2020 - Where Do We Go From Here?

Financial Tools for Fiscal Sustainability

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While we all rise to meet the challenges presented by the COVID-19 pandemic and resulting stay-at-home (now safer-at-home) state orders, they offer a unique opportunity to assess certain aspects of your organizations' finances and profile. Today, we focus on three core aspects of prudent financial management and identify concerns and opportunities that may help you maintain stability and achieve success in this unprecedented environment.

On April 28, 2020, a Wall Street Journal headline read "Coronovirus Prompts Record Souring of Consumers' Outlook – and Hope Pain Will Be Short-Lived." The article itself speaks to the record decline of current conditions driving consumer confidence down by 30 points between March and April. While the article does incite hope, citing a seven-point increase in the expectations index, the record-setting pace of the drop due to COVID-19 hastens an assumption of a potential 25% decline in gross domestic product for the second quarter.

We all are hopeful of a 'V-shaped' recovery, but must brace for one that looks more 'U-shaped.' There's even the possibility of a 'W' due to increases in infection rates as states begin to reopen economic activities. Below are three financial tools every community can leverage to better prepare and position themselves for near and long-term uncertainties.

1. Investments

As we have watched investment rates dramatically decrease over the past two months, we can reasonably expect yields for investment pools, money market funds and cash-like instruments to approach zero. In fact, a portfolio more heavily weighted towards cash will likely experience higher income volatility over longer periods than one with a termed maturity structure. It's times like these when your investment portfolio needs to be carefully examined to protect revenue and provide a reliable source of income, even if that income potential has diminished. There is incremental return to be gained by moving out a bit on the yield curve. For instance, there is an almost 100% increase in yield available by extending from 1-year out to 3-years on the Treasury curve. Lengthening your portfolio duration effectively, however, requires that you have a clear picture of your cash flow cycle and constraints to determine which reserves or assets you may be able to comfortably "put to work" for a longer term.

As most entities operate with a certain – and in many instances required – level of reserves, maintaining liquidity, yet still earning a reasonable rate of return on your funds is now more important than ever. A key component to any investment plan is to develop a cash flow forecast. Doing so will give you the opportunity and confidence to take reserves likely not needed for current operations and invest them further out on the yield curve to increase return. Additionally, it's a good time learn more about alternatives to traditional investments (e.g. U.S. Treasuries, agencies and brokered CDs) that don't necessitate increased risk exposures. Broadening your view can prove valuable, although it may require amending your investment policy to widen the universe of permissible investments.

A properly constructed investment portfolio that incorporates a cash flow forecasting model can help improve your returns, while preserving the liquidity needed to operate a sustainable and resilient organization.

2. Revenue Forecasting

While investment income is generally a smaller proportion of your annual revenues, there are far larger sources that may impact your overall finances for both current and future fiscal years. Revenue forecasting may be significantly more difficult today given our present environment, but it is also now far more important. Effectively analyzing the probable decline in current revenues and how that may affect your short- and long-term financial profile is critical for maintaining stability.

Accurate revenue forecasting is not only critical from an operational standpoint to maintain the essential services you provide, but also from a debt management perspective.

We know in many cases, data on economically sensitive revenues like sales taxes and user fees lags as long as two months or more. March may not look great and April may very well be worse, but what does that do to our overall projections for the fiscal year? Once we begin to normalize, are we facing a 'V' or 'U' economic return (or even the 'W') and what does that mean to us in the long run?

Will revenues keep pace for you to be able to continue operations and make your debt payments? Knowing, through effective modeling built on reasonable assumptions, will help you anticipate future challenges, mitigate risk, and ultimately answer that question with a confident "yes." It is better to assess looming financial struggles today through scenario analysis so you can pragmatically minimize negative impacts. While, in most cases, you have cash or debt service reserves to rely on, a protracted downturn has the potential to overwhelm both without a forecast built on a solid foundation of accurate data and thoughtful planning.

3. Debt Refinancing/Restructuring

If your financial condition becomes impaired or begins to deteriorate, the current interest rate environment may be your best ally in alleviating fiscal pressures by refinancing and/or restructuring existing debt that may include a multitude of options and structures such as taxable advance refundings, Cinderella bonds, current refundings and forward purchases, just to name a few. There are pros and cons involved for nearly all debt refunding and restructuring options and it's important you analyze each carefully with the assistance of your municipal advisor and guidance of **GFOA Best Practices** – before you act – to clearly understand the short- and long-term implications, allowing you to mitigate risks and maintain a sound financial footing.

Summary

Even as we all face the inevitable uncertainties COVID-19 has created in our communities and financial markets, now is not the time to retreat and simply try to "shelter-in-place" by relying on the status quo. Instead, use this occasion as an opportunity to reevaluate your organizations' investments, revenues and debt profile to prudently adapt and ensure you can weather any storm. And remember, Ehlers stands ready to partner with you as a trusted advisor and fiduciary whether its developing cash flow models, constructing investment portfolios, establishing revenue forecasts or debt planning and management. After all, building strong, vibrant and sustainable communities is what we do!

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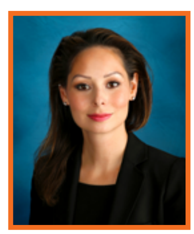

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