

# ***CITY OF WATERTOWN***

## **CASH MANAGEMENT & INVESTMENT PROGRAM REPORT**



**YEAR ENDED  
DECEMBER 31, 2015**

Cash Management and Investment Program  
Year Ended December 31, 2015

**INVESTMENTS**

The investment policy adopted by City Council applies to all financial assets of the City that are in the custody and control of the City Finance Officer.

The primary objective of the City's investment program is the preservation of capital and protection of investment principal. All participants in the investment process shall act responsibly as custodians of the public trust. The Finance Officer shall avoid any transaction that might impair public confidence in the City's ability to govern effectively.

The Finance Officer is the chief financial officer and the designated investment officer of the City. Investments shall be made with the exercise of that degree of judgment and care which persons of prudence, discretion, and intelligence exercise in the management of their own affairs.

Codified law is concerned with the preservation of investment principal which consists of mostly public funds. Any financial institution that holds the authorized investments listed below must back that investment with collateral to ensure the City's ability to recoup the investment principal if the investment itself lost its value. Investment earnings are not the focal point for municipalities, but a by-product of healthy cash reserves. It is always the goal to maximize earning potential on this cash reserve while maintaining the safety and stability of the investment program.

South Dakota Codified Law allows financial assets of the City to be invested in:

- A. Deposit-type investments with local financial institutions including certificates of deposit, savings accounts, money market accounts or other interest-bearing deposits.
- B. Securities of the United States government and securities guaranteed by the United States government either directly or indirectly including, without limitation, United States treasury bills, notes, bonds and other obligations issued or directly or indirectly backed by the full faith and credit of the United States Government.
- C. Repurchase agreements fully collateralized by securities described in "B" above provided that any repurchase agreement must comply with SDCL Section 4-5-6.
- D. Shares of an open-end, no load fund administered by an investment company registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933 and whose only investments are in securities described in "B" and repurchase agreements described in "C" above.

Fixed-term securities will be purchased with the intention of holding the security until maturity. This does not preclude the investment of funds in an open or no load fund holding securities having maturities exceeding two years such as that available from the South Dakota Public Funds Investment Trust. Market price risks can be controlled by avoiding volatile investment instruments and by purchasing securities with the intention of holding until maturity.

Assets of the City shall be invested in instruments that are expected to mature within two years of the time of purchase so sufficient liquidity can be maintained to meet the funding needs of the City as they arise. The City continues to invest in CD's with an original maturity of up to two years as follows:

<u>Term</u>	<u>Purchased</u>	<u>Matures</u>	<u>APR Rate</u>	<u>Amount</u>
182-day	07/10/15	01/08/16	0.46%	1,000,000.00
182-day	07/10/15	01/08/16	0.46%	500,000.00
364-day	01/09/15	01/08/16	0.53%	1,000,000.00
364-day	01/09/15	01/08/16	0.53%	500,000.00
728-day	01/10/14	01/08/16	0.65%	201,296.44
184-day	08/10/15	02/10/16	0.46%	1,000,000.00
184-day	08/10/15	02/10/16	0.46%	500,000.00
365-day	02/10/15	02/10/16	0.53%	1,000,000.00
365-day	02/10/15	02/10/16	0.53%	500,000.00
730-day	02/10/14	02/10/16	0.50%	200,000.00
182-day	09/10/15	03/10/16	0.51%	1,000,000.00
182-day	09/10/15	03/10/16	0.51%	500,000.00
366-day	03/10/15	03/10/16	0.54%	1,000,000.00
366-day	03/10/15	03/10/16	0.54%	500,000.00
731-day	03/10/14	03/10/16	0.50%	201,000.00
182-day	10/09/15	04/08/16	0.58%	1,000,000.00
182-day	10/09/15	04/08/16	0.58%	500,000.00
364-day	04/10/15	04/08/16	0.49%	1,000,000.00
364-day	04/10/15	04/08/16	0.49%	500,000.00
729-day	04/10/14	04/08/16	0.35%	200,000.00
182-day	11/10/15	05/10/16	0.59%	1,000,000.00
182-day	11/10/15	05/10/16	0.59%	500,000.00
368-day	05/08/15	05/10/16	0.53%	1,000,000.00
368-day	05/08/15	05/10/16	0.53%	500,000.00
732-day	05/09/14	05/10/16	0.51%	201,022.79
183-day	12/10/15	06/10/16	0.61%	1,000,000.00
183-day	12/10/15	06/10/16	0.61%	500,000.00
366-day	06/10/15	06/10/16	0.57%	1,000,000.00
366-day	06/10/15	06/10/16	0.57%	500,000.00
364-day	07/10/15	07/08/16	0.60%	1,000,000.00
364-day	07/10/15	07/08/16	0.59%	500,000.00
729-day	07/10/14	07/08/16	0.46%	200,920.00
366-day	08/10/15	08/10/16	0.66%	1,000,000.00
366-day	08/10/15	08/10/16	0.66%	500,000.00
733-day	08/08/14	08/10/16	0.46%	200,920.00
365-day	09/10/15	09/09/16	0.68%	1,000,000.00
365-day	09/10/15	09/09/16	0.68%	500,000.00
730-day	09/10/14	09/09/16	0.47%	200,940.00
364-day	10/09/15	10/07/16	0.72%	1,000,000.00
364-day	10/09/15	10/07/16	0.72%	500,000.00

728-day	10/10/14	10/07/16	0.54%	201,088.88
366-day	11/10/15	11/10/16	0.73%	1,000,000.00
366-day	11/10/15	11/10/16	0.73%	500,000.00
731-day	11/10/14	11/10/16	0.55%	201,100.00
365-day	12/10/15	12/09/16	0.76%	1,000,000.00
365-day	12/10/15	12/09/16	0.76%	500,000.00
730-day	12/10/14	12/10/16	0.49%	200,980.00
732-day	01/09/15	01/10/17	0.67%	200,000.00
731-day	02/10/15	02/10/17	0.55%	200,000.00
731-day	03/10/15	03/10/17	0.91%	200,000.00
731-day	04/10/15	04/10/17	0.56%	200,000.00
733-day	05/08/15	05/10/17	0.55%	200,000.00
731-day	07/10/15	07/10/17	0.80%	200,000.00
731-day	08/10/15	08/10/17	0.77%	200,000.00
729-day	09/10/15	09/08/17	1.01%	200,000.00
732-day	10/09/15	10/10/17	0.76%	200,000.00
730-day	11/10/15	11/09/17	0.80%	200,000.00
729-day	12/10/15	12/08/17	0.80%	200,000.00

Total Certificates of Deposit

31,409,268.11

As shown above, a modest portion of the overall portfolio has a maturity date longer than one year. At year-end, \$4.4 million or about 14.0% of the total portfolio was held in CD's with original maturities of 24 months. 93.0% of the current investments will mature in 2016 reflecting a rather liquid portfolio. The investments are "laddered" so a portion of the CD's come due each month to allow for the greatest amount of flexibility for funding needs. With only a small amount of the total portfolio being reinvested each month, this "laddering" technique helps reduce the risk that the majority of investments will mature and be reinvested at a time of relatively low interest rate.

Unfortunately, there seems to be no quick recovery in sight for interest rates. As a result, all of the investments have come due and been renewed multiple times at low interest rates. Another factor affecting the City's ability to receive higher rates and more bidders is the cost to the banks to invest public funds along with the amount of cash banks have on hand to lend. To comply with state law, City deposits in excess of FDIC insurance must be 100% collateralized. Pledging collateral is an additional cost to banks causing them to lower the interest rate on public investments.

As of December 31, 2015, the average interest rate on investments is 0.60% compared to the 0.36% average interest rate in investment as of December 31, 2014. Even though the average remains under 1%, it does show that interest rate renewals have been gradually increasing versus decreasing as in previous years. At the end of 2015, long term rates were seeing a higher interest rate than those purchased in 2014 reflecting a slight increase in the overall long term investment market throughout 2015.

Ten-year historical interest earnings are as follows:

2006	1,812,208
2007	2,040,969
2008	1,718,324
2009	1,239,360
2010	899,929
2011	758,809
2012	687,113
2013	629,434
2014	658,937
2015	738,228

Total interest revenue for 2015 was \$738,228 which is still below the 10-year average of about \$1.12 million. The total portfolio of investments began the year at \$29,507,768.49 and by year end had increased 13% to \$31,409,268.11. The total number of investments increased from the previous year showing a better response from banks in bidding for 6-month and 1-year CD's with rates above the pooled account. It has taken some time to get the remaining investments previously declined bid back out and in the "laddering" rotation. The interest amount shown above also includes interest from economic development loans that are not part of the investment portfolio. The interest collected from these loans will be discussed later in the report.

How much interest is received not only depends on the interest rate but also the cash balances in each fund available to invest. Higher interest rates will allow greater yields on investment even when cash balances are lower than other years. The following chart shows the average cash balance available to invest, the total interest from those investments and the average interest rate.

Year	Average Cash Balance	Total Interest Received	Average Interest Rate
2006	33,231,903	1,496,799	4.50%
2007	31,964,322	1,728,608	5.41%
2008	33,403,003	1,406,782	4.21%
2009	34,444,396	929,193	2.71%
2010	35,413,141	536,639	1.52%
2011	32,357,261	265,989	0.82%
2012	39,813,300	185,967	0.47%
2013	44,694,733	147,355	0.33%
2014	48,564,699	173,512	0.36%
2015	69,246,621	253,298	0.60%

- Total interest received does not include loan interest from economic development loans.

With the slow recovery nation-wide, interest rates on investments have seen modest increases; however, they continue to be fairly low. Municipal CD rates are even lower than other business and private interest rates because of the costs for banks to collateralize municipal funds to protect the principal investment.

The overall cash in the pooled account has increased significantly since the beginning of 2015 mostly due to the additional bonds issued to complete the Community Center, 5-Plex Softball Complex and the new Ice Complex projects. These projects will be ongoing throughout 2016 and 2017 which will slowly decrease the cash balance in the Construction Fund. Once completed, the pooled account will reflect a more normal balance typical of previous year's amounts. Any excess cash not invested is held in a checking account and receives a minimum rate of return of 0.29% or the Fed Funds rate plus 2 basis points whichever is greater.

Unless provided otherwise by State law or City policy, interest earnings shall be allocated to the fund making the investment. In order to receive interest allocations, a fund must maintain a minimum balance of \$10,000 on a regular basis unless state statute requires otherwise. Earnings from pooled investments shall be allocated to the funds participating in the pool on a systematic manner determined by the Finance Officer. Interest allocation is based off the average cash balance in each fund at the end of the month the interest is received.

The distribution of interest revenue for each fund comparison as of December 31, 2015 and 2014 respectively is as follows:

Fund Name	Interest Revenue in 2015	Interest Revenue In 2014	Increase (Decrease) for Year
General	32,037	22,786	9,251
Park & Recreation	3,233	1,981	1,252
1% BBB Sales Tax	873	606	267
Community Rec Center	333	310	23
Casualty Reserve	152	158	(6)
Capital Improvement Sales Tax	476,333	471,134	5,199
E-911 Emergency Fund	16	259	(243)
Library Fines	1,173	1,410	(237)
UR Revolving Loan	655	521	134
Tax Increment Fin. Fund #1	114	149	(35)
Tax Increment Fin. Fund #2	33	36	(3)
Tax Increment Fin. Fund #3	40	35	5
Tax Increment Fin. Fund #5	14	14	0
Tax Increment Fin. Fund #6	54	65	(11)
GO Bond Debt Service	1,750	1,367	383
Community Improv Projects	52,694	0	52,694
Utilities	66,991	58,054	8,937
Sewer	92,400	88,585	3,815
Solid Waste	9,333	11,467	(2,134)
Airport	0	0	0
<b>Total</b>	<b>738,228</b>	<b>658,937</b>	<b>79,291</b>

Interest revenue increased 12.0% from 2014 reflecting an increase in the amount of investments being purchased each month and the overall increase in certain fund's cash reserves which is mainly the Community Improvement Projects Fund. The Capital Improvement Sales Tax Fund and Sewer Fund receive interest from other interest-earning assets in the form of economic development and interfund loans. The interest earned on these loans is included in the total interest revenue reported above.

The Capital Improvement Sales Tax Fund has the following economic development and interfund loans:

CURMAR, LLC had an economic development loan for the purchase and remodel the Verifications building secured by the mortgage of \$821,743 with an amortization schedule date of March 24, 2010. This is a 5 year loan with the first two years paying interest only at 3%. Years 3 through 5 will be payments of principal and interest of \$4,557.37 with a balloon payment at the end of 5 years in the amount of \$730,469.78. CURMAR, LLC was granted a two month extension in their balloon payment which extended their amortization schedule two payments. Their final balloon payment along with any unpaid accrued interest was paid May 29, 2015.

McKeever Vending has a special assessment loan for \$51,618.60 of public improvements assessed to the land in the Endres Industrial Park due at the time the property is purchased. This loan is for five years with a 4% interest rate. The loan amortization schedule start date is 10/26/2011 with five yearly payments of \$11,619.10 due October of each year.

The Watertown Development Company has an economic development loan for the construction of a spec building secured by the mortgage of \$450,000 with an amortization schedule date of February 15, 2014. This is a five year loan with an interest rate of 3%. The payments are based on a 20-year amortization schedule with a balloon payment at the end of 5 years in the amount of \$362,979.65.

CMW Industrial Properties has an economic development loan to purchase the former Minnesota Rubber building. The building will be leased to SpecSys, a manufacturing company expanding into South Dakota. This is a ten year loan with an interest rate of 3%. The loan amortization schedule start date is 01/26/2015 with monthly payments of \$6,300.59 due on the 26th of each month.

The Capital Improvement Fund also has five Tax Incremental District (TIF) inter-fund loans for various economic development projects as follows:

The City made an inter-fund loan in 2004 to the TIF 1 Fund in the amount of \$2,400,000 to finance the project costs for public improvements in the Hanten Industrial Park within the TIF 1 district. The loan will be paid back as incremental property taxes are collected by the TIF 1 Fund over a period not to exceed twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2015 is \$1,756,521.17.

TIF 2 inter-fund loan was made in 2004 in the amount of \$1,020,000 to finance the project costs for public improvements in the Mallard Pointe Business Park within the TIF 2 district. The loan will be paid back as incremental property taxes are collected by the TIF 2 Fund over a period not to exceed twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2015 is \$1,251,822.63.

TIF 3 inter-fund loan was made in 2005 in the amount of \$450,000 to finance the project costs for street and sewer improvements in the Pheasant Ridge Business Park within the TIF 3 district. The loan will be paid back as incremental property taxes are collected by the TIF 3 Fund over a period not to exceed twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2015 is \$100,991.40.

TIF 5 inter-fund loan was made in 2010 in the amount of \$1,016,264 to finance the project costs for storm sewer improvements along the 1<sup>st</sup> Ave. North Extension within the TIF 5 district. The loan will be paid back as incremental property taxes are collected by the TIF 5 Fund over a period not to exceed twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2014 is \$1,389,497.96.

TIF 6 inter-fund loan was made in 2010 in the amount of \$770,956 to finance the project costs for street improvements in the Pheasant Ridge Industrial Park within the TIF 6 district. The loan will be paid back as incremental property taxes are collected by the TIF 6 Fund over a period not to exceed twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2014 is \$706,968.74.

The interest earned in the Capital Improvement Fund from these other interest-earning assets in 2015 is as follows:

Borrower	Original Loan Amt	Interest Rate	Outstanding Balance 12/31/2015	Interest Earned in 2015
CURMAR, LLC	821,743	3.0%	0	9,363
McKeever **	51,619	4.0%	21,891	0
Wtn Development Co.	450,000	3.0%	418,993	12,848
CMW Industrial Prop.	652,500	3.0%	600,490	17,297
TIF #1	2,400,000	7.0%	1,756,521	128,962
TIF #2	1,020,000	7.0%	1,251,823	86,034
TIF #3	450,000	7.0%	100,991	9,198
TIF #5	1,016,264	7.0%	1,389,498	92,687
TIF #6	770,956	7.0%	706,969	52,676
Total Interest				<u>409,065</u>

\*\*McKeever payment was not received until January 11, 2016.

This accounts for 86% of the total interest earned in the Capital Improvement Fund for 2015. The outstanding balance in TIF #2 and TIF #5 loans is more than the original loan amount because accrued interest costs are more than the incremental property revenues being received. Contributing factors to this is the lack of development in these TIF districts and the property tax factoring by the County. New properties take five years to begin paying 100% of the property taxes due on the development which also delays the repayment of the outstanding balances of these loans.

The Sewer Fund also has a Tax Incremental District (TIF) inter-fund loan for an economic development project as follows:

TIF 5 inter-fund loan was made at the end of 2010 in the amount of \$808,736 to finance the project costs for sewer improvements along the 1<sup>st</sup> Ave. North Extension within the TIF 5 district. The loan will be paid back after the Capital Improvement Sales Tax TIF has been repaid if incremental property taxes collected by the TIF 5 Fund are sufficient within the twenty years at an interest rate of 7.00%. The outstanding balance as of December 31, 2015 is \$1,222,508.08.

The interest earned in the Capital Improvement Fund from these other interest-earning assets in 2015 is as follows:

Borrower	Original Loan Amt	Interest Rate	Outstanding Balance 12/31/2015	Interest Earned in 2015
TIF #5	808,736	7.0%	1,222,508	75,865
Total interest				75,865

This accounts for 82% of the total interest earned in the Sewer Fund for 2015. This is the fifth year of this TIF loan and has kept the overall interest allocation in the Sewer Fund higher than other enterprise fund interest amounts.

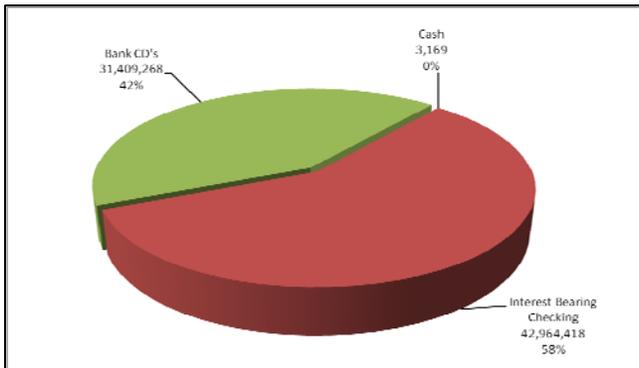
Economic indicators reflect a slight increase in short term rates with long term rates seeing a continued increase through 2016 and into 2017. Even with increases in rates, they remain much lower than other years prior to the recession. This seems to be the “new normal” all government entities around the country including Watertown are faced with when reviewing the investment policy and procedures. Because of the restrictive nature of eligible investment options, a portfolio of largely CD's has an acceptable rate of return compared to the current US Treasuries rate at .46% for six month, .59% for one year, and 1.06% for two year maturities as of December 31, 2015. As of February 18, 2016, the US Treasuries rate was .43% for six month, .51% for one year, and .74% for two year maturities. Continuing to ladder investments also is the most beneficial way to guarantee the greatest flexibility in cash flow needs and protect against interest rate fluctuations.

Since interest rates continue to be lower than we have seen in the past, a question that comes up is whether to use available cash balances to pay off debt which is accruing interest at a higher rate. No matter what the economic condition, this option should be carefully reviewed considering both short term gains and longer term capital needs. Having a healthy cash reserves especially for the General Fund and Capital Improvement Fund allows the City to maintain service levels and personnel needs even when revenue projections are not met. The Capital Improvement Fund is where the majority of the debt is paid, and is also where the greatest chance for a large, unanticipated project to occur.

Another consideration to review when determining whether to pay off debt is the generational equality that comes with the issuance of debt. The concept is the cost of the infrastructure is being paid for by the taxpayers receiving the benefit over time. Cash reserves allows capital projects such as roads and storm sewers not identified during the budget project to be completed to best serve the Watertown citizens. It also allows large projects such as new buildings or major additions to be completed without the need for additional debt.

## CASH AND CASH RESERVES

Cash and cash reserves are an important part of the budgeting and cash-flow processes of the city. The City maintains a pooled cash portfolio that is used by all City funds using the pooled deposit and investment concept. This concept provides the City with the ability to maximize earnings on idle funds while ensuring that the liquidity needs of each fund are met and the integrity of the cash balances of each fund is preserved. As of December 31, 2015 the cash and investment amounts are as follows:

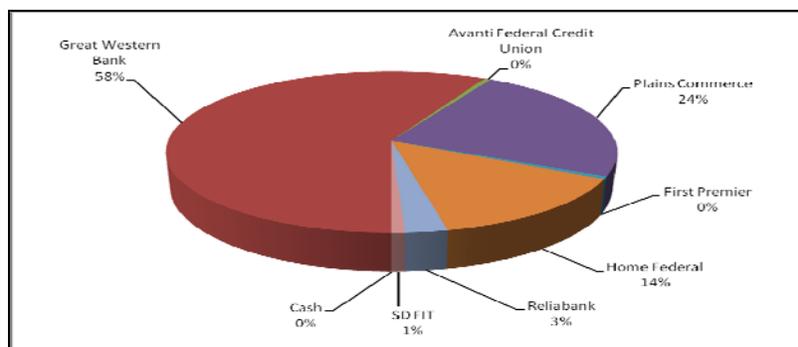


Depositories shall be selected through a competitive banking services procurement process which shall include a formal request of proposals issued as often as deemed appropriate by the City Finance Officer. Great Western Bank is currently the depository that holds the various accounts the City uses to conduct business. A small amount of petty cash (\$3,169) is kept at various

departments including the Finance Department for change drawers and to cover postage. Petty cash is tracked by each department and audited on a regular basis.

Deposit-type investments (i.e. certificates of deposit) will be placed on a competitive basis with depositories as authorized by the Council. The majority of the authorized depositories are local banks that are given the opportunity each month to bid on the available investments with varying maturities. The bank that bids the highest interest rate for that investment receives the CD. As of December 31, 2015 the location and amount of cash and investments were as follows:

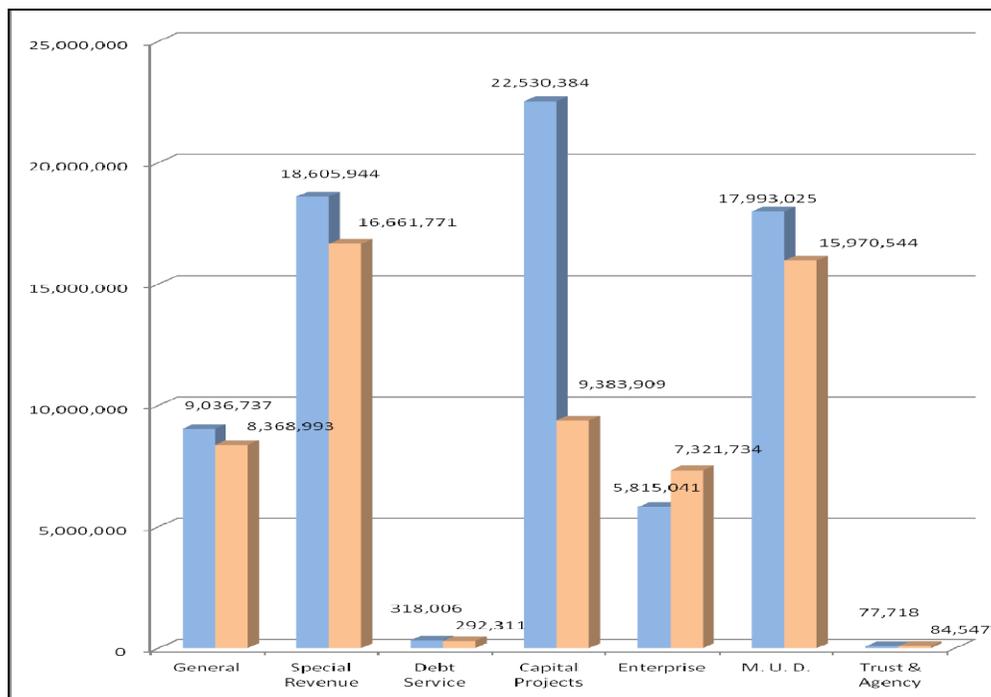
Location	Amount	% of Total
Cash	3,169	0.00%
Great Western	42,964,418	57.76%
Avanti Federal Credit Union	400,940	0.54%
Plains Commerce	17,602,820	23.67%
First Premier	401,100	0.54%
Reliabank	2,001,089	2.69%
Home Federal	10,403,319	13.99%
SD FIT	600,000	0.81%
Total	74,376,855	100.00%



The fund by fund cash balance comparison as of December 31, 2015 and 2014 respectively are as follows:

Fund Name	Cash Balance 12/31/15	Cash Balance 12/31/14	Increase (Decrease) for Year
General	9,036,737	8,368,993	667,744
Park & Recreation	899,628	605,892	293,736
1% BBB Sales Tax	295,940	214,233	81,707
Community Rec Center	73,736	85,696	(11,960)
Casualty Reserve	28,583	41,925	(13,342)
Capital Improvement Sales Tax	16,663,432	15,005,542	1,657,890
E-911 Emergency Fund	(5,605)	(6,611)	1,006
Library Fines Fund	283,587	276,709	6,878
UR Revolving Loan	159,390	160,734	(1,344)
Sioux River Project	187,201	257,695	(70,494)
Tax Increment Fin. Fund #1	3,223	5,779	(2,556)
Tax Increment Fin. Fund #2	4,202	3,341	861
Tax Increment Fin. Fund #3	2,305	5,099	(2,794)
Tax Increment Fin. Fund #5	6,686	1,572	5,114
Tax Increment Fin. Fund #6	3,636	4,165	(529)
GO Debt Service	318,006	292,311	25,695
Community Impr. Project	22,530,384	9,383,909	13,146,475
Utilities	17,993,025	15,970,544	2,022,481
Sewer	3,777,768	4,561,641	(783,873)
Solid Waste	2,254,944	2,799,311	(544,367)
Airport	(217,671)	(39,218)	(178,453)
Wellmark Funds	13,597	20,548	(6,951)
Redemption	500	500	0
Bid Deposit	63,621	63,499	122
Total	74,376,855	58,083,809	16,293,046

The following graph shows the cash balance comparison by fund type as of December 31, 2015 and 2014 respectively:



The largest percent change in cash balances from 2014 to 2015 is found in the Community Improvement Project Fund, Airport Fund, Park and Recreation Fund and the 1% BBB Sales Tax Fund. The remaining \$20 million in bond proceeds were completed in 2015 accounting for the large increase in the Community Improvement Project Fund. The Airport Fund's negative cash balance increased in 2015 due to a lag in State and Federal Fund reimbursements on AIP eligible projects until the projects have been closed out by the State. The Park and Recreation Fund actual revenues exceeded the actual expenditures by approximately \$300,000 accounting for the increase in the cash balance. Sales tax collections exceeded budgeted amounts in the 1% BBB Sales Tax Fund allowing the year-to-date revenues to exceed year-to-date expenditures in that fund.

The largest dollar change in cash balances from 2014 to 2015 is found in the Community Improvement Project Fund, Airport Fund and Municipal Utilities Fund. The Community Improvement Fund was set up in 2014 to account for the bond proceeds and private funding proceeds for the construction of the Community Center, 5-plex ball field, and new Ice Complex. The Municipal Utilities fund is an enterprise fund, so user fees are adjusted to meet the increase in costs or to pay for large capital project debt such as the Water plant expansion and subsequent debt covenant requirements. The Airport Fund has a significant negative cash balance at the end of 2015 because of construction projects and equipment that was partially federally funded. The grant reimbursements lag behind the expenses until the projects are complete.

The General Fund saw an 8.0% increase in cash balance compared to 2014. This increase is due to both actual revenue collections over budget amounts and actual expenditures under budget. Actual revenues exceeding budgeted amounts is an outcome of conservative budgeting practices carried out by the governing body. Actual expenditures under the anticipated budgeted amount is not only because of conservative budgeting, but also Department Heads finding ways to efficiently run the departments versus a "use it or lose it" mentality. On the revenue side, sales tax collections, sales tax audit collections, charges for services, Police Department land sales and Intergovernmental revenues such as grant proceeds and county shared revenues exceeded budgeted amount by almost \$1.2 million. On the expenditure side, very little of the \$300,000 in contingency was used along with multiple departments including snow removal coming under their allocated operating and maintenance budgets.

The Capital Improvement Sales Tax Fund saw an 11.1% increase in cash balance compared to 2014. One reason for the increase is that sales tax revenues, sales tax audit, and land sale revenues exceeded budgeted amounts by almost \$900,000. Another factor that affects the cash balance is the amount of project budgets that will be "carried over" into the following year because they have either not been started or are still in progress at the end of the year. Since the Capital Improvement Sales Tax Fund mostly funds larger nonrecurring capital projects, the cash balance will naturally fluctuate from year to year depending on the number and size of the projects and the cash flow sources dedicated to the project.

All of the excess cash that was not used will be added to the fund's reserve amount to be used at a later time when needed. Unassigned fund balances are necessary to help pay for emergencies, pay for unanticipated expenditures, offset revenue shortfalls and help fund future capital purchase needs. However, most of the funds have some sort of restriction either internal or external that restricts how the funds can be used.

To understand the different cash balances and how much of these financial resources are available for spending, it is important to understand the different fund types and how their financial resources are collected and tracked. Certain funds have financial resources that are restricted or assigned for other purposes which makes them unavailable to be used for any other purpose identified by the governing body.

The General Fund has approximately \$9.0 million which includes departments such as police, fire, streets, library, building services, finance, etc. The majority of funding for the General fund departments comes from property taxes and the first penny local sales tax. There are other revenue sources such as charges for services and other taxes like bank franchise taxes, however, they do not make up a significant portion of the total revenues needed to fund these departments. The General Fund cash reserves are also used to "borrow" cash to the Airport Fund and E-911 Fund to eliminate their negative cash balance. The cash reserves in the General Fund are unrestricted on their general purpose or use.

There are currently 14 special revenue funds within the city with a total cash value of over \$18.6 million. Special revenue funds include Parks, Recreation and Forestry, Rec Center, E-911 and Capital Improvement Sales Tax Fund. Special revenue funds are limited in their purpose based on their special revenue status. Special revenue funds charge fees for providing services and various recreation programs. However, to keep those services and programs affordable, the fees do not cover the total cost of providing those services and programs. The first penny sales tax is used to help cover any revenue deficit in the cost of providing services and programs for special revenue funds. Any excess money remains in that fund to help pay for future years. The Park and Rec, Library Fines and Rec Center funds fall into this limited purpose category.

Some Special Revenue Funds are restricted by State Statute as to their use. The BBB 3<sup>rd</sup> penny sales tax, E-911, and Tax Increment Financing (TIF) Districts are regulated by state law as to their creation and the revenue streams created from those funds. BBB sales taxes are used to promote the municipality and to fund recreation, E-911 surcharge revenues are dedicated to servicing 911 emergency services, and TIF Districts are created to capture the incremental property taxes from the development within the TIF boundaries to reimburse public improvement costs such as roads, storm sewer and rail lines.

The Sioux River Watershed Project Fund is a Special Revenue Fund regulated by an EPA 319 Federal grant. Revenue and expenditures through this grant have strict guidelines that are audited each year for both compliance with grant regulations as well as fair presentation of financial statement.

The Urban Renewal Fund is a Special Revenue Fund created with both grant funds and special assessment funds collected from businesses within the Urban Renewal District

boundaries to help revitalize the uptown area within the downtown geographical footprint and is restricted in its use to that purpose.

The Capital Improvement Sales Tax Fund is a Special Revenue Fund that is self funded by the second penny local sales tax. City Ordinance restricts the use of these sales tax funds for the acquisition of land, capital projects, the purchase of fire trucks and ambulances, transfer to the special 911 fund, debt retirement and costs related to the study of or planning for potential capital improvements as determined by the City Council. Changing the purpose of the second penny local sales tax restrictions would take an ordinance change approved by City Council.

There is one debt service fund which is the GO (General Obligation) Bond for the Event Center. This fund is set up exclusively to collect the property taxes assessed to pay the annual principal and interest payments. The debt covenant specifies that 105% of the total debt payment must be assessed each year leaving a small amount of cash left over after the payments are made. This is a legally restricted cash balance that cannot be used to fund other operational costs of the City. The excess cash reserves will go towards the final principal and interest bond payment.

There are four enterprise funds which are the Municipal Utilities, Waste Water, Solid Waste, and Airport with a total cash value of \$23.8 million. Enterprise or proprietary funds are “business” type funds meaning user fees are charged to cover the expenses of providing those services. Like private business, any cash reserves remaining at the end of each year will go back to the fund that generated the revenue to fund future budgets and capital projects. It is important for these reserves to stay in their respective funds to ensure user fees aren’t being used to fund general government activities.

The Municipal Utilities provides Water, Gas and Electric services to the citizens of Watertown. They are overseen by the Utility Board responsible for adopting an annual budget and making decisions on the day-to-day operations of the Utility Department. The Utility Board is appointed by the Mayor but run independently of the City Council restricting their cash balance of \$18.0 million to the Utility Board discretion.

Agency funds are basically holding funds for pass through money that does not belong to the city. There are three agency funds; Section 125 Escrow, Redemption and Bid Deposit that has a cash balance of approximately \$78,000. The Section 125 Escrow Fund is used to account for the employee’s contribution and disbursement of flexible spending funds. The Redemption Fund is used to account for the collection of and remittance to contractors holding special assessment certificates for various improvements. The Bid Deposit Fund is used to account for the collection and return of surety coverage receipts required by the City such as house moving fees.

These agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of result of operation. Because of this, no interest is allocated to the cash balances. The interest earned on the cash balances in these funds is deposited into the General Fund. The only exception to this is in the Bid Deposit Fund. Contractor funds of \$30,000 were deposited into the Bid Deposit Fund as part of liquidated damages on the tennis court renovation project. Per the 2010 agreement, the funds will be held by the City and accrue interest for seven years. If the City doesn’t need the funds to

replace fence poles around the tennis court in that time, the principal and any allocated interest will be returned to the contractor.

Of the \$74.4 million in city cash reserves, only the general fund amount of \$9.0 million is truly unrestricted for future unanticipated needs. Funds such as Municipal Utilities, Capital Improvement Sales Tax, E-911, Urban Renewal, Debt Service and Sioux River Watershed Project funds are either restricted by State law or Ordinance as to their uses. The excess cash in these funds must stay in those funds to be used for future needs as identified by the governing body or municipal utilities board.

The following shows how much cash reserves are available for any purpose as of December 31, 2015.

Total Cash and Investment	\$74.4 Million
Less – Cash held in funds:	
Municipal Utilities	(\$18.0 Million)
Legally Restricted (Cap. Impr, BBB, Lib. Fines, E-911, Urban Renewal, SR Watershed Proj., Debt Service, TID’s, Casualty Res., Agency Funds, Community Impr Project)	(\$40.6 Million)
Intended for limited purpose (Sewer, Solid Waste, Park and Rec, Rec Center, Airport)	<u>(\$6.8 Million)</u>
Balance – (General Fund)	\$9.0 Million

As you can see, the General Fund is the only fund with unassigned cash reserves, but how much is available as a “rainy day” balance? As of December 31, 2015, \$8.2 million has not been allocated and is available to be used for any purpose agreed upon by the governing body or future budget cycles as shown below.

General Fund Cash	\$9.0 Million
Plus Other Current Assets	\$1.2 Million
Less Other Current Liabilities/Reserves:	
Amount "Borrowed" to other Funds	(\$0.2 Million)
Claims Payable (bills)	(\$0.4 Million)
Legally Restricted	(\$0.2 Million)
Designated for future Capital Outlay	<u>(\$1.2 Million)</u>
“Unassigned” Fund Balance	\$8.2 Million

The Government Finance Officer Association sets best practices for government finances and recommends an unassigned fund balance minimum to two to three months of General Fund expenditures depending on the revenue volatility to ensure funds will be available when necessary. Based on the budgeted 2016 General Fund expenditures, the cash reserves are equal to approximately 5.8 months. This shows the

the General Fund is very healthy to withstand any unanticipated economic downturn or catastrophe that could occur in the future.

The other fund that is monitored closely to make sure adequate cash reserves are on hand because of large projects is the Capital Improvement Sales Tax Fund. Most of the capital projects are budgeted out of the second penny sales tax which includes buildings, roads, storm sewers and economic development. A healthy cash reserves in this fund ensures there will be adequate cash flow during the construction months along with additional funds available for unanticipated infrastructure projects that may occur in the middle of a budget cycle.

The following shows how much cash reserves are available for any purpose as of December 31, 2015.

Cash Balance	\$16.7 Million
Restricted for Debt Service	(\$ 5.3 Million)
Restricted for Land	(\$ 0.9 Million)
Carryover for 2015 Projects (Estimate)	(\$ 1.7 Million)
Anticipated to fund 2016 Projects	(\$ 0.7 Million)
Designated for future capital outlay	<u>(\$ 6.1 Million)</u>
“Unassigned” Fund Balance	\$ 2.0 Million

As shown above, there is only \$2.0 million of the \$16.7 million cash balance not already allocated through debt covenants or council action that can be used for any purpose that fits into the second penny sales tax ordinance guidelines.

Please remember that the numbers used in this report are unaudited numbers from the 2015 financial reports. These numbers are subject to change with the audit or future long term capital outlay plans.

As always, I invite comments and questions on this report or any other finance-related matter that is of interest to you.

Respectfully submitted,



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February 22, 2016