Taxation, Revenue and Utilization of Expenditures (TRUE) Commission

BANKING FUND REPORT

May 2011

Subcommittee Chair
Marc Majed El Hassan

Subcommittee Commissioners
Joe Andrews
Randall Deen
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Taxation, Revenue and Utilization of Expenditures (TRUE) Commission

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BANKING FUND SUBCOMMITTEE
Final Report
May 5, 2011

Marc Majed El Hassan, Subcommittee Chair

Subcommittee Commissioners: Joe Andrews, Randall Deen, Ryan Jones, Marcella Lowe, Gamal Lyons, Tom Martin, and Mike McCollum

Purpose of Study:

The general purpose of this study is to gain a better understanding of the City of Jacksonville's (City) Banking Fund. More specifically, the TRUE Commission is interested in:

1. what the process was prior to the enactment of the Banking Fund;
2. what brought about the Banking Fund;
3. what is the purpose and/or goals of the Banking Fund;
4. how the Banking Fund operates/functions on a day to day basis;
5. how the Banking Fund is capitalized;
6. and – perhaps most directly – how and why has the Banking Fund "cap" grown from $118,656,171 to in excess of $551,476,334 in the past 5 years.

In order to address these issues, the TRUE Commission, on September 2, 2010, approved a motion to create the Banking Fund Subcommittee. Marc Majed El Hassan volunteered and was approved to Chair said Subcommittee. Joe Andrews, Randall Deen, Ryan Jones, Marcella Lowe, Gamal Lyons, Tom Martin, and Mike McCollum subsequently volunteered to participate in the subcommittee. Since that time, the Bank Fund Subcommittee has researched the Banking Fund including but not limited to a meeting with Michael Givens on October 13, 2010, a meeting regarding internal service accounts held by Jack Webb on November 10, 2010, and communicated by phone and email with Mr. Givens on several occasions.

The Banking Fund, originally called the Internal Loan Pool, was established beginning with FYE 9-30-05 and was enacted by City Ordinance 2005-1373-E on December 13, 2005. It was created by the City, and more specifically, Mr. Mickey Miller, the City's Director of Finance/Chief Financial Officer as a borrowing/lending device. The City breaks its borrowing into three basic debt categories, which are based on the revenue streams/repayment sources for City borrowing. The three debt categories are; 1) General Fund Covenant Debt (promise to pay from any available General Fund revenues); 2) Specific Revenue Debt (pledged Specific General Fund revenue streams i.e. excise tax, utility service tax); and 3) Better Jacksonville Program Debt (Better Jacksonville Plan – local option sales tax – transportation tax and infrastructure tax). Of the three debt categories, the Banking Fund falls into the General Fund Covenant Debt category. Further, the two types of borrowing excluded from incorporation into the Banking Fund are any debt that pre-existed the creation of the Banking Fund, and any debt with a dedicated repayment source (Specific Revenue Debt and Better Jacksonville Program Debt).

In regards to how the Banking Fund is tracked from an accounting standpoint, it was created and is treated as an internal service fund of the City. That being the case, the Banking Fund differs from other City internal service funds in that it is not used as a cost allocation mechanism to distribute shared services/expenses of the fund to other City agencies. Rather, the Banking Fund, as is suggested by its name, was established with the goal of creating an "internal bank."

As an "internal bank", the Banking Fund – as with all banks – exists to lend money to its clients or in this case its client – the City of Jacksonville. It can therefore easily be deduced that when looking at the amount of money that the Banking Fund has on its books at any given time, one is in actuality looking at the amount of the City's indebtedness – at least in large part. This being the case, it is of great concern that since its inception, the Banking Fund has increased from $118,656,171 to $551,476,333 as of the date of this report. That is an increase of 464.77% in just 5 years. The True Commission would like to know how and why there was such an increase in City borrowing over such a short period of time and what roll the Banking Fund played in that increase? To find out, TRUE has researched the history of the Banking Fund and spoken with key City personnel. The results of our study are herein contained.

To fully understand the Banking Fund, why it was created and the roll that it plays, one must first have a general understanding of the City's pre-Banking Fund borrowing practices. Prior to the Banking Fund, the City practiced single-purpose "theme" borrowing to fund its capital needs. In other words, the City's borrowing needs (i.e. recreation, road paving, drainage, etc.) would accumulate over a period of time until a large scale bond issuance occurred. The obvious problem with the pre-Banking Fund method is that projects would remain on the shelf and go unfunded for long periods of time. In part, the Banking Fund was created to solve this issue. Through the Banking Fund, the City is able to address project funding needs as they arise by utilizing blended borrowing to fund multiple types of capital projects with varying maturities reflecting the varied life spans of the assets being procured.

In addition to solving the issue of single-purpose “theme” borrowing, the general idea behind the Banking Fund was to establish a more efficient and beneficial tool for City borrowing. In this regard, the City “DEBT MANAGEMENT POLICY,” adopted June 23, 2009, has the following to say about the Banking Fund:

“Banking Fund Objectives- The City created its Banking Fund as a conduit device to distribute the debt proceeds into loans to various operating funds of the City. Initial objectives of this program were and are to:

- Alleviate the need for small inefficient borrowing;
- Provide a blended cost of money with a variety of interest rates and interest rate methodology resulting in lower debt service requirement than would be present in a long-term fixed rate only program;
- Provide a revolving device which would allow for the individual loan repayments to be available for loans for new projects;
- Expand the potential use of the covenant (a private sector styled promise to pay) pledge; and
- Provide flexibility of loan terms to meet the needs of the borrower.”

For a more detailed explanation, consider the following example. A City department has a need to borrow money for a capital project. Said City department approaches the “bank” (Banking Fund) and requests a loan. The “bank” then externally borrows, either through commercial paper or covenant fund borrowing, the funds necessary to lend to the City department. The funds are then lent to the department for a period not to exceed the maximum time allowed under IRS regulations, which is 125% of the useful life of the asset being purchased. (The Banking Fund’s current lending period is 100% of the useful life of the asset being purchased.) As with any other loan, the borrower, in this case the City department, pays back the loan over time. Should the City department repay the loan early; the “bank” can then relend the money to another borrower, in this case another City department, without raising new funds.

Such an example is intended to demonstrate not only how the Banking Fund is intended to work, but also the potential benefits. The most prominent potential benefit being the ability to capitalize on debts that are retired early through the relending of those funds. To put it more succinctly, the Banking Fund’s purpose is to “disconnect” internal and external borrowing and repayments in order to provide a tool that allows for flexibility and the reuse of funds before debt retirement.

Now, with a basic understanding of the Banking Fund, a very simple question arises: Is the City realizing enough of the benefits of the Banking Fund to justify the move from the previous practice of single-purpose “theme” borrowing to the Banking Fund? Unfortunately, the answer is not a straightforward yes or no. Perhaps the best way to begin answering the question is to address the previously mentioned “Banking Fund Objectives” as outlined in the City “DEBT MANAGEMENT POLICY,” adopted June 23, 2009.

Of these five stated goals, there are four of them that can be addresses very easily. In fact three of them can be addressed simultaneously. These three goals are: first, “Alleviate the need for small inefficient borrowing”; second, “Provide a blended cost of money with a variety of interest rates and interest rate methodology resulting in lower debt service requirement than would be present in a long-term fixed rate only program”; and third, “Provide flexibility of loan terms to meet the needs of the borrower.” I believe that these goals have been achieved through the Banking Fund’s blended borrowing practices. As describe earlier the City is able to utilize the Banking Fund’s blended borrowing practices to fund multiple types of capital projects with varying maturities reflecting the varied life spans of the assets being procured. Intuitively, this means there is larger, more efficient borrowing, blended rates, and more flexibility.

The other stated goal that can be addressed fairly simply is the goal to “Expand the potential use of the covenant (a private sector styled promise to pay) pledge.” As a general trend, the City has moved from specific pledged revenues to covenant pledges to back its bonds. This is easily evidenced by the increase in covenant debt from the time of the Banking Fund’s inception in 2005 to today. That being said, the current state of the economy is likely to put a damper on this goal due to the effect that the downturn has had on property values. The reason for this is the direct and obvious relationship between property values and property tax revenue. As property tax revenue falls or even remains stagnant, the City will be forced to consider non-ad valorem revenues as a means of maintaining a balanced budget. This in turn may pose problems for bond repayments and subsequently bond ratings. To that end, it has been indicated by bond rating agencies, Moody’s Investor Services in particular, that they will be paying more attention to covenant pledge debt ratings.

In regards to the fifth goal, “Provide a revolving device which would allow for the individual loan repayments to be available for loans for new projects,” it is a bit more difficult to address. In a meeting with City Treasurer, Michael Givens, on October 13, 2010 at 3:00 PM in City Council Conference Room B, Suite 425, City Hall, TRUE asked Mr. Givens several questions relating to whether or not the City is realizing, and if not when the City would realize the full benefits of the Banking Fund. Mr. Givens explained that the real value of the Banking Fund lies in its ability to disconnect the external debt instruments’ amortization schedules from the City departments’ borrowing amortization schedules, which would allow for the reuse of those funds. That being the case, Mr. Givens believes that current budget pressures are hindering accelerated repayments from City departments.

Mr. Givens expanded on this explaining that in order for this “revolving device” to work and for the City to get the benefit of the Banking Fund’s ability to relend money prior to the external repayments becoming due, the City departments would have to repay their debt faster than a period of 100% of the useful life of the asset being purchased. Subsequently, Mr. Givens was asked when or how long it would take for the Banking Fund to be fully functional and for the City to realize the full benefits. To this Mr. Givens indicated that it was understood by the City’s current Administration and current City Council what needs to be done to realize the full benefits of the Banking Fund, but he was unaware of any specific time goals.

Finally, Mr. Givens was asked a question about whether the Banking Fund is really achieving its purpose given the current budget restraints and when and how a decision might be made to discontinue the “experiment.” Mr. Givens indicated that the fund needs the opportunity to prove its worth in better financial times and with the large scale projects that provide a better prospect for loan recapture and reuse before a decision can be made about whether the model makes sense or not. If it becomes apparent that tight budgets and an inability to speed up loan recapture and reuse is a permanent condition, then the potential advantages of an internal banking program might go unrealized.

In addition to whether or not the City is realizing the full potential of the Banking Fund, it is also pertinent to ask whether or not the Banking Fund is functioning as originally intended. In addressing this question, we again turn to the meeting with Mr. Givens. When asked a question about whether the scope or use of the Banking Fund has changed over the years, Mr. Givens stated that it had not. He further explained that the Banking Fund is both an accounting mechanism and borrowing mechanism, designed to provide financing for approved capital projects. The number, nature and funding sources of projects have not changed; they’re just being grouped, tracked and paid off in a slightly different manner. Mr. Givens further explained that neither the internal loan repayments nor the external bond payments are directly connected on a project basis. Rather, a software program tracks the inflow and outflow of borrowings and repayments to ensure that there are always sufficient reserves in the City’s coffers. He explained that there is no built-in cushion or reserve fund in the Banking Fund to protect against non-payment from the City’s other funds. He also explained that the City does not borrow to pay off previous borrowing through the Banking Fund. In fact, the Banking Fund’s borrowed proceeds are pooled with all the City’s other funds for investment purposes and each contributing fund receives a proportional share of the interest earnings.

So why, if the number, nature, and funding sources of projects have not changed with the inception of the banking fund, why has the Banking Fund authorization cap increased 465% in the past 5 years? In the October 13th meeting, Mr. Givens explained that a “double counting” often occurs as a result of the accumulation of multiple years of Banking Fund allocations for projects listed in the 5-year Capital Improvement Plan. Specifically, if a Banking Fund allocation to a project is authorized in one fiscal year but the debt to fund the project is not issued until a succeeding year, then a “double counting” occurs in the subsequent years as the unissued debt allocation from the previous year is added to the new allocation authorized in succeeding years. Recognizing this problem, the system was changed for FY10-11 to recognize a category of “authorized but not issued” debt capacity in order to clarify what’s happening.

That said, since the October 13th meeting, there has been ongoing dialogue between Commissioner El Hassan and Mr. Givens concerning the Banking Fund. On November 24, 2010, Mr. Givens sent an email response, which included the following, “We have come to realize as a result of our efforts to answer your questions and prepare our offering document for a December, 2010 transaction that the cap reflected in the ordinance, while not wrong, is a more measure of active projects appropriations than an actual borrowing limitation.” Through subsequent emails and phone conversations, and with the help of Mr. Givens, TRUE believes it has been able to identify both an area in which it believes the Banking Fund's authorization cap can and should be more accurately reported and an area in which the fund, with action by the City Council, can be immediately reduced.

In regards to the reporting of the Banking Fund cap, a discrepancy between the most recent cap increase ordinance and the actual amount of authorized debt has been identified. To demonstrate and fully explain the discrepancy, it is necessary to look at the most recent Banking Fund cap increase, the total of Banking Fund debt authorizations to date, and the amount of previously issued, but now retired Banking Fund debt. To begin, a review of Ordinance 2010-840 reveals an ordinance approving and enacting an increase in the Banking Fund cap "resulting in the total aggregate principal amount of Banking Fund Bonds authorized to be issued under the Banking Fund Bond Ordinance, net of amounts previously issued and retired, to equal the aggregate principal amount necessary to provide not in excess of $551,476,334 of net available funds to pay the costs of the Banking Fund Project (exclusive of costs of issuance, Reserve Account deposits and capitalized interest)." Next, a quick exercise totaling all Banking Fund debt authorizations equates to a total of $615,347,302. (See the below table titled "Banking Fund Debt Authorizations".) Finally, and as is above indicated in the excerpt from Ordinance 2010-840, which states "net of amounts previously issued and retired,", it is necessary to subtract the amount of previously issued, but now retired Banking Fund debt - $615,347,302 less $39,914,267 (retired debt as provided by Mr. Givens) is $575,433,035. From here, a quick comparison of the numbers - $575,433,035 versus the $551,476,334 approved and enacted by Ordinance 2010-840 – reveals a discrepancy of $23,956,701. (See the below table titled "Discrepancy between Actual Banking Fund Cap and Approved and Enacted Banking Fund Cap".)

Banking Fund Debt Authorizations		
2007 and Prior	$	234,294,396.00
Ord 2008-124	$	6,119,946.00
Ord 2008-482	$	425,000.00
Ord 2008-555	$	109,893,355.00
Ord 2009-054	$	3,745,309.00
Ord 2009-512	$	113,628,206.00
Ord 2009-445	$	5,979,181.00
Ord 2010-559	$	64,761,909.00
Ord 2010-840	$	76,500,000.00
Total	**$**	**615,347,302.00**

Discrepancy between Actual Banking Fund Cap and Approved and Enacted Banking Fund Cap	
Total Banking Fund Debt Authorizations	$ 615,347,302.00
Less Issued and Retired Debt	$ (39,914,267.00)
Sub-Total	$ 575,433,035.00
Less Approved and Enacted Banking Fund Cap	$ (551,476,334.00)
Discrepancy	**$ 23,956,701.00**

What this means is that the current authorized debt issuance is actually $23,956,701 more than what has been approved and enacted by City Council. That being said, there is approximately $23,956,701 worth of projects that have been de-appropriated. In other words, these projects were approved then cancelled before funding or debt issuance occurred. This brings us to the issue of reducing the Banking Fund cap. To preface, this reduction is a reduction of the total authorized Banking Fund debt issuance or $615,347,302, as opposed to the $515,476,334 referred to in Ordinance 2010-840, which, as Mr. Givens explained, "is a more measure of active projects appropriations than an actual borrowing limitation." What TRUE recommends is that City Council put forth an ordinance to reduce the total authorized Banking Fund debt issuance to $551,476,334. Furthermore, TRUE recommends that as issued Banking Fund debt is retired and/or Banking Fund projects are de-appropriated, City Council put forth an Ordinance to reduce the total authorized Banking Fund debt issuance by an amount equal to that of said retired debt and/or de-appropriated project(s).

Still, the question remains. Regardless, of any "double counting", inaccurate reporting, retired debt, de-appropriated projects, etc., etc… …the question still remains: Why has the Banking Fund authorization cap increased 465% in the past 5 years? The answer to this question can only be address by asking another question: Who sets the cap (maximum amount or ceiling) of the Banking Fund. The answer can be found in the original Banking Fund ordinance, Ordinance 2005-1373-E, which address the "maximum indebtedness of the City Banking Fund" by stating that it, "shall not exceed $118,656,171 (the cap at that time)… …except as increased from time to time by the City Council either in the annual budget ordinance or other ordinance supported by an itemized list of planned expenditures." One may also consider that Ordinance Code Section 104.203 empowers the City Council to authorize the issuance of revenue bonds. These authorizations are based on the funding requirements outlined in the Capital Improvement Plan (CIP) included in the Mayor's budget submission. Borrowing not contemplated in the CIP requires specific authorization by City Council.

To further illustrate the above point, one need only look to the Budget Process. First, the Budget is approved for a fiscal year. This Budget includes the sources of repayment of the City's existing departmental Banking Fund borrowings. Second, there are approved increases in the Banking Fund cap over the course of the year. Third, the Budget for the next fiscal year is adjusted/increased to include the repayment of the City's new departmental Banking Fund borrowings. That Budget is then approved. As a hypothetical example, consider the following:

> The 2012 Budget is approved at $100K, of which $10K is for the repayment of the City's existing departmental Banking Fund borrowings. 2012 arrives and over the course of the year there are approved increases in the Banking Fund Cap to accommodate new departmental debt issuances. These new departmental debt issuances require $5K in annual repayment. The 2013 Budget is approved at $105K, of which $15K is for the City's existing departmental Banking Fund borrowings.

To answer the question more directly, the reason the Banking Fund authorization cap has increased 465% in the past 5 years is because the City's Administration and, perhaps more so, the City Council has allowed it to increase. Other than a pledge of property tax revenue to debt (and perhaps a few others), City Council – by way of ordinance and without voter referenda – has the ability to pledge any other revenue source to debt. In other words, it is not the Banking Fund that is the problem, but the use of the Banking Fund. Whether or not the Banking Fund exists is irrelevant. What is relevant are the decisions made by those who have the power to approve debt issuances through and cap increases to the Banking Fund or any other debt management tool.

To conclude this study, it should be reiterated that the general purpose of this study is to gain a better understanding of the City Banking Fund. It should, therefore, be explained that the sole purpose for the answer (and subsequent explanation), immediately preceding this paragraph, is not to point blame. Though the TRUE Commission obviously has great concern for the City's ongoing budgetary issues and continually increasing debt levels, that is not the focus of this study. Rather, the sole purpose of the above answer to the question, "Why has the Banking Fund authorization cap increased 465% in the past 5 years?" is merely to illustrate a point, which – hopefully – is abundantly clear upon reading this study. That point is that the Banking Fund is merely a tool. Whether it will ultimately prove to be an effective tool that provides its full or partial intended benefits and reaches all or some of its goals or is ultimately considered to be a failure because budgetary constraints continue to prohibit the City's departments from repaying their debt faster than a period of 100% of the useful life of the asset being purchased is yet to be seen. But it is just a tool.

Recommendations to City Council:

- Consider the establishment of review criteria and a review timeline at the end of which the City council should consider the effectiveness and benefits of the banking fund. Appropriate action should then be taken based on the results of the review.
- Require, by ordinance or other appropriate means, that the reporting and ordinance reflection of the maximum indebtedness of the City Banking Fund, i.e. the cap, be the total aggregate principal amount of Banking Fund Bonds authorized to be issued under the Banking Fund Bond Ordinance, net of amounts previously issued and retired, as opposed to a measure of active projects appropriations.
- Require, by ordinance or other appropriate means, that as issued Banking Fund debt is retired and/or Banking Fund projects are de-appropriated, the total authorized Banking Fund debt issuance, i.e. the cap, be reduced by an amount equal to that of said retired debt and/or de-appropriated project(s).
- Require, by ordinance or other appropriate means, that any new debt issuance or cap increase approved to the Banking Fund must be accompanied by a source of repayment that is tied to the budget, as well as a statement of the overall effect on the Budget.
- In an attempt to stimulate the "pay as you go" process and reduce the Banking Fund cap, consider making pooled asset items, such as computers, fleet vehicles, ineligible for purchase through the Banking Fund or any other debt source. Also, consider increasing the Banking Fund's per-unit value minimum of $1,000 to a per-unit value of $100,000 and the Banking Fund's useful life minimum of 1 year to a useful life minimum of 10 years. This recommendation will also lead to a better budgeting process on both a departmental and city wide basis.