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# 2010 Financial Policy Report and Recommendations\*

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City of Dover, NH  
Ad-Hoc Financial Policy  
Review Committee

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*February 10, 2011*

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\* Report and Recommendations approved by vote of Committee with Councilor Cheney opposed

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**Contents**

An Introduction to Financial Policies: ..... 1

The Initial Development and Adoption of Dover’s Financial Policies: ..... 2

Benefits Resulting From the Adoption and Implementation of Financial Policies: ..... 2

The Current Review and Update of Dover’s Financial Policies: ..... 3

The Recommended Update of Dover’s Financial Policies: ..... 3

    Stabilization Funds: ..... 3

    Fees and Charges: ..... 5

    Debt Issuance and Management: ..... 5

    Debt Level and Capacity:..... 6

    Use of One-Time Revenues:..... 7

    Use of Unpredictable Revenues:..... 7

    Balancing the Operating Budget: ..... 8

    Revenue Diversification: ..... 8

    Contingency Planning: ..... 8

Accounting Basis and Concepts: ..... 9

Financial Condition and Bond Ratings: ..... 11

Explanation of Policies Related to Stabilization Funds: ..... 14

Explanation of Policies Related to Fees and Charges: ..... 23

Explanation of Policies Related to Debt Issuance and Management: ..... 25

Explanation of Policies Related to Debt Level and Capacity: ..... 28

Explanation of Policies Related to Use of One-time Revenues: ..... 32

Explanation of Policies Related to the Use of Unpredictable Revenues: ..... 33

Explanation of Policies Related to Balancing the Operating Budget: ..... 34

Explanation of Policies Related to Revenue Diversification: ..... 35

Explanation of Policies Related to Contingency Planning:..... 36

Implementation of Recommended Updates to Financial Policies:..... 38

Appendices..... 39

    Recommended Financial Policies Impact Analysis..... 40

    2010 Moody’s Investor Services Dover, NH Rating Information ..... 45

    2010 Standard & Poor’s Rating Services Dover, NH Rating Information ..... 51

# Report and Recommendations of the Ad-Hoc Financial Policy Review Committee

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## **An Introduction to Financial Policies:**

Financial policies are a highly recommended component of any government financial management program. The Government Finance Officers Association (GFOA), through its recommended practices, endorsement of the National Advisory Council on State and Local Budgeting (NACSLB) recommended budget practices, and the GFOA distinguished Budget Presentation Awards program, recommends that all governments develop financial policies.

Financial policies are guidelines for operational and strategic decision making related to financial matters. Financial policies identify acceptable and unacceptable courses of action, establish parameters in which a government can operate, and provide a standard against which a government's fiscal performance can be judged.

The characteristics that define good financial policies are those that:

- Incorporate a long term perspective;
- Establish linkages to broad organizational goals;
- Focus budget decisions on results and outcomes;
- Involve and promote effective communications with stakeholders; and
- Provide incentives to government management and employees.

Elected officials and staff are wise to support the design and implementation of financial policies. Policies offer guidance to new board members and staff unfamiliar with a government's finances. Financial policies also serve as an ongoing context for policy making and management decisions, thereby providing consistency and quality control.

Financial policies strengthen a public organization during times of financial difficulty because guidelines are set to control debt, limit spending, and increase revenues. Formal policies codify the "rules of engagement" for enhancing and maintaining the overall financial health of a public organization.

### **The Initial Development and Adoption of Dover's Financial Policies:**

In 1996, the then Mayor and City Council established an ad-hoc Financial Planning Committee consisting of two City Council members, three citizens experienced in strategic finance related matters and the Finance Director. Committee members were charged with developing and recommending to the City Council a financial plan for the City of Dover. The Committee held several meetings over the course of one year, reviewing financial information and meeting with the City's independent auditors to identify and consider sound financial practices and develop recommendations for financial policies.

On October 16, 1996, the Financial Planning Committee submitted their final report with recommended financial policies to the City Council. The report contained a series of recommendations addressing maintenance of fund reserves, capital improvements planning, debt issuance, cash flow, management of enterprise funds and the City's budget process. Following a subsequent workshop meeting to review the findings presented in the report, the Mayor and City Council adopted on December 11, 1996 twelve finance policy goals as recommended by the Committee. These policy goals have remained in place and unchanged since their formal adoption thereby constituting the City's continuing financial policies, providing several key parameters by which the City's finances have been guided to this day.

### **Benefits Resulting From the Adoption and Implementation of Financial Policies:**

Since the formal adoption of Financial Policies in 1996, the City has proceeded with implementing the various recommendations. Although the policies have not been fully achieved in all regards, substantial progress has been made and the Financial Policies continue to provide guidance today in managing the fiscal affairs of the community.

As was anticipated by the 1996 Financial Planning Committee, several key benefits have resulted since the implementation of the policies and these benefits continue to be realized in various degrees today. These include:

- Better ability to address budgetary emergencies and withstand economic downturns
- Better long term planning
- Proper financing of capital acquisitions
- Smoothing the tax levy change from year to year in accommodating large purchases
- Timely replacement of capital assets through capital reserve funds
- Control debt growth
- Maintain aggressive debt retirement
- Improve cash flow and investment income opportunities
- Elimination of short term borrowing
- Maintain self sufficiency of the utility funds
- Avoid large year to year increases in user fees
- Improved budgeting process
- Upgrades and maintenance of the City's bond rating
- More flexibility and savings in debt financings

## **The Current Review and Update of Dover’s Financial Policies:**

Recognizing the continued benefit with maintaining and adhering to sound financial policies and noting that the last formal review of the City’s financial policies had occurred more than a decade earlier, the current Mayor and City Council established an ad-hoc Financial Policy Review Committee on January 13, 2010. This Committee consisted of the Mayor, a City Councilor, a School Board member, two citizens with financial planning backgrounds, the City Manager and the City’s Finance Director. The Committee was charged with considering and recommending to the City Council revisions to the City’s existing financial policies as originally adopted in 1996.

The Finance Policy Review Committee began meeting on March 25, 2010 and since that time has met on several occasions. Meetings have included presentations and recommendations made by both the City’s independent auditor and Financial Advisor. The existing financial policies adopted in 1996 were reviewed along with the recommended practices established by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB). The Committee evaluated the basis for certain index levels established earlier in existing policies and the need for updating those levels based upon more current economic circumstances.

In completing its review, the current Finance Policy Review Committee has now developed an updated series of recommended financial policies building upon those first established in 1996. These recommendations include maintaining all of the existing policy statements with updates to several of the benchmark indices included therein. In addition, several new policy statements are also included in the recommendations reflecting the most current best practices identified by the GFOA and NACSLB.

## **The Recommended Update of Dover’s Financial Policies:**

The revised Financial Policies with updates and additions as recommended by the Ad-Hoc Financial Policy Review Committee are as follows:

### Stabilization Funds:

1. The City shall maintain adequate fund reserves to protect itself against emergencies and economic downturns.
  - a. General Fund – The City shall achieve and maintain a minimum unassigned fund balance of 8% of the General Fund’s annual budget, including City, School and County appropriations. The City Council may appropriate the General Fund unassigned fund balance for emergency purposes per City Charter Section C3-9 A or otherwise unanticipated expenses at year end, as deemed necessary, even if such use decreases the General Fund fund balance below the designated percentage. For purposes of this section the following shall apply:
    - i. Emergency purpose does not include the offsetting of property taxes.
    - ii. Unassigned fund balance will be defined by generally accepted accounting principles.
    - iii. The General Fund unassigned fund balance target level shall be achieved by annually budgeting a fund balance contribution over a six year period apportioned between both the City and School portions of the General Fund annual budget. These amounts shall be removed if the targeted level is achieved earlier.

- b. Special Revenue Funds – Non Grant – The City shall achieve and maintain minimum unassigned fund balances of 5% of the total appropriations of each such fund budgeted.
    - c. Enterprise Funds – The City shall maintain net current assets (excluding unspent cash from bond proceeds) of 15% of the total appropriations of each such fund in a given fiscal year.
    - d. Internal Service Funds (in general) – The City shall maintain net current assets of 100% of inventory levels.
      - i. Workers Compensation Fund – The City shall maintain 100% funding for an actuarially determined claims liability based on a 65% confidence level.
2. The City shall establish a dedicated fund and maintain sufficient annual contributions to offset the liability associated with other post-employment benefit (OPEB) obligations.
  - a. OPEB Fund – The City shall achieve and maintain an annual contribution from the respective budgetary funds based upon the actuarially calculated Annual Required Contribution (ARC) for its OPEB obligation.
    - i. The OPEB annual contribution target level shall be achieved by annually budgeting in each of the respective budgetary funds, at a minimum, the current year OPEB related expense plus an additional amount equivalent to 5% of the ARC amount and increasing in increments of 5% each year. The increasing increments will be stopped once the accumulated net OPEB related liability is decreased.
3. The City shall establish and maintain sufficient annual contributions into capital reserves for infrastructure and equipment needs associated with the City’s major operating funds as identified and planned for in the annually adopted Six-Year Capital Improvements Plan (General, Water, and Sewer).
  - a. The General Fund Capital Reserve shall be funded at a minimum amount based on achieving a discounted ten year goal of \$5,000,000.
  - b. The Water Capital Reserve shall be funded at a minimum amount based on achieving a discounted ten year goal of \$5,000,000.
  - c. The Sewer Capital Reserve shall be funded at a minimum amount based on achieving a discounted ten year goal of \$5,000,000.
4. The City shall establish and maintain regular contributions into an employee benefit stabilization fund to be used to offset fluctuations in actual benefit related expenses from year to year.
  - a. The amount to be budgeted each year for health insurance premiums will be set based upon the average change in the cost of health insurance premiums over the prior 10 years.
  - b. When the actual premium costs paid are less than the amount budgeted, the savings will be contributed into a health insurance stabilization fund.
  - c. When the actual premium costs are more than the amount budgeted, funds will be withdrawn provided no more than 25% of the fund balance is depleted.
5. The City shall utilize year-end surplus funds to build and maintain stabilization funds at minimum levels giving priority for allocations to be made in the following order: unassigned fund balances, OPEB obligations, capital reserves and then benefit expenses.

6. Upon achieving minimum levels established for each stabilization related fund, should amounts fall below the minimum thresholds in subsequent years, the City shall include allocations in the following annual budgets to return to the minimum amounts specified.

Fees and Charges:

7. The various boards and commissions that advise the City Council and City Manager shall review all fees that support such functions annually and report recommended changes to the City Council and City Manager prior to the preparation of the annual budget.
8. It shall be the intent for the City to establish fees and charges to cover costs associated with providing certain services or programs that individually benefit a person, family or other specific segment of the community at a given time as opposed to utilizing funds derived from general tax dollars for services and programs intended to generally benefit the whole population of the community all of the time.
  - a. In establishing non-resident fees and charges, the City shall strive to cover all direct and indirect costs including debt service and inter-fund transfers associated with the service or program.
  - b. In establishing resident fees and charges, the City shall strive to cover, at a minimum, direct costs associated with the service or program.
9. The City shall continue to maintain all enterprise funds on a self-sustaining user fee basis, with no support from property tax revenues. Fees shall be set annually to support the adopted budget.
  - a. Water and Sewer fees shall be calculated by dividing the amount of money to be raised by the billable volume, in one hundred cubic feet units, expected for the year.
10. The City shall prepare and adopt a Fee Schedule in conjunction with the annual adoption of the budget that will itemize and provide the justification for all fees and charges to be levied in the coming fiscal year.

Debt Issuance and Management:

11. The City Council shall annually, by resolution, adopt a six year Capital Improvements Planning (CIP) document.
  - a. The CIP document shall contain a listing of all planned capital improvement program projects, identifying the source of financing and delineating the estimated impact to annual operations and maintenance.
  - b. The City Council shall typically appropriate the funding for multi-year projects at the same time it funds the first year portion of the project.
  - c. The first year of the adopted CIP shall provide the basis for the City Manager to develop the proposed capital outlay and debt service portions of the subsequent fiscal year budget.
12. The City shall maintain formal criteria for inclusion of a project in the CIP:
  - a. In order to be included within the CIP, a project needs to have an estimated annual aggregate cost of \$25,000 or more and have a useful life of three years or greater.
  - b. Projects must satisfy at least one of the following:

- i. Protect the health and safety of employees and/or the community at large.
- ii. Significantly improve the efficiency of existing services.
- iii. Preserve a previous capital investment made by the City.
- iv. Significantly reduce future operating costs or increase future operating revenues.

13. The City shall finance qualifying CIP projects using established criteria:

- a. Debt Financed – Purchases financed by the issuance of bonds or capital leases. Purchase of assets of \$250,000 or more, nonrecurring within a five year period, and with a useful life of five years or more are recommended for debt financing. This shall include design costs for projects even when the costs occur in an earlier year.
- b. Capital Reserve Financed – Purchases financed by savings from annual appropriations over a period of time for assets over \$25,000 recurring or not. Capital reserves can be established for a specific item or a type of item.
- c. Grant Financed – Purchase of assets over \$25,000 partially or wholly funded by grants from the State or Federal government.
- d. Existing Funds Financed – After the CIP projects are submitted and compiled, any items that can be financed with existing funds shall be identified. Existing funds could be any funds available from savings from another project or other source of funds.
  - i. If bonded funds are to be used, the item has to meet the useful life criteria for the remaining years of amortization of the bond funds used.
- e. Operating Budget Financed – Purchase of assets of less than \$250,000 or recurring in nature, are recommended to be financed through the annual operating budget for the fund involved. Annual programs, whether over \$250,000 or not, are suited for operating budget financing due to the ongoing nature of the program.

14. In utilizing debt financing for CIP related projects, the useful life span of the capital project or item shall equal or exceed the years for amortization of the bond.

15. In consultation with the City’s designated financial advisor, the City shall regularly analyze and pursue bond refunding in instances where significant savings or other substantial benefits will be realized.

Debt Level and Capacity:

16. The City shall size the issuance of the local share of new debt so as not to exceed certain parameters in any given fiscal year:

- a. The City portion shall not exceed 65% of the State of NH legal limit.
  - i. The debt related to Tolend Landfill Closure is to be excluded in calculating the City portion for purposes of this section.
- b. The School portion shall not exceed 28% of the State of NH legal limit.
- c. The Water portion shall not exceed 5% of the State of NH legal limit.
- d. The Sewer portion shall not exceed 1.5% of the City’s equalized assessed value for debt limits.



17. The City's net annual debt service (payment of principal and interest less reimbursements) shall not exceed certain parameters in any given fiscal year:
  - a. General Fund debt service for a fiscal year shall not exceed 10% of the total appropriations of the General Fund.
    - i. The debt service related to Tolend Landfill Closure is to be excluded in calculating the City portion for purposes of this section.
  - b. Enterprise and Special Revenue Fund debt service for a fiscal year shall not exceed 40% of the total appropriations for the fund involved.
18. The City shall maintain a pay down of net debt (debt principal less reimbursements to be received) for each fund whereby 75% or more is retired within the next ten years.
19. To reduce reliance on an increased utilization of debt for capital related maintenance needs in future years, the City shall achieve and maintain a minimum level of capital outlay in each of the major operating funds as part of the annual budget adoption for sustaining the community's existing and future infrastructure and equipment:
  - a. The target level of operating capital outlay to be included as part of the General Fund annual budget shall be increased annually to achieve at least 7.5% of total General Fund appropriations.
  - b. The target level of operating capital outlay to be included as part of the Water Fund annual budget shall be increased annually to achieve at least 13% of total Water Fund appropriations.
  - c. The target level of operating capital outlay to be included as part of the Sewer Fund annual budget shall be increased annually to achieve at least 11% of total Sewer Fund appropriations.

Use of One-Time Revenues:

20. The City shall use one-time revenues for the limited purpose for which they were intended or, in the absence of a specified purpose, for a non-recurring capital expenditure or as a contribution towards building established stabilization funds. One-time revenues shall not be used to fund existing operations.
  - a. One-time revenues are those which are not expected to recur beyond a limited period or remain sustainable for a continued future use. These may include proceeds from sale of a specific asset, grant funds, etc.
21. Grant funds with continuing obligations beyond the grant period shall be reviewed and approved by vote of the City Council prior to acceptance of award.

Use of Unpredictable Revenues:

22. To improve the timing of cash collections required for disbursements made throughout the fiscal year and minimize the possibility of incurring additional expenses associated with short term borrowing for operational needs, the City shall revise Property Tax due dates in accordance with provisions established by NH law.

23. The City shall anticipate and take into consideration unpredictable revenues in conjunction with reviewing and adopting the annual budget.
  - a. Unpredictable revenues include types that originate from sources not under the City's own control or influence such as intergovernmental revenues shared at the discretion of other levels of government.
24. The City shall rely upon conservative and reasonable revenue estimates in establishing annual budgets. The City Manager, in consultation with the Finance Director, is responsible for assembling and submitting revenue estimates supporting the annual budget that are current and based upon objective and reasonable analysis.

Balancing the Operating Budget:

25. In preparing and adopting the annual budget, the City shall achieve a balanced budget whereby estimated revenues equal or exceed budgeted expenses (including debt service and transfers).
26. Preliminary budget estimates reflecting the adopted Financial Policies for the following fiscal year for both the City and School portions shall be submitted to the City Council by the City Manager prior to January 31<sup>st</sup>. The City Council shall review and approve a preliminary budget resolution by its next regularly scheduled meeting to give budgetary guidance to the City Manager and the School Department for development of the budget for the next fiscal year.
27. Throughout the course of a fiscal year, actual budget results will be monitored and reported on a regular basis. Adjustments to estimated revenues and budgeted expenditures may be made at any time during the course of the fiscal year to ensure the budget remains balanced. If necessary, transfers and/or overall budget amendments will typically be made immediately prior to year end closing.

Revenue Diversification:

28. The City shall strive to achieve a diversified and stable revenue system as a protection from short run fluctuations.
  - a. The City shall maintain support for economic development initiatives which diversify the local property tax base, retain and expand existing businesses and create additional job opportunities.
29. The City shall periodically review and maintain impact fees to offset the local impact of private development.
  - a. Impact fees will be accumulated and utilized for their intended purpose in accordance with State of NH law and whenever a significant portion of a project cost previously identified in the CIP can be covered.

Contingency Planning:

30. The City shall routinely budget funds annually for unanticipated expenses and minor emergency situations as a contingency line item in each of the major operating funds.

31. In the instance of a catastrophic or otherwise significant unanticipated financial need impacting the community, the City shall utilize the emergency powers afforded by provisions of State of NH law and City Charter to address the matter in a fiscally responsible and timely manner. Use of existing discretionary budgeted funds, the curtailment of discretionary expenditures, and access to accumulated stabilization funds, along with pursuing reimbursements where available, will be utilized to meet the City's contractual and other obligatory financial commitments along with addressing the need that has arisen.
32. Deviations from adopted financial policies are to be anticipated to accommodate various situations that may arise from time to time. In particular, deviations may specifically occur where there is an offsetting condition or benefit to the City. In such cases where adherence to a specific financial policy may not be possible or otherwise is not achieved, the nature of the deviation and the rationale shall be noted as part of the decision making process.

Each of the overall financial policies listed above are further defined and substantiated with supporting background and explanation as provided in the following sections.

### **Accounting Basis and Concepts:**

In order to understand many of the finance policy goals presented herein, it is important to understand a little about governmental accounting and the City's financial reporting. By necessity, there are key differences between governmental financial accounting and the accounting used for private-sector business enterprises. These differences reflect the special emphasis on demonstrating compliance with finance related legal and contractual provisions, as well as the desire to provide readily accessible information relevant for decision-making in a public sector environment.

The three key elements that distinguish governmental financial accounting from the private sector model are:

Fund Accounting – Governments establish separate funds to segregate financial resources that are subject to special regulations, restrictions, or limitations. These funds are categorized into Governmental, Proprietary, and Fiduciary type funds depending upon the nature of the activities for which they account. Governmental funds (General, Special Revenue and Capital Projects) are used to primarily account for tax-supported (governmental) activities. Proprietary funds (Enterprise and Internal Service) are used in connection with a government's business type (fee-supported) activities (i.e. Water and Sewer). Fiduciary funds (Trusts and Agency) are used to account for government-held resources that are not available to support the government's programs (i.e. cemetery perpetual care, student scholarships, etc.).

Accounting Basis - there are two basic methods of governmental accounting; modified accrual and full accrual.

The first method, modified accrual, is applied to Governmental Funds (General Fund, Special Revenue, Capital Projects), Expendable Trusts and Agency Funds. This method of accounting measures the financial position and changes of *current financial resources*, that is, current assets

and current liabilities. Fixed assets and long term liabilities are not reflected within the funds. Current assets are cash, receivables, inventories and other assets that are likely to be converted, exchanged or expensed within a year. Current liabilities are accounts payable or other debts that will be due within a year. Net current assets, or working capital, are arrived at by subtracting current liabilities from current assets.

The second method, full accrual, is applied to Proprietary Funds (Enterprise and Internal Service) and Nonexpendable Trusts. This method of accounting measures the financial position and performance of operations of all assets and liabilities, both current and long term, associated with the operations of the fund. Long term assets include land, property, plant and equipment used to generate revenue. Long term liabilities are debts payable beyond the next year including bonds used to finance long term assets.

**Budget Statements** – Although private sector businesses adopt budgets as financial plans, they generally do not officially report budget to actual comparisons in connection with their publicly available financial reports. For governments, the budget is much more than an internal financial plan. The budget is publicly reported and serves as a key control providing certain legal authority.

Also differentiating governmental accounting from private sector financial reporting are the controlling standards. The generally accepted accounting practices followed by governmental entities, the City included, are derived from the standards developed and published by the Governmental Accounting Standards Board (GASB). This body, through the issuance of statements and other written guidance, establishes the standardized practices and promotes improvement of accounting and financial reporting specific to governmental entities.

Traditional governmental financial reporting has always placed strong emphasis on legal budgetary compliance and as a result has been generally successful at providing a higher level of fiscal accountability albeit with a short-term year-to-year horizon. Recognizing a need to improve operational accountability with a longer term view beyond that which had often been lost in the detail of fund accounting, in 1999, GASB instituted Statement 34, *Basis Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. In conforming with the requirements of this new standard, governments across the country, including the City, instituted a number of significant financial reporting changes beginning in 2000 and continuing through 2004. These changes have resulted in a government wide financial report that unifies and captures all activities into a single comprehensive financial report reflecting both short and long term perspectives of financial resources. The City’s issuance of a Comprehensive Annual Financial Report (CAFR) in conjunction with the fiscal year-end independent audit not only ensures continuing compliance with this standard but provides a reporting mechanism by which adherence to the City’s financial policies can be checked for both past and future periods.

In further refining and improving upon governmental accounting practices, GASB continues to develop and institute additional accounting standards, of which two others, in particular, are noteworthy for purposes of the specific policies recommended in this report: GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* instituted in 2004 and Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions* instituted in 2010.

Recognizing that the financing of post-employment benefits represents a substantial long-term expense for governmental entities, GASB Statement 45 requires that these continuing benefit costs be calculated in advance and reflected in ongoing financial reports. Other Postemployment Benefits (OPEB) are obligations payable to, or resulting when, former employees continue to access employer provided benefits such as insurances. These obligations can be in the form of explicit or implicit expenses incurred over the duration of having access to the benefit.

State of NH law requires public employers such as the City to allow retired employees to continue to access the employer's group insurance plan. As a result of this requirement, there is an implicit expense incurred by the City from higher risk retirees (often older and more prone to health problems) increasing the premiums paid for current employees. In addition to this implicit expense, for employees hired prior to 1999, the City had contractually agreed to provide various levels of paid insurances for the remaining life of the full-time employee following their retirement. The continuation of this insurance coverage for those eligible retirees results in a recurring explicit annual expense for the insurance premium being paid by the City.

The combination of the implicit and explicit expenses resulting from these OPEB's are projected forward using actuarial calculations and, as a result of GASB Statement 45, are now required to be reflected as a long term liability in governmental financial reports. The inclusion of these OPEB related amounts in financial reports contributes to a more objective and accurate measure of the government's long term financial obligations. The City has been completing these calculations and recording this liability in its CAFR since 2006.

Lastly, the most recent GASB related standard impacting governmental accounting and specific recommendations addressed in this report, Statement 54, seeks to improve the understanding of the components and terminology that make up various fund balances.

There is no single number in governmental accounting and financial reporting that attracts more interest and discussion than fund balance. GASB Statement 54, now requires that fund balances be reported using refined terminology that better reflects "the extent to which a government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent. In doing so, terminology such as "designated" and "undesignated" fund balances have been replaced and expanded into five components. These components include Non-spendable, Restricted, Committed, Assigned and Unassigned fund balance. For purposes of these financial policies, the unassigned fund balance component is addressed specifically and is comparable to the undesignated fund balance definition reflected in the 2006 Financial Policies.

### **Financial Condition and Bond Ratings:**

The existing financial policies adopted in 1996 have provided a continuing framework for the City's financial management practices over the past fourteen years. The combination of having formally established financial policies and sound financial management practices has served to strengthen the City's financial condition during that time. The current review and updating of the City's financial policies in combination with ongoing managerial practices is essential to support a continued strengthening of the City's overall financial health going forward. This need is particularly evident in the

face of current and future fiscal challenges resulting from ongoing municipal obligations, mandates and increased downshifting of costs by other levels of government, and the impact of a prolonged economic recession throughout our region and the world.

The measure of any community's fiscal condition is primarily determined by its ability to appropriately finance services and related infrastructure on a continuing basis. More specifically, financial condition is reflected in the community's ability to sustain existing service levels, withstand both local and far-reaching economic disruptions and meet the demands that natural growth, decline and change create throughout the community.

The City's financial condition in the early 1990's, prior to the adoption of the original financial policies, was weakened significantly by deficits in the General Fund, high uncollected tax and utility receivables, and an increasing reliance on debt to address infrastructure maintenance needs. Dover, along with other communities, also suffered from the economic decline that occurred in the late 1980's and early 1990's impacting property values, slowing new construction and rising unemployment levels. At its lowest during that time period, the City experienced a deficit in its General Fund Undesignated Fund Balance approaching \$2.6 million and deferred tax revenues exceeding \$4.1 million. Property values and new construction activity declined sharply and unemployment approached 8%.

Following the adoption of the original financial policies, varying degrees of progress have been made in meeting the goals that were established. In recent years, the City's General Fund undesignated fund balance has consistently realized a surplus exceeding \$5.0 million, remaining slightly above the 6% of budget level established by current policy. Deferred tax revenues are slightly below \$2.3 million and unemployment has fallen to less than 6% despite the lingering effects of a world-wide financial crisis. Property values have declined as a result of the recession brought on by this wide spread crisis. In addition, new building has slowed after a near decade of record construction activity and property value appreciation.

A qualitative, yet more objective measure of a community's overall financial condition is derived from the periodic bond rating process conducted by independent credit rating firms. Prior to issuing municipal bonds for sale, the City seeks a formal review and rating of its financial condition to establish a comparative ranking of the financial risk involved in purchasing bonds from the City. This credit risk is determined by analysts reviewing the finances of the City, completing comparative year to year analyses, calculating ratios, detecting both economic and financial trends, considering any major liability issues and interviewing management regarding current and future policy related initiatives. The City has engaged Moody's Investor Services along with Standard & Poor's Rating Services consistently over the past several years to evaluate and establish its official bond rating.

There are seven major rating categories used by Moody's for municipal bonds. They are in order 'Aaa' (highest quality), 'Aa', 'A', 'Baa', 'Ba', 'B', 'C' (lowest quality). Except for 'Aaa' & 'C', each category has sub ratings of 1, 2 and 3 to indicate finer levels of quality within each category. 'Baa' is Moody's lowest investment grade rating.

There are nine major rating categories used by Standard & Poor's for municipal bond ratings. They are in order 'AAA' (highest quality), 'AA', 'A', 'BBB', 'BB', 'B', 'CCC', 'CC', 'C' (lowest quality). Ratings

from 'AA' to 'CCC' may be modified by a '+' or '-' to indicate the finer levels of quality within each category. 'BBB' is Standard & Poor's lowest investment grade rating.

From 1940 until 1990 the City of Dover held an 'A' rating as determined by Moody's. Prior to adoption of the current financial policies, the City received two downgrades in 1990 and 1991 based upon Moody's analysis of the City's declining financial condition and increasing credit risk. The City was downgraded initially to a 'Baa1' and then to a 'Baa', where 'Baa' reflected the lowest investment grade rating before falling into what was then commonly referred to as "junk bond" status. The reason for the downgrades was related to growing fund balance deficits, unbalanced budgets, lack of sufficient reserves, and substantially reduced tax collections brought on by the significant economic decline that occurred throughout the late 1980's and continuing into the 1990's.

Following adoption of the current financial policies in 1996 and with efforts underway to achieve the related goals, the City began to realize bond rating improvements beginning first in 1999 when upgraded by Moody's to 'Baa1'. This upgrade was primarily attributed to improved fund balances and tax collections resulting from an improving economic climate along with recognition of the initial progress made towards achieving the formal goals outlined in the financial policies.

In 2001, the City received a second bond rating upgrade by Moody's to 'A3'. In 2003, the City received a third upgrade from Moody's to 'A2' and was recognized with an initial rating by Standard & Poor's of 'A+'. In 2005, Standard & Poor's raised the City's rating a second time to 'AA-' and a third time, in 2008, to 'AA'. Most recently in 2010, Moody's recalibrated its U.S. Municipal Rating scale to coincide with the Global Scale for corporate and sovereign debt familiar to private investors, which resulted in the City's 'A1' rating converting to 'Aa2'.

At this time, the City maintains a bond rating by Moody's of 'Aa2' and by Standard & Poor's of 'AA'. The definitions associated with these current ratings relate directly to the assessment made of the City's overall financial condition:

Moody's 'Aa' Rating – "Obligations rated 'Aa' are judged to be of high quality and are subject to very low credit risk."

Standard & Poor's 'AA' Rating – "An obligor rated 'AA' has very strong capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree."

Issued in 2010, the Standard and Poor's report, assigning their current 'AA' rating, specifically noted that the City's financial condition benefits from a sound local economy, moderate debt burden with limited additional capital needs, overall income levels in the good to strong range, low unemployment consistently below state and national levels and maintenance of a good financial position as measured by the City's unreserved fund balance. While addressing strong income levels benefiting the City, the Standard and Poor's analysts noted that per capita income was high in comparison to both national and state-wide measures while household income was above national figures yet below state levels. Analysts also recognized "double-digit" growth in property values over the course of the last decade and, despite more recent declines, the City's per capita market value remained very strong above both national and state levels.

Also issued in 2010, the Moody's report, resulting in their current 'Aa2' rating, noted the City's moderately sized tax base with average wealth levels, satisfactory financial operations, above average debt burden and economic stability. The Moody's analysts noted that the City's continuing commitment to balance budgets without use of fund balance and adherence to adopted fund balance policies contributed to the satisfactory assessment.

The outlook for the City's financial condition as recently reported by both Moody's and Standard & Poor's was stable. This outlook is reflected in a sound local economy, a healthy and stable tax base, an above average but manageable debt burden and a satisfactory general fund financial position. Also considered were consistent efforts in managing the City's finances to maintain balanced budgets and minimum fund balances consistent with policy guidance.

For more details concerning the individual assessments made of the City's overall financial condition, the recent ratings reports provided by Moody's and Standard and Poor's are included in the appendices to this report.

In determining credit risk, the bond rating process provides an independent comparative measurement of the City's financial health and, as such, it is routinely referred to and made available to all interested parties. Aside from determining and reporting the City's overall financial condition, there are major implications to having a lower bond rating. Even if bonds are insured, the underlying credit of the municipality can affect the interest rate attained. Lower credit ratings generally mean higher interest rates, which for long term securities can mean significantly higher costs. Second, it can restrict the City from issuing its own long term debt. Although other avenues may be present, they may not have the structure or maturity dates the City desires. Lower ratings can also affect short term financings, either through higher interest costs or, even worse, the evaporation of investor interest. A good rating can increase flexibility in the market place by allowing the City to structure its bonds to its needs. Better ratings tend to draw more investors, which can save money through competition.

There are two major implications to having a lower bond rating. Lower ratings generally mean higher interest rates, which for long term securities can mean significantly higher costs. Generally, there is an exponential increase in cost for every quality level change in a bond, the spread widens as the quality level lowers. Using this rough guide, for ten million dollars bonded on its own over 20 years, the City would pay an added cost difference of \$1,250,000 in interest if its bond rating were to fall one level and \$3,100,000 if its bond rating were to fall two levels. Conversely, if the City were to improve its bond rating by one additional level and bond the same ten million dollars over 20 years it would realize a significantly smaller savings of \$228,000. Given the disparity in benefits associated with a rating increase versus a decrease it is imperative that the City continue to at least maintain its current bond rating and avoid both the stigma associated with a rating decrease and the sizeable increase in borrowing costs that would result.

### **Explanation of Policies Related to Stabilization Funds:**

Following are the policy explanations that guide the creation, maintenance, and use of resources for financial stabilization purposes. In general, governments should maintain a prudent level of financial



resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures.

These policies establish how and when the City builds up stabilization funds and the purposes for which they may be used.

Stabilization funds have been called by many names including rainy day funds, unreserved fund balance, undesignated fund balance, and/or contingency funds. These funds are to be used at the City Council’s discretion to address temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. They provide flexibility to respond to unexpected opportunities that may help the local government achieve its goals. Policies on the use of these funds also address adverse changes in economic indicators (such as declining revenues or slowing tax collections) to ensure that the funds are not depleted before an emergency arises. The minimum amounts to be accumulated are based on the fund type, the level of uncertainty associated with revenues, the condition of capital assets, and the City’s level of security with its financial position.

1. **The City shall maintain adequate fund reserves to protect itself against emergencies and economic downturns.**

**General Fund**

The General Fund is the primary fund of the City and its financial health affects the well-being of the whole municipal organization. Because the General Fund is a Governmental Fund, the fund reserves, or fund balance, represent net current assets or working capital. It is important to maintain a certain amount of fund balance in order to assist with cash flow, to deal with emergencies that may arise and/or help during economic downturns. How much fund balance to maintain is dependent on many factors. Each community has different needs, but some rules of thumb apply. Moody's Investors Service advises that a community of Dover’s size and character should have median fund balances approaching 28% of the operating budget. The N.H. Department of Revenue Administration recommends NH municipalities have a fund balance of upwards of 10% of the operating budget. The GFOA advises local governments to maintain fund balances in the range of 8% to 17% of operating expenditures. No municipality, company, nor individual should operate without a financial buffer. It is too risky to do so and the City's credit rating suffered prior to the establishment of the current 6% minimum as a result of not having consistently maintained this buffer.

After reviewing various percentage levels of fund balance and the impact to the budget of achieving that level, the Committee recommends an 8% level for the General Fund. The Committee believes the City needs to set a higher level than the 6% minimum recommended by the previous Finance Policy Committee, however, a 10% level seems excessive. The table below reflects achieving a target balance of 8% by budgeting an annual contribution to be apportioned between the City and School portions of the budget over the next six years.

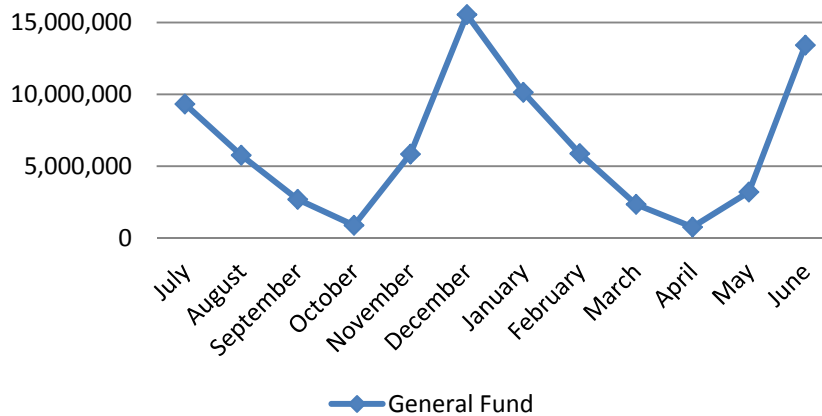
<b>GF Fund Balance</b>					Budget	Policy		Baseline	Policy
	Estimated				Increase	Change	Assessed	Tax Rate	Tax Rate
	Budget	Target	Est Balance	Change	Impact	Impact	Value	Impact	Impact
2011	84,710,539	6.00%	5,082,632				2,606,535.05		
2012	87,997,308	6.20%	5,455,833	373,201	197,206	175,995	2,632,600.40	0.07	0.07
2013	91,411,603	6.75%	6,170,283	714,450	204,858	509,592	2,658,926.40	0.00	0.12
2014	94,958,374	7.25%	6,884,482	714,199	212,806	501,393	2,685,515.67	0.00	0.12
2015	98,642,759	7.75%	7,644,814	760,332	221,063	539,269	2,712,370.83	0.01	0.13
2016	102,470,098	8.00%	8,197,608	552,794	229,640	323,154	2,739,494.53	0.01	0.05
2017	106,445,937	8.00%	8,515,675	318,067	238,550	79,517	2,766,889.48	0.01	(0.04)

The policy being recommended also addresses the use of Unassigned General Fund balance for emergency purposes. The City Council may appropriate unassigned fund balance for emergency purposes per City Charter Section C3-9 A or otherwise unanticipated expenses at year end, as deemed necessary, even if such use decreases the fund balance below the designated percentage. The policy clarifies that emergency purpose does not include the offsetting of property taxes. Once the target level is achieved the policy indicates that the budgeted contribution will be eliminated from future budgets.

The objective of maintaining an adequate unassigned fund balance is to provide the City with a stable financial base at all times. To insure financial stability, the City needs to maintain an Unassigned General Fund Balance sufficient to fund the cash flow needs of the City, to provide financial reserves for unanticipated expenditures and/or revenue shortfalls of an emergency nature, and to provide funds for all existing General Fund encumbrances.

The graph below reflects the General Fund unrestricted cash balance as of month end for a typical fiscal year (based on FY09 and FY10). While maintaining a minimum fund balance level of 6% as specified in the existing financial policies, there are periods when cash on hand begins to fall to levels with little to no margin. General Fund cash balances in October and April have been nearing inadequate levels to safely meet cash flow disbursement requirements. This could generate the need for the City to obtain a TAN (Tax Anticipation Note), which would result in the City paying interest as part of the TAN. This additional cost to the community is easily avoided by maintaining an adequate General Fund Unassigned Fund Balance, increasing the minimum threshold over time from the current 6% level to 8%.

### General Fund Unrestricted Cash Balance



Special Revenue Funds - Non-Grant

Many Special Revenue Funds consist of grants received from the Federal or State governments. These funds are self-supporting and as such the prior Finance Planning Committee did not develop fund balance policies. This position is also reflected in the current Financial Policy Review Committee’s recommendation.

The balance of the Special Revenue Funds are not grant related. These funds, such as the Residential Solid Waste Fund, are supported by specific revenue sources and limit their use to specific purposes. The current Financial Policy Review Committee recommends maintaining the current 5% fund balance for these funds.

<b>Special Revenue Funds (Non-Grant)</b>							
	Parking	Residential	McConnell	Recreation	School	School	Alternative
	Activity	Solid Waste	Center	Programs	Cafeteria	Tuition	Education
<b>FY 2010 (Unaudited)</b>							
Undesignated Fund Balance	117,436	(7,141)	(691,881)	337,499	105,990	(1,777)	98,269
FY 11 Adopted Budget	669,513	1,061,802	816,840	545,900	1,347,341	348,761	862,300
% of Budget Appropriations	17.5%	-0.7%	-84.7%	61.8%	7.9%	-0.5%	11.4%

At the end of FY2010, the Residential Solid Waste Fund, McConnell Center, and School Tuition Funds have Undesignated Fund Balances below the recommended 5% level. The current Financial Policy Review Committee recommends continuing to build these fund balances over the course of the next six years through the normal budget process and resulting surplus derived from gradually increasing revenues in combination with continuing expenditure controls.

#### Enterprise Funds

Accounting for Enterprise Funds differs from Governmental Funds. The major difference is that the fund balances of these funds (referred to as Retained Earnings) include equity in fixed assets. This is non-liquid and not able to be used for operations. As a result, using a percentage of budget for a target Retained Earnings will not supply a comparative amount to cushion operational needs similar to the Fund Balances available in Governmental Funds. One of the most important aspects to maintain within Enterprise Funds is sufficient net current assets, or working capital. By having sufficient working capital, an Enterprise Fund can cover its needs in between billing periods or protect itself from a change in its revenue stream. A relatively high percentage of working capital is necessary to be maintained at a minimum level or else the General Fund must cover the cash needs of the Enterprise Fund through an inter-fund transfer potentially resulting in additional cost associated with short term borrowing.

The previous Finance Planning Committee recommended that the minimum level of working capital to be maintained in Enterprise Funds be equal to 15% of the annual budget, inclusive of debt service and operating budget capital outlay requirements. This level of working capital appears sufficient to cover the current liabilities with cash and the balance remaining consisting mainly of average receivable balances. The current Financial Policy Review Committee recommends continuing at this level.

<b>Enterprise Funds</b>		Water	Sewer
		Fund	Fund
<b>FY 2010 (Unaudited)</b>			
Working Capital		2,788,795	3,524,204
Adopted Budget		4,162,633	5,750,387
Working Capital % of Budget		67.0%	61.3%

The Water and Sewer Funds currently meet the minimum 15% minimum target level. Should the working capital amounts fall below the recommended level in any given year, an adjustment to the rate should be made to return to the minimum target level in the following year.

#### Internal Service Funds

The accounting method for Internal Service Funds is the same as Enterprise Funds. The major difference is the customer base and thus the revenue source. Internal Service Funds have the various city departments as their customers. For this reason there is no need to have a net current asset base to cover accounts receivable. The one item the funds need to cover is cash for replenishing inventory. As a result, the prior Finance Planning Committee recommended working capital to be maintained at levels equal to 100% of the inventory levels to avoid impacting General Fund cash reserves. The current Financial Policy Review Committee recommends continuation of this target level.

The City's self-insured Workers Compensation Fund is an exception to the rule for internal service funds. This fund carries no inventory, however, it does carry a significant liability related to incurred workers compensation claims. The claims liability is an estimate of the city's ultimate payout of claims incurred through the end of the fiscal year based on expected levels determined by actuarial calculations.

Confidence Level is a measure of probability of not exceeding the claims liability amount after all claims are finally settled. The expected level of ultimate incurred losses represents a confidence level of 56%. The minimum recommended confidence level suggested for funding a self-insured workers compensation program as calculated by an actuary is 50%. A more commonly funded level is 75%. The prior Finance Planning Committee recommended a middle of the road approach to use a 65% confidence level for funding of the claims liability. The current Financial Policy Review Committee recommends continuation of this target level.

The workers compensation claims liability at the end of FY2010 was \$326,324, and was fully funded.

2. **The City shall establish a dedicated fund and maintain sufficient annual contributions to offset the liability associated with other post-employment benefit (OPEB) obligations.**

*GASB Statement 45, Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions*, requires governments to account for other post-employment benefits (OPEB), primarily healthcare, on an accrual basis rather than on a pay-as-you-go (PAYG) basis. The effect is the recognition of an actuarially required contribution as an expense on the statement of revenues, expenses, and changes in net assets when a future retiree earns their post-employment benefits, rather than when they use their postemployment benefit. To the extent that an entity does not fund their actuarially required contribution, a postemployment benefit liability is recognized on the Statement of Net Assets over time.

The City currently pays toward the cost of health care benefits for certain qualified retirees. The City is also obligated to pay in the future toward the cost of health care benefits for certain current employees upon their leaving employment with the City (generally limited to those hired on or before 1999 and achieving 20 years of full-time service with the City prior to retiring). The benefits, benefit levels, employee contributions and employer contributions are governed by NH RSA 100-A:50 and provisions contained in prior collective bargaining agreements.

Currently, retirees contribute various percentages of the cost of their health plan, as determined by provisions established in prior and current collective bargaining agreements. The City contributes the remainder of the health plan costs on a PAYG basis. The retiree health care benefit cost to the City is lessened by subsidies received by retirees from the New Hampshire Retirement System (NHRS). Health care benefit costs are reduced significantly upon a retiree or their dependents attaining the age of 65, at which time they become eligible for Medicare and are changed to a Medicare supplement plan.

For purposes of complying with GASB Statement 45, the City's annual OPEB expense is actuarially calculated and designated as the annual required contribution of the employer (ARC). The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost necessary per year to amortize the OPEB expense over a period of thirty years and thereby avoid an increasing cumulative liability.

The following table shows the City's actuarially calculated and projected OPEB ARC, the current annual pay-as-you-go OPEB cost obligation and the accumulating OPEB liability (the net of ARC and PAYG) through June 30, 2017.

		PAYG = Pay-as-You-Go Cost for the City			
		NOO = Net OPEB Obligation (Difference of ARC minus PAYG)			
	Actuary/or				Cumulative
Fiscal Year	Projected	ARC	PAYG	NOO	OPEB Liability
2009	Actuary	3,982,897	1,144,571	2,838,326	2,838,326
2010	Actuary	3,831,195	1,264,860	2,566,335	5,404,661
2011	Projected	3,877,066	1,378,697	2,498,369	7,903,030
2012	Projected	3,877,066	1,612,234	2,264,832	10,167,862
2013	Projected	3,877,066	1,803,148	2,073,918	12,241,780
2014	Projected	3,877,066	2,003,857	1,873,209	14,114,989
2015	Projected	3,877,066	2,223,033	1,654,033	15,769,022
2016	Projected	3,877,066	2,469,868	1,407,198	17,176,220
2017	Projected	3,877,066	2,744,605	1,132,461	18,308,681
2018	Projected	3,877,066	2,842,970	1,034,096	19,342,777
2019	Projected	3,877,066	3,130,514	746,552	20,089,329

In order to minimize and eventually assist with reducing the accumulating OPEB expense, the City previously grandfathered and eliminated the availability of paid retiree health insurance through prior collective bargaining negotiations. However, the remaining OPEB obligation continues to be addressed on a PAYG basis and, as a result of the accrual accounting requirements established by GASB Statement 45, an accumulating liability results.

The FY2010 present value of the City's actuarially calculated OPEB obligation over the next 30 years is currently \$42,171,618, a slight reduction from the \$42,669,587 present value calculated previously for FY2009. These actuarial calculations reflect no prefunding of the obligation and a 5% discount rate for liabilities and return for assets. This long term OPEB liability amount is able to be significantly reduced if pre-funding of the obligation is addressed by making the minimum ARC. The reduction results not only from the offset of accumulating ARC funding that is retained beyond the

annual PAYG amount necessary each year but also the higher 8% investment rate of return that is allowed in determining the present value of the OPEB obligation. To illustrate, if fully funding the ARC amount each year, the FY2010 present value of the OPEB accrued liability would fall to \$28,595,086.

To address the OPEB liability being recorded in the City’s annual financial statements, an amount beyond the minimum PAYG cost obligation must be achieved, eventually reaching the levels of an actuarially calculated ARC. The Financial Policy Review Committee recommends that this amount be achieved by supplementing the annual PAYG contribution by an amount equivalent to 5% of the ARC amount and increasing this calculation in increments of 5% each year until the accumulated net OPEB related liability is decreased, at which point the annual 5% escalator will no longer be necessary. As the OPEB liability is associated with each of the major funds, this contribution is to be apportioned accordingly.

Other Post Employment Benefits (OPEB) Contribution						
			Supplement	PAYG	Cumulative	Supplemented
Fiscal Year	ARC	PAYG	% of ARC	Supplement	NOO	Cumulative NOO
2011	3,877,066	1,378,697	-	0	15,848,618	15,848,618
2012	3,877,066	1,612,234	5%	193,853	18,113,450	17,919,597
2013	3,877,066	1,803,148	10%	387,707	20,187,368	19,605,808
2014	3,877,066	2,003,857	15%	581,560	22,060,577	20,897,457
2015	3,877,066	2,223,033	20%	775,413	23,714,610	21,776,077
2016	3,877,066	2,469,868	25%	969,267	25,121,808	22,214,009
2017	3,877,066	2,744,605	30%	1,163,120	26,254,269	22,183,350

3. **The City shall establish and maintain sufficient annual contributions into capital reserves for infrastructure and equipment needs associated with the City’s major operating funds as identified and planned for in the annually adopted Six-Year Capital Improvements Plan (General, Water, and Sewer).**

The use of capital reserve financing allows for level contributions to be budgeted from year to year in order to save and eventually fund future planned capital expenditures. By utilizing this financing mechanism, large swings in budgeted amounts and resulting rate changes are avoided. Additionally, as funds accumulate towards a savings goal, investment returns help to mitigate the expense. To fund the same capital acquisitions utilizing debt financing would result in driving the cost for the item upwards by 150% when interest expenses are factored in.

The previous Financial Planning Committee recommended that 10 year target levels for funding capital reserves in the Water and Sewer Fund be attained. General Fund capital reserve target levels were not specified. The water and sewer related ten year capital reserve targets were originally recommended to be \$500,000 for water and \$3,500,000 for sewer. As planned capital improvement projects have been adopted in subsequent CIP’s, the actual budgeted capital reserve ten year targets have increased and currently are equivalent to \$4,500,000 for water and \$4,000,000 for sewer. Recognizing that the 10 year target level will change over time based upon the adopted CIP, the Finance Policy Review Committee recommends that the policy be updated to set the 10 year capital

reserve funding targets at an amount which will provide for level annual budget contributions to support funding of reserve financed projects planned over the forthcoming 10 year window. The forthcoming 10 year window requires funding 10 year target amounts at \$5,000,000 each for the Water and Sewer Funds.

Although the prior Financial Planning Committee did not recommend a similar capital reserve funding policy for the General Fund, the Financial Policy Review Committee recommends a similar approach be utilized to reserve finance future planned General Fund related capital projects. The same benefits associated with leveling budget impacts, avoiding additional interest expense and benefiting from offsetting investment income will be realized. The forthcoming 10 year window of capital reserve financed projects in the General Fund also requires funding a 10 year target amounts at \$5,000,000.

The Financial Policy Review Committee further recommends that contributions for capital reserve funds in the General, Water and Sewer Funds be phased to increase to 10-year target levels for each fund over the course of the next several years. The following chart illustrates the recommended phasing of contributions:

<b>Capital Reserve Funding Contributions</b>				
		General	Water	Sewer
Fiscal Year		Fund	Fund	Fund
2011		265,000	450,000	400,000
2012		500,000	475,000	420,000
2013		500,000	500,000	440,000
2014		500,000	500,000	460,000
2015		500,000	500,000	480,000
2016		500,000	500,000	500,000
2017		500,000	500,000	500,000

4. **The City shall establish and maintain regular contributions into a health insurance stabilization fund to be used to offset fluctuations in actual benefit premium expenses from year to year.**

The City incurs significant expense each year for employee health insurance. Rate increases have the potential to be volatile from year to year and as a result introduce widely varying increases in annual budgets and corresponding tax and utility rate adjustments. To help absorb and stabilize extreme tax and utility rate fluctuations from year to year, the Finance Policy Review Committee recommends that a health insurance stabilization fund be created from which funds may be drawn to offset budgetary spikes that result from health premium cost fluctuations in any given year.

Health Insurance Premium Percentage Change				
Example of Stabilization Fund Calculation for Source/Use			Annual	Annual
	Actual	Ten Year Average	Contribution	Offset to be
	Premium Cost	Increase to be	Made To	Used From
Fiscal Year	Increase	Budgeted*	Stabilization Fund	Stabilization Fund*
2002	9.7%	10.0%	0.3%	
2003	11.7%	8.1%		3.7%
2004	27.8%	9.1%		18.7%
2005	9.9%	11.4%	1.5%	
2006	8.5%	11.4%	2.9%	
2007	13.4%	11.4%		2.0%
2008	0.3%	11.4%	11.1%	
2009	1.6%	10.7%	9.1%	
2010	3.0%	10.7%	7.7%	
2011	15.8%	10.2%		5.6%
Ten Year Average	10.2%	10.4%		
Min/Max Spread	27.5%	3.4%		

note: assumes sufficient balance accumulated for Use from Stabilization Fund

In stabilizing the adjustment of tax and utility rates from year to year, the amount to be budgeted each year for health insurance premiums is set based upon the average change in the cost of health insurance premiums over the prior 10 years. In years when the actual premium costs paid are less than the amount budgeted, the savings are contributed into the health insurance stabilization. Conversely, in years when the actual premium costs paid are in excess of the amount budgeted, funds are utilized.

It is also recommended that the utilization of this stabilization fund be limited so as not to withdraw an amount in any given year greater than 25% of its balance.

5. **The City shall utilize year-end surplus funds to build stabilization funds to the minimum levels giving priority for allocations to be made in the following order: unassigned fund balances, OPEB obligations, capital reserves and then health insurance.**

At the conclusion of each fiscal year, surplus funds resulting from revenues in excess of expenditures are desirable and should be allocated based upon the priorities established for the various stabilization funds of the City. In order from highest priority for directing year-end surplus allocations to lower are making contributions to unassigned fund balances, OPEB funding obligations, capital reserves and then insurance stabilization funds.

6. **Upon achieving minimum levels established for each stabilization related fund, should amounts fall below the minimum thresholds in subsequent years, the City shall include allocations in the following annual budgets to return to the minimum amounts specified.**

Over the course of ten years, sufficient funds are expected to be accumulated in the various stabilization funds of the City to achieve and likely exceed the minimum target levels. Should funds be drawn from these stabilization funds causing them to fall below the minimum amounts established by policy, prompt attention should be given to replenishing the stabilization funds by budgeting contributions in following years until such time as the minimum threshold amounts are again exceeded.



## **Explanation of Policies Related to Fees and Charges:**

Following are the policy explanations that guide the manner in which fees and charges are set and the extent to which they cover the cost of services provided. In general, governments should require identification of both the cost of programs and the portion of the cost that will be recovered through fees and charges.

These policies establish a requirement to review all fees and charges and the level of cost recovery to be established for certain types of programs and services.

By ensuring a regular review of fees and charges, stakeholders may develop a better understanding of the cost of services and consider the appropriateness of established fees and charges. Annual review in conjunction with the annual budget process ensures that stakeholders are given an opportunity to provide input into the formulation of fees and charges for publicly provided services and programs. Such a review also ensures fees and charges are publicly available and summarized in materials used in budget preparation.

The costs incurred in delivering governmental programs and services include direct and indirect costs such as operating and maintenance costs, overhead, and charges for use of capital (depreciation and debt service).

7. **The various boards and commissions that advise the City Council and City Manager shall review all fees that support such functions annually and report recommended changes to the City Council and City Manager prior to the preparation of the annual budget.**

To ensure that a review of fees is conducted routinely with the inclusion of input from associated stakeholders, the various boards and commissions that advise the City Council and City Manager regarding various functions of the City shall review fees annually prior to the preparation of the annual budget. The review shall include considering the appropriateness of the fee for the service or program, its cost recovery associated with the service or program and the competitiveness of the fee with other similar programs and services.

The recommendations assembled by the various boards and commissions shall be communicated to the City Council and City Manager and considered during the annual review of budgets prior to final adoption.

8. **It shall be the intent for the City to establish fees and charges to cover costs associated with providing certain services or programs that individually benefit a person, family or other specific segment of the community at a given time as opposed to utilizing funds derived from general tax dollars for services and programs intended to generally benefit the whole population of the community all of the time.**

The most basic element of a user fee policy is to determine what costs user fees will be designed to recover. One necessary distinction is between public good/service, and a more specific service provided to a particular individual or group.

Public goods/services are those from which particular constituents cannot choose to be excluded and/or a good/service that delivers benefit to the public, in general. Public goods/services are not usually subject to a user fee, partially because of the social nature of the benefits, and partially because of the difficulty of pricing the service and collecting the fee (e.g. how would police patrols be priced and collected?). On the other hand, certain specific programs and services allow an individual or group to choose to be included or likewise excluded and are appropriate to be subjected to a user fee or charge (i.e. enrollment in swim lessons).

The Financial Policy Review Committee recommends that those services and/or programs that can be readily distinguished from public goods/services be subject to user fees and charges. The user fees and charges should be set at levels which allow for cost recovery based upon the resident status of the user/participant. Fees and charges for non-residents are to cover all direct and indirect costs including debt service and inter-fund transfers associated with the service or program. Fees and charges for residents are to cover, at a minimum, the direct costs associated with the service or program.

9. **The City shall continue to maintain all enterprise funds on a self-sustaining user fee basis, with no support from property tax revenues. Fees shall be set annually to support the adopted budget.**

Enterprise Funds represent funds operated, financed and accounted for in a manner similar to private business, primarily supported by user fees. The City currently has two major Enterprise Funds; the Water and Sewer Funds. Both base their user fees on the amount of consumption of water used by a customer.

In formulating their Financial Policy Recommendations, the prior Financial Planning Committee noted that the lack of consistent rate setting for water and sewer utility use negatively impacted the financial health of the Water and Sewer Funds. Following a study of the situation, it had been recognized that rates needed to be adjusted regularly to support the final adopted budgets for each year of operation. The City Council in 1992 adopted a new rate structure and streamlined the rate setting process so it would be accomplished each year as part of the annual budget process. This change made it more equitable for users and ultimately improved the long term financial health of the utility funds.

The rate structure implemented in 1992 was based on straight line calculation of amounts to be raised (cash needed for operations, debt and capital reserve) divided by the billable volume of water measured in one hundred cubic feet. With no minimum, each customer was billed for actual usage and paid the same per unit price. This billing methodology remains in effect today. Each year the budget is prepared and adopted, new rates are calculated to support the cash needs of the respective utilities. The Financial Policy Review Committee recommends continuation of this rate setting policy.

Prior to 2009, the City also maintained a third major Enterprise Fund for the Arena. In 2009, the Arena operations and related finances were incorporated into the General Fund in recognition of the Arena's public recreation function supported by an ongoing General Fund subsidy. Although the absorption of the Arena's finances and the budget for the Arena operations within the General Fund

eliminated the Arena Fund entirely, the revenues, expenses and associated debt continue to be monitored for evaluating cost recovery as a distinct cost center within the General Fund.

**10. The City shall prepare and adopt a Fee Schedule in conjunction with the annual adoption of the budget that will itemize and provide the justification for all fees and charges to be levied in the coming fiscal year.**

The adoption of a Fee Schedule in conjunction with the annual budget adoption not only formally establishes the fees and charges to be levied during the year, but also articulates important characteristics including the legal justifications for individual items. The Fee Schedule provides documentation for the annual review of fees, noting changes in fees and the establishment of new fees.

**Explanation of Policies Related to Debt Issuance and Management:**

Following are the policy explanations that guide the manner in which debt is issued and managed by the City. In general, issuing debt commits a government's revenues years into the future, and may limit the government's flexibility to respond to changing service priorities, revenue inflows, or cost structures. Adherence to debt related policies helps ensure that debt is issued and managed prudently in order to maintain a sound fiscal position and protect credit ratings.

These policies define purposes for which debt may be issued; matching of the useful life of an asset with the maturity of the debt; and, refunding of debt.

Debt policies should be made available to the public and other stakeholders. Because these policies are also essential to budget decision making, particularly capital budgets, they are to be reviewed by City Council and staff members during the annual CIP and budget processes. To facilitate this review, these policies will be summarized in the respective documents.

The debt policies below are to be integrated with other financial policies, particularly operating and capital budget policies contained herein. These policies coincide with statutory and legal requirements as well as the City's financial condition and philosophy.

**11. The City Council shall annually, by resolution, adopt a six year Capital Improvements Planning (CIP) document.**

The City formulates a six-year Capital Improvements Program (CIP) each year. The CIP is submitted to the Planning Board for advisory comment regarding Master Plan related projects and to the City Council for overall review, adjustment and approval. The CIP document is ultimately amended and adopted by the City Council establishing a six year plan for capital improvements.

Following adoption of the CIP, the first year planned projects are funded via authorization of a debt resolution along with a separate resolution for the appropriation of reserves and other existing funds. The operating budget financed portion of the CIP's first year are then incorporated into and considered as part of the annual operating budget. In the instance where a year 1 project also extends

into subsequent years, the City Council may authorize the full amount of financing for the project, understanding that the actual issuance of bonds and/or expenditure of funds will not occur until project cash flows are required.

By revisiting the six year CIP on an annual basis, in the subsequent year, minor adjustments and addition of a new sixth year of proposed projects constitutes the newly proposed six year CIP. The prior Finance Planning Committee recommended this approach and it was adopted and has generally been followed by the City Council. The Financial Policy Review Committee recommends continuation of this practice.

12. **The City shall maintain formal criteria for inclusion of a project in the CIP:**

The prior Finance Planning Committee reviewed and recommended criteria to be used for including projects within the six-year Capital Improvements Program (CIP). The City Council adopted and has continued to follow this guidance. The Financial Policy Review Committee supports continuing these criteria with adjustments to the minimum amount for a project to be included in the CIP from \$10,000 to \$25,000.

In order to be included within the CIP, a project needs to have an estimated annual aggregate cost of \$25,000 or more and have a useful life of three years or greater. Although items from \$1,000 to \$24,999 and with a useful life of three years or more qualify as capital outlays, these are routinely included within the operating budgets and therefore are immaterial to the nature and size of the projects represented in the CIP. Projects to be included in the CIP must also satisfy at least one of the following purposes:

- Protect the health and safety of employees and/or the community at large;
- Significantly improve the efficiency of the existing services;
- Preserve a previous capital investment made by the City;
- Significantly reduce future operating costs or increase future operating revenues.

13. **The City shall finance qualifying CIP projects using established criteria.**

The prior Finance Planning Committee reviewed and recommended financing criteria to be used for projects included within the six-year Capital Improvements Program (CIP). The City Council adopted and has continued to follow this guidance. The Financial Policy Review Committee supports continuing these criteria with adjustments to the minimum amount for a project to be operating financed in the CIP from \$100,000 to \$250,000.

Debt Financed - Purchases financed by the issuance of bonds or capital leases. The City issues debt (generally tax exempt) to finance projects and the principal and interest are paid over the useful life of the asset. The structuring of debt issuance is done with consideration of interest rates, debt profile and future debt financing requirements. The purpose of debt financing is to make an outright purchase of an asset where the impact would be too great for one budget period allowing payments to be distributed over multiple budget periods. Just as an individual would normally take out a mortgage to finance a home, the City purchases its big ticket items with credit so it can make payments out of

future "earnings." A general rule of thumb is every \$100,000 bonded will cost \$50,000 to \$55,000 in interest expense over the life of the bond. The question becomes, at what level should a city issue debt for a purchase versus purchasing outright? A \$250,000 General Fund purchase funded through the operating budget (no debt) will have approximately a \$0.10 rate impact. This impact is consistent with the prior impact criteria and allows the City to establish criteria that limits the size of projects financed by debt to the larger projects, helping to mitigate debt growth with multiple smaller projects. The Financial Policy Review Committee recommends the purchase of assets of \$250,000 or more, nonrecurring within a five year period, and with a useful life of five years or more be debt financed. This includes design costs for projects even when the costs occur in an earlier year. In conjunction with capital reserve, financing projects under \$250,000 would be financed through the operating budgets.

Capital Reserve Financed - Purchases financed by savings from annual appropriations over a period of time for assets over \$25,000, recurring or not. Capital Reserves can be established for a specific item or a type of item. The City currently has Capital Reserves for the General, Water and Sewer Funds. Individuals may save for a purchase they don't want to buy outright and also don't want to take a loan on. Similarly, the City purchases items either outright or through debt financing. This causes sharp one year budget increases or the incurring of interest expense respectively. These midsize, recurring, predictable purchases are best financed by saving for the item. With a Capital Reserve, a smaller flat amount is added to the annual budget, smoothing rate impacts and saving on interest. The Financial Policy Review Committee recommends the continuation of capital reserves for infrastructure and equipment needs for the General, Water and Sewer Funds. This includes addressing utility facility upgrades, recreation facility rehabilitation, heavy equipment replacement as well as fire apparatus purchases.

Grant Financed - Purchase of assets over \$25,000, partially or wholly funded by grants from the State or Federal government. The Financial Policy Review Committee recommends the City continues efforts to seek out Federal and State aid for projects, remaining cognizant of continuing grant requirements and ongoing expenses.

Existing Funds Financed - The Financial Policy Review Committee recommends continuing the practice that after the CIP projects are submitted and compiled, any items that can be financed with existing funds should be. Existing funds could be any funds available from savings from another project or other source of funds. If unexpended and unused bond proceeds are to be used, the item has to meet the useful life criteria for the remaining years of amortization of the bond funds used.

Operating Budget Financed - The Financial Policy Review Committee recommends that purchase of assets of less than \$250,000 or recurring in nature, be financed through the annual operating budget for the fund involved. Annual programs, whether over \$250,000 or not, are suited for operating budget financing due to the ongoing nature of the program. Ongoing programs that are continually financed with debt end up costing more through annual debt service than if paid directly.

14. **In utilizing debt financing for CIP related projects, the useful life span of the capital project or item shall equal or exceed the years for amortization of the bond.**

The amortization of debt associated with capital purchases is often set at or reasonably below the expected useful life of the asset being financed. This helps to insure intergenerational equity in debt financing by matching the benefits of the debt funded project with repayment of that debt. Likewise it would not make sense for the community to continue to pay debt for an asset that is no longer in service and available for use.

15. **In consultation with the City’s designated financial advisor, the City shall regularly analyze and pursue bond refunding in instances where significant savings or other substantial benefits will be realized.**

Refunding is a procedure whereby the City refinances an outstanding bond issue by issuing new bonds. The advantages for refunding include reducing the City’s interest expense and/or restructuring terms that may benefit the City. To determine the feasibility and cost effectiveness for undertaking a refunding the City consults regularly with its designated financial advisor. In instances where a sizeable savings or other significant benefit is identified, bond refunding is recommended to the City Council for authorization.

**Explanation of Policies Related to Debt Level and Capacity:**

Following are the policy explanations that established the maximum amount of debt and debt service that should be outstanding at any one time. In general, the policies guiding the amount of debt that may be issued by a government help ensure that outstanding and planned debt levels do not exceed an amount that can be supported by the existing and projected tax and revenue base.

These policies define acceptable debt levels and capacity. Factors that influence the recommended debt capacity include current financial capacity, projected future capacity, statutory and constitutional limitations, and bond covenants.

As noted previously, debt related policies should be made available to the public and other stakeholders. Because these policies are also essential to budget decision making, particularly capital budgets, they are to be reviewed by the City Council and staff members during the annual CIP and budget processes. To facilitate this review, these policies will be summarized in the respective documents.

The debt policies below are also to be integrated with other financial policies, particularly operating and capital budget policies contained herein. These policies coincide with statutory and legal requirements as well as the City’s financial condition and philosophy.

16. **The City shall size the issuance of the local share of new debt so as not to exceed certain parameters in any given fiscal year.**

Equalized assessed value (EAV) remains the basis for the legal debt limits set by NH state statute. EAV is representative of a community’s ability to tax, and thus repay its debts. The statutes establish the percentages of EAV for the debt limits of the City at 3.0%, the School at 7.0% and the Water at 10%. There are no statutory limits for Sewer.

The prior Financial Planning Committee and the current Financial Policy Review Committee used the statutory debt limit as a basis to evaluate an appropriate policy goal more in line with maximum debt limits they perceived as realistic. The current Financial Policy Review Committee recommends the City portion remain at 65% (exempting debt associated with the Tolend Landfill Closure), the School portion increase from 15% to 28%, and the Water remain at 5%, of the statutory debt limit. Additionally the Financial Policy Review Committee concurs with the prior recommendation that the Sewer, although no statutory limit exists, remain at 1.5% of EAV.

The more conservative debt limit levels being recommended reflect an intent to retain legal bonding capacity well below the full amount allowed by NH state statute. In addition, the lower limits are recommended to be adjusted and set to assure the community maintains a reasonable ability to pay any debt obligations it currently has and may assume in the future.

<i>City Estimated Legal Debt Limits</i>			<i>School Estimated Legal Debt Limits</i>			
	Statutory	Policy		Statutory	Prior Policy	New Policy
FY End	3.0% EAV	65% of State	FY End	7.0% EAV	7% of State	28% of State
2011	83,067,093	53,993,610	2011	193,823,217	13,567,625	54,270,501
2012	84,963,420	55,226,223	2012	198,247,979	13,877,359	55,509,434
2013	85,803,399	55,772,209	2013	200,207,931	14,014,555	56,058,221
2014	86,651,777	56,323,655	2014	202,187,480	14,153,124	56,612,494
2015	87,508,640	56,880,616	2015	204,186,827	14,293,078	57,172,312
2016	88,374,071	57,443,146	2016	206,206,165	14,434,432	57,737,726
2017	89,248,154	58,011,300	2017	208,245,692	14,577,198	58,308,794

<i>Water Estimated Legal Debt Limits</i>			<i>Net Sewer Estimated Legal Debt Limits</i>		
	Statutory	Policy		Statutory	Policy
FY End	10% EAV	5% of State	FY End	Exempt	1.5% EAV
2011	276,890,310	13,844,516	2011	None	41,533,546
2012	283,211,399	14,160,570	2012	None	42,481,710
2013	286,011,331	14,300,567	2013	None	42,901,700
2014	288,839,257	14,441,963	2014	None	43,325,889
2015	291,695,467	14,584,773	2015	None	43,754,320
2016	294,580,236	14,729,012	2016	None	44,187,035
2017	297,493,846	14,874,692	2017	None	44,624,077

**17. The City’s net annual debt service (payment of principal and interest less reimbursements) shall not exceed certain parameters in any given fiscal year:**

An important aspect of establishing a debt level and capacity policy is setting a net debt service ceiling. This is the maximum that the City should want to payout in principal and interest in a year less any reimbursements to be received. In general, 10% to 15% is seen as the high end to credit rating analysts evaluating General Fund debt service levels.

Debt Service as a Percentage of Budget is the typical measure used to evaluate debt service ceilings and represents the percentage of the overall budget that goes toward debt payments. The prior Financial Planning Committee recommendation was 8% for the General Fund and 40% for the Water and Sewer Funds. The Financial Policy Review Committee recommends that this ceiling be set at

10% for the General Fund and 40% for the Enterprise and Special Revenue Funds, which incorporates the Water and Sewer Funds.

For the General Fund, the debt service ceiling is calculated by dividing the annual property tax supported debt payments (principal and interest) by the total General Fund budget less any reimbursements. For the Water and Sewer Funds, this is calculated by performing the same calculation but instead using the annual utility rate supported debt payments (principal and interest) divided by the respective total utility fund’s budget.

For purposes of the debt limit and net debt service ceiling of the General Fund, the prior Finance Planning Committee had recommended any debt related to the Tolend Road Landfill Closure be exempted from the calculations. As Tolend Road Landfill Closure was a unique cost obligation imposed by the federal government, it was deemed inappropriate to preclude any future city-wide capital improvements through debt issuances for an extended period. The Financial Policy Review Committee recommends continuing this exemption.

<b>Debt Service as % of Appropriations:</b>				
<b>FY2012 Estimate</b>				
		General Fund	Water Fund	Sewer Fund
City Existing General Fund Debt Service		5,591,864	1,350,394	1,241,998
School Existing General Fund Debt Service		4,075,514		
Less: Tolend Landfill Debt Service		820,302		
Less: State School Building Aid		614,891		
	Subtotal	8,232,185	1,350,394	1,241,998
	Appropriations (Indexed Estimate)	87,997,308	4,518,484	6,146,658
	Debt Service as % of Appropriations	9.36%	29.89%	20.21%
	Policy for Debt Service Percent	10.0%	40.0%	40.0%
	Debt Service allowed per % Appropriation	8,799,731	1,807,394	2,458,663
	Less Existing Debt Service Obligations	(8,232,185)	(1,350,394)	(1,241,998)
	Additional Debt Service Available for Proposed CIP	567,546	457,000	1,216,665

18. **The City shall maintain a pay down of net debt (debt principal less reimbursements to be received) for each fund whereby 75% or more is retired within the next ten years.**

Another important aspect of debt maintenance is how fast the debt is paid off. Generally, credit rating agencies like to see debt aggressively paid off. In credit rating reports for the City, the rating agencies positively noted the rapid pay down associated with the City’s debt obligations. The City generally structures its debt to favor shorter amortization schedules with fixed principal and interest payments. 10, 15 and 20 year amortization schedules are commonly used depending on the project type and asset life expectancy. The prior Finance Planning Committee recommended a pay down rate of 75% or better over ten years. The Financial Policy Review Committee recommends continuing this policy.



Debt Pay Down FY2011-FY2021				
		General Fund	Water Fund	Sewer Fund
Outstanding Debt Balance as of FY2011		68,447,325	10,334,000	8,957,500
Principal Payments through FY2021		52,073,825	7,969,000	8,066,000
	Percent Paid	76.1%	77.1%	90.0%

19. **To reduce reliance on an increased utilization of debt for capital related maintenance needs in future years, the City shall achieve and maintain a minimum level of capital outlay in each of the major operating funds as part of the annual budget adoption for sustaining the community’s existing and future infrastructure and equipment.**

The City has a sizeable investment in public infrastructure including schools, parks, streets, water lines, utility equipment, rolling stock and more. These assets require continuing maintenance and periodically require major rehabilitation and/or eventual replacement. Recognizing that a minimum level of capital outlay is necessary to adequately maintain the community’s stock of capital assets, the Financial Policy Review Committee has considered the existing level of effort maintained in current budgets in relation to the value of net assets recorded in the General, Water and Sewer Funds. Target levels recommended for capital outlay based upon a percentage of total fund appropriations are 7.5% for the General Fund, 13% for the Water Fund and 11% for the Sewer Fund. These levels are recommended in recognition of the need to fund ongoing maintenance and replacement needs of existing capital assets at reasonable levels. These levels of annual recurring funding are expected to reduce future needs for major rehabilitation expenses and avoid significant year to year budget fluctuations.

<b>City General Fund</b>				
	City Budget (Indexed Estimate)	Actual/ Target %	Actual/Target Capital Outlay	Actual/Target Change
2011	30,694,146	4.65%	1,427,682	165,005
2012	31,885,079	5.00%	1,594,254	166,572
2013	33,122,220	5.50%	1,821,722	227,468
2014	34,407,362	6.00%	2,064,442	242,720
2015	35,742,368	6.50%	2,323,254	258,812
2016	37,129,172	7.00%	2,599,042	275,788
2017	38,569,783	7.50%	2,892,734	293,692
<b>Water Fund</b>				
	Water Budget (Indexed Estimate)	Actual/ Target %	Actual/Target Capital Outlay	Actual/Target Change
2011	4,241,115	12.55%	532,400	7,630
2012	4,518,484	13.00%	587,403	55,003
2013	4,813,993	13.00%	625,819	38,416
2014	5,128,828	13.00%	666,748	40,929
2015	5,464,253	13.00%	710,353	43,605
2016	5,821,615	13.00%	756,810	46,457
2017	6,202,349	13.00%	806,305	49,495
<b>Sewer Fund</b>				
	Sewer Budget (Indexed Estimate)	Actual/ Target %	Actual/Target Capital Outlay	Actual/Target Change
2011	5,959,529	8.60%	512,400	37,400
2012	6,146,658	9.00%	553,199	40,799
2013	6,339,663	9.50%	602,268	49,069
2014	6,538,729	10.00%	653,873	51,605
2015	6,744,045	10.50%	708,125	54,252
2016	6,955,808	11.00%	765,139	57,014
2017	7,174,220	11.00%	789,164	24,025

**Explanation of Policies Related to Use of One-time Revenues:**

Following are the policy explanations that limit the use of one-time revenues for ongoing expenditures. By definition, one-time revenues cannot be relied on in future budget periods. Policies on the use of one-time revenues provide guidance to minimize disruptive effects on services due to non-recurrence of these sources.

- 20. **The City shall use one-time revenues for the limited purpose for which they were intended or, in the absence of a specified purpose, for a non-recurring capital expenditure or as a contribution towards building established stabilization funds. One-time revenues shall not be used to fund existing operations.**
  
- 21. **Grant funds with continuing obligations beyond the grant period shall be reviewed and approved by vote of the City Council prior to acceptance of award.**

## **Explanation of Policies Related to the Use of Unpredictable Revenues:**

Following are the policy explanations that guide the requirement for identifying major revenue sources and uses for those that are unpredictable. Unpredictable revenue sources cannot be relied on as to the level of revenue they will generate. Particularly with major revenue sources, it is important to consider how significant variation in revenue receipts will affect the government's financial outlook and ability to operate programs in the current and future budget periods.

Many of the most important revenue sources relied on by governments are unpredictable to some degree. Examples may include intergovernmental revenues, investment income, and revenues subject to future judicial rulings. To a certain extent, even property tax collections may be considered unpredictable as the timing of their receipt may be influenced not only by poor economic conditions but also the ability for taxpayers to time payments to federal or state tax incentives.

To ensure that a government can meet its cash flow requirements supporting operations, unpredictable revenue fluctuations need to be understood and countered to the extent possible. Specific allocation and contingency plans do not have to be developed for all unpredictable revenues, but become increasingly necessary as the size or unpredictability of the revenue source increases. To counter the unpredictability of certain major revenue sources, shifting the timing of payments from arrears to beforehand may facilitate better operational and cash flow controls.

**22. To improve the timing of cash collections required for disbursements made throughout the fiscal year and minimize the possibility of incurring additional expenses associated with short term borrowing for operational needs, the City shall revise Property Tax due dates in accordance with provisions established by NH law.**

In 1982, the City converted its accounting year from a January/December to a July/June year. The reason for converting to a fiscal year was to collect taxes twice a year versus just once in December. The normal method of converting was to enter an eighteen month accounting period, issue 12 months of taxes in 2 billings and bond 6 months of taxes, thus beginning a July and December tax billing method. In 1982, the City did not wish to bond for the 6 months as this would mean increasing debt by over 50%. As an alternative, the City pursued special legislation to allow the City to convert its year with an eighteen month accounting period and issue 18 months of taxes in three billings. This placed the City in a situation of a July/June fiscal year with tax collections occurring in arrears during December and June. Although this change helped cash flow by cutting short term borrowing in half, it still kept the City dependent on the short term debt market.

During the recession of the late 1980's and early 1990's, it was apparent that the current collection method left the City exposed to short term cash flow shortages. As a result, the City sought options for how to improve its cash flow by changing tax due dates. Legislation exists to allow this by billing 13 months of taxes over a six year period and to escrow the funds for the last year when a conversion would occur. This changes the budgeting process and the escrow funds are potentially targeted for other funding purposes.

The City explored its own option of simply moving the tax due dates ahead one month each year for six years until they are aligned with July and December. This method does not require any special budgeting or escrow of funds. No additional money is received by the City it is just received approximately 30 days earlier each year. By moving to July-December due dates, the City would strengthen its cash flow and improve its investment income. The potential need for short-term borrowing to sustain operations is virtually eliminated as cash receipts are recognized ahead of expenditures allowing for operational adjustments to be made in advance of realizing cash shortfalls.

Although there is no change to the City's budget and assessment processes, taxpayers would be paying 12 months of taxes every 11 months. For taxpayers with mortgage escrow accounts, this would require a one-time adjustment to accounts that would remain in place during the conversion period. After the conversion period, the escrow accounts could be adjusted back to a normal level.

Another option is the bonding option usually used in the accounting conversion year. This requires six months of a fiscal year to be bonded in order to move the dates forward. The conversion would occur in one year.

The prior Finance Planning Committee recommended the adoption of legislation to move the property tax due dates ahead by one month each year for six years. The current Financial Policy Review Committee recommends that an educational effort with the taxpayers be undertaken to show the benefits that will be returned through elimination of costs and increasing of nontax revenue by moving tax collections from being paid twice per year in December and June to instead being due twice per year during January and July. This is a major change that will assist the City significantly in managing and responding proactively to changing fiscal circumstances.

23. **The City shall anticipate and take into consideration unpredictable revenues in conjunction with reviewing and adopting the annual budget.**
24. **The City shall rely upon conservative and reasonable revenue estimates in establishing annual budgets. The City Manager, in consultation with the Finance Director, is responsible for assembling and submitting revenue estimates supporting the annual budget that are current and based upon objective and reasonable analysis.**

#### **Explanation of Policies Related to Balancing the Operating Budget:**

Following are the policy explanations that define a balanced operating budget, encourage commitment to a balanced budget going forward, and provide for disclosure and adjustment when a deviation from a balanced operating budget may occur. In general, a balanced budget is a basic budgetary constraint intended to ensure that a government does not spend beyond its means.

These policies define how budgetary balance is to be achieved and maintained. In short, all sources of funds must equal or exceed uses of funds budgeted so that the City may achieve and maintain structural balance. All funds are included. All statutory and other legal "balanced" budget requirements will be met.

At a minimum, a budget balance is defined to ensure that a government's use of resources for operating purposes does not exceed available resources over a defined budget period. More specifically, a balanced operating budget requires a balance between operating expenditures and operating revenues over the long term, not just during the current operating period. This latter definition of balance is referred to as structural balance, and is the goal of these policies.

25. **In preparing and adopting the annual budget, the City shall achieve a balanced budget whereby estimated revenues equal or exceed budgeted expenses (including debt service and transfers).**
26. **Preliminary budget estimates reflecting the adopted Financial Policies for the following fiscal year for both the City and School portions shall be submitted to the City Council by the City Manager prior to January 31<sup>st</sup>. The City Manager will provide a five (5) year budget forecast model by budget function or key cost components. The City Council shall review and approve a preliminary budget resolution by its next regularly scheduled meeting to give budgetary guidance to the City Manager and the School Department for development of the budget for the next fiscal year**
27. **Throughout the course of a fiscal year, actual budget results will be monitored and reported on a regular basis. Adjustments to estimated revenues and budgeted expenditures may be made at any time during the course of the fiscal year to ensure the budget remains balanced. If necessary, transfers and/or overall budget amendments will typically be made immediately prior to year end closing.**

#### **Explanation of Policies Related to Revenue Diversification:**

Following are the policy explanations that guide establishing a diversity of revenue sources. In general, all revenue sources have particular characteristics in terms of stability, growth, sensitivity to inflation or business cycle effects, and impact on tax and rate payers. A diversity of revenue sources can improve a government's ability to handle fluctuations in revenues and potentially help to better distribute the cost of providing services.

These policies identify approaches that will be used to improve revenue diversification and lessen the impact of development on existing residents and business owners.

Over time a government should strive to improve its revenue diversity to the extent feasible. When a government is statutorily or otherwise limited as to the types of revenues it may raise, it should consider options to enhance flexibility within the constraints of available revenue sources. For example, where the City relies heavily on property taxes it seeks to diversify the tax base on which the property tax is levied.

28. **The City shall strive to achieve a diversified and stable revenue system as a protection from short run fluctuations.**
29. **The City shall periodically review and maintain impact fees to offset the local impact of private development.**

### **Explanation of Policies Related to Contingency Planning:**

Following are the policy explanations that guide the financial actions to take in the event of emergencies, natural disasters, or other unexpected events. When emergencies or unexpected events occur, these policies will be applied, or at least serve as a starting point, for financial decisions and actions that improve the ability of the City to take timely action and manage such situations. The contingency planning policies also recognize that instances may arise where deviations from existing policies may be justified and therefore allowed.

These policies identify types of emergencies or unexpected events and the way in which these situations will be handled from a financial management perspective benefitting the community. They are to be used as a general guide when an emergency or unexpected event occurs. They allow for operational and management impacts to be appropriately addressed while ensuring the continuing ability of the community to meet its ongoing fiscal obligations.

The establishment of these policies are intended to expedite relief efforts when an emergency does occur and allow the City to recover funds more quickly or more effectively in the event of a natural disaster. Additionally, these policies ensure the City is able to respond and is not unduly hampered when situations arise that have significant benefit or other positive attributes for the community.

30. **The City shall routinely budget funds annually for unanticipated expenses and minor emergency situations as a contingency line item in each of the major operating funds.**

The City recognizes that despite the best budget forecasting efforts, unanticipated expenses and minor emergencies will occur throughout the fiscal year. To address such contingencies and avoid creating a funding crisis, an appropriate amount tied to the overall budget of each fund should be appropriated at the time of budget setting. The Finance Policy Review Committee recommends that this contingency amount be equivalent to 0.5% of the expenditures budgeted for each fund.

<b>Contingency Funding</b>				
<b>General Fund</b>				
	General Fund Budget (Indexed Estimate)	Target %	Target Contingency	Target Change
2011 (Actual)	84,710,539	0.12%	100,000	
2012	87,997,308	0.15%	131,996	31,996
2013	91,411,603	0.25%	228,529	96,533
2014	94,958,374	0.34%	322,858	94,329
2015	98,642,759	0.38%	374,842	51,984
2016	102,470,098	0.50%	512,350	137,508
2017	106,445,937	0.50%	532,230	19,879
<b>Water Fund</b>				
	Water Budget (Indexed Estimate)	Target %	Target Contingency	Target Change
2011 (Actual)	4,241,115	0.00%	0	
2012	4,518,484	0.20%	9,037	9,037
2013	4,813,993	0.28%	13,479	4,442
2014	5,128,828	0.36%	18,464	4,985
2015	5,464,253	0.44%	24,043	5,579
2016	5,821,615	0.50%	29,108	5,065
2017	6,202,349	0.50%	31,012	1,904
<b>Sewer Fund</b>				
	Sewer Budget (Indexed Estimate)	Target %	Target Contingency	Target Change
2011 (Actual)	5,959,529	0.00%	0	
2012	6,146,658	0.20%	12,293	12,293
2013	6,339,663	0.28%	17,751	5,458
2014	6,538,729	0.36%	23,539	5,788
2015	6,744,045	0.44%	29,674	6,134
2016	6,955,808	0.50%	34,779	5,105
2017	7,174,220	0.50%	35,871	1,092

31. **In the instance of a catastrophic or otherwise significant unanticipated financial need impacting the community, the City shall utilize the emergency powers afforded by provisions of State of NH law and City Charter to address the matter in a fiscally responsible and timely manner. Use of existing discretionary budgeted funds, the curtailment of discretionary expenditures, and access to accumulated stabilization funds, along with pursuing reimbursements where available, will be utilized to meet the City’s contractual and other obligatory financial commitments along with addressing the need that has arisen.**
32. **Deviations from adopted financial policies are to be anticipated to accommodate various situations that may arise from time to time. In particular, deviations may specifically occur where there is an offsetting condition or benefit to the City. In such cases where adherence to a specific financial policy may not be possible or otherwise is not achieved, the nature of the deviation and the rationale shall be noted as part of the decision making process.**

### **Implementation of Recommended Updates to Financial Policies:**

As was recognized in the original 1996 Financial Planning Committee report to the City Council, the most important aspect associated with implementing Financial Policies for the City, then and now, is not the development and formal adoption, but instead the commitment by the community through the actions of its elected and appointed officials to proceed with achieving and upholding the policies on an ongoing and consistent basis.

Following a presentation and review with the City Council of the recommendations above, the Ad-Hoc Financial Policy Review Committee looks forward to working with the City Council to craft a formal resolution for adoption. With adoption of such a resolution, it will remain incumbent upon the City's elected officials and staff to strive to achieve the goals outlined therein in the course of managing the overall affairs of the community going forward. Further, a continuing effort to routinely familiarize the public, along with newly elected officials and appointed staff with the Financial Policies is to be undertaken.

Lastly, to ensure the Financial Policies remain current and therefore relevant, their periodic review and updating is recommended to be initiated by the City Council and City Manager at least once every five years. A significant change in budgeting and/or accounting practices will also require a review and updating of the policies.



## **Appendices**

Recommended Financial Policies Impact Analysis

2010 Moody's Investor Services Dover, NH Rating Information

2010 Standard & Poor's Rating Services Dover, NH Rating Information

<b>City of Dover</b>								
<b>Recommended City Financial Policies</b>								
<b>Summary of Impacts</b>								
<b>(Assumes full and continuing implementation beginning 2012)</b>								
<b>GENERAL FUND:</b>	<b>Impact To</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Totals</b>
Fund Balance Minimum	Budget	175,995	509,592	501,393	539,269	323,154	79,517	2,128,919
	Tax Rate	0.067	0.125	0.120	0.132	0.051	(0.038)	0.456
Capital Reserve Funding	Budget	255,000	0	0	0	0	0	255,000
	Tax Rate	0.097	0.000	0.000	0.000	0.000	0.000	0.097
Benefit Stabilization Fund	Budget	Impact will be positive pending accumulation of funds						
	Tax Rate							
Operating Budget Capital Outlay	Budget	166,572	227,468	242,720	258,812	275,788	293,692	1,465,052
	Tax Rate	0.063	0.086	0.090	0.095	0.101	0.106	0.541
OPEB Contribution	Budget	181,156	181,156	181,156	181,156	181,156	181,156	1,086,935
	Tax Rate	0.069	0.068	0.067	0.067	0.066	0.065	0.403
Contingency Funding	Budget	31,996	96,533	94,329	51,984	137,508	19,879	432,230
	Tax Rate	0.012	0.036	0.035	0.019	0.050	0.007	0.160
Debt Financed Threshold Change (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Tax Rate							
Debt Service as % of Budget (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Tax Rate							
<b>GENERAL FUND TOTALS:</b>	<b>Budget</b>	<b>810,718</b>	<b>1,014,750</b>	<b>1,019,598</b>	<b>1,031,221</b>	<b>917,606</b>	<b>574,244</b>	<b>5,368,136</b>
	<b>Tax Rate</b>	<b>0.31</b>	<b>0.31</b>	<b>0.31</b>	<b>0.31</b>	<b>0.27</b>	<b>0.14</b>	<b>1.66</b>

<b>City of Dover</b>								
<b>Recommended City Financial Policies</b>								
<b>Summary of Impacts</b>								
<b>(Assumes full and continuing implementation beginning 2012)</b>								
<b>WATER FUND:</b>	<b>Impact To</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Totals</b>
Capital Reserve Funding	Budget	25,000	25,000	0	0	0	0	50,000
	Rate	0.026	0.025	0.000	0.000	0.000	0.000	0.051
Operating Budget Capital Outlay	Budget	55,003	38,416	40,929	43,605	46,457	49,495	273,905
	Rate	0.056	0.039	0.041	0.043	0.046	0.048	0.274
Benefit Stabilization Fund	Budget	Impact will be positive pending accumulation of funds						
	Rate							
OPEB Contribution	Budget	7,269	7,269	7,269	7,269	7,269	7,269	43,617
	Rate	0.007	0.007	0.007	0.007	0.007	0.007	0.044
Contingency Funding	Budget	9,037	4,442	7,036	5,713	2,880	1,904	31,012
	Rate	0.009	0.005	0.007	0.006	0.003	0.002	0.031
Debt Financed Threshold Change (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Rate							
Debt Service as % of Budget (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Rate							
<b>WATER FUND TOTALS:</b>	<b>Budget</b>	<b>96,309</b>	<b>125,128</b>	<b>55,234</b>	<b>256,588</b>	<b>56,606</b>	<b>158,669</b>	<b>748,534</b>
	<b>Rate</b>	<b>0.10</b>	<b>0.08</b>	<b>0.06</b>	<b>0.06</b>	<b>0.06</b>	<b>0.06</b>	<b>0.40</b>

<b>City of Dover</b>								
<b>Recommended City Financial Policies</b>								
<b>Summary of Impacts</b>								
<b>(Assumes full and continuing implementation beginning 2012)</b>								
<b>SEWER FUND:</b>	<b>Impact To</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Totals</b>
Capital Reserve Funding	Budget	20,000	20,000	20,000	20,000	20,000	0	100,000
	Rate	0.022	0.022	0.022	0.022	0.022	0.000	0.110
Operating Budget Capital Outlay	Budget	40,799	49,069	51,605	54,252	57,014	24,025	276,764
	Rate	0.046	0.054	0.057	0.059	0.061	0.000	0.277
Benefit Stabilization Fund	Budget	Impact will be positive pending accumulation of funds						
	Rate							
OPEB Contribution	Budget	5,428	5,428	5,428	5,428	5,428	5,428	32,567
	Rate	0.006	0.006	0.006	0.006	0.006	0.006	0.036
Contingency Funding	Budget	12,293	5,458	5,788	6,134	5,105	1,092	35,871
	Rate	0.014	0.006	0.006	0.007	0.005	0.001	0.039
Debt Financed Threshold Change (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Rate							
Debt Service as % of Budget (Per Proposed CIP 2012-2017)	Budget	Impact offset by adjustments to adopted CIP						
	Rate							
<b>SEWER FUND TOTALS:</b>	<b>Budget</b>	<b>78,520</b>	<b>129,954</b>	<b>282,821</b>	<b>235,814</b>	<b>262,547</b>	<b>30,545</b>	<b>1,020,203</b>
	<b>Rate</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>	<b>0.01</b>	<b>0.46</b>
Combined Utility Rate		0.19	0.16	0.15	0.15	0.15	0.06	0.86

<b>CALCULATION ASSUMPTIONS:</b>										
<b>GENERAL FUND:</b>										
	Estimated	Assessed	Fund Balance	Capital	Debt				Capital	
	Budget	Value	Target	Reserve	Debt	Service	Contingency	Estimated	Outlay	
				Contribution	Threshold	Percent	Target	City Budget	Target	
2011	84,710,539	2,606,535.05	6.00%	245,000	100,000	10%	0.12%	30,694,146	4.65%	
2012	87,997,308	2,632,600.40	6.20%	500,000	250,000	10%	0.15%	31,885,079	5.00%	
2013	91,411,603	2,658,926.40	6.75%	500,000	250,000	10%	0.25%	33,122,220	5.50%	
2014	94,958,374	2,685,515.67	7.25%	500,000	250,000	10%	0.34%	34,407,362	6.00%	
2015	98,642,759	2,712,370.83	7.75%	500,000	250,000	10%	0.38%	35,742,368	6.50%	
2016	102,470,098	2,739,494.53	8.00%	500,000	250,000	10%	0.50%	37,129,172	7.00%	
2017	106,445,937	2,766,889.48	8.00%	500,000	250,000	10%	0.50%	38,569,783	7.50%	
Assumed										
Annual Increase	3.88%	1.00%						3.88%		

<b>WATER FUND:</b>								
	Estimated	Capital				Debt		Capital
	Billable	Reserve	Debt	Estimated	Service	Contingency	Outlay	
	Useage	Contribution	Threshold	Budget	Percent	Target	Target	
2011	999,253	450,000	100,000	4,241,115	40%	0.00%	12.55%	
2012	975,000	475,000	250,000	4,518,484	40%	0.20%	13.00%	
2013	984,750	500,000	250,000	4,813,993	40%	0.28%	13.00%	
2014	994,598	500,000	250,000	5,128,828	40%	0.40%	13.00%	
2015	1,004,543	500,000	250,000	5,464,253	40%	0.48%	13.00%	
2016	1,014,589	500,000	250,000	5,821,615	40%	0.50%	13.00%	
2017	1,024,735	500,000	250,000	6,202,349	40%	0.50%	13.00%	
Assumed								
Annual Increase	1.00%			6.54%				

<b>CALCULATION ASSUMPTIONS:</b>							
<b>SEWER FUND:</b>							
	Estimated	Capital				Debt	
	Billable	Reserve	Debt	Estimated	Service	Contingency	
	Useage	Contribution	Threshold	Budget	Percent	Target	
2011	933,000	400,000	100,000	5,959,529	40%	0.00%	
2012	893,000	420,000	250,000	6,146,658	40%	0.20%	
2013	901,930	440,000	250,000	6,339,663	40%	0.28%	
2014	910,949	460,000	250,000	6,538,729	40%	0.36%	
2015	920,059	480,000	250,000	6,744,045	40%	0.44%	
2016	929,259	500,000	250,000	6,955,808	40%	0.50%	
2017	938,552	500,000	250,000	7,174,220	40%	0.50%	
Assumed							
Annual Increase	1.00%			3.14%			