

City of Hutchinson Comprehensive Plan

Appendix E Financing Hutchinson's Growth

APPENDIX E

Financing Hutchinson's Growth

The City of Hutchinson has reviewed the financial implications of using general obligation bonds to support the City's annual capital improvement program. This report is prepared as a step in the City's ongoing capital improvement process summarizing the current and previous analysis prepared and reviewed by City staff.

This revised report includes actions and additional recommendations prepared by the Financing Growth Committee. The revisions are shown in bold text.

1. Establish a target level of tax levy debt to be financed annually between \$2,500,00 to \$3,000,000.

The committee has recommended that this target will be averaged over a five-year period.

2. Establish and prioritize three development corridors within the City.

The priorities as recommended are:

2.1 South Boundary of City-Jefferson to lake on west.

2.2 East boundary of City Highway 7 south with new Highway 222 seen as developers request.

2.3 North Highway 15-City boundary and west.

3. **Establish a Resource Allocation Committee to prioritize annual improvement projects for City financing.** It is recommended that the committee will prioritize annual improvement projects for City financing. The Committee will consist of the following members: City Administrator, City Finance Director, City Engineer, City Planner, EDA Director, HRA Director and City Council.
4. **Adopt an ordinance, including a participation policy, to authorize recapture agreements.** (Completed see attached ordinance.) Representative assigned to planning commission.
5. **Develop alternatives for funding improvements.** The committee has recommended the following options for improvement financing be provided:
 - 5.1 Use of 429 funding will be limited to those projects receiving the highest rating by the committee and within the established guidelines.

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5.2 Developers may recapture the cost of privately financed utility improvements under the terms of the Recapture Ordinance.

5.3 Tax increment funding will follow guidelines as established by the EDA and City Council policies.

5.4 The City may consider financing improvements with seceding years' improvements bonds provided the project meets City criteria as established herein. Financing and bond issuance cost will be added to the construction costs.

6. The City will collect connection and wide area fees for water and wastewater as outlined in the City rate ordinance. A storm water utility will be established for the purpose of financing storm water related operating and capital costs.

In reviewing the report, keep in mind that there is no single right answer to determining the proper mix of capital financing sources. A guideline is recommended to provide a framework, not an absolute limit, in which to make decisions on resource allocation. The final decisions involve balancing the necessity for capital improvements with the management of financial resources. A strong local economy, an aggressive payout on debt burden, which receives significant support from non-levy sources, will positively impact a higher debt burden. The failure to provide capital improvements in a timely and cost-effective manner may create more problems than exceeding the guidelines.

Overview

Assuring the long-term vitality of a City requires a number of factors including good planning, solid financial stewardship and securing resources for community investment. Growing communities, like Hutchinson, face unique challenges in balancing these factors. How Hutchinson manages the conflict created by a desire to accommodate development during growth periods while at the same time maintaining reasonable tax rates, reasonable financial reserves and avoiding inappropriate risk levels will determine the future long term vitality of Hutchinson.

Communities' understandably want to avoid turning away desirable development, which are consistent with their community growth plans. The demand for City improvements no longer only comes from citizens and developers within the Hutchinson area but also from large Twin Cities developers. However, there is a limit to as City's ability to finance this growth. For these reasons Hutchison City Officials have directed preparation of this report.

The focus of this report is to provide the City Council with a framework to guide them in establishing growth-financing policies. It should be recognized that there is no universally accepted policy, which can be offered for consideration. Each community has different and unique factors influencing their considerations. This report will attempt to consider those issues unique to Hutchinson, but the final policy decision is best made by officials who have been elected to lead the community.

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Need for Debt Management

The ability to issue improvement bonds is an important element of the City's capital finance plan. Many large projects cannot be financed without borrowing. This tool must be carefully managed. The City possesses a limited capacity to incur general obligation debt. Its use must strike a balance between current and future needs. Debt places demands on financial resources, primarily property taxes, to support its retirement.

The City's debt management and capital finance plans are key elements of the City's credit rating strategy. The City of Hutchinson's debt is rated by Moody's Investors Service. This rating serves as a benchmark to investors not familiar with the City of Hutchinson. Generally speaking, the better the rating, the lower the interest rates. The general obligation debt of the City has just been upgraded to an "A3" from a "Baa1". Given current market conditions, this should lower the City's borrowing cost by 15 basis points (15/100 of 1%) for each debt issue. This rating upgrade was given recognizing the City's efforts to establish a debt management plan. Maintaining the best possible rating will reduce future borrowing costs and reduce the tax levy impact. To achieve an A2 credit rating, the City must strive to maintain a debt ratio on its direct debt of not more than 5%.

Currently the City's rating affects \$34.2 million of outstanding debt, which includes \$14 million of self-supporting hospital as well as sewer, and water debt. Based on a 1999-estimated full market value of \$553 million, the City's overall debt ratio is 6.2%. This above average ratio includes the direct debt of the City, school district, County and all other overlapping taxing jurisdictions. While the City cannot manage debt decisions of other taxing jurisdictions, it would be beneficial to the City's debt rating if this ratio were to stay at less than 7%. As recently as 1997, it was more than 9%. The goal is to maintain a debt ratio of not to exceed 7%.

Overall Financial Framework

One of the primary ways cities accommodate growth is for the City to issue debt which finances infrastructure development. Subject to certain legal and rating constraints, the City can issue its debt at a tax-exempt rate resulting in the lowest possible interest rate which reduces the cost and financial stress brought to bear on private developers. Over the last ten years Hutchison has issued \$24,010,000 in 429 General Obligation Improvement Bonds, which are repaid by an annual property tax levy and annual special assessment payments. Over this ten -year period the amount of the property tax levy needed for debt has been a high percentage of the total City property tax levy. The table below shows the City of Hutchison debt service levy as a ratio to total levy for 1994 through 1999.

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Budget Year	Total Debt Levy for Tax Levy Debt & Special Assessment Debt Levy	HACA/LG A Credits	Direct Tax Debt Levy	Total Tax Levy	% of Total Levy
1996	1,403,412	388,930	1,014,482	2,405,176	42.18%
1997	1,444,500	392,151	1,052,349	2,525,435	41.67%
1998	1,545,400	372,183	1,173,217	2,700,071	43.45%
1999	1,709,500	372,183	1,337,317	2,968,589	45.05%
2000	1,844,600	415,025	1,429,575	3,269,023	43.73%

It is not possible to use comparisons with any degree of real reliability because the needs and circumstances of each City are unique. However, Hutchinson is at the higher end of the portion of the property tax levy that is used to make annual debt service payments.

There is an obvious paradox in this situation. On one hand, the City is encouraging private development that expands the property tax base of the City by issuing debt that finances the installation of the necessary public infrastructure. On the other hand, the cost of this debt reduces the ability of the City to fund current year municipal services.

- * Attempt to issue \$10 million or less in City debt each calendar year so that all City debt can be designated as “qualified tax-exempt obligations”. This designation results in an overall lower interest rate on City debt.
- * Attempt to avoid an arbitrage rebate by issuing \$5 million or less in City debt each calendar year. This will avoid the cost and administrative expense of an arbitrage rebate.
- * Retiring the cost of water and sewer improvements financed by 429 General Obligation Improvement Bonds with revenues from the water and sewer utilities to lower the tax levy portion of the debt.
- * Adjusting water rates from 1998 to 2000 so the costs of water projects are paid from current year utility revenues and not financed by 429 General Obligation Improvement Bonds. This reduces bond issue costs, future interest costs, and lowers the debt outstanding by the City.
- * Reviewing sewer rates for 2000 so that the cost of sewer projects can be paid from current year utility revenues and not financed by 429 General Obligation Improvement Bonds. This reduces bond issue costs.

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To date the City has undertaken a number of initiatives to reduce the tax levy portion of the 429 General Obligation Improvement Bonds. These initiatives include:

- * Future interest costs, and lowers the City's outstanding debt
- * Since 1994, sewer and water trunk connection charges have been paid at the time a building permit is issued to pay for system extensions and components.

Without additional changes in current City policy for financing capital projects, the City will continue to see this debt levy portion of the total property tax, levy increase in the amount of dollars levied on the tax rolls. Future total debt levies before Homestead Credits/HACA allocations are as follows:

This levy does not include any other future debt levies:

<u>Budget Year</u>	<u>Projected Total Debt</u>
1999	\$1,617,600
2000	1,541,900
2001	1,561,249
2002	1,399,627
2003	1,348,880
2004	1,296,540
2005	1,248,300
2006	1,209,518
2007	1,177,112
2008	803,991
2009	765,412
2010	748,379
2011	748,538

Proposed Capital Project Needs			
Budget Year	Bond Issue	% Special Assessed	Projected Tax Levy Over 10 Years
2000	\$2,900,000	36%	\$242,000/yr
2001	2,500,000	78%	73,000/yr
2001	2,450,000	80%	130,000/yr
2003	1,100,00	68%	48,000/yr

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Given the current overall and debt service tax level, it is recommended that the City Council establish a target debt level between \$2,500,000 and \$3,000,000. That target and actual level should be reviewed annually.

This amount should be treated as a policy guideline and not as an absolute limit. This limit should be reviewed periodically and would change if other initiatives were undertaken.

To further reduce the tax levy portion of the debt levy, possibly increase the debt that could be issued in future years, and expand the financial capacity of the utility, we recommend the City consider the following initiatives:

Review the City special assessment policy to determine if more project costs can be special assessed to benefit property owners. From 1994 to 1998 the City special assessed 33.5% of the improvements. This overall amount seems low when compared to the amount of debt issued. For 1999 this amount is projected to be 50%.

Consider adding 1 to 2% additional interest cost on top of the cost of the tax-exempt interest rates the City incurs for borrowing. This rate is still lower than the rate at which anyone could borrow. **The Council has adopted a policy to add 1% over Net Interest Rate.**

Levy special assessments on new construction over a 3 to 5 year term instead of the normal 10-year term for reconstruction projects.

Consider going 12 years over which the City portion of the debt issue is retired instead of 10 years. **This policy has been adopted.**

For sewer and water major trunk extension, establish an Area Assessment for opening up an area. Advantage is to have fees paid up front instead of waiting and being at risk for hook up fees paid when building permit is being issued. The assessment is due before waiting for the area to actually develop. Agricultural land could have the assessments be deferred and interest on the unpaid assessment accrued. Problem special assessments might be carried by Developers if there is strong financial success for the project.

Review water and sewer connection charges to determine if they are at appropriate levels.

Storm water utility - Hookup - Maintenance

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Resource Allocation Committee

Given the limited resources available, it is appropriate for the City Council to adopt a formal policy to prioritize the use of city financing. Without a policy, requests will be considered on a first come-first serve basis. This can be especially problematic when highly desirable projects request assistance after resources have already been committed to a less desirable project. We also recommend that the request for funding should be evaluated by staff meeting as the resource Allocation Committee.

In November of each year we would recommend the convening of a resource Allocation Committee to discuss the capital projects which are to be constructed next year. The Committee should consist of the Finance Director, Engineer, and Planner. A review would be made of:

Improvement projects that are required by the City to upgrade City facilities.

All current year reconstruction projects - (Street replacement or resurfacing)

These projects would be included in the current year financing. A determination would be made of the remaining available financing capacity for the current year. Developers, landowners and the general public would be given until February 1 of each year to formalize their improvement project request to the City Engineer. By March 1, the Resource Allocation Committee would have reviewed the requests and determined which projects would be included in the City financing. Projects after these dates are subject to availability. To assist in determining which improvement projects should be financed, we recommend that the City Council identify and prioritize three development Corridors within the City as follows:

Priority Development Corridor Number 1
Priority Development Corridor Number 2
Priority Development Corridor Number 3

Priority would be given to finance those public improvement projects found in the development area based on the assigned priority. The Resource Allocation Committee would report these recommendations to the leadership committee and the City Administrator.

If all projects could not be financed within each development area, priorities within the development area would be developed by the Committee with final approval by the City Council based on:

- * The overall community benefit from the private development
- * Consistency with the Comprehensive Plan and City development objectives
- * Level of developer participation in the project compared to the required public improvement cost
- * Previous experiences with the developer
- * If the housing project achieves Citywide housing goals

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Alternative Financing Options

Like many other communities, Hutchinson relies on tax levy, special assessment and hook up fees to fund street and utility expansion/extensions. These should continue to be major funding sources. If the City does not have the current year financial capacity to finance proposed projects, these additional options for financing are available and include:

Private Financing - This is one of the most basic options. This may be appropriate in cases where there is strong development interest in a City area outside the City Council designated priority area. This option permits development to occur but does not utilize limited City financing resources for lower priority area. Engineering work would be performed under a policy approved by the City Council using a City approved firm under review by the City Engineer and at the Developer's expense.

Recapture Agreements - Recapture agreements, between a developer/landowner and the City, provide for the developer/landowner to finance the utility extension. The actual construction is typically performed by a City Contractor but paid for by the developer/owner. The city agrees to repay the developer/owner an agreed upon amount plus specified interest when other City customers connect to the utility extension. This is particularly appropriate when utilities must be extended past an underdeveloped parcel or significantly oversized to permit future connections.