Financial Management Policy

Adopted per Resolution No. ____ on May __, 2023

Ford Handley, City Administrator / Finance Director

Table of Contents

I. POLICY STATEMENT

The purpose of this document is to serve as an all-encompassing financial management policy for The City of Orange Beach (the "City"), which will provide direction in budgeting, reserve balances, debt management and accounting, auditing, and financial reporting practices. Moreover, this will provide recommended methods to accomplish and adhere to the proposed procedures contained herein. This policy document will create, manage, and ensure ongoing adherence to a purposeful, planned, and deliberate set of guidelines to create both operating and restricted accounts. A conservative approach should be followed when dealing with public funds.

II. PROCEDURAL REQUIREMENT

In order to carry out this policy, the following steps must be taken:

A. BUDGETARY POLICY PROCEDURES:

1. **Budget Preparation.** The Finance Director prepares an annual budget for each fiscal year of the City. The budget process begins in August of each year when the heads of the various city departments are presented with reports assisting them to prepare and submit budget requests for the immediately succeeding fiscal year. The departmental requests are submitted to and reviewed by the Finance Director upon receipt thereof and public budget deliberations are conducted by the City Council in October and November to provide an opportunity for department managers to present information on their budgets and to offer comments with respect to the proposed budget. During the deliberations, the City Council may modify any departmental budget request to such extent as it deems appropriate.

2. **Revenue Estimates.** Budgeted revenues are based on statistical computation of past collections from the previous 5 years, applied to current revenue trends. Tools utilized for the establishment of these trends include property tax abstracts and other statistical revenue data from current collections. Any growth projections are to be conservative in nature.

3. **Adoption of Budget.** The City Council is required to adopt the annual budget no later than December 31 of each year. The appropriations must not exceed the total revenues and reserves available for appropriation. Expenditures may not legally exceed budgeted appropriations. Adjustments to the Budget during the fiscal year must be approved by the City Council. Any changes must be within the revenues and reserves estimated to be available, or as approved by the City Council.

4. **Budgeting Administration.** Formal budgeting integration is used during the fiscal year as a management control device for the City's General Fund, Special Revenue Funds, Debt Service Funds and Capital Project Funds. The budget is adopted on a departmental "line-item" basis consistent with generally accepted accounting principles. The City Clerk at the request of a department head, may let for bid any routine annual purchase or any equipment purchase or contract which is specifically identified in the annual budget. All contracts must be approved by the City Council before execution and must comply with Purchasing Policy. The City of Orange Beach’s expense items are classified in three broad categories: Compensation, Operations, and Capital. The compensation and capital

categories are supported by detailed lists of employees by position and approved capital items. The operating category contains many and varied line items. For budgetary control, this operating category will be treated as a total although each department has a detailed line-item budget. City staff members are prohibited from encumbering any funds in these broad categories which exceed the budgeted amounts. The Finance Director or designee may make transfers between "operating" line items. Further budget control is maintained by prohibiting transfers between the compensation, operations, and capital categories without the consent of the Council at a regularly scheduled meeting by resolution spread upon its minutes.

B. DEBT MANAGEMENT POLICY:

1. **Purpose.** The purpose of this policy is to establish the guidelines for the issuance of debt by the City. Debt levels and the related annual debt service expenditures are important long-term obligations that must be managed with available short and long-term resources. This policy also addresses the level of indebtedness that the City can reasonably expect to incur without jeopardizing its existing financial position. Adherence to a debt management policy, along with the utilization of other sound and prudent financial practices and the City's other financial policies, will assure the lending market that the City is well managed and will meet its obligations in a timely manner.

2. **Principles.** The City's debt management policy seeks to encourage the following principles:

   a. Complete payment of principal and interest on all outstanding debt.

   b. The payment of City debt will be secured by full faith, credit and taxing power held by the City, in the case of general obligation warrants and by the pledge of specific, limited revenues in the case of revenue warrants. The City may also issue warrants through a public building authority (or other appropriate issuer) secured by an annual appropriation lease (or other revenue source). On occasion the City or a political subdivision thereof may serve as a conduit to other issuers. The City will not pledge revenues to these conduit issuers and will have no obligation, moral or legal, to repay conduit debt issued under the authority of the City, except as approved by the City Council.

   c. Principal and interest retirement schedules will be constructed to: (1) achieve a low borrowing cost to the City, (2) accommodate the debt service payments of existing debt, and (3) respond to market conditions at the time of sale.

   d. Factors which the City will consider prior to the issuance of debt include:
      i. Does the useful life of assets being financed exceed the term of the financing?
      ii. Are financial resources available, sufficient, and reliable to service both the existing and new debt?
      iii. Will the issuance of debt adversely affect the City's credit ratings, and if so, how can that best be mitigated?

iv. The City will strive to manage its debt level, operating performance, reserves, and management practices to maintain strong credit ratings, and minimize its cost of capital. As of 2021, the County's general obligation debt is rated S&P: AA+ and Moody's: Aal.

v. The proposed uses of the debt should be expended within 3 years.

e. The City reserves the right to conduct a negotiated or competitive sale in the future depending on market conditions. All methods of sale are subject to City Council approval.

3. **Planning and Performance**. Debt management means adopting and maintaining financial plans for both the issuance and repayment of debt. Planning for the repayment of debt will include analysis of the operating budget to determine if the fund will incur the additional debt service required by the new debt.

4. **Use of Short-Term and Long-Term Debt.** Short-term debt should be limited to borrowing to cover short-term, temporary cash flow shortages within the City's fiscal year using tax anticipation notes in those instances where there is an inadequate level of cash flow or using bond anticipation notes when cash is required to initiate a capital project prior to the receipt of bond proceeds. The City Council should manage the City's finances to avoid the use of short-term debt when possible. Long-term debt should be issued for the acquisition, construction, or improvement of land, buildings, infrastructure, and public improvements when the use of debt is appropriate and within the principles outlined above. Current year budget appropriations and accumulated reserve funds may be used to minimize the amount of long-term borrowing that is required, but, keeping in mind that the City must maintain adequate liquidity and reserves.

5. **Purpose of Debt.** General obligation debt and annual lease appropriation debt funded by general fund receipts and other appropriate sources shall be used for projects that provide a general benefit to City residents and that cannot otherwise be self-supporting. Debt incurred for use by an enterprise fund, even if backed by a general obligation pledge of the City, should be self-supporting and repaid from the revenues of such fund, unless a general benefit to City residents can be demonstrated.

6. **Repayment of Debt.** The City Council will conservatively project the revenue sources that will be utilized to repay any debt and will analyze the impact of both the additional debt service as well as any additional operating expenses resulting from the improvement, to determine if new debt should be issued and to structure the appropriate repayment terms for each debt issue.

7. **Use of Variable Rate Debt, Balloon Payments, etc.** The City Council recognizes the use of variable rate debt, balloon payments, derivative products such as interest rate swaps, carries additional risks. While this policy does not preclude the use of such options, additional considerations apply:

a. Generally, fixed rate debt should be preferred over variable rate debt. However, at times there may be considerations which favor variable rate debt. If variable rate debt is utilized, it should be limited to no more than 5% of the City's total debt.

b. Balloon payments pose future refinancing, and interest rate, risks. Before incorporating balloon payments into a financing structure, the City should consider its ability to pay the balloon payment from its reserves in the event a refinancing was not available or advantageous. The size of the balloon payment, its timing, and the window of opportunity to refinance prior to the balloon, are all relevant considerations.

C. RESERVE BALANCES POLICY:

1. **Purpose.** The City Council believes that sound financial management requires that sufficient funds be maintained by the City for unanticipated expenditures and revenue shortfalls during the fiscal year as may be caused by economic downturns in local/state/federal levels, natural disasters, and other unforeseen circumstances. Maintaining such funds will help sustain the stability of the City's finances and reduce the need for short-term borrowing.

2. **Objective**. The City Council's objective is for twenty percent (20%) of general fund budget expenditures to be set aside as a reserve in a planned and consistent manner and that these moneys may not be spent for regular City expenditures to maintain the City's creditworthiness.

3. **Reserve Balance Expenditures**. The reserve balances will be established by the City Council for the purpose of covering unanticipated revenue shortfalls and paying non-recurring, unanticipated expenditures and capital expenditures of the City or as otherwise approved by the City Council. To this end, the City Council prefers to use the reserve balances to alleviate unanticipated short-term budgetary issues such as revenue shortfalls or unforeseen expenses. Any expenditure of the reserve balances by the City Council for such purposes shall require a majority approval of the City Council members.

4. **Reserve Fund Appropriations.** Annually, the City Council will propose funding of the contingency reserve balances through the budget to maintain the balance at the minimum amount. If expenditures reduce the contingency reserve balance below the established minimum amount, the City Council will, as part of its approval of such expenditures, adopt a plan to restore the funds to the prescribed level. Fund Balance reserves shall be evaluated annually to provide necessary citizen services while maintaining strong financial position.

D. CONSTRUCTION PROGRAMS FUND POLICY:

1. **<u>Purpose</u>**. The purpose of the Construction Programs Fund Policy is to establish and maintain dedicated funds to be annually budgeted, funded and used for new facilities or facility improvements. The overall goal of the Construction Programs Fund Policy is to order the City's fiscal expenditures while coordinating public investment with adopted plans and policies to properly manage the City's long-term investments.

2. **<u>Capital Improvements Budget.</u>** The City will prepare and adopt a Capital Improvements Budget which will detail planned capital projects over a five-year period. The Capital Improvements Budget will detail for each capital project, the estimated project cost, description, and funding source. The Capital Improvements Budget will be adopted in conjunction with the annual budget.

3. **<u>Capital Improvement Project Requirements</u>**. All capital improvement projects must be justified based on providing a basic service, improving or rehabilitating deteriorating facilities, reducing costs, promoting jobs or economic development, or otherwise benefiting a large population segment or target area of the City. They must also be compatible with other planned projects and overall City development plans.

4. **<u>Construction Programs Fund</u>**. The City may if deemed necessary and/or beneficial, establish one or more dedicated funds to service capital improvement projects undertaken by the City. Funds in the Construction Programs Fund(s) shall be restricted in use to capital improvement projects of the City.

5. **<u>Funding Sources.</u>** The Construction Programs Fund(s) shall be funded through appropriations from the City Council on an annual basis. All capital improvement projects of the City shall be funded from the Construction Programs Fund(s) unless specifically financed from other sources such as City warrants, notes or other indebtedness, or other revenue sources specifically dedicated to such projects. All uncompleted projects must be reconsidered annually to determine if unspent funds need to be recommitted to a given project or reallocated to other planned projects.

6. **<u>Budget Shortfalls.</u>** Notwithstanding anything herein to the contrary, in the event of an operating budget or General Fund shortfall, the funds from the Construction Programs Fund(s) may be transferred into the County General Fund to alleviate in whole, or in part, such shortfall.

E. ACCOUNTING, AUDITING AND FINANCIAL REPORTING POLICY:

1. **<u>Purpose</u>**. The purpose of this Accounting, Auditing and Financial Reporting Policy is to establish and maintain high standards for accounting practices in the City, thereby enabling the City Council, the City Administrator, Finance Director, and the City Clerk to make sound decisions in preparing and adopting

the City budget and managing City finances.

2. **Accounting**. The accounting practices of the City will conform to Generally Accepted Accounting Principles for local governments as established by the Governmental Accounting Standards Board. The Finance Director will establish and maintain a system of fund accounting and shall measure financial position and results of operations using GASB approved methodologies and practices.

3. **Auditing**. The City Council complies with state mandated requirements that annual audits be conducted by the Alabama Department of Examiners of Public Accounts.

4. **Monthly and Annual Financial Reporting**. Monthly financial reports are generated for the City Council's management purposes. These will consist of:

    a. Budget Report showing revenues collected and appropriations expended for the previous month with the variance from the budget amounts for each line item.

    b. Statement of Revenue, Expenditures, and Changes in Fund Balance showing revenues and expenditures and the difference between the two, the beginning fund balance for the period, the ending fund balance; and

    c. Balance Sheet showing City assets less liabilities and the fund balance.

The Finance Director will prepare an annual financial report. This report should include financial statements for each of the funds of the City, as well as appropriate additional disclosures as necessary for the complete understanding of the financial statements presented. In addition, for each item that exceeds a 10% variance from the previous year, the report should include a narrative discussion to explain how the City's current financial position and results of financial activities compare with those of the prior year and with budgeted amounts. This process is completed by the auditors during their financial audit process. Input from the entire management team is essential.

F. POST ISSUANCE COMPLIANCE POLICY

1. **Continuing Disclosure Requirements.** The Finance Director shall maintain and ensure compliance with all continuing disclosure requirements as provided for by the City's outstanding debt obligations, including but not limited to, the posting of the City's audited financial statements to the City Website at orangebeachal.gov or other such repository as designated by the City's continuing disclosure requirements set forth in the City's outstanding debt obligations or coordinating such filings with a dissemination agent engaged by the City for such purpose.

2. **Issuance of Tax-Exempt Obligations.** Upon the issuance of tax-exempt obligations by the City, the Finance Director shall (i) confirm with bond counsel

the filing of all related forms with the Internal Revenue Service, and (ii) obtain and keep the transcript of proceedings prepared by bond counsel.

3. **Recordkeeping**. The following records shall be maintained by the City Clerk with respect to the issuance of City obligations:

   a. Transcript of proceedings:
      i. Documentation evidencing the allocation and expenditure of the proceeds of the obligations.
      ii. Documentation evidencing the use of facilities financed with tax exempt proceeds.
      iii. Documentation relating to arbitrage rebate compliance; and
      iv. Continuing annual disclosures.

4. **Arbitrage Rebate and Arbitrage Yield Restriction.** Relating to the issuance and monitoring of outstanding tax-exempt obligations of the City, the Finance Director shall:

   a. Engage the services of an arbitrage/rebate consultant for assistance in compliance with any arbitrage related issues; this consultant may be the bond counsel, financial advisor, or other qualified entity or individual.

   b. Work with bond counsel, financial advisor and/or arbitrage/rebate consultant to monitor compliance with "temporary period expenditures" for expenditure of warrant proceeds, typically three years for new money obligations, and provide for yield restriction of investments or "yield reduction payments" if exceptions are not satisfied.

   c. Work with bond counsel and/or financial advisor to ensure investments acquired with tax-exempt obligation proceeds are purchased at fair market value. This may include use of bidding procedures under the regulatory safe harbor (Section 1.148-5(d) of the Regulations).

   d. Consult with bond counsel prior to the creation of funds which would reasonably be expected to be used to pay debt service on tax-exempt obligations to determine in advance whether such funds must be invested at a restricted yield.

   e. Consult with bond counsel and/or financial advisor before engaging in post issuance credit enhancement transactions (e.g., bond insurance, letter of credit).

   f. Consult with bond counsel, financial advisor, and/or arbitrage/rebate consultant to identify situations in which compliance with applicable yield restriction depends upon subsequent investments (e.g., purchase of 0% SLGS from U.S. Treasury) and monitor implementation; and

g. Work with arbitrage/rebate consultant to arrange for timely computation of rebate/yield reduction payment liability and, if an amount is payable, for timely filing of Form 8038T, Arbitrage Rebate, Yield Reduction and Penalty In lieu of Arbitrage Rebate (or applicable successor form), and payment of such liability. Rebate Yield Reduction payments are ordinarily due at 5-year intervals.

5. **Private Use of Facilities**. "Private Use" means the use of warrant-financed property in a trade or business by any person other than a 501(c)(3) or state or local government entity, or by a 501(c)(3) entity in an unrelated trade or business.

a. Examples of Private Use include:

i. Leases of government property to non-government entities.
ii. Noncompliant management or service contracts.
iii. Transfer of ownership to a private user of warrant financed facilities; and
iv. Naming rights arrangements with a private user.

While it is not anticipated that there will be a Private Use issue with respect to the warrant- financed facilities, if a question arises about a specific proposed Private Use, the Finance Director shall consult bond counsel as to whether such use constitutes a Private Use with respect to the outstanding tax-exempt obligations of the City. The Finance Director shall keep records of private use, if any, of facilities of the City financed with tax-exempt obligations. Private use of such facilities shall be reviewed once a year. If a change in private use occurs, bond counsel will be consulted to determine if remedial action is necessary.