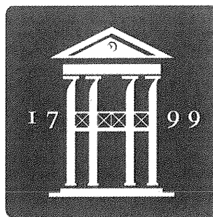
ADMINISTRATION

Russell B. Truell
Assistant City Administrator, CFO
Finance



Eric S. Stuckey
City Administrator

HISTORIC
FRANKLIN
TENNESSEE

March 20, 2012

TO: Members of the Board of Mayor & Aldermen
Eric Stuckey, City Administrator

FROM: Russ Truell, ACA/CFO

RE: Discussion of Assumption in the PFM Debt Capacity Model

Purpose

The purpose of this item is to provide background on the calculation of debt service for future years in PFM debt capacity model.

Background

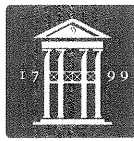
The debt capacity model attempts to provide an indication of financial capacity in future years. It does so by making calculations about the level of debt service and converting those numbers into ratios that are customarily used by rating agencies and investors. To look at overall financial health, several ratios are used, in much the same way that a doctor uses blood pressure, temperature, height/weight ratios, blood work, etc., to gain a sense of a patient's overall condition.

The staff recommendation, as modified in the three scenarios offered in the attachments, will not add a significant amount of bonded debt in relation to the existing debt plus the future debt already assumed in the PFM capacity model. [Note: $11 million in additional debt for the Hillsboro Road project was included in the original capacity calculations in 2009.] Because the change is small relative to numbers already approved, it is difficult to see a substantial change in the charts that PFM provides. For that reason, we have included at the bottom of the attached spreadsheets the numerical impact of adopting scenario 5A, 5B, and 5C. This gives more detail on the exact amounts needed to fund the projects, as well as one of the ratios. The "debt service as a percentage of the General Fund budget," on which we have focused most of our attention during meetings, has been calculated with and without the projects proposed in the staff recommendation.

It should be noted that the numbers provided have been calculated using a number of assumptions about interest rates, the timing of the expenditures, the timing of debt issuance, the amounts issued in each installment, and the growth of general fund budget.

For example, at current interest rates the amount required for debt service is roughly $6 per year for each $100 of borrowing. The model assumes $7 per $100.

The expenditures are assumed to be made at the beginning of the fiscal year in which the project is budgeted. It is unlikely that such a project schedule will hold true, given that FY2012 is 75% complete as of this meeting. Nevertheless, we have assumed that the expenditures are on the front end of the time period.



As a companion to the expenditures, the borrowing for those expenditures in year one are assumed to occur within the same year of the expenditures with the debt service beginning to be paid in the next fiscal year. Thus, borrowing in FY2012 is assumed at mid-year, with principal and interest payments due in full in FY2013. As a matter of procedure, it is unlikely that we would issue debt that quickly. The only reason to do so would be to take advantage of current low interest rates or to optimize the use of issuing debt under the "bank-qualified" rule for small issuers.

One significant assumption is that there will be zero contribution from impact fees in offsetting the principal and interest payments of the borrowed funds. We know that there will be a significant contribution of impact fees from the area surrounding the South Carothers project, but we have not included those as an offset to the cost of the project or a potential source for debt service payments.

Even using the very conservative assumptions described above, the ratio of debt service as a percentage of General Fund budget would move from roughly 9.6% to 11.0% using Scenario 5C, the most expensive of the three scenarios provided. In dollars, the additional debt service would top out at $2 million per year and the additional debt, including the portion already approved for Hillsboro, would total $29 million; that compares to our annual reduction (payoff of principal on existing debt) of over $6 million per year.