City of Petersburg, Virginia

A Financial Review
(City Council Briefing)

August 3, 2012

Prepared By
Davenport & Company LLC
Member NYSE • FINRA • SIPC

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Background

- Davenport & Company LLC was engaged to undertake a detailed Financial Review for the City of Petersburg (the "City") in order to assist the newly appointed City's Staff and Council Members in developing a new financial course for the City in FY 2013 and beyond.

- The Financial Review addresses, amongst other topics, the following:

A. With respect to the General Fund (Including Mass Transit and Golf Funds):

  - Historic Operating Trends (*i.e. Year to Year Financial Performance*);
  - Historic Undesignated Fund Balance and Uncommitted Cash Reserves;
  - Monthly Cash Flow and Revenue Anticipation Note Analysis;
  - Debt Portfolio Review, Capacity and Affordability Analysis;
  - City Peer Comparison of Key Debt and Fund Balance Ratios.

B. With respect to the Utility Fund:

  - Historic Operating Trends (*i.e. Year to Year Financial Performance*);
  - Debt Portfolio Review;
  - Development of a high level projection incorporating anticipated CIP needs; and
  - Evaluation of Future Revenue Adjustments based on Projected CIP needs.

Executive Summary

General Fund – Key Observations

1. ***Reliance on Tax Revenue Anticipation Notes (RAN):***

   - The City has historically relied on borrowing RANs in anticipation of receiving its tax collections because of the lack of timely revenue collection and inadequate Liquidity or Cash Reserves (i.e. Unassigned Fund Balance).

   - The City has used RANs for over a decade which is a further sign of insufficient Liquidity / Cash Reserve levels.

   - The practice of using RANs throughout each fiscal year is not considered a desirable situation for local governments.

   - An increasing reliance on RANs has a real cost to the City approximating $100,000 in today's interest rate environment. As interest rates increase from today's historic lows, this cost could more than triple.

   (See Davenport's Financial Review Dated July 9, 2012, Tab B, Page 10 and Tab C, Pages 34 - 35.)

Executive Summary

General Fund – Key Observations (cont)

2. *Unassigned Fund Balance Levels:*

- The City has essentially no Unassigned Fund Balance that can be considered Cash Reserves.
- As of FY 2011, the City has essentially a negative Cash Reserve level after discounting all of the receivables and Interfund Loans due from the Mass Transit, Golf and Utility funds.

FY	Undesignated / Unassigned Fund Balance(1)	Less: Due from Other Governments / Comp. Units	Less: Interfund Loans(1)	Cash Reserves (i.e. Liquidity)
2011	$6,522,487	**($7,934,587)**	$0	**($1,412,100)**
2010	15,403,526	**(7,391,158)**	**(7,434,105)**	578,263
2009	14,837,698	**(5,381,551)**	**(7,663,840)**	1,792,307
2008	11,935,096	**(9,793,654)**	**(5,341,648)**	**(3,200,206)**
2007	10,227,794	**(5,489,016)**	**(6,451,837)**	**(1,713,059)**
2006	10,447,674	**(4,251,707)**	**(4,775,247)**	1,420,720

(1) Note Beginning in FY 2011 Interfund loans are reported separately from Unassigned Fund Balance. In prior years Interfund loans were included in Undesignated Fund Balance.

- The City should have at least $9 million of true Unassigned Fund Balance (consisting of Cash Reserves not interfund /government receivables) in order to ***NOT*** rely on RAN cash flow borrowings. Based on the City's total General / School / Mass Transit / Golf fund budgets a $12 million level is consistent with "Best Practices".

. *(See Davenport's Financial Review Dated July 9, 2012, Tab B, Page 13.)*

General Fund – Key Observations (cont)

3. ***Historic "Non-Budgeted" Interfund Loan Practices:***
   - This budgetary practice has directly resulted in the need to borrow RANs on an annual basis and essentially led to the zero Unassigned Fund Balance as discussed in Key Observation #2.
   - Until the FY 2013 budget, the City has had a past practice of providing "non-Budgeted" Interfund loans from the General Fund to the Mass Transit, Utility and Golf Funds which have grown to approximately $9.1 million as of FY 2011.

     (See Davenport's Financial Review Dated July 9, 2012, Tab B, Page 14 and Tab C, Pages 30 - 33.)

4. ***Capital Improvement Plan:***
   - For all intents and purposes the City does not have a true Multi-year Capital Improvement Plan (CIP) that matches sources of revenues with planned capital expenditures.

Executive Summary

General Fund – Recommendations

5. ***Maintain Structurally Balanced Budgeting:***
   - The City has taken great strides in implementing a Structurally Balanced Budget with Fiscal Year 2013.
   - Continue to provide for Structurally Balanced Budgets for the General Fund. In the future, continue to include any General Fund operating support of the Mass Transit and Golf Funds within the General Fund budget.

6. ***"Clean Up" all Interfund Loans:***
   - Any Interfund loans that are not considered realizable should be removed from the balance sheet and fund balance.

7. ***Revisit Financial Policy Guidelines:***
   - Simultaneous with the City's development of a Strategic Plan, revisit all existing Financial Policy Guidelines and consider implementation of new Debt and Fund Balance Policies, amongst others.
   - Consider undertaking such review and implementation over the course of the next three to six months.

8. ***Budget Increases to Unassigned Fund Balance:***
   - Annual operating budgets should include additions to Unassigned Fund Balance until the City's desired target has been met.

Executive Summary

General Fund – Recommendations (cont)

9. Implement Strategic Financial Turnaround Plan for the General Fund:

- This strategy could provide a "jump start" in replenishing the City's Unassigned Fund Balance with approximately $4.2 million of "freed up" cash flow.
- Simultaneously with certain new money capital needs, consider a strategic restructuring of the City's 2004 and 2005A G.O. Bonds that may be accomplished either through a Direct Bank Loan or Virginia Resources Authority, which will generate the "freed up" cash flow.

(See Davenport's Financial Review Dated July 9, 2012, Tab B, Page 16.)

10. Use a 5-year Bond Anticipation Note (BAN) Plan of Finance for the estimated $10 million of new money needs:

- This approach minimizes the immediate debt service cash flow impact to the General Fund and could be implemented in one or two parts depending on the timing of the City's capital needs.
- Beginning in year six permanently refinancing the BAN on a long-term 20 year basis to take advantage of the natural decline in the City's debt service.

11. Re-establish Pro-Active Rating Agency Communication:

- With the new management team in place, formally re-establish official dialogue and communication with the National Credit Rating Agencies to discuss changes in the City's financial position (i.e. Unassigned Fund Balance) since the last review, which could potentially lead to a Negative Outlook or Downgrade by Standard & Poor's.

Utility Fund – Key Observations

12. Debt Levels:

- The Utility Fund has been overly reliant on Equity Funding its long-term capital improvement needs, which is underscored by the fact that the Utility Fund has only $1.48 million of allocated debt, all of which will be repaid in the next 5 fiscal years.
- Most utility funds operate with a combination of Equity and Long-term Debt Funding of their capital improvement needs. However, the City does not have the wherewithal to fund any of its anticipated $9 million in New Money capital needs with cash.

13. Cash Reserves:

- As of the 2011 Audit and similar to the General Fund, the City's Utility Fund has no Cash Reserves.
- For a self-supporting Utility this is a non-sustainable financial position.

14. Capital Improvement Plan:

- Like the General Fund, the City's Utility Fund does not have a formal Multi-year Capital Improvement Plan (CIP).

Executive Summary

Utility Fund – Recommendations

15. Borrow for Anticipated $9 million of New Money Capital Needs:

- The City should use Long-term Debt to fund the $9 million of New Money capital needs, which will:
  A. Enable the Utility to rebuild its Cash Reserves; and
  B. Allow for an orderly and planned rate adjustment for debt service (and operations/maintenance) over a three year period. Preliminary analysis indicates that after the projected rate adjustments (for debt service only), the City's rate structure will still remain competitive and in the bottom 25% of utility systems as compared in Draper Aden's 23rd Annual Virginia Water and Wastewater Rate Report 2011.

(See Davenport's Financial Review Dated July 9, 2012, Tab A, Pages 7 -8 and Tab C, Pages 38 - 43.)

16. Build up Utility Fund Cash Reserve Levels:

- Based on the size of the Utility Fund budget, a minimum of $1.16 million of Cash Reserves, which is approximately 45 days of operating expenditures, should be maintained independently of the General Fund's Unassigned Fund Balance

Utility Fund – Recommendations (cont)

17. Implement Strategic Restructuring of Certain General Obligation Bonds:

- This strategy could provide a "jump start" in replenishing the City's Utility Fund Cash Reserves and return $1.2 million of "freed up" cash flow to the Utility Fund over the next 5 years.
- Simultaneously with the strategic restructuring for the General Fund (See #9) that may be accomplished either through a direct bank loan or Virginia Resources Authority, restructure the Utility Fund portion to create cash flow relief.

(See Davenport's Financial Review Dated July 9, 2012, Tab B, Page 22.)

18. Consider a Formal Utility Fund Transfer Policy:

- Prior to the FY 2013 Budget, the Utility Fund transferred monies to the General Fund on an ad hoc basis.
- Building upon the new management team's progress in incorporating budgeted Utility Fund transfers to the General Fund with the FY 2013 Budget process, consider a more formalized Transfer Policy.

(See Davenport's Financial Review Dated July 9, 2012, Tab B, Pages 20 - 21 and Tab D, Page 44.)

Recommended Plan of Finance

- A Strategic Restructuring of the City's 2004 and 2005A G.O. Bonds that may be accomplished either through a Direct Bank Loan or Virginia Resources Authority, which will be used to "jump start" the replenishment of the City's Unassigned General Fund Balance and the Utility's Reserves.

- The 2005A Bond Issue is allocated to both the General Fund and the Utility Fund.
  - Approximately $2.4 million would be restructured with the resulting debt being repaid from FY 2019 through FY 2023.

- The 2004 Bond Issue is allocated to only the General Fund.
  - Approximately $1.7 million would be restructured with the resulting debt being repaid from FY 2019 through FY 2023.

- By restructuring the 2005A and 2004 Bonds ***AND*** maintaining the City's future debt service budgets at FY 2013 levels, the City will be able to save approximately $5.4 million of "freed up" cash flow by FY 2017.

- Simultaneously with the Strategic Restructuring, consider alternative 5-Year Bond Anticipation Notes for the estimated $10 million of General Fund new money needs in order to minimize the cash flow impact of the debt service.

- For the Utility Fund, consider alternative long-term (i.e. 20+ year) financing options for the estimated $9 million of new money FY 2013 – FY 2015 CIP Needs through Virginia Resources Authority's fall bond pool or subsidized DEQ programs, if available.

Strategic Restructuring – General Fund Impact

Key Assumptions

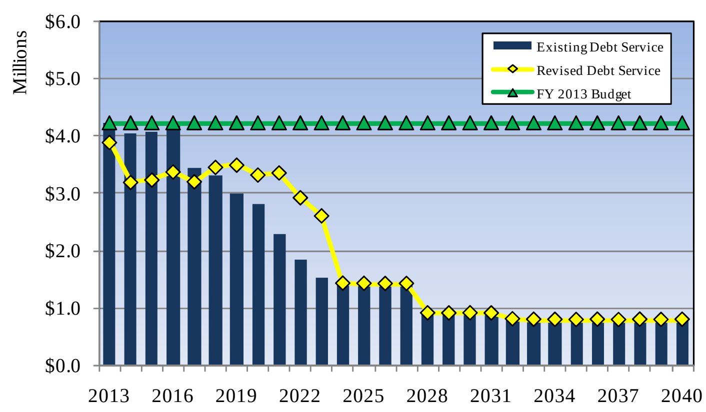
- Refinancing of the following Bonds for Cash Flow purposes:
  - G.O. Series 2004 – $1,730,000 maturing from FY 2014 through FY 2016.
  - G.O. Series 2005A – $2,385,000 maturing from FY 2013 through FY 2017 (75% allocated to General Fund).
- The Restructuring is repaid over 10 years.
  - Estimated taxable refinancing rate of 4.25% for 10 year term.

Preliminary Results

- The final maturity of the debt is lengthened by approximately 5 years which results in $4.2 million of "freed-up" cash flow to the General Fund based on the FY 2013 budget for debt service.

FY	FY 2013 Budget for Debt Service (1)	Revised Debt Service	Cash Flow Freed-up vs. FY 2013 Budget	Cumulative Cash Flow Back to the General Fund
2013	$4,223,632	$3,893,054	$330,578	**$330,578**
2014	4,223,632	3,193,118	1,030,514	**1,361,092**
2015	4,223,632	3,235,806	987,826	**2,348,918**
2016	4,223,632	3,376,425	847,207	**3,196,125**
2017	4,223,632	3,204,406	1,019,226	**4,215,350**

Revised Debt Service



(1) Excludes Capital Leases.

Strategic Restructuring – Utility Fund Impact

Key Assumptions

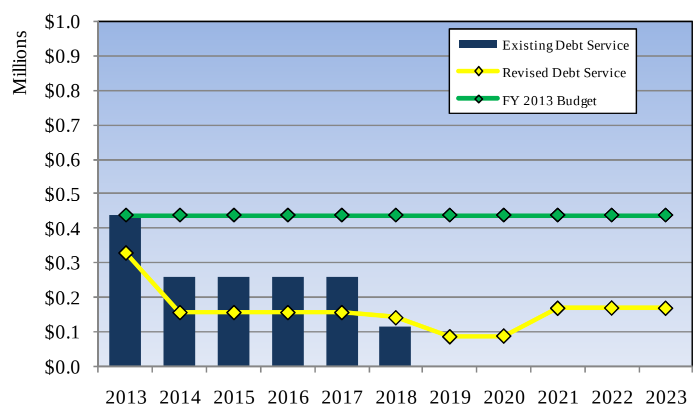
- Refinancing of the following Bonds for Cash Flow purposes:
  - G.O. Series 2005A – $2,385,000 maturing from FY 2013 through FY 2017 (25% Allocated to Utility Fund).
- The Restructuring is repaid over 10 years.
  - Estimated taxable refinancing rate of 4.25% for 10 year term.

Preliminary Results

- The final maturity of the debt is lengthened by approximately 5 years which results in $1.2 million of "freed-up" cash flow to the Utility Fund based on the FY 2013 budget for debt service.

FY	FY 2013 Budget for Debt Service(1)	Revised Debt Service	Cash Flow Freed-up vs. FY 2013 Budget	Cumulative Cash Flow Back to the Utility Fund
2013	$438,351	$329,672	$108,679	**$108,679**
2014	438,351	157,381	280,970	**389,649**
2015	438,351	157,381	280,970	**670,620**
2016	438,351	157,381	280,970	**951,590**
2017	438,351	157,381	280,970	**1,232,560**

Revised Debt Service



(1) Excludes Capital Leases.

Closing Comments

- The City's lack of true Cash Reserves (i.e. Liquidity) requires Petersburg to rely on RANs, which are essentially a "Pay Day Loan" strategy, to meet its annual operating requirements.

- The City's current credit rating by Standard & Poor's is in jeopardy of being downgraded due to the true financial picture of the City.

- Proper implementation of the Proposed Plan of Finance and various recommendations herein will ultimately strengthen the City's credit rating and provide the City with an ability to fund several new capital projects for both the General Fund and Utility Fund.

Timetable for Implementation

August 2/3	• City Council Retreat – Davenport to brief City Council on the Financial Review and preliminary findings. • City Council provides authorization to proceed with Strategic Restructuring.
Week of August 6	• Davenport drafts Request for Proposals for Strategic Restructuring via Direct Bank Loan.
August 10	• Request for Proposals for Strategic Restructuring via Direct Bank Loan distributed to local, regional and national banking institutions. • Submit application to VRA for participation in the fall pooled financing (Anticipated to close in late November/early December).
August 27	• Due date for proposals.
August 27 – 31	• Davenport analyzes responses received and provides recommendation to either proceed with Direct Bank Loan or Virginia Resources Authority's fall pooled financing program.
September 4	• Davenport to provide recommendation to City Council to proceed with Direct Bank Loan or VRA fall pooled financing program.
September	• Alternative A – Close on Direct Bank Loan Restructuring • Alternative B – Proceed with application to VRA for participation in the fall pooled financing (Anticipated to close in late November/early December).

Glossary

Cash Reserves	Uncommitted cash that is available for any purpose and not budgeted or designated for any particular use. Based on the new GASB 54 terminology Cash Reserves are referred to as “Unassigned Fund Balance”.
Debt Affordability	Ability to pay for additional new debt in future years based on the current budgeted level of debt service.
Debt Capacity	Ability to incur additional debt based on standardized methods of measurements such as Total Debt versus Assessed Valuation or Total Debt Service versus Total Expenditures.
Equity Funding	The practice of using cash to fund a portion of the locality’s capital needs. Sometimes referred to as “Pay-as-you-go funding”.
Financial Policy Guidelines	Formally adopted policies that govern the locality’s financial and budgeting behavior. Such policies typically provide ranges for Cash Reserves and Debt Capacity.
Interfund Loans	Loans made between two or more internal funds within a locality. Typically these loans occur when a particular fund does not have sufficient revenues to pay of all of the its allocable operating expenses.
Liquidity	Another term for available cash. See Cash Reserves.

Glossary

Long-term Debt Funding	The practice of funding capital needs by issuing long-term bonds with regularly scheduled payments of principal and interest typically over a period of ten or more years.
Multi-year Capital Improvement Plan	A formal multi-year budget for capital improvements that typically looks forward five fiscal years. Such plans match sources of funding with anticipated capital expenditures.
Non-self Supporting Fund	A fund such as the Golf and Mass Transit Funds that does not have sufficient non-General Fund sources of revenue to pay all of its related expenses and debt service, if any. Such funds need revenue support from the General Fund to balance their respective budgets.
Structurally Balanced Budget	Budget for a fiscal year that is based on realizable ongoing revenues to fund all anticipated expenditures. Where there are multiple funds in a locality that may not be Self Supporting and which need General Fund support, the amounts to be funded by the General Fund are included in the General Fund Budget.
Self Supporting Fund	A fund such as the Utility Fund that has sufficient non-General Fund sources of revenue that is used to pay all of its expenses and debt service, if any.

Glossary

Tax Revenue Anticipation Notes (RAN)	Short-term cash flow financing for ongoing cash flow needs that is borrowed within a fiscal year and repaid on or before June 30 of the same fiscal year. RAN financings are needed when a locality does not have sufficient Cash Reserves to pay for operating expenditures when there is a timing mismatch with operating revenues.

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