

# Town of Federalsburg, Maryland

## Comprehensive Financial Review



December 2022

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# Goals and Objectives



# Goals and Objectives

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- The Town of Federalsburg (the “Town”) has engaged Davenport & Company LLC (“Davenport”) to complete a Comprehensive Financial Review of the Town’s financial status of both the General Fund and Water & Sewer Fund (the “Funds”).
  
- The main goals and objectives of Davenport’s Comprehensive Financial Review are:
  - Provide the Town with a perspective of its economic and demographic profile, as well as its financial and debt position with respect to historical Town trends, current peers, and national medians for the Funds;
  - Assess the Town’s current financial policies for the Funds against GFOA and other industry standards; and
  - Provide initial observations and recommendations based on the foregoing, and where appropriate, discuss next steps.



# Economic and Demographic Overview



# Peer Group Overview

- The Town of Federalsburg will be compared to the following Peer Group to provide a frame of reference for the Town's performance vs. similar cities and towns in Maryland, Delaware and North Carolina.
- The Peer Group was chosen in part by its similarity to the Town's population, tax base size, and location.

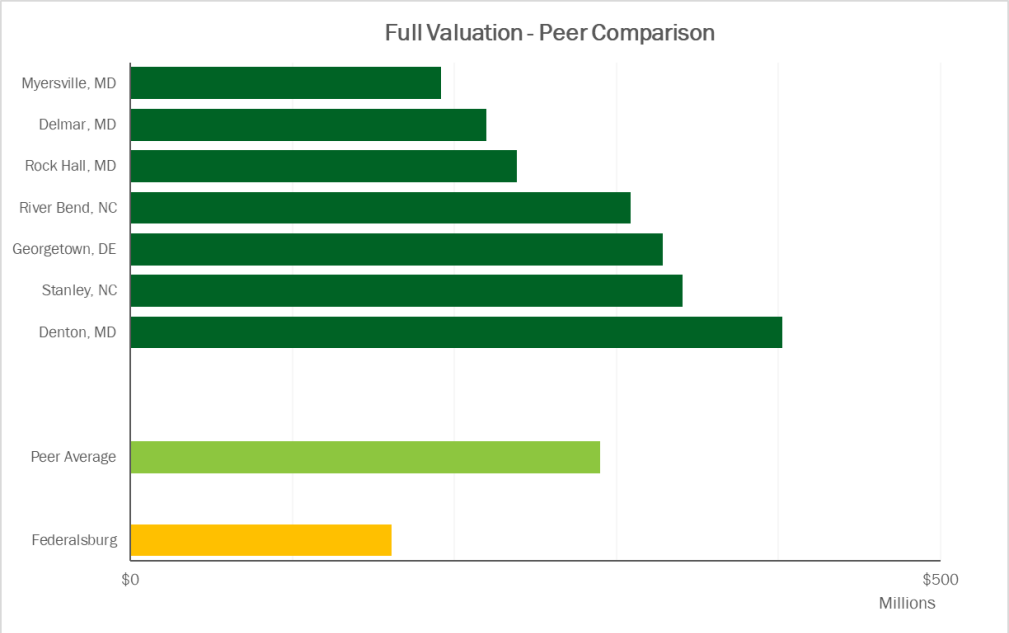
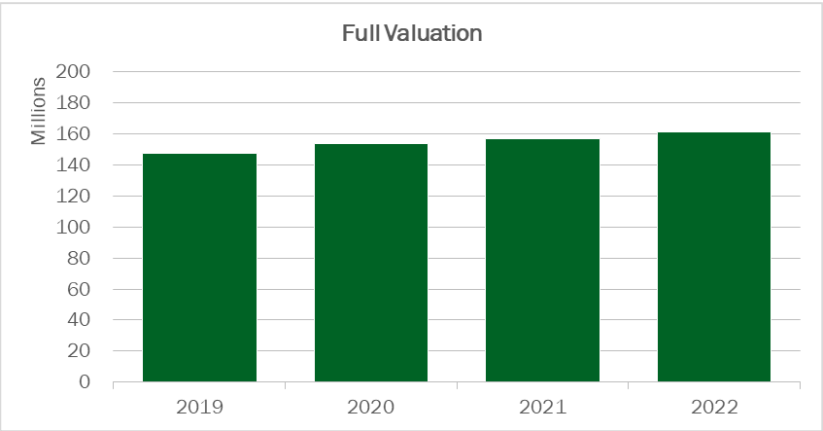
City/Town	Population	Tax Base Size
Town of Federalsburg, MD	2,824	\$ 161,343,152
Town of Rock Hall, MD	1,397	\$ 238,832,287
Town of Myersville, MD	2,427	\$ 191,756,512
Town of River Bend, NC	3,036	\$ 308,741,620
Town of Stanley, NC	3,734	\$ 340,638,800
Town of Delmar, MD	3,748	\$ 219,904,005
Town of Denton, MD	4,712	\$ 402,551,880
Town of Georgetown, DE	7,079	\$ 328,549,600



# Historic Trends: Full Valuation

- A local government’s tax base is the resource from which a government draws its revenues, the larger the tax base, the larger the potential pool of revenues.
- The Town’s assessable base has grown approximately 9.4% since 2019 driven primarily by an increase in real property valuations.
- While the Town anticipates some new residential projects to come online in the near-term with the potential for industrial development over time, the Town is only anticipating approximately \$60,000 in new property tax revenues in both fiscal years 2023 and 2024.
  - Given that property taxes are the Town’s main revenue source, this limited revenue growth will need to be carefully managed to ensure that the Town’s reserve position does not experience any additional declines, as reserves are already under the Town’s established policy target.

	Full Valuation	% Change
2019	147,380,679	-
2020	153,782,088	4.3%
2021	156,908,491	2.0%
2022	161,343,152	2.8%

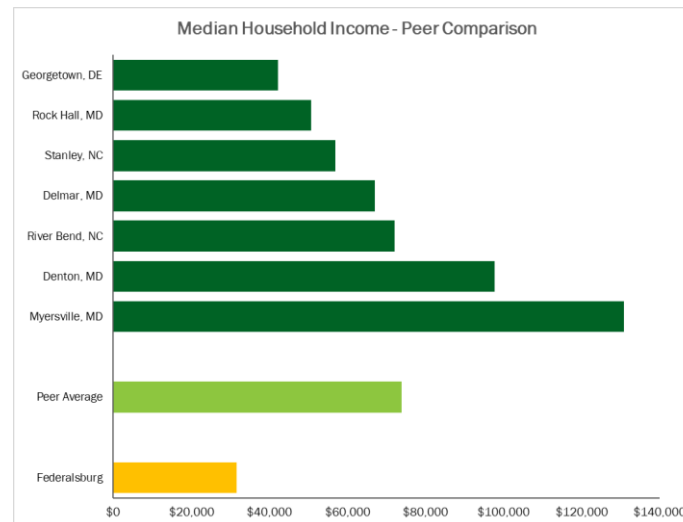




# Historic Trends: Median Household Income

- Median Household Income (“MHI”) provides an indication of the relative strength of a local government’s capacity to generate revenue at the local level.<sup>1</sup>
- While the Town’s MHI has increased 10.2% over the last five years, growth in county, state, and national income levels has outpaced the Town.
  - The recent declines in the Town’s income levels are likely attributable to the COVID-19 pandemic.
- The Town’s income levels remain below its peers, and only represent 50% of the County, 35% of the State, and 45.2% of the nation.

Median Household Income				
Fiscal Year	Town of Federalsburg	Caroline County	State of Maryland	United States
2017	28,625	52,469	78,916	57,652
2018	33,250	54,956	81,868	60,293
2019	34,028	58,638	84,805	62,843
2020	31,915	59,042	87,063	64,994
2021	31,532	63,027	90,203	69,717



<sup>1</sup> Moody's US Cities and Counties Methodology.

Source: U.S. Census Bureau; Moody's MFRA database.





# General Fund Financial Analysis



# Historical General Fund Financials

	2017	2018	2019	2020	2021
<b>Revenues</b>					
Property Taxes	\$1,845,955	\$1,818,607	\$1,777,496	\$1,779,673	\$1,879,794
Income Taxes	118,188	100,345	138,269	131,992	176,235
Other Taxes	0	67,704	0	0	0
Licenses and permits	71,568	50,047	64,411	72,377	75,907
Intergovernmental	173,659	184,045	165,425	207,401	246,846
Charges for services	180,858	183,491	191,446	187,941	183,043
Note receivable - principal	48,024	32,876	53,689	71,301	45,391
Note receivable - interest	5,385	4,124	6,651	6,477	2,935
Miscellaneous	30,809	7,086	13,277	21,052	51,960
<b>Total Revenues</b>	<b>\$2,474,446</b>	<b>\$2,448,325</b>	<b>\$2,410,664</b>	<b>\$2,478,214</b>	<b>\$2,662,111</b>
<b>Expenditures</b>					
General government	\$483,822	\$500,811	\$652,227	\$524,282	\$465,602
Public safety	930,476	1,012,124	951,363	1,151,767	1,124,602
Public works	472,059	497,553	496,655	542,648	495,207
Recreation	51,464	59,055	38,680	25,401	15,002
Economic development	12,292	5,259	5,278	5,292	15,110
Debt service	291,216	314,718	321,119	235,422	230,791
Capital outlay	266,751	50,438	27,208	48,977	210,869
<b>Total Expenditures</b>	<b>\$2,508,080</b>	<b>\$2,439,958</b>	<b>\$2,492,530</b>	<b>\$2,533,789</b>	<b>\$2,557,183</b>
<b>Revenues over (under) Expenditures</b>	<b>(\$33,634)</b>	<b>\$8,367</b>	<b>(\$81,866)</b>	<b>(\$55,575)</b>	<b>\$104,928</b>
<b>Other Financing Sources (Uses)</b>					
Proceeds from sale of land	\$86,782	\$500	\$119,437	\$0	\$98,674
Interests and dividends	257	1,457	2,151	7,779	10,719
Proceeds from issuance of debt	212,318	0	0	0	86,214
Transfers in (out)	(81,806)	112,739	41,608	(263,718)	(135,606)
<b>Total Other Financing Sources</b>	<b>\$217,551</b>	<b>\$114,696</b>	<b>\$163,196</b>	<b>(\$255,939)</b>	<b>\$60,001</b>
<b>Net Change in Fund Balance</b>	<b>\$183,917</b>	<b>\$123,063</b>	<b>\$81,330</b>	<b>(\$311,514)</b>	<b>\$164,929</b>
Fund Balance Beginning	\$800,739	\$984,656	\$1,107,719	\$1,189,049	\$877,535
<b>Fund Balance End</b>	<b>\$984,656</b>	<b>\$1,107,719</b>	<b>\$1,189,049</b>	<b>\$877,535</b>	<b>\$1,042,464</b>

The financial performance of a local government greatly influences its ability to meet existing financial obligations and its flexibility to adjust to new obligations or unexpected contingencies, such as unanticipated revenue shortfalls or cost increases.<sup>1</sup>

- A positive for the Town is that revenues have been growing at a faster rate (7.6% over 5-years) than expenditures (2.0% over 5-years).
- The Town has been very vigilant about outsourcing any function that will produce cost savings for the Town as a way to help manage expenditures.
- As a result, the Town's fund balance has increased by 30.2% since fiscal year 2016.



# Historical General Fund Breakouts

- Property taxes, the most stable and reliable source of revenue, is the Town's largest revenue source representing approximately 71% of total revenues as of fiscal year 2021. Property taxes represent an average 52% of total revenues for the peer group.
  - Property taxes have experienced slight growth of 1.8% since fiscal year 2017. The property tax rate was increased by 6 cents between fiscal years 2017 and 2019, but has remained unchanged thereafter.
- Intergovernmental and income taxes represented approximately 9% and 7% of total revenues as of fiscal year 2021. These revenues have experienced growth of approximately 42.1% and 49.1%, respectively, since fiscal year 2017.
  - The growth in intergovernmental includes the one-time CARES funding that the Town received in fiscal year 2021 due to COVID-19.
- Community development and public safety are the Town's largest expenditures, which have increased by 20.9% and 4.9%, respectively, since fiscal year 2017.

Revenues	FY 2017	Percentage	FY 2021	Percentage
Property Taxes	\$1,845,955	75%	\$1,879,794	71%
Income Taxes	118,188	5%	176,235	7%
Licenses and Permits	71,568	3%	75,907	3%
Intergovernmental	173,659	7%	246,846	9%
Charges for Services	180,858	7%	183,043	7%
Note Receivable - Principal	48,024	2%	45,391	2%
Note Receivable - Interest	5,385	0%	2,935	0%
Miscellaneous	30,809	1%	51,960	2%
<b>Total Revenues</b>	<b>\$2,474,446</b>		<b>\$2,662,111</b>	

Expenditures	FY 2017	Percentage	FY 2021	Percentage
General government	\$483,822	19%	\$465,602	18%
Community development	930,476	37%	1,124,602	44%
Public safety	472,059	19%	495,207	19%
Public works	51,464	2%	15,002	1%
Social services	12,292	0%	15,110	1%
Parks and recreation	291,216	12%	230,791	9%
Debt service <sup>1</sup>	266,751	11%	210,869	8%
<b>Total Expenditures</b>	<b>\$2,508,080</b>		<b>\$2,557,183</b>	

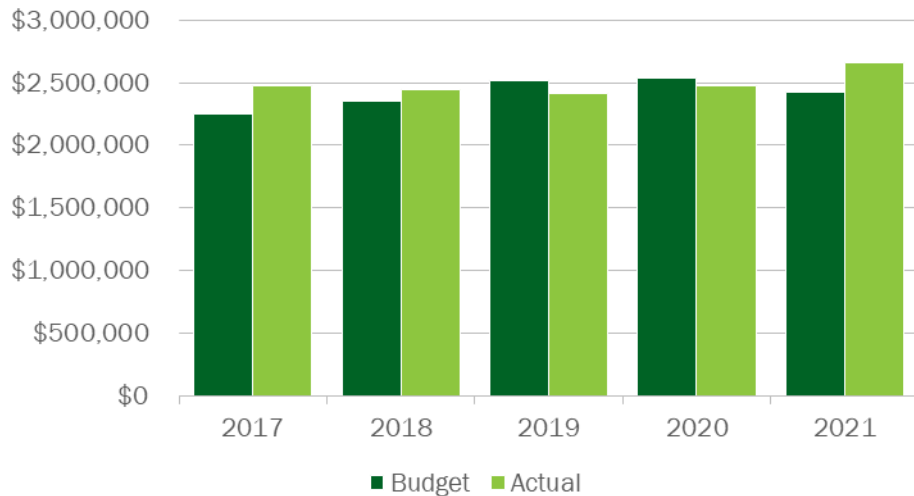
Source: 2017 and 2021 Financial Statements.



# Historical Performance vs. Budget\*

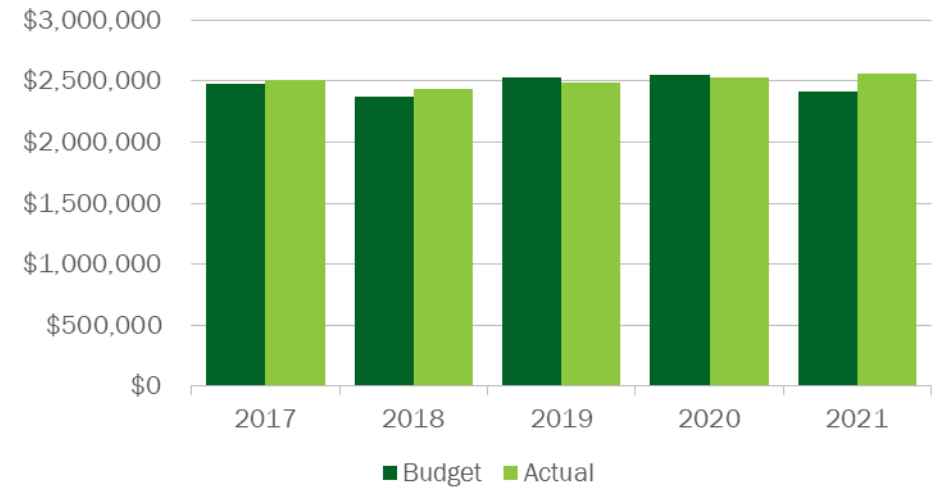
General Fund Revenues				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$2,252,918	\$2,474,446	\$221,528	10%
2018	2,355,270	2,448,325	93,055	4%
2019	2,518,928	2,410,664	(108,264)	-4%
2020	2,540,407	2,478,214	(62,193)	-2%
2021	2,428,064	2,662,111	234,047	10%

Budget vs. Actual: Revenues



General Fund Expenditures				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$2,482,243	\$2,508,080	\$25,837	1%
2018	2,369,306	2,439,958	70,652	3%
2019	2,534,148	2,492,530	(41,618)	-2%
2020	2,552,086	2,533,786	(18,300)	-1%
2021	2,419,677	2,557,183	137,506	6%

Budget vs. Actual: Expenditures



\*The General Fund revenues and expenditures above exclude Other Financing Sources (Uses).

Source: 2017 - 2021 Financial Statements.



# Fund Balance/Reserves

- The Town's available reserves have declined by 18.5% over the last five years to \$269,184 or 11% of budgeted General Fund expenditures for the following fiscal year.
  - This reduction was primarily due to an unbudgeted transfer to the Water & Sewer Fund in fiscal year 2020 as rates haven't been increased since 2018.
  - The Town also had a smaller unbudgeted transfer to the Water & Sewer Fund in 2021. If these unbudgeted transfers continue, there will likely be additional negative impacts to the financial health of the General Fund.

Fiscal Year	General Fund Assigned	General Fund Unassigned	General Fund Available Fund Balance	Audited General Fund Expenditures	Available Fund Balance as % of Audited General Fund Expenditures	Budgeted General Fund Expenditures for Following Fiscal Year	Available Fund Balance as % of Budgeted General Fund Expenditures for Following Fiscal Year	Town Policy
2017	\$0	\$330,190	\$330,190	\$2,508,080	13.2%	\$2,369,306	13.9%	15.0%
2018	50,000	377,025	427,025	2,439,958	17.5%	2,354,148	18.1%	15.0%
2019	80,000	445,128	525,128	2,492,530	21.1%	2,552,086	20.6%	15.0%
2020	0	130,653	130,653	2,533,789	5.2%	2,419,677	5.4%	15.0%
2021	0	269,184	269,184	2,557,183	10.5%	2,453,433	11.0%	15.0%

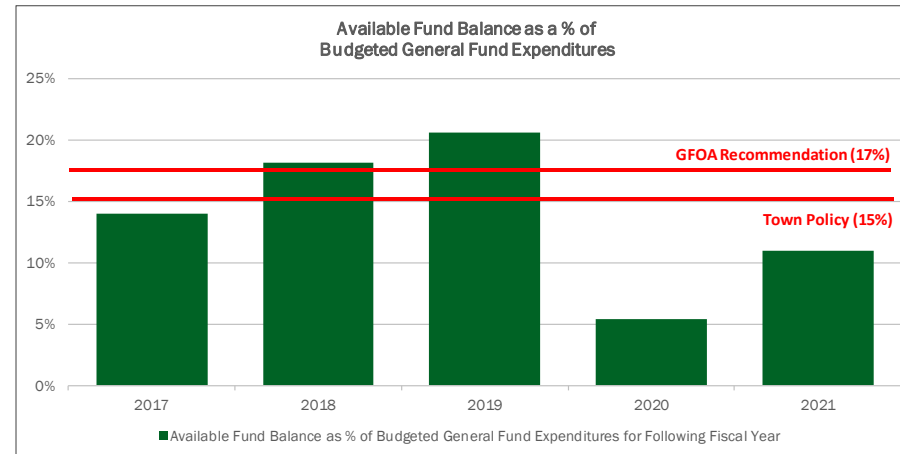
- A local government's reserve position is arguably the most important metric for a local government, as a well-funded reserve can help offset any economic downturn or other one-time event.
- Since most local government budgetary decisions are influenced by financial position, maintaining formal financial policies can help guide decision making and can be a key contributor to a local government's long-term fiscal health.
  - Positively, the Town already adopted a reserve policy in January 2021 to maintain a General Operating Contingency of at least 15% of General Fund expenditures of the following year's General Fund annual operating and capital budget as originally adopted.
    - The Town is not currently in compliance with this policy, having only maintained available reserves of approximately 11% of expenditures.
  - Davenport would recommend that at least a portion, if not all, of any annual operating surplus be used to continue to build this reserve back up to its 15% target.
  - In addition, once the 15% target is achieved, the Town might want to consider adding an upper threshold target of 17%, as this would be in line with GFOA's recommended policy to maintain at least two month's of operating expenditures.

Source: 2017-2021 Financial Statements, Moody's MFRA Database.

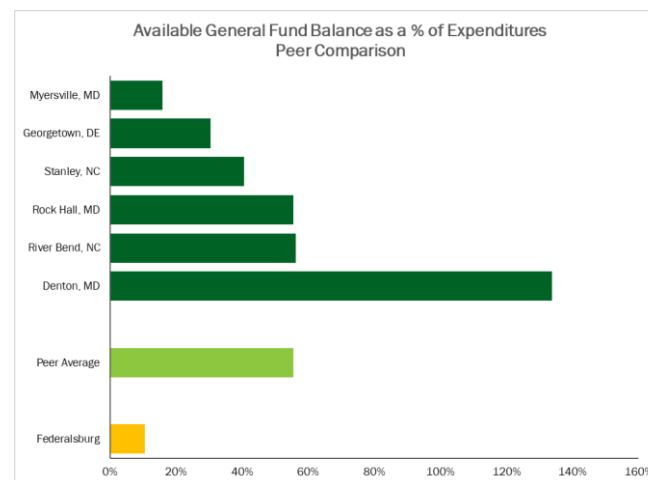


# Fund Balance/Reserves (continued)

- The following chart depicts the Town's available reserve position over the last five years, as compared to the Town's current reserve policy and the GFOA reserve policy recommendation.
  - The Town's fund balance was below the established 15% reserve threshold in three of the last five years.



- The peer average for available reserves is approximately 55.5% (39.8% net of Denton, MD) of expenditures. The Town of Myersville's reserve is approximately 16% of expenditures, similar to the Town's current policy and the GFOA recommendation.



Please note that reserve levels are not available for Delmar, MD.

Source: 2017-2021 Financial Statements; Moody's MFRA Database.



# General Fund FY 22 & 23 Budget Comparison

	2022 Adopted Budget	2023 Adopted Budget	Inc (Dec) vs. 2022 Budget	Percentage Change
<b>Revenues</b>				
Property Taxes	\$1,907,206	\$1,973,743	\$66,537	3.5%
Income Taxes	90,000	90,000	0	0.0%
Highway User Revenue	140,054	153,951	13,897	9.9%
Other Taxes	1,000	1,000	0	0.0%
Licenses and Permits	35,515	20,350	(15,165)	-42.7%
Revenue from Other Agencies	51,390	47,390	(4,000)	-7.8%
Public Safety	77,000	77,000	0	0.0%
Sanitation and Waste Removal	179,000	200,120	21,120	11.8%
Recreation	3,170	3,170	0	0.0%
Fines and Forfeitures	100	100	0	0.0%
Miscellaneous Revenues	21,977	43,977	<u>22,000</u>	<u>100.1%</u>
<b>Total Revenues</b>	<b>2,506,412</b>	<b>2,610,801</b>	<b>104,389</b>	<b>4.2%</b>
<b>Expenditures</b>				
General Government	\$505,674	\$535,747	\$30,073	5.9%
Public Safety	1,159,520	1,232,673	73,153	6.3%
Public Works	668,888	708,158	39,270	5.9%
Recreation and Culture	20,800	23,800	3,000	14.4%
Economic Development	4,950	5,450	500	10.1%
Debt Service	63,317	63,317	0	0.0%
Miscellaneous	30,284	30,284	0	0.0%
<b>Total Expenditures</b>	<b>\$2,453,433</b>	<b>\$2,599,429</b>	<b>\$145,996</b>	<b>6.0%</b>
<b>Operating Surplus (Deficit)</b>	<b>\$52,979</b>	<b>\$11,372</b>		

## Revenues

- The fiscal year 2023 budget includes a 4.2% increase in revenues.
- This increase was primarily driven by growth in property taxes, highway user taxes (which can be volatile) and revenues generated by solid waste collection and disposal.

## Expenditures

- Growth in expenditures outpaced revenues increasing by 6.0% in fiscal year 2023.
- Additional costs are related to growth in general government, public safety and public works.
- Unfortunately, as a result of increased expenditures, the Town's operating contingency (budgeted operating surplus) was reduced by 78.5% to \$11,372.

- A reduced contingency translates to less financial flexibility to address unexpected items without having to utilize reserve funds.



# General Fund Recommendations

- With limited revenue growth expected over the near-term, the Town will have to either cut expenditures or raise revenues to ensure that the Town's healthy financial position is maintained and no additional draws on reserves occur.
  - The Town has diligently worked to find efficiencies and cost savings related to General Fund expenditures. As a result, there may not be many options left to consider for reductions/cost savings and an increase in revenues (tax rate increase) may be required.
- The Town has a history of budgeting relatively conservatively on both the revenue and expenditure side, which includes building in a contingency to help any unexpected budgetary impacts.
  - However, with expenditure growth outpacing revenue growth, this budgetary contingency has declined. With this reduced contingency, there is a greater likelihood that the reserves could potentially be needed to balance the budget if this trend continues.
  - In addition, the Town has made unbudgeted transfers to the Water & Sewer Fund in fiscal years 2020 and 2021. If these transfers continue, the Town's General Fund position could weaken.
- While timing of future economic development projects is not known, Davenport believes it would be beneficial for the Town to develop a more long-term budget model to help proactively monitor the expected growth in revenues and expenditures and their impact on reserves.
  - This will allow the Town to explore budgetary options available to ensure a balanced budget is adopted without the use of reserves.
  - The budget model could be adjusted as needed as more detail on timing of upcoming economic development projects is known.
- Davenport would also propose expanding on the Town's current 15% reserve policy to provide some additional guidelines on how the reserve can be used, as well as replenished.
  - Once the Town meets its current 15% policy, the Town could consider adding an upper benchmark target of 17% to keep the policy in line with GFOA practices and provide added financial flexibility. The additional 2% could act as a budget stabilization reserve that would act as a first line of defense for any unanticipated revenue or expenditures fluctuations.
  - The 15% reserve policy should include additional language detailing what the funds could be used for (i.e. - extreme one-time events) and would require a majority/super-majority vote of Council before they could be utilized.
  - The 15% reserve policy should also include details on how this reserve would be replenished if it fell below the 15% target. This would include having Council establish a replenishment plan restoring the reserve to the 15% target within a three-year timeframe which is a GFOA/industry standard.





# Water & Sewer Fund Financial Analysis



# Historical Water & Sewer Fund Financials

	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021
<b>Operating Revenues</b>					
Water service charges	\$428,956	\$367,955	\$406,872	\$414,555	\$395,544
Sewer service charges	1,087,432	1,025,085	1,080,165	1,079,223	1,035,151
<b>Total Operating Revenues</b>	<b>\$1,516,388</b>	<b>\$1,393,040</b>	<b>\$1,487,037</b>	<b>\$1,493,778</b>	<b>\$1,430,695</b>
<b>Operating Expenses</b>					
Water	\$128,241	\$193,953	\$189,583	\$157,915	\$319,370
Sewer	664,901	781,799	831,132	925,105	712,339
Depreciation and Amortization	662,248	666,046	660,531	659,552	664,173
<b>Total Operating Expenses</b>	<b>\$1,455,390</b>	<b>\$1,641,798</b>	<b>\$1,681,246</b>	<b>\$1,742,572</b>	<b>\$1,695,882</b>
<b>Operating Income (Loss)</b>	<b>\$60,998</b>	<b>(\$248,758)</b>	<b>(\$194,209)</b>	<b>(\$248,794)</b>	<b>(\$265,187)</b>
<b>Nonoperating Revenues (Expenses)</b>					
Intergovernmental revenues	\$0	\$0	\$0	\$35,100	\$1,699,321
Capital asset transferred from General Fund	-	-	-	-	23,131
Transfers in	65,046	(162,110)	3,186	78,308	214,354
Financial expense, net	(140,185)	(136,533)	(130,559)	(123,612)	(116,500)
<b>Total Nonoperating Revenues (Expenses)</b>	<b>(\$75,139)</b>	<b>(\$298,643)</b>	<b>(\$127,373)</b>	<b>(\$10,204)</b>	<b>\$1,820,306</b>
<b>Change in Net Position</b>	<b>(\$14,141)</b>	<b>(\$547,401)</b>	<b>(\$321,582)</b>	<b>(\$258,998)</b>	<b>\$1,555,119</b>
Net Position - Beginning of Year	\$12,211,238	\$12,197,097	\$11,649,696	\$11,328,114	\$11,069,116
<b>Net Position - End of Year</b>	<b>\$12,197,097</b>	<b>\$11,649,696</b>	<b>\$11,328,114</b>	<b>\$11,069,116</b>	<b>\$12,624,235</b>

- A utility's financial health determines its flexibility to respond to contingencies, protect against short-term shocks, and its cushion against unfavorable long-term trends.<sup>1</sup>
- While the net position of the Water & Sewer Fund ("W&S Fund") has increased by 3.5% over the last five years, primarily driven by the \$1.7 million in intergovernmental revenues received in fiscal year 2021.
- Despite the recent improvement in the W&S Fund's net position, expenditures have grown at a significant 30.1% over the last five years, while revenues have declined by 5.7% over the same time period.
  - This has resulted in a significant decline in the W&S Fund's cash position as you will see on Slide 23.
  - The last rate increase that was adopted was in fiscal year 2018.



# Historical Water & Sewer Fund Performance vs. Budget

## WATER FUND:

- Over the last five years, the Water Fund revenues have ended on average 5.1% under budget, while expenses ended under budget by an average of 18.8%. The Town's conservatism on the expenditure side has helped to offset revenue underperformance.

Water Operating Revenues				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$407,229	\$428,956	\$21,727	5.3%
2018	420,642	367,955	(52,687)	-12.5%
2019	413,143	406,872	(6,271)	-1.5%
2020	416,143	414,155	(1,988)	-0.5%
2021	473,499	395,544	(77,955)	-16.5%

Water Operating Expenses (Net of Depreciation)				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$169,304	\$128,241	(\$41,063)	-24.3%
2018	246,827	193,953	(52,874)	-21.4%
2019	217,151	189,583	(27,568)	-12.7%
2020	236,049	157,915	(78,134)	-33.1%
2021	327,861	319,370	(8,491)	-2.6%

## SEWER FUND:

- Over the last five years, the Water Fund revenues have ended on averaged 18.9% under budget, while expenses ended over budget by an average of 13.2%. This has resulted in a net loss in the Sewer Fund during four of the last five fiscal years. Fiscal year 2021 was the only year in which the Sewer Fund was able to produce net income due to the one-time receipt of \$1.7 million in intergovernmental revenues.

Sewer Operating Revenues				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$1,325,424	\$1,087,432	(\$237,992)	-18.0%
2018	1,408,661	1,025,085	(383,576)	-27.2%
2019	1,324,000	1,080,165	(243,835)	-18.4%
2020	1,212,500	1,079,223	(133,277)	-11.0%
2021	1,295,603	1,035,151	(260,452)	-20.1%

Sewer Operating Expenses (Net of Depreciation)				
	Budget	Actual	Variance (\$)	Variance (%)
2017	\$597,719	\$664,901	\$67,182	11.2%
2018	642,357	781,799	139,442	21.7%
2019	732,709	831,132	98,423	13.4%
2020	772,376	925,105	152,729	19.8%
2021	714,281	712,339	(1,942)	-0.3%



# Water & Sewer Fund FY 22 and 23 Budget Comparison

	2022 Adopted Budget	2023 Adopted Budget	Inc (Dec) vs. 2022 Budget	Percentage Change
<b>Revenues</b>				
Water	\$473,724	\$484,615	\$10,891	2.3%
Sewer	1,295,718	1,369,238	73,520	5.7%
<b>Total Revenues</b>	<b>\$1,769,442</b>	<b>\$1,853,853</b>	<b>84,411</b>	<b>4.8%</b>
<b>Expenditures</b>				
Water	\$479,165	\$497,946	\$18,781	3.9%
Sewer	1,269,429	1,213,082	(56,347)	-4.4%
<b>Total Expenditures</b>	<b>\$1,748,594</b>	<b>\$1,711,028</b>	<b>(\$37,566)</b>	<b>-2.1%</b>
<b>Operating Surplus (Deficit)</b>	<b>\$20,848</b>	<b>\$142,825</b>		

- Revenues are budgeted to increase by 4.8% between fiscal years 2022 and 2023 despite rates remaining flat.
  - As seen on the previous slide, both Water and Sewer revenues have historically ended under budget.
- Expenses are expected to decline by 2.1%, primarily driven by the sewer portion of the Fund.
  - However, sewer expenses have historically ended over budget.
- Positively, both the fiscal year 2022 and fiscal year 2023 budgets include an anticipated operating surplus that acts as a budgetary contingency. This contingency increased by 5.9x to \$142,825 in fiscal year 2023, providing additional flexibility to offset any changes to the budget.



# Key Water and Sewer Enterprise Ratios

- The following Key Ratios will be discussed to provide context for the overall health of the Town's Water & Sewer Fund:

	Key Ratio	Definition	Significance
1	Net Debt to Operating Revenues	Net debt divided by most recent year's operating revenues.	Indicates system's overall leverage and fixed costs.
2	Debt Service Coverage	Current year revenues available for debt service divided by current-year total debt service.	Indicates the financial margin to meet current total annual debt service with current revenues available for debt service.
3	Days Cash on Hand	Current unrestricted cash and investments plus any restricted cash and investments, divided by operating expenditures minus depreciation, divided by 365.	Indicates financial flexibility to pay near term obligations.
4	Asset Condition	Net fixed assets divided by most recent year's depreciation.	Indicates condition of utility's capital assets which determines its ability to comply with environmental regulations and continue delivering adequate service with existing resources.



# Key Ratio #1: Outstanding Debt vs. Operating Revenues

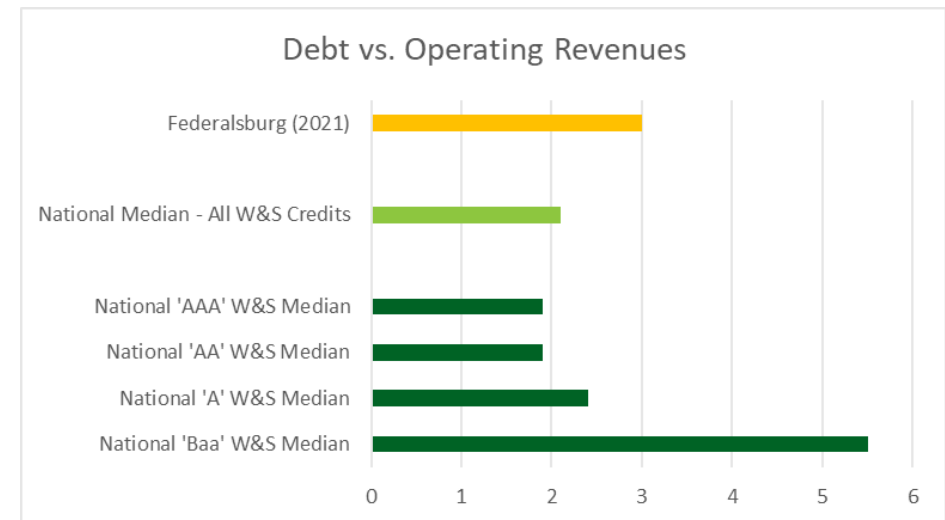
- The amount of long-term debt outstanding divided by the system's operating revenues provides an indication of a system's overall leverage and fixed costs.
- Positively, the Town's debt vs. operating revenues has continued to decline over the last five years due to a reduction in total debt even as operating revenues have decreased. The Town is above-average compared to the national median.

	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021
Total Debt	\$5,926,348	\$5,499,585	\$5,067,354	\$4,665,707	\$4,294,812
Total Operating Revenues	\$1,516,388	\$1,393,040	\$1,487,037	\$1,493,778	\$1,430,695
Debt vs Operating Revenues	3.91	3.95	3.41	3.12	3.00

## Context:

Under Moody's Utility Revenue methodology, debt vs, operating revenues:

- Aaa: <2.00x
- Aa: 2.00x - 4.00x
- A 4.00x - 7.00x
- Baa and below >7.00x





## Key Ratio #2: Debt Service Coverage

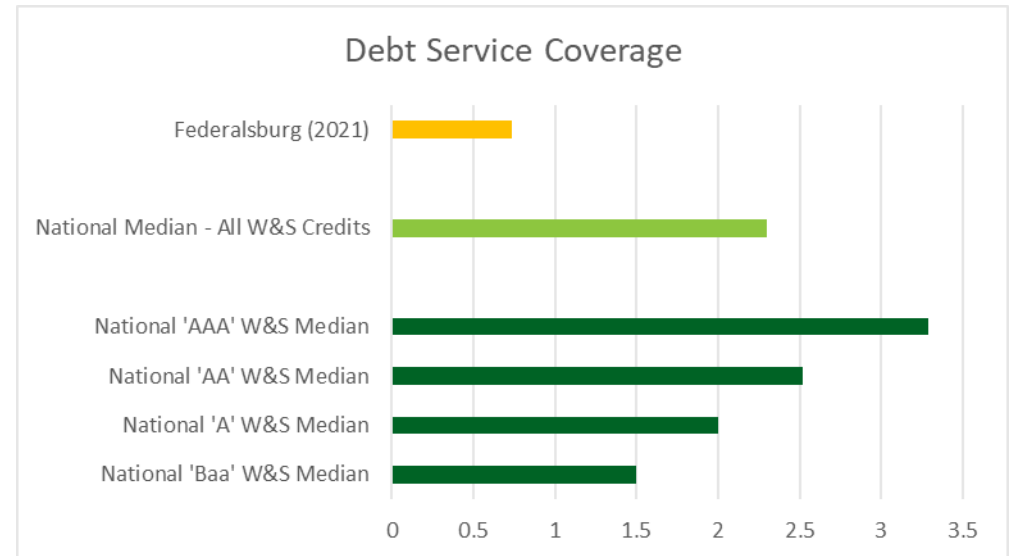
- The **Debt Service Coverage** ratio (Net Revenues divided by Total Annual Debt Service) measures the Town's ability to meet its annual debt service requirements after all operational expenses.
- Debt Service Coverage has declined since fiscal year 2017 to 0.74x, which means the fund is not self-supporting (need at least 1.00x coverage). This reduced coverage is being driven by a 44.8% reduction in net revenues as rates have remained unchanged. Debt Service has remained relatively consistent over the last five years.

	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021
Net Revenues	\$723,246	\$417,288	\$466,322	\$410,758	\$398,986
Total Debt Service	\$553,175	\$562,889	\$562,201	\$527,074	\$540,210
Debt Service Coverage Ratio	1.31	0.74	0.83	0.78	0.74

### Context:

Under Moody's Utility Revenue methodology, debt service coverage is classified as follows:

- Aaa: >2.00x
- Aa: 1.70 – 2.00x
- A: 1.25 – 1.70x
- Baa and below <1.25x



Source: 2017-2021 Financial Statements; Moody's MFRA



## Key Ratio #3: Days Cash on Hand

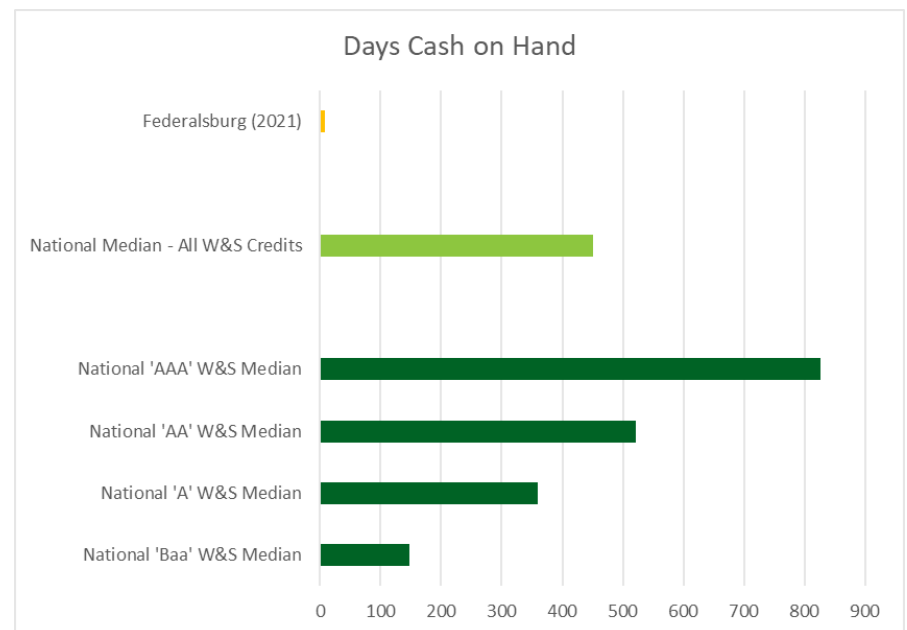
- **Days Cash on Hand** (“DCOH”) (Current unrestricted cash and liquid investments divided by operating expenditures minus depreciation, divided by 365) is a liquidity metric that gauges flexibility to pay near term obligations.
- The Town’s Water & Sewer Fund cash position has declined significantly representing a very low seven DCOH as of fiscal year 2021. This cash position is well below the one (30 days) to three (90 days) month range recommended by the American Waterworks Association, Water Environment Federation, ICMA, and GFOA.

	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021
Unrestricted cash and investments	\$ 539,145	\$ 263,303	\$ 173,967	\$53,987	\$ 20,777
Operating Expenses Less Depreciation	\$793,142	\$975,752	\$1,020,715	\$1,083,020	\$1,031,709
Cash Operating Expense Per Day	\$2,173	\$2,673	\$2,796	\$2,967	\$2,827
<b>Days Cash on Hand</b>	<b>248</b>	<b>98</b>	<b>62</b>	<b>18</b>	<b>7</b>

### Context:

Under Moody’s Utility Revenue methodology, Days Cash on Hand is classified as follows:

- Aaa: >250 Days
- Aa: 250 – 150 Days
- A: 150 – 35 Days
- Baa and below <35 Days



Source: 2017-2021 Financial Statements; Moody's MFRA





## Key Ratio #4: Asset Condition

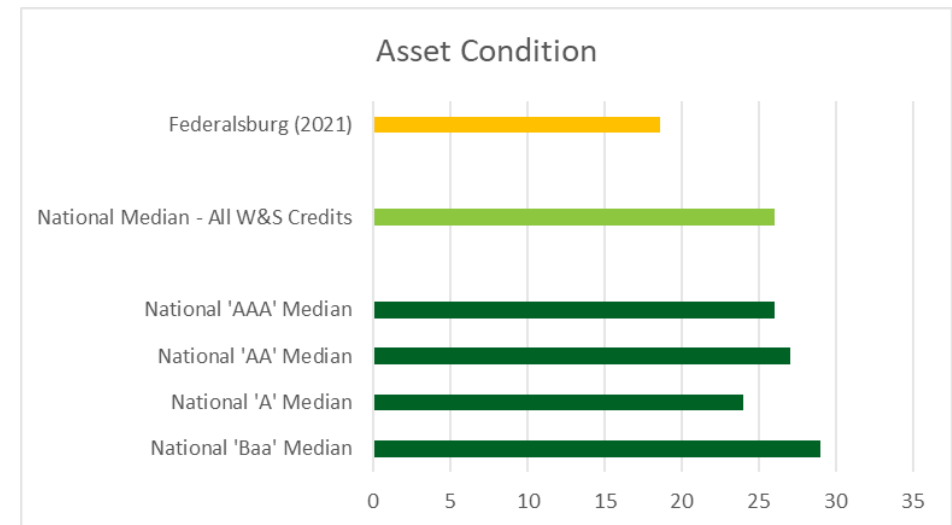
- **Asset Condition** (Net fixed assets divided by current year depreciation) is a system characteristic metric that gauges the condition of a utility's capital assets. Asset condition provides context to a system's ability to comply with environmental regulations and continue to deliver adequate service with existing resources.
- Based on the figures below, the asset condition of the Water & Sewer system has improved slightly over the five-year period, but still remain below the national median.

	Fiscal Year 2017	Fiscal Year 2018	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021
Net Capital Assets	\$11,408,933	\$11,211,936	\$10,983,991	\$10,800,137	\$12,370,194
Depreciation	\$662,248	\$666,046	\$660,531	\$659,552	\$664,173
Asset Condition	17.23	16.83	16.63	16.37	18.62

### Context:

Under Moody's Utility Revenue methodology, Asset Condition is classified as follows:

- Aaa: >75 years
- Aa: 75 – 25 years
- **A: 25 - 12 years**
- Baa and below <12 years





# Water and Sewer Recommendations

- With the significant decline in the W&S Fund's debt service coverage and cash position, it is strongly recommended that the Town consider hiring a third-party to conduct a full rate study.
  - This rate study would provide the Town with the necessary information about what rate increases would be required to bring the W&S Fund back to self-supporting status (1.00x debt service coverage).
  - If a rate study is not conducted and rates are not increased, the W&S Fund is likely to realize additional net losses resulting in further declines in the Fund's net position.
  - Depending on the frequency and size of the annual net losses, the W&S Fund could potentially require additional financial assistance from the General Fund. The General Fund already made unbudgeted transfers to the W&S Fund in 2020 and 2021.
    - If these transfers continue, there will be added financial pressure on the General Fund, which isn't currently meeting its own reserve policy.
- As recommended for the General Fund, Davenport believes that establishing a long-term budget model for the W&S Fund to help proactively monitor the expected growth in revenue and expenses, as well as determine what rate increases (if any) are potentially needed in any given fiscal year.
- Once the rate study is complete and a rate plan has been established, Davenport would recommend that the Town adopt additional financial policies related to the W&S Fund that will help to ensure a healthy financial position can be obtained and maintained going forward.
  - Establish a DCOH policy of 90 days as recommended by the industry to ensure the W&S Fund remains liquid and able to address any short-term budgetary issues.
  - To help manage current and future debt, Davenport would recommend establishing a Debt Service Coverage Requirement policy. While debt service coverage of 1.00x is considered self-supporting, adopting a slightly higher target of 1.20x would provide additional flexibility and be in line with industry standards.



# Current Debt Profile and Capital Needs



# Overview of Outstanding Debt

- The Town had total debt outstanding of \$5,527,685 as of June 30, 2022.

Debt Outstanding	Interest Rate	Maturity Date	General Fund as of 6/30/22	W&S Fund as of 6/30/22	Total Debt as of 6/30/22
MD Loan 1995	4.95%	2026	\$0	\$20,842	\$20,842
MD Water Quality Loan 2007	0.04%	2027	-	474,893	474,893
MD WWTP Upgrade	1.10%	2028	-	933,742	933,742
Note - Police Radio	2.57%	2028	56,888	-	56,888
Roads Bond	4.75%	2028	547,500	-	547,500
MDE Water Quality	0.80%	2033	-	138,427	138,427
Water Quality Bond 2013	1.00%	2033	-	202,704	202,704
Drinking Water Bond 2014A	1.10%	2033	-	7,747	7,747
Drinking Water Bond 2014C	1.10%	2033	-	344,322	344,322
CDA Bonds of 2015	3.29%	2034	-	2,016,500	2,016,500
USDA Public Safety	1.95%	2049	784,120	-	784,120
<b>All Debt Total</b>			<b>\$1,388,508</b>	<b>\$4,139,177</b>	<b>\$5,527,685</b>

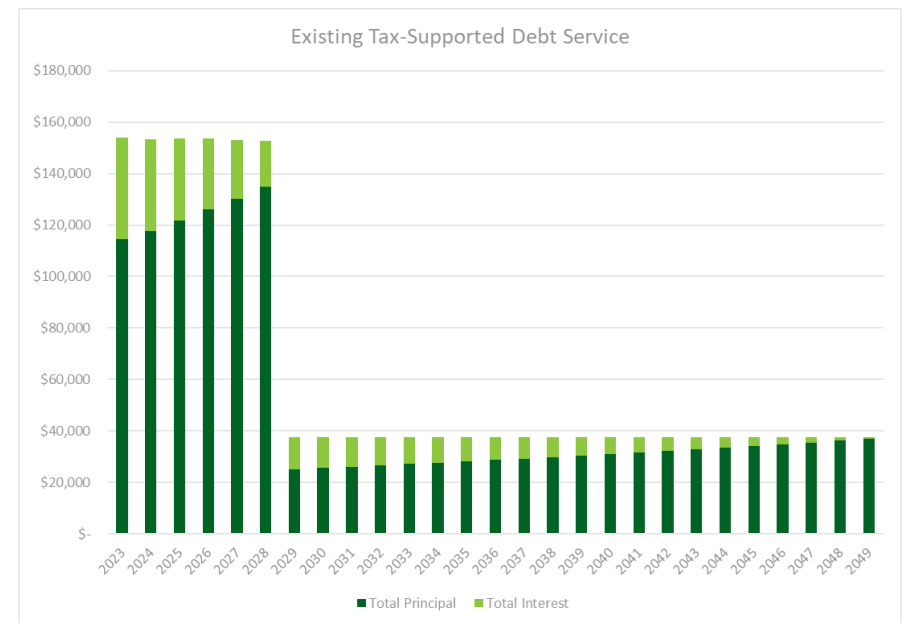
\*The table above does not include the MD Pension obligation with a total amount outstanding of \$229,967 as of 6/30/22. The interest rate for this obligation is 7.75% and it matures in 2031.



# Existing Tax Supported Debt Service

- Below is an overview of the Town's existing tax-supported Debt Service that is paid out of the General Fund.
- Current debt service for the General Fund is structured as declining debt service including 75% decline (approximately \$115,175) in fiscal year 2029.

Fiscal Year	Total Principal	Total Interest	Total Debt Service
2023	\$ 114,432	\$ 39,530	\$ 153,962
2024	117,614	35,810	153,424
2025	121,813	31,806	153,619
2026	126,025	27,466	153,491
2027	130,253	22,775	153,028
2028	134,995	17,811	152,806
2029	25,085	12,546	37,631
2030	25,574	12,057	37,631
2031	26,073	11,558	37,631
2032	26,581	11,050	37,631
2033	27,099	10,531	37,630
2034	27,627	10,003	37,630
2035	28,166	9,464	37,630
2036	28,715	8,915	37,630
2037	29,276	8,355	37,631
2038	29,847	7,784	37,631
2039	30,429	7,202	37,631
2040	31,021	6,609	37,630
2041	31,626	6,004	37,630
2042	32,243	5,387	37,630
2043	32,873	4,758	37,631
2044	33,514	4,117	37,631
2045	34,167	3,464	37,631
2046	34,833	2,797	37,630
2047	35,513	2,118	37,631
2048	36,204	1,426	37,630
2049	36,910	720	37,630
<b>TOTAL</b>	<b>\$ 1,388,508</b>	<b>\$ 322,064</b>	<b>\$ 1,710,572</b>

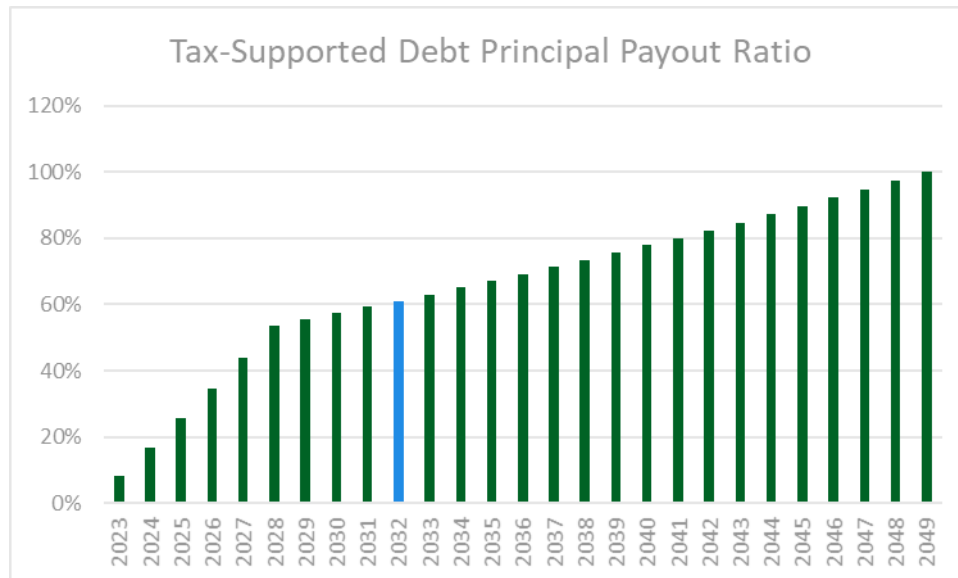


Source: 2021 Financial Statement; Debt Book.



# Principal Payout Ratio – Tax Supported Debt

- Below you will see the Principal Payout Ratio for the Town's existing tax-supported debt.
  - The Principal Payout Ratio measures the rapidity of debt retirement. The more rapid the debt repayment, the more future financial flexibility the Town has to utilize that money for additional capital projects/debt service as debt service declines.
  - The Town's payout ratio of 61.1% is just above the industry benchmark of 60.0%. As additional debt retires and no new tax-supported debt is issued, this payout ratio will continue to increase.



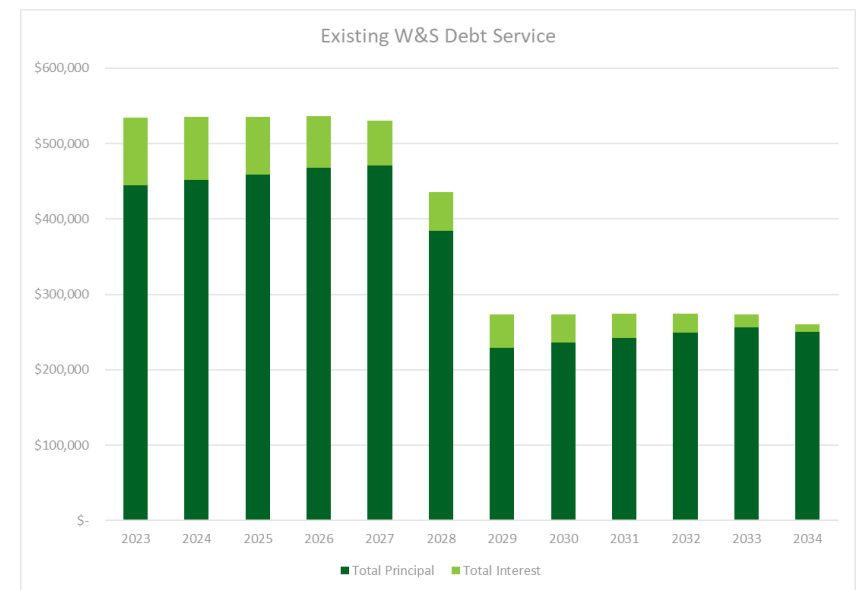
EXISTING TAX-SUPPORTED DEBT SERVICE				
Fiscal Year	Total Principal	Total Interest	Total Debt Service	Payout Ratio
2023	\$ 114,432	\$ 39,530	\$ 153,962	8.2%
2024	117,614	35,810	153,424	16.7%
2025	121,813	31,806	153,619	25.5%
2026	126,025	27,466	153,491	34.6%
2027	130,253	22,775	153,028	43.9%
2028	134,995	17,811	152,806	53.7%
2029	25,085	12,546	37,631	55.5%
2030	25,574	12,057	37,631	57.3%
2031	26,073	11,558	37,631	59.2%
2032	26,581	11,050	37,631	61.1%
2033	27,099	10,531	37,630	63.1%
2034	27,627	10,003	37,630	65.0%
2035	28,166	9,464	37,630	67.1%
2036	28,715	8,915	37,630	69.1%
2037	29,276	8,355	37,631	71.3%
2038	29,847	7,784	37,631	73.4%
2039	30,429	7,202	37,631	75.6%
2040	31,021	6,609	37,630	77.8%
2041	31,626	6,004	37,630	80.1%
2042	32,243	5,387	37,630	82.4%
2043	32,873	4,758	37,631	84.8%
2044	33,514	4,117	37,631	87.2%
2045	34,167	3,464	37,631	89.7%
2046	34,833	2,797	37,630	92.2%
2047	35,513	2,118	37,631	94.7%
2048	36,204	1,426	37,630	97.3%
2049	36,910	720	37,630	100.0%
<b>TOTAL</b>	<b>\$ 1,388,508</b>	<b>\$ 322,064</b>	<b>\$ 1,710,572</b>	



# Existing Water & Sewer Fund Debt Service

- Below is an overview of the Town's existing debt service for the Water & Sewer Fund.
- Current debt service for the Water & Sewer Fund is structured with an overall decline including a \$95,115 decline in fiscal year 2028 and another \$162,334 decline in fiscal year 2029.

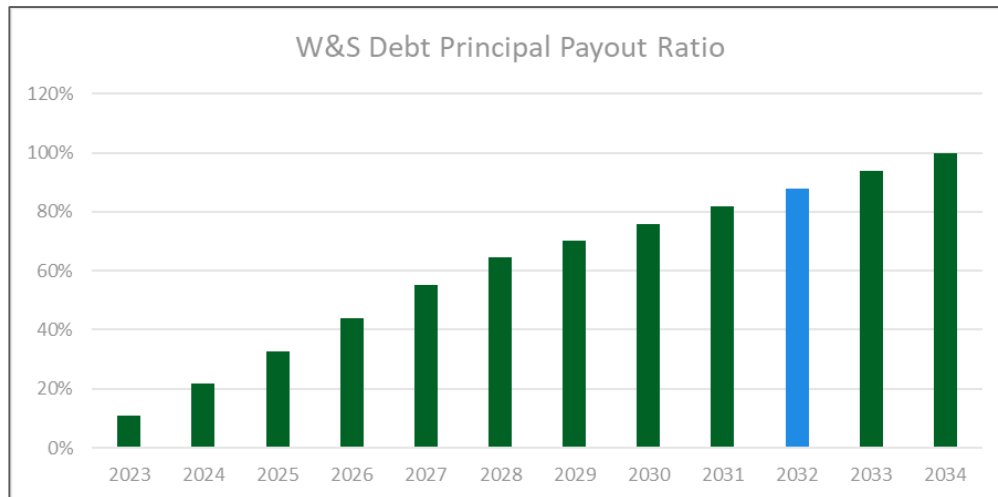
Fiscal Year	Total Principal	Total Interest	Total Debt Service
2023	\$ 444,137	\$ 90,413	\$ 534,550
2024	451,481	83,771	535,252
2025	458,359	77,023	535,382
2026	467,276	68,772	536,048
2027	470,362	60,058	530,420
2028	383,948	51,357	435,305
2029	229,126	43,845	272,971
2030	235,721	37,878	273,599
2031	242,323	31,608	273,931
2032	249,430	24,430	273,860
2033	256,545	17,011	273,556
2034	250,468	9,351	259,819
<b>TOTAL</b>	<b>\$ 4,139,176</b>	<b>\$ 595,517</b>	<b>\$ 4,734,693</b>





# Principal Payout Ratio – Water and Sewer Fund Debt

- Below you will see the Principal Payout Ratio for the Town's existing debt for the Water & Sewer Fund.
  - The Principal Payout Ratio measures the rapidity of debt retirement. The more rapid the debt repayment, the more future financial flexibility the Town has to utilize that money for additional capital projects/debt service.
  - Positively, the Town's payout ratio for Water & Sewer Fund debt is very rapid at 87.8% providing flexibility to address any new Water & Sewer capital needs.



EXISTING W&S DEBT SERVICE					
Fiscal Year	Total Principal	Total Interest	Total Debt Service	Payout Ratio	
2023	\$ 444,137	\$ 90,413	\$ 534,550	10.7%	
2024	451,481	83,771	535,252	21.6%	
2025	458,359	77,023	535,382	32.7%	
2026	467,276	68,772	536,048	44.0%	
2027	470,362	60,058	530,420	55.4%	
2028	383,948	51,357	435,305	64.6%	
2029	229,126	43,845	272,971	70.2%	
2030	235,721	37,878	273,599	75.9%	
2031	242,323	31,608	273,931	81.7%	
2032	249,430	24,430	273,860	87.8%	
2033	256,545	17,011	273,556	93.9%	
2034	250,468	9,351	259,819	100.0%	
TOTAL	\$ 4,139,176	\$ 595,517	\$ 4,734,693		





# Key Debt Ratios

- While there are several different ratios/metrics that can be tracked to evaluate a government's debt profile, three are generally regarded industry-wide as **Key Debt Ratios**:

## 1. Debt vs. Full Value

- The Town does not currently have a policy for this Key Debt Ratio.
- This is a Key Ratio because it measures **Debt Capacity**, i.e., the amount of debt the government can legally bear, as it often is subject to state or local limitations imposed by legislation; it answers the ***"Can I Borrow This?"*** question.

## 2. Debt Service vs. Expenditures

- The Town does not currently have a policy for this Key Debt Ratio.
- This is a Key Ratio because it measures **Debt Affordability**, i.e., how much of the annual budget is being spent to pay for debt, and can show how much additional revenue needs to be raised to pay for new debt being considered. It answers the ***"Can I Afford This?"*** question.

## 3. Fixed Cost Burden

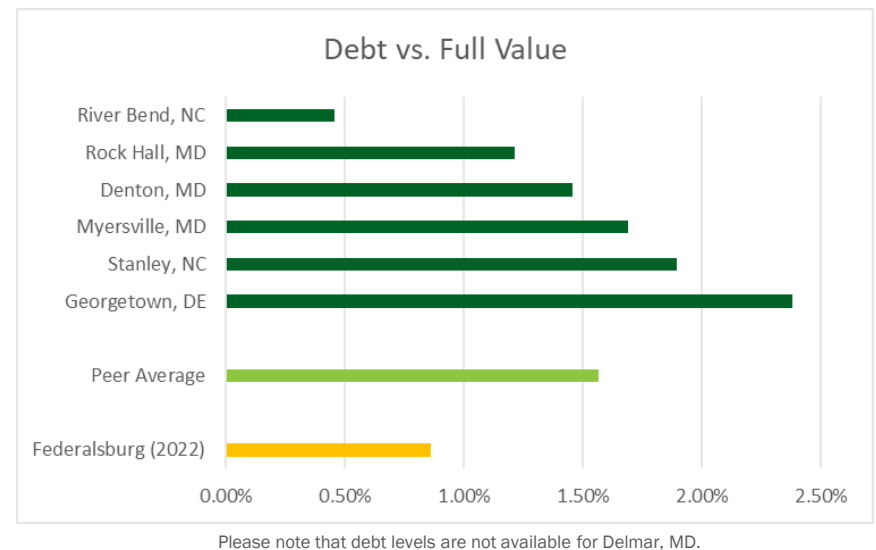
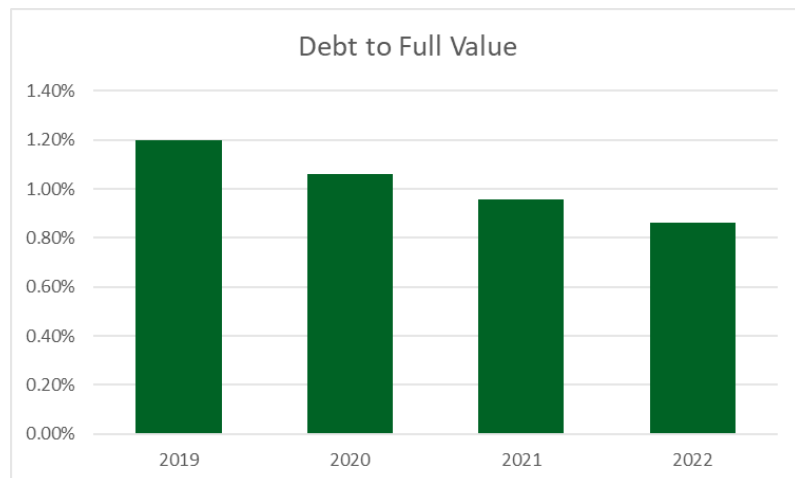
- The Town does not currently have a policy for this Key Debt Ratio.
- Like Debt Service vs. Expenditures, this is a Key Ratio that answer the ***"Can I Afford This?"*** question. However, it provides a more comprehensive view of a government's fixed cost burden by including Pension and OPEB contributions, in addition to debt service.



# Historical Debt vs. Full Value

- As introduced previously, Debt vs. Full Value is often referred to as a “Key Ratio” because it measures **Debt Capacity**, or the question of “Can I borrow this?”
  - The Town’s tax-supported Debt vs. Full Value has been declining as the Town’s outstanding debt has matured and no additional tax-supported debt has been issued.
    - While the Town’s debt vs. full value ratio remains below most of its peers, these peers have larger tax bases, wealth levels and reserve positions that help to offset higher debt positions.
  - To our knowledge, the Town does not currently maintain a Debt vs. Full Value policy, but Davenport would recommend one be established as it is a common policy adopted by similar local governments.
    - Davenport would recommend the Town adopt a policy of no more than 3% debt vs. full value, which is inline with industry practice and provides flexibility for future debt issuances, if needed.

Fiscal Year	Total Full Value	Tax-Supported Debt Outstanding	Debt vs. Full Value
2019	\$147,380,679	\$1,766,555	1.20%
2020	153,782,088	1,630,762	1.06%
2021	156,908,491	1,498,795	0.96%
2022	161,343,152	1,388,508	0.86%



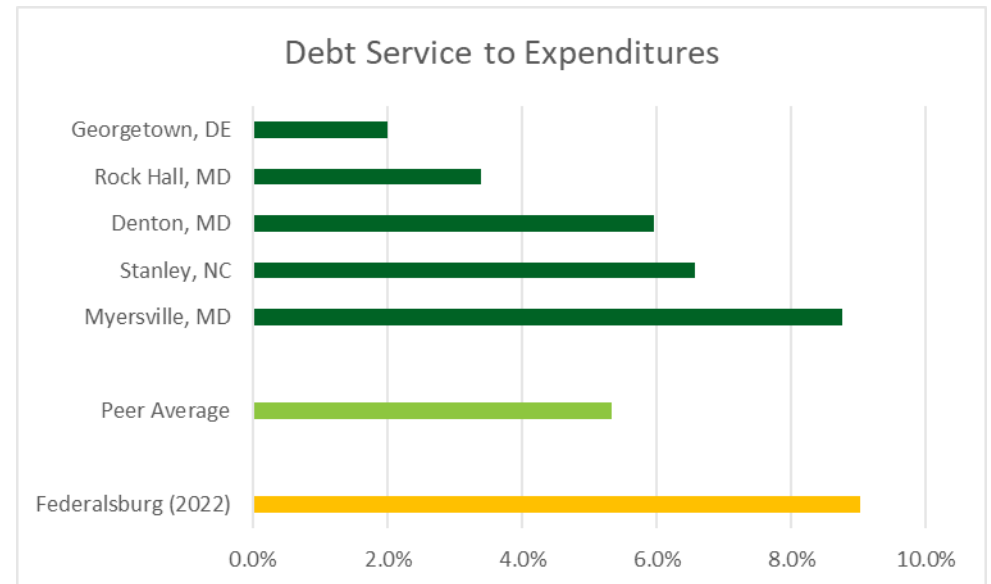
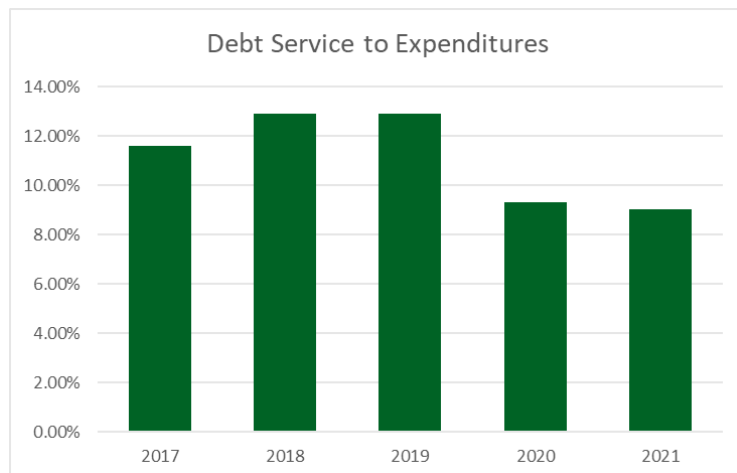
Source: 2019-2021 Financial Statements; Debt Book; 2021 Financial Statements for Peer Governments.



# Key Debt Ratio: Debt Service vs. Expenditures

- As introduced previously, Debt Service vs. Expenditures is often referred to as a “Key Ratio” because it measures **Debt Affordability** – “Can I afford this?”
- While this metric decreased in fiscal years 2020 and 2021, the Town is still near industry standard of 10%-12% of expenditures, providing the Town with limited flexibility for future capital needs.
  - However, the Town remains below the peer average of 5.3% of expenditures.
- The Town does not currently maintain a policy on debt service to expenditures, but we would recommend that one be established as it is a common policy adopted by other similar governments.
  - Drafting the policy with a target of 10% and a ceiling of 12% would provide some flexibility for future needs, while still limiting the amount that could be issued to protect the financial health of the Town.

Fiscal Year	Debt Service	General Fund Expenditures	Debt Service to Expenditures
2017	\$291,216	\$2,508,080	11.61%
2018	314,718	2,439,958	12.90%
2019	321,119	2,492,530	12.88%
2020	235,422	2,533,789	9.29%
2021	230,791	2,557,183	9.03%



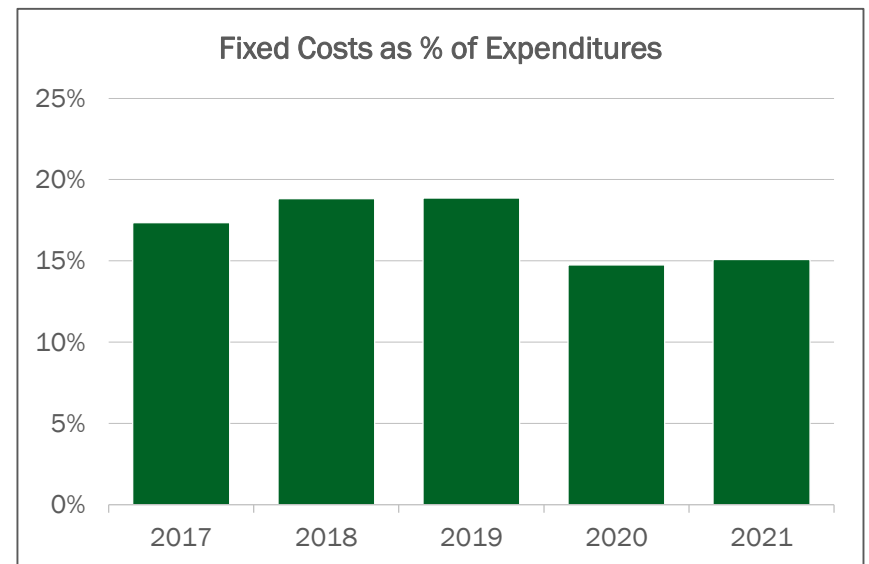
Please note that General Fund debt service expenditures are not available for Delmar, MD or River Bend, NC.



# Key Debt Ratio: Fixed Cost Burden

- Fixed Cost Burden is emerging as a “Key Ratio” because it measures overall **Financial Flexibility**. It expands on debt service vs. expenditures to include the Town’s other long-term liabilities such a pension obligations. Positively, the Town does not offer Other Post-Employment Benefits (“OPEB”).
  - The higher the a local government's fixed costs, the less financial flexibility that government will have for other operating needs.
- The Town does not currently maintain a policy on total fixed costs, but the industry standard to maintain fixed costs below 25% of expenditures.
  - As you can see below, The Town’s fixed costs have declined since fiscal year 2017 due to reduced debt service costs and remain under the 25% threshold.
  - Davenport would recommend implementing the proposed policy for fixed costs not exceed 25% of General Fund expenditures.

Fiscal Year	Tax-Supported Debt Service	Pensions	Total Fixed Costs	General Fund Expenditures	Fixed Costs as % of Expenditures
2017	\$291,216	\$143,897	\$435,113	\$2,508,080	17.3%
2018	314,718	144,748	459,466	2,439,958	18.8%
2019	321,119	148,978	470,097	2,492,530	18.9%
2020	235,422	138,538	373,960	2,533,789	14.8%
2021	230,791	155,129	385,920	2,557,183	15.1%





# Future Capital Needs

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- While the Town has approximately \$2.6 million in projects included in the fiscal year 2023 budget, the Town does not have any plan to issue additional debt in the near-term.
  - Historically, funding of capital projects was driven by the receipt of state or federal funding.
  
- Projects included in the fiscal year 2023 budget will be cash-funded, including approximately \$1.7 million that will use a portion of the Town's American Rescue Plan Act ("ARPA") funds to finance these capital needs.



# Debt and Capital Needs Recommendations

- To ensure that the Town maintains a healthy financial position both in the General Fund and W&S Fund, Davenport recommends that the Town consider adopting debt policies. These policies will provide benchmarks to guide the annual budget and capital planning process, ultimately protecting the Town from becoming overleveraged and causing financial stress. The proposed policies include:
  - Debt to Full Valuation policy of no greater than 3%;
  - Debt Service to Expenditure policy with a target of 10% and ceiling of 12%; and
  - Fixed Costs policy of no greater than 25%.
- In conjunction with the development of a long-term budget model, Davenport believes this model should also include a long-term Capital Improvement Plan (CIP).
  - This will allow the Town to determine what capital projects are outstanding and prioritize those projects in terms of need.
  - Reviewing the long-term budget forecast in conjunction with the CIP will provide a more comprehensive view of the Town's future financial challenges. This proactive approach will allow the Town time to discuss and manage these challenges with the goal of maintaining a healthy financial position in both the General Fund and W&S Fund.
- While the Town does not currently have any refunding opportunities (refinancing outstanding debt at a lower interest rate) based on current interest rates, Davenport will continue to monitor the Town's debt portfolio for any potential opportunities going forward.
  - Any debt service savings realized from future refundings could help provide budgetary relief.
  - Davenport will also monitor the ability for any potential debt restructuring (extending the original debt maturity to produce budgetary savings) as another way to produce annual budgetary savings.
    - While not guaranteed, the only restructuring candidate that the Town could consider is the \$2.016 million CDA Bonds of 2015. These bonds were originally issued with a 20-year amortization, the bonds could be extended and amortized over 30 years and still be within the useful lives of the assets originally financed.



# Summary & Next Steps

# Summary



## ■ GENERAL FUND

- While the Town has a history of budgeting relatively conservatively including building in a contingency to help with unexpected budgetary impacts, expenditure growth has been outpacing revenues. As a result, this budgetary contingency has declined.
  - If this trend continues with an already reduced contingency, there is a high likelihood that the reserves could be needed to balance the budget.
  - The Town has also made unbudgeted transfers to the Water & Sewer Fund in fiscal years 2020 and 2021. If these unanticipated transfers continue, this could further weaken the General Fund position.
- In addition, with limited revenue growth expected over the near-term, the Town will have to either cut expenditures or raise revenues to ensure that the Town's healthy financial position is maintained and no additional draws on reserves occur.
  - The Town has diligently worked to find efficiencies and cost savings related to General Fund expenditures. As a result, there may not be many options left to consider for reductions/cost savings and an increase in revenues (tax rate increase) may be required.

## ■ WATER & SEWER FUND

- With the significant decline in the Water & Sewer Fund's debt service coverage and cash position, it is strongly recommended that the Town consider hiring a third-party to conduct a full rate study.
  - This rate study would provide the Town with the necessary information about what rate increases would be required to bring the Water & Sewer Fund back to self-supporting status (1.00x debt service coverage).
  - If a rate study is not conducted and rates are not increased, the Water & Sewer Fund is likely to realize additional net losses resulting in further declines in the Fund's net position.
  - Any financial stress in the Water & Sewer Fund could have an impact on the General Fund as additional transfers may be required even through the General Fund isn't currently in compliance with its adopted reserve policy.

## ■ OTHER

- Davenport believes it would be beneficial for the Town to develop a long-term budget model, including a Capital Improvement Plan, to help proactively monitor the expected growth in revenues and expenditures and their impact on reserves for both the General Fund and Water & Sewer Fund.
  - This will allow the Town to explore budgetary options available to ensure a balanced budget is adopted without the use of reserves.
- Review and update the Town's financial policies to provide additional benchmarks that will support a healthy financial position going forward.
  - Compliance with these financial policies could be tracked in the long-term budget model.





# Next Steps

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- **January 2023**: Follow-up on any questions that the Council might have or would like to explore in more detail as a result of this presentation.
- **February 2023 – March 2023**: Develop a long-term budget model, along with multi-year Capital Improvement Plan to help proactively manage and protect the Town's financial position.
- **April 2023**: Draft financial policies that would help support the ongoing fiscal health of the Town to be adopted by Council.

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