Department of County Management
MULTNOMAH COUNTY OREGON
Finance & Risk Management Division

TO: Mindy Harris, Interim Director, Department of County Management

FROM: Mark Campbell, Sr. Revenue & Financial Analyst

DATE: October 5, 2009

**SUBJECT: Options for Funding Short Term General Fund Cash Flow Shortfall**

The County General Fund (CGF) typically experiences a cash flow deficit prior to the collection of Property Tax revenues. We are not unique in this regard. It is a common occurrence for most government jurisdictions in Oregon that rely on the Property Tax to fund operations.

The purpose of this memorandum is to explain why and when the shortfall occurs, present options to cover the shortfall in FY 2010, and to recommend a preferred option.

## Overview

Property Tax is the largest single source of revenue in the CGF. It normally accounts for approximately 65% of total CGF revenues. Tax bills are mailed in October, with tax payments due on November 15. Most other CGF revenues are received on a fairly regular (i.e., monthly, quarterly) basis with one significant exception. The Business Income Tax (BIT) for most taxpayers is due on April 15 and the BIT typically accounts for 10% - 15% of total CGF revenue.

On the expense side, payroll costs account for roughly 65% of CGF expenditures. Payroll expenses occur on a regular, bi-weekly or semi-monthly, basis. Expenditures, therefore, normally exceed available revenue at some point prior to the receipt of Property Tax revenues. There are times it is possible to avoid a CGF cash shortfall because Beginning Working Capital (BWC), when combined with other revenue collections, is sufficient to cover expenses until Property Tax payments are recorded. However, this has been a fairly rare occurrence over the past several years.

## Options Available to Cover a Cash Flow Shortfall

The County strives to maintain a positive cash balance in all funds throughout the year. Each year, following adoption of the annual budget, the County Treasurer prepares a forecast of the cash flow needs in the CGF and reviews that forecast with other Finance & Risk Management staff in addition to the County's Budget Director.

The County's Financial Policies present two distinct options for financing a CGF cash flow shortfall. The County may issue debt, as outlined in the policy on Short-term and Long-term Debt Financings:

> *"If it is determined by the Finance & Risk Management Division that the General Fund cash flow requirements may be in a deficit position prior to receiving property tax revenues, the County may issue short-term debt to meet anticipated cash requirements."*

Likewise, state law provides the County with the ability to execute an interfund loan. The County's policy on Interfund and Insubstance Loans states:

> *"Interfund loans are subject to ORS 294.460 and are designed to provide financing resources to address cash flow needs in County operations or capital financing plans."*

The policy limits the funds that may make an interfund loan. A loan "shall not be made from reserve, debt service, or any other fund restricted by law, constitutional provisions, bond covenants, grantor requirements, Board resolutions or ordinances unless the restrictions on these funds allow for the purpose of the interfund loan."

In general, this limitation suggests that a loan to the General Fund be made from an Internal Service Fund. As defined in policy the County's internal service funds include – Risk Management, Fleet Management, Information Technology, Mail/Distribution, and Facilities Management.

Recently, one other alternative for financing a CGF cash flow shortfall became available. The American Recovery and Reinvestment Act (ARRA) was signed into law on February 17, 2009. It contains a number of provisions related to the issuance of municipal debt. Of particular relevance to the question of how the County might finance a short-term cash flow shortfall is a provision that increases the existing limits on bank qualified loans.

Prior to ARRA there was a $10 million limit on tax-exempt, bank loans. ARRA increased that limit to $30 million. The increase provides a greater degree of flexibility in addressing the County's cash flow needs when the forecast shortfall is expected to be greater than $10 million.

**Implications for FY 2010**

The anticipated CGF cash flow shortfall as of the end of October is estimated to be approximately **$15.5 million**. This is based on analysis completed in mid-September following August month-end closing. ***Attachment 1*** provides a summary of the estimated shortfall along with a forecast for the year-end CGF balance.

Each option described above offers some advantages and disadvantages. In general, however, they range in order of preference as follows:

1. Internal Loan
2. Bank Qualified Loan
3. Short-Term Borrowing

All three options require Board approval. The order of preference noted here primarily reflects the availability of cash, the cost of issuance, and the time required to secure a loan. ***Attachment 2*** presents a table that highlights the pro's and con's associated with each financing option.

Historically, the County has issued short-term, tax and revenue anticipation notes (TRAN) to finance the cash flow shortfall. There were two principal reasons why this approach was chosen. First, and foremost, BWC in the CGF was typically not large enough to cover the cash flow deficit, and, until 1999, the County did not have the option to finance the shortfall through an internal loan.

Issuing a TRAN also offered the ability to generate additional interest earnings for the CGF by "playing the yield curve." More often than not the cost of short-term borrowing (the interest rate paid) is lower than the interest rate that can be earned by investing the proceeds. That spread could often be up to half a percent. A $20 million short-term loan that was repaid within the fiscal year could, therefore, generate up to $100,000 in additional interest earnings for the CGF.

Internal loans became an option as a result of revisions to Oregon Budget Law which occurred during the 1999 legislative session. The County has typically used internal loans to finance capital projects when the cost of issuing bonds would be prohibitive. For example, the Dunthorpe-Riverdale Sanitary Service District is currently repaying an internal loan from the Risk Management Fund that supports upgrades to a sewage treatment plant. A debt issue was ruled out as an option because the district serves a relatively small number of customers over whom the financing costs would have been spread.

As noted above, the funds from which an internal loan can be made are fairly limited. An internal loan to finance the CGF cash flow shortfall has become a more viable option in recent years. Through prudent application of Financial Policies and financial management practices we have accumulated fairly large balances in a couple of the County's internal service funds. Last year, for example, the balance in the Risk Management Fund was approximately 28% of total annual revenues. This level of reserves provides the County with a great deal of flexibility in assessing the options for short-term borrowing.

Until recently a bank qualification, or Banker's Note, was not an option the County would consider to cover the CGF cash flow shortfall. Before implementation of the ARRA provisions bank qualified loans for tax-exempt entities were limited to $10 million. In most years the shortfall has exceeded this amount. ARRA, however, increased the amount to $30 million and this would be sufficient to cover the shortfall in most years.

A bank loan has many of the same features as a TRAN. The Board is required to authorize the County to enter into the loan agreement, interest is generally charged at market rates, and there are some costs associated with issuance of the loan. But, unlike a TRAN, the loan is not subject to rating by Moody's and the time required to secure the loan is generally measured in days rather than weeks.

**Summary and Recommendations**

The CGF typically experiences a cash flow shortfall prior to the receipt of Property Tax revenues. It is short-term in nature, normally not longer than six to eight weeks in duration. Under the County's existing Financial Policies, as well as state and federal legislation, there are a few options available to finance the shortfall.

In years when the interest rate environment is favorable the County can realize positive interest arbitrage earnings. This would tend to make the issuance of a TRAN the recommended option for covering the CGF shortfall. However, the economic downturn has caused yields to decline and, based on analysis of current market trends, a TRAN is not a good option this year. The current yield on the County's investment portfolio is slightly more than 1.25% while it is likely that a one-year TRAN would have a true interest cost of 2% or more.

In addition, if we were to issue a TRAN it would take approximately eight weeks to secure the proceeds. That process should have begun in June or July in order to effectively cover the CGF shortfall. A bank loan, however, could be secured within two weeks. The interest on a bank qualification would be similar to the interest charged on a TRAN. But, the County could minimize the cost of borrowing by restricting the loan to a period that would not exceed the necessity of covering the cash flow shortfall. The County would also not be required to secure a rating from Moody's nor would there be a need to utilize Financial Advisor services. All these factors make a bank qualified loan a much more attractive option than issuing a TRAN at this time.

The recommended option, given an analysis of all the factors involved, is to request that the Board authorize a short-term, interfund loan from the Risk Management Fund to the CGF. This is the option that was used in FY 2009 (Resolution # 08-147) and most of the same factors apply again this year.

It is estimated that an **internal loan of up to $17.5 million** would be sufficient to cover the projected CGF cash flow shortfall (and any potential contingencies) in the current fiscal year. There is sufficient cash in the Risk Management Fund to make this loan. The resolution can be drafted to direct that the loan be made in October and repaid at the end of November which would effectively limit the impact on interest earnings in the Risk Management Fund. In addition, there is no requirement to accrue an interest payment on the loan. It is, therefore, the lowest cost, least time consuming option available to the County.

Based on the considerations noted above it is recommended that the Board authorize an internal loan to cover the anticipated CGF cash flow shortfall. A resolution can be prepared and brought forward on October 22nd to authorize a loan from the Risk Management Fund to the General Fund. It is also recommended that the matrix outlined in ***Attachment 2*** be used to guide future decisions regarding the appropriate option for financing short-term cash flow shortfalls.

# Attachment 1

## Multnomah County, Oregon

General Fund Cash Flow Summary - Projected For Fiscal Year 2009-2010

| | Budget | Maximum Deficit (October 31) | Year-End Forecast |
|---|---|---|---|
| Beginning Balance | $ 23,133 | $ 29,984 | $ 29,984 |
| Property Taxes | 221,248 | 1,210 | 220,877 |
| Other Taxes | 61,942 | 16,546 | 59,397 |
| Intergovernmental | 26,807 | 5,663 | 25,279 |
| Interest Earnings | 2,260 | (1,503) | 2,147 |
| Other Receipts | 45,797 | 22,749 | 39,842 |
| Total Revenue | $ 381,188 | $ 74,650 | $ 377,527 |
| | | | |
| Personal Services | $ 202,905 | $ 66,384 | $ 197,597 |
| Contractual Services | 59,476 | 14,979 | 57,190 |
| Materials & Supplies | 15,198 | 5,336 | 14,657 |
| Internal Services | 45,710 | 14,127 | 44,204 |
| Debt Service | 940 | 13 | 13 |
| Capital Outlay | 317 | 39 | 192 |
| Cash Transfers | 23,778 | 1,500 | 21,965 |
| Total Spending & Cash Transfers | $ 348,325 | $ 102,377 | $ 335,818 |
| Excess/(Shortfall) | $ 32,863 | $ (27,727) | $ 41,709 |
| Cash & Current Assets (Trial Balance) | | 12,235 | |
| Net Excess/(Shortfall) | | $ (15,492) | |

# Attachment 2

## Options to Finance Short-Term Cash Flow

| | TRAN | Tax Exempt Bank Loan | Internal Loan |
|---|---|---|---|
| Amount Required | \$17,500,000 | \$17,500,000 | \$17,500,000 |
| Interest Cost (1) | 1.8% - 2.5% | 2% - 2.25% | N/A |
| Other Issuance Costs | \$30,000 - \$50,000 | \$1,000 - \$2,000 | N/A |
| Duration of Loan | 1 Year | 3 Months | 1 Month |
| Potential Arbitrage | Negative | Slightly Negative | N/A |
| Time Needed to Secure Funds | 8 - 10 Weeks | 2 Weeks | Board Resolution |
| Moody's Rating Required | Yes | No | No |

Notes:
(1) Interest Rates Estimated at Time of Borrowing, TRAN Estimate Based on Offerings of Comparable OR Jurisdictions, No Interest Payment Required on Internal Loan if Duration is Less Than One Year.