FINANCE COMMITTEE MINUTES
OF APRIL 9, 2018

Municipal Council of the City of Vermilion
Municipal Complex, 685 Decatur Street, Vermilion, Ohio 44089

<u>In Attendance</u>: **Vermilion City Council:**
Monica Stark, Council at Large; John Gabriel, Ward One; Frank Loucka, Ward Two; Steve Holovacs, Ward Three; Barb Brady, Ward Four; Brian Holmes, Ward Five. Excused: Steve Herron, President of Council

Administration:
Jim Forthofer, Mayor; Chris Howard, City Engineer; Chris Hartung, Police Chief; Amy Hendricks, Finance Director; Chris Stempowski, Fire Chief

<u>Call to Order</u>: Brian Holmes, Chairman, RESOLVED THAT this Finance Committee comprised of the committee of the whole does now come to order.

TOPIC ONE: <u>Debt Service Planning (Michael Prcela – Sudsina & Associates)</u>

Amy Hendricks said at a prior council meeting they had discussed the city's long term debt and the planning that was needed in taking this forward. She determined there were no additional loans taken out from the state Water Agency. She advised council as moving forward they need to be conscious of the financial health indicators which showed up in the 2015 and 2016 audit reports. As far as their measurements, the City of Vermilion is considered to be in a critical risk range for the debt to revenue ratio. The ratio is an indicator to the city's ability to repay debt without negatively impacting the day to day operations. They view cautionary debt to revenue ratio as 12-15% and critical is anything over 15%. For 2015, the City of Vermilion was at 30% and in 2016 at 34%. This is not only a sign of stagnant revenues, but also some increases in the actual liabilities they are not paying down. She believes the city needs to call in the experts because it's so technical. Therefore, she contacted Michael Prcela, Managing Director and Greg Van Wagnen, Senior Advisor of Sudsina & Associates as she has worked with them many times over the years.

Michael Prcela presented council with an introduction of his firm and a summary as it relates to the city's aggregate debt portfolio. He noted that Greg Van Wagnen is a credit expert who put together the package in terms of what they believe is some money saving opportunities for the city, and an opportunity to lower the aforementioned ratio. He has worked with Amy Hendricks throughout the course of their careers in several positions, including Vermilion and Fairview Park Schools. In terms of municipal debt, they advise the cities, school districts, counties, and non for profits. They issue opinions and suggestions in terms of the best way to structure debt and act as the city's fiduciary. When you work specifically only with an underwriter, it's a firm that goes into the capital markets and they get the city their money. He said in other states they only have municipal advisors with minimal underwriter interaction. Therefore, his firm represents the city and they will structure debt to the city's best situation; not to be the best situation for an underwriter to sell the debt. Naturally, they can only go to certain boundaries where the marketability then starts to suffer, but an underwriter basically has to work with their desk who sells the debt, and his firm is really there to police that arrangement. It's a unique situation that will benefit the city. In this particular situation, they are actually contemplating taking the underwriter right out of the equation. They will do this debt competitively and will go right to the investors on their own. Vermilion is a marketable credit and the city has had a lot of experience in the markets, so Vermilion is a well-known name. It will not come up as a no-name credit. On the other side of the coin, they had to do a little spin work on the credit itself; again referring back to the finance director's comments in terms of the debt to revenue ratios. They believe the presentation as submitted to council is the start of a multi-year approach in approving the overall debt picture in the city.

Greg Van Wagnen reviewed the main terms by explaining a BOND is a long term borrowing (similar to a mortgage) and a NOTE is a one year borrowing situation. When you're pricing a bond there is coupons that is usually a 5% rate and for every $100 of bonds you would have to pay $5 back to the issuer every year. The Yield (interest rate charged) and the Coupon/Yield combined is how they come up with the price. He addressed the 'CALL DATE' which is the date they can call back the bonds and issue new bonds to replace them with. He explained Bank Qualified and Non-Bank Qualified means that anything under $10 million is considered a small issuer in the eyes of the federal government, so it gives the banks more tax incentives to buy the city's bond over a $11 million bond, so with the size of the bonds outstanding for Vermilion currently, they should be able to take advantage of the Bank Qualified as much as possible over the next few years.

He explained there are two types of methods to sell bonds, which can be through a negotiated sale or a competitive sale. There is also a direct placement which they might end up using in the future at some point. With a *negotiated sale* they would need to go to an investment bank and have them sell the bonds for the city, which then creates more costs. He believes a *competitive sale* is the way to go because it's essentially saying that at 11:00 a.m. on Tuesday this is what they're selling, and they get a bunch of banks to bid on the specific bonds. He explained the GFOAs recommendation is the issuer doesn't have a great credit rating of BBB or lower, which Vermilion is above this, or that the bonds that you're issuing are too confusing for the market and it needs someone to explain it to the investors, which neither are the case in Vermilion. They are interested in the *competitive sale* and their firm sells the most competitive bonds in the state for any municipal advisor, so they are very seasoned in selling this way specifically for cities. The recommendations are that it's a simple debt structure and it's 'A' rated or better, which Vermilion is. Per their summary, he reviewed with council their Aa1 rated competitive sale results from competitive bonds they have sold in the past. He also reviewed one of their competitive sales verse a negotiated sale at the same time period. It's important to get the best interest rates and getting the right team together. He addressed the third method of sale "Direct Placement" and said if they need to take this approach the main benefits is that you don't have to get the credit rating or pay for a few pieces of the issuance process, but the interest rates are always higher because you're dealing with one direct bank.

Michael Prcela said they propose to implement in the situation specific to the City of Vermilion; a competitive sale with full disclosure; meaning they will put together a preliminary official statement. What really revolves around their strategy for the city focuses primarily on the debt rating. Currently the city is rated 'A2' which they think is underachieved, but they definitely believe the city can work its way up the scale as there is potential for 'AA' standard in terms of the credit rating. They need to start taking the current debt picture and slowly transforming it. They have a long term strategy and he doesn't want to sound negative to the point where the city is in some type of dire financial straits; this is not the picture in the least. At an 'A2' level the city is right in the meat of the average credit rating for a municipality within the State of Ohio, but they believe the city can be a step above that with a little help in examining the entire picture of debt. The city has been in a process of rolling the note and he equates this to someone paying their interest down on a credit card once that payment comes up every month. It's not an indication that Vermilion doesn't have the physical solvencies to eliminate the debt, but as it comes across in the rating agencies; then why is Vermilion just rolling the note with minimal pay down. They need to face these questions head on. The one thing about rolling the note is the redundancy of expenses the city must pay year over year; counsel, the registrar, the rating. After three or four years this becomes counterproductive and all of the money the city is paying year over year could be going toward the pay down of principle. As minimal as it may be, but overall you're talking $20,000 to $40,000 that needs to be eliminated. Those funds need to be redirected to pay down the note. Their objective is to take the note from a one year roll and bond it out. So they will go from a note-short to a bond-long. They will work with the city's bond counsel and will come up with a plan knowing exactly how long they can go on that note, but they don't want to fully extend the amortization to the point where they are putting a band aid on a severed limb. They want to make certain what they do within the eyes of the rating agencies is a productive plan that starts to pay down the bonds, but at the same time they need to reconstruct the debt portfolio to allow for potential near term borrowings. The city can't survive without its capital arm/leg. It has to have that function of borrowing money in the capital markets. They don't want to limit the city in putting together a debt plan that essentially suffocates the funds in the early years and they have to wait till money starts to come in or bonds need to be paid down. They will come and approach this again on a step by step basis.

M. Prcela addressed slide 19 on the city's future debt service on an annual basis of what the city's payments currently are on a long term basis. There is a gradual decline just like a home mortgage; the longer you're into your loan the less interest you're paying in the principle. They are going to take advantage of this situation; it's going to be non-cost effective in terms of an interest rate approach to the city. However, they will relieve an upfront debt service burden and will try to bring down the ratio. They will bring into the mix the bonding of that note and then they have the opportunity to refinance an existing piece of debt in conjunction with bonding that note. They have a unique situation of prepayment options. B. Brady asked if the summary of the debt review is combined; whether they are enterprise funds or whatever; it's all debt across the city? M. Prcela said it's the city's general obligation debt and didn't believe they included EPA and water revenue funds into this equation. It's just the general fund debt.

Greg Van Wagnen explained the 'call dates' in conjunction with slide 18 of the packet. He explained to council anything beyond the lines in bold can be refunded and they can move the principle payments around to structure it to even out the payments on slide 19. So instead of having the over million for the next couple of years and then dropping down in the $600,000 range as those bonds start to become callable, they will take the principle out of the earlier years and push it further down as they can and make it a more even schedule throughout the life of the bonds. Part of the Ohio Revised Code says they have to stay to the 3-1 ratio, so if you have $100,000 as your lowest, the highest payment can't be above $300,000. M. Prcela said this very rule precludes cities and school districts from trying to put all their debt to the back end because you're otherwise pushing off a problem for future taxpayers while current taxpayers get a free lunch. Ohio Revised Code requires that you cannot in your lowest year have anything more than three times greater than that in any subsequent year where you pay principle and interest, so it gives them a good amount of latitude to re-shift that principle payment. Why they can't go and structure these pieces now is because in 2018 the tax law changed. You cannot refinance these issues in advance of the call date. Up until through 2017, that had been the rule since 1986. However, over the course of the next four to five years, they have a step down where each of these subsequent years they will be currently callable. So if a call date is June 1, you can call those bonds within 90 days before June 1, which is considered a current call. Anything more than 90 days is a call in advance of that date and they cannot do this anymore. So, as these subsequent call date years approach they will go ahead, starting throughout the course of this year, and will start examining revenues and the fiscal and debt policy. Next year when a call date comes up they will examine the option of taking a chunk of the principle and put it to the back end, which will free some debt for the near future years. It will allow the city to borrow if need be and it gives them some breathing room to restructure the debt service to make certain the city is not in a situation to float a note which is putting fuel on the fire; it's digging the city in deeper. This is the objective and strategy they will take. They will start working with the finance director to put together a disclosure statement and will couple the note by bringing in a refinancing piece. Now they have the benefit of the economies of scale because they are now going to be doing two issues essentially for the price of one. There are third party expenses that are associated with every transaction which can't be avoided, so they would rather lump as many into one and get charged the one time third party expense versus doing an issue, and then a few months later doing another issue because you start at zero at that point. It works in the city's behalf in killing more than one bird with one stone.

Amy Hendricks asked Sudsina & Associates to touch on some of their other municipal clients in the area that speaks to their experience. Greg Van Wagnen said he is from Lorain, Ohio, originally and their founder is from Vermilion, and he has worked with Huron, Erie County, City of Sandusky, Sandusky Schools, Vermilion Schools, Sandusky County, City of Toledo, and Lucas County. This is their strongest area in the state and currently they are working with the City of Huron as they are bonding out for a new sub-station surrounding the tomato greenhouses. Their knowledge of the economic situation in this area is second to none.

B. Brady said since the city has to wait for call dates, then they are at risk for interest rate increases she would think. Greg Van Wagnen said this is true and something they take into consideration. They wouldn't call them if it were at a cost to the city. They will review everything and if it were to be more expensive, then it wouldn't make sense to go through with it.

John Gabriel said he is excited to get this started because they have treated each individual borrowing as a standalone issue, which has wedged the city into a corner in many ways, so he is grateful that A. Hendricks brought them to Vermilion. M. Prcela said with absolute confidence that the whole educational industry has lost a good one with Amy, so the city has benefitted tremendously. He said Vermilion got a real good one and they will help Vermilion and will take care of business for the city. They will look at the entire picture within the city; nothing will be overlooked. They will put together a comprehensive presentation for the rating agency on this very borrowing. B. Brady asked if the enterprise funds have to be kept separate. M. Prcela said it depends on the legal structure of how it was put together within the ordinances themselves, but they will examine all of this. They will work hand in hand with council.

TOPIC TWO: <u>**BAC (Health Care – Tom Forrester)**</u>

Tom Forrester said the Mayor has started a new committee and they will be meeting in the near future to try to move forward with their negotiations. He reviewed the structure of the city's health plan going into 2018. He received a number of questions from Council and they are in the process of working out the questions and getting back to those individuals.

He said in the City they have an individual deductible which is $2,000 and a $4,000 family deductible. He said the most important area in a health plan is to look at out of pocket costs. In a single the out of pocket maximum costs is $2,000 and a family is $4,000. Another way of looking at this particular plan is if you met your deductible, you now have met your out of pocket expenses and you now have a 100% plan. In today's world this is an extremely rich program. Also, they allow the employees to participate in a wellness program to buy down the deductible and most of the employees have done this. Therefore, this means they are almost down to a zero deductible and out of pocket health plan; it's an extremely wealthy plan and you don't see this any longer.

He said between B. Brady, J. Gabriel, the Mayor, and the Finance Director, they have to rethink this going forward. The wellness program will pick up all of the dollars that people have bought back. Last year it was close to $120,000 and this is another expense they have within the health plan. If you're healthy and you meet your deductible, then the city pays for it.

The actual cost the city spent (including dental, prescriptions, major medical, wellness, and administration claims) in 2015 is $942,324.39. In 2016, it was $1,201,353.83, and in 2017 it was $1,145,984.10. One of the reasons they had the increases was the claims. Claims are different than deductibles and out of pocket. When they purchase the insurance to cover all of this; they are in a self-insured plan and basically this means they are buying from an insurance company a specific deductible, which is $50,000. He said this is a specific claim that an individual can incur and they are going to be responsible for the first $50,000. B. Brady clarified that each employee has a $50,000 deductible. J. Gabriel said it's an obligation and T. Forrester agreed and said a year ago they changed it to a $50,000 obligation per individual or per claim. He said if an individual had a claim for $2 million, then the obligation of the city is to pay the first $50,000. There is another layer of insurance they buy which is called 'aggregate'. If they are involved in paying the first $50,000 of the claim, and the claim never reaches $50,000, but say $20,000, then it falls into the aggregate column and they are responsible for that to the tune of about $1 million. This is all the little claims that everybody has; not counting dental, it's medical and prescription. If you had a claim of $1,000, it falls into the aggregate and the city pays it. He stated last time he was before council he advised them they had some large claims, but they had a whole host of aggregate claims. Most is due to the aging workforce across the board. They buy insurance to protect that. He said actuaries can pretty much see in a course of a year or two where those claims are going to come out, and they start looking at worse case scenarios or expected claims. They are in a position as of today, that some of the large claims are no longer large claims, and they don't see anything on the horizon that will be serious hopefully, but it will affect their cash flow dramatically and what they are paying out in a smaller aggregate.

One thing they are hoping to do as they go through this year is to make some changes in the basic benefit plan, which will reflect what they are buying in the stop/loss market. Some suggestions have been HSAs and certainly a change in the deductible; perhaps adding an out of pocket cost. He doesn't believe today that Vermilion or any other municipality can continue on with basically a zero deductible plan. They need some regular participation. He said one of the questions was whether they could look at Blue Cross/Blue Shield plans or things like that and absolutely they can because they are fully insured. One of the issues is that as long as they are 51 years or older those will all be underwritten. When they went to the direct fully insured market a little over two years ago, they were declined because the claims had to be reported. He explained that 50 years and below is a pooled product and they don't ask for medical claims. They are too early in the game yet to look for that market. He believes they will be able to see very clearly by the next two to three months where they are heading claims wise. He thinks

Susan Anderson from Walter Haverfield will get involved and they should give important data to Susan so there is some buffer and idea where she can go into negotiations this year to try to get this thing under wraps. This will be an ongoing process for probably the next number of years. If council has additional questions then he will be able to get back to them with answers.

J. Gabriel said he sent out an email with questions related to how much the city pays versus what was listed in the BAC quote, which was addressed tonight. They will try to work through this because the income growth doesn't match the numbers. They will bring back another set of numbers and will try to get the number more accurate because that's a lot of money they don't have to budget, so they can work with the unions and the employees on the left hand and show them where they are at, and then on the right hand they will still try to come up with what that number is. T. Forrester said if employment goes up and down by just a few people it really does impact the numbers. They have lost the ability to bring in the deductible to help them offset. Being self-funded gives them a great opportunity to recap a lot of dollars and keep the expenses low, but when you have gotten hit on top of everything else with two years of serious claims; claims that have gone for an individual in the $500,000 range and a whole series of much smaller numbers, it makes it much more difficult.

After no further discussion came before the committee, Chairman Holmes adjourned the meeting.

Next Meeting: May 14, 2018

Gwen Fisher Certified Municipal Clerk