September 4, 2020

To: Columbia Association Board of Directors
Milton W. Matthews, President/CEO

From: Susan Krabbe, Vice President and CFO

Cc: Lynn Schwartz, Director of Finance/Treasurer
Members of the Senior Leadership Team

Subject: New Reserve Fund Parameter

Background

As you know, the March 2020 mandated closures of CA's facilities and programs due to the COVID-19 pandemic created serious financial challenges for CA for several reasons. The closure of Howard County Public Schools as of March 16, 2020 resulted in the FY 2020 loss of $810,000 revenue from the School Age Services program. CA chose to not bill members for memberships while the facilities were closed, resulting in a loss of $4.2 million, which included non-dues revenue from all fitness and recreational activities. The closures came near the end of the FY 2020 fiscal year, giving staff little time to reduce expenses to more fully offset the lost revenue. Nonetheless, the team responded very well, so that CA ended FY 2020 with an increase in net assets of $1.7 million.

The timing was also difficult for CA in that it was mid-month; we did not bill the March membership revenue, and we had very limited options to offset the cash shortfall created by the absence of the Sport and Fitness revenue. The existing line of credit had a limit of $12 million for the month of March. CA's cash reserves were limited to the excess cash in the general liability self-insurance trust. We obtained permission to transfer $3 million, the majority of that excess cash, to CA's account as a precaution, helping CA to keep the line of credit balance under $8 million for the month, and providing some reserve cushion as we implemented cost reduction measures immediately and until we received the new loan proceeds in June 2020.

Financing Strategy

For decades, CA had significant long-term debt outstanding due to the concept of pre-servicing, whereby the Columbia community was able to enjoy amenities such as pathways, tot lots, neighborhood centers, parks, lakes and ponds, fitness and sports facilities, indoor and outdoor pools, an art center, teen center, etc., many of which were built far in advance of a population adequate to support them. CA did not have any cash reserves for the first few decades of its existence. Previous management teams and

Boards established a very effective strategy taking advantage of extremely favorable short-term rates to pay off high interest rate, non-callable bonds; obtain an upgraded bond rating and issue new, long-term debt with more favorable terms. In FY 2015, CA retired the last of those bonds, obtained an upgraded issuer credit rating of Aa1 and issued $30 million in long-term debt to pay off the $27 million balance on the short-term line of credit. CA kept the short-term line of credit in place to continue to take advantage of historically low short-term interest rates to help fund much-needed capital reinvestments, including significant projects in open space, such as the first-time ever dredging projects for all three of CA's lakes.

For FY 2018 through FY 2020, CA's cash flow from operations averaged $16 million, while the capital spending averaged $19 million and long term debt repayment averaged $1.9 million. Thus, over the three most recent fiscal years, CA generated enough cash flow from operations to fund almost 77% of its capital reinvestment and long-term debt repayment.

The October 2019 updated 10-Year Financial Projection projected little need for more long-term debt, in part due to an average annual capital budget of only $15 million (down from $20 million for more recent years. In fact, the model projected only one long-term debt issuance of $35 million to occur in FY 2026, primarily to finance the purchase of CA's headquarters building.

June 2020 Financing

As you know, due to the pandemic and resulting mandated closures, as well as changes in CA's relationship with the then-existing line of credit holder, CA obtained a $20 million term loan and a revolving line of credit of up to $20 million, both of which are secured by the annual charge revenue. The $20 million term loan was used to pay off the old line of credit balance of approximately $17.5 million.

This new financing requires CA to maintain minimum liquidity of $3 million. That amount has been set aside in CA's cash flow projections. Unfortunately, that amount is not available for use.

"Rainy Day" or Reserve Fund Information

Staff research into "rainy day" or reserve funds indicates that at least at the state government level, the median rainy day fund balance as a percentage of general fund expenditures in 2019 was 7.3% for all 50 states. The State of Maryland's rainy day fund balance was 5% of its general fund expenditures in 2019. Howard County's rainy day fund is to be maintained at no less than 7% of the total audited general fund expenditures for the prior fiscal year.

Staff research into reserve fund guidance for nonprofit organizations (without funding sources like the CA annual charge) found general recommendations of three to six months' of expenses, with the low end being enough to cover at least one full payroll including taxes.Clearly these amounts vary widely as shown in this chart.

	FY 2019 Actual	FY 2020 Actual	FY 2021 Budget
CA's total expenses	$68,812,000	$68,498,000	$55,961,000
5% of CA's total expenses (similar to State of Maryland)	$3,440,600	$3,424,900	$2,798,050
7% of CA's total expenses (similar to Howard County)	$4,816,840	$4,794,860	$3,917,270
3 months of CA's total expenses	$17,203,000	$17,124,500	$13,990,250
6 months of CA's total expenses	$34,406,000	$34,249,000	$27,980,500

Research indicates that funding sources vary, with some entities setting aside a portion of their ongoing annual revenue and others designating less routine sources, such as funds from legal settlements, growth in annual revenue, special or additional taxes, etc. Regardless of the source, those funds are not used for current operating expenses, and have various restrictions over their withdrawal and usage, as well as their replenishment.

The pandemic and corresponding economic downtown have created extreme financial uncertainty for most organizations, including CA. Balancing the funding of a reserve fund with the agility needed to respond to the constantly evolving pandemic is crucial over the next fiscal year, at least.

Recommendations

For the FY 22 budget, staff recommends that the Board approve a reserve parameter of $2 million for FY 22, in addition to the $3 million liquidity required by the new financing. This $2 million would be the beginning of a reserve fund for CA that would be built upon on an annual basis going forward.

Staff further recommends that $1 million of the $3 million excess cash transferred from the general liability self-insurance trust be returned in May 2021. The actuarial analysis for the FY 2020 financial statements did not require the return of the $3 million, so the return of $1 million would be a favorable adjustment to the program at this time.

Our current cash flow projections include the return of the $3 million to the general liability self-insurance trust that was removed in March 2020 as a precautionary measure to offset the revenue shortfall noted above, indicating that it would be possible to establish an initial reserve of $2 million and return $1 million to the trust. This combination of really $3 million in additional cash reserves moves CA forward on at least the lower benchmarks in the above chart.

Longer term, staff recommends that the Board charge staff with the development of a full rainy day fund policy and program, including funding sources and timeline, withdrawal and replenishment directions, to be submitted for Board evaluation, analysis and approval by April 30, 2021.