues (primarily building permits and plan check fees) is warranted. A sustained slowdown in commercial and residential construction, could lead to severe revenue shortfalls. However, reductions in development revenues should result in some cost savings for the City as well.

In summary, I believe the City is in a strong position to weather this storm. We will continue to monitor economic data, as it becomes available and react to that data in order to keep the City's general fund in sound condition.

Utility Funds

Economic challenges for utility funds don't tend to be as severe for utility funds as they do for the general fund. During the 2009 recession, I did not see dramatic reductions in revenue or collection rates. What could be examined is the overall stability of the funds. The City's water revenue bonds have a strong Aa3 rating with Moody's Investor Services. Moody's recently issued an updated analysis of the City's water bonds, which affirmed this rating. In my analysis below, I will use three of Moody's metrics and ratios in analyzing utilities.

Days Expenditures in Cash – Measures how long the fund could pay expenditures using current cash reserves. $\text{Unrestricted Cash} / \text{Cash Operating Expenditures} * 365$

Debt Service Coverage – Measures a utility's ability to pay repay their annual debt payments. $(\text{Revenues} - \text{Cash Operating Expenditures}) / \text{Debt Payments}$

Debt to Operating Revenue – Compares a utility's total debt to annual revenues. $\text{Outstanding Debt} / \text{Annual Revenues}$

Culinary Water

Culinary water holds a strong cash position with 1,088 days expenditures in cash. This is a very strong number as compared to the US Median of 418 days. The City's reserve policy aims to have 180 days cash on hand, which I consider to be a sufficient amount. With debt service coverage of 12.85, the culinary fund generates sufficient revenues to pay for its annual debt payments. US median debt service coverage is 2.10. Culinary's debt to operating revenue comes in at a healthy .59, which indicates low debt levels compared to the US median of 1.8. In keeping with the rate study implemented two years ago culinary water rates will increase three percent on July 1.

Pressurized Irrigation (PI)

The numbers for the pressurized irrigation fund are not as strong as the culinary fund. In order to obtain the best possible bond rating and lowest possible interest rate, Lehi combined the culinary and pressurized irrigation funds when issuing the 2019 bonds, which were used for the construction of Dry Creek Reservoir as well as other storage and distribution projects. Therefore, I will give the ratios for the PI fund along with the numbers for both funds combined. Days cash on hand for the PI fund are on the low end at 50 days. However, when combined with the culinary fund, days cash on hand is a healthy 552 days. Debt service coverage is .49 for the PI fund alone and 3.11 for both funds combined. Pressurized irrigation fund debt to operating revenue is 3.91, while it totals 1.79 for both funds. These metrics for the PI fund will improve over time. But looking at both funds combined, the numbers are very solid. Pressurized irrigation rates are also set to increase by three percent on July 1.

Power

The power utility has very solid numbers in all areas. Number of days expenditures in cash is 245 days. Debt service coverage is 3.62 times and debt to operating revenues is a low .45. No change is anticipated in power rates.

Storm Drain

The storm drain fund also has solid numbers with 1,207 days operating expenditures in cash, a debt service coverage ratio of 2.20 and debt to operating revenues of .89. The storm drain fee, which is \$4.50 per residential unit, is set to increase to \$4.75 on July 1. Rates have been raised recently to cover the cost of street sweeping and federal compliance to ensure the storm water that flows into Utah Lake is not contaminated.

Sewer

The sewer fund has solid ratios but will likely operate at a deficit for the next year or two. This is primarily related to the rapid acceleration in cost for treatment. Lehi does not treat the sewage, this function is handled by Timpanogos Special Services District. These costs are paid by the City and passed along to its utility customers. The sewer fund has cash reserves of 310 days expenditures. The other ratios are not relevant since the sewer fund has no debt. The lack of debt in the sewer fund allows flexibility that would not otherwise be possible.