

State of the city 1-28-2016

Good afternoon. Thank you for the invitation to talk about Berea.

I can report that your city government is strong, its future bright, and our **short term prospects** good.

We have (**\$19M in the bank** as of 12/31/2015, \$4.4M in checking and \$14.5M in CDs); our **revenue forecast is robust** (General Fund revenue last year was \$11.3M, \$9.2 in license fees that included \$6.1 in employee withholding and \$1.1 in utility franchise fees, \$892,000 in insurance premium tax and \$840,000 in net profits); we have **well trained employees** providing quality services, safely, efficiently and ethically (130 full time and 15 part-time); and in 2015 we completed important projects and will attempt more this year.

In terms of good jobs done by city employees, not enough good can be said about the recent job of snow removal by the street department, or the very professional substation upgrade by BMU from 4 to 12 KV, or the routine security provided by our police and fire, the Tourism initiatives that are the envy of the state, and the unseen work of finance in budget preparation, and the important work of parks, codes, GIS and business development.

If you are interested in city finances, you can get more information by reading the three-page Budget Message and the eleven-page Management Discussion of the current Audit which are available on the city's website ([bereaky.gov](http://bereaky.gov) -click government, then city finances, and choose FY 15-16 Budget or from among our last 8 audits).

That audit confirms our city's strong financial position:

--**Total assets increased** by \$4.8M, from \$85.1M to \$89.9M, including \$1.4M in accumulated cash; newly completed infrastructure like the Bratcher Lane widening, Water Street drainage, and Indian Fort Trail phase II; and newly acquired real property like the Tolle building and Berea Hotel.

--**Long term liabilities decreased** by half a million dollars when Berea's share of the net CERS pension liability is excluded. (allocated \$7.7M to the General Fund and \$19.9M to Utilities).

--**The net position of governmental activities increased by over \$2.4M**, mostly from an increase in occupational license fees (up over \$361,000) and net profit receipts (up over \$136,600). Building permits, restaurant taxes and utility franchise fees showed smaller increases. **And the net position of utility activities increased by over \$3M.**

The strength of the City is also reflected in the **Berea Fire, Police, and City Hall Consolidation and Reconstruction Project** that will dominate city operations this year.

City staff has already begun moving from city hall and the police station and spreading out to temporary locations from the west-end of Chestnut to the east-end of Center Street and north to Glades Road.

Here are two views of the project. It will remain at the same central location in town; will consolidate county services in the old Post Office building; locates the Food Bank behind city hall; provides more parking, a drive through window to pay utility bills and taxes, centralizes all financial activity; provides more space for everyone; upgrades technology; will lower utility costs; and prepares Berea for the next 50 years.

There are three reasons why it is essential to do this project now: the Cost, the Need to Modernize, and providing better service, visibility, accessibility.

1) **As to the Cost:** interest rates are low and the City can lock in a rate of 3.125% for 30 years with the ability to pay the loan off early without penalty;

2) **As to the Need to Modernize:** our building is 50 years old and the city's **growth** has increased demands for service; we require **additional space** for all departments and more **usable space** for the specialized needs of the fire and police departments; and we need upgraded **technology**.

**3) As to providing better service, visibility, and accessibility:** this project will retain the current central location of city hall and bring essential departments like finance under one roof and provide important coordination, centralization and flexibility for fire and police. The consolidation of management will enhance the likelihood of better decision making and make city services and employees more visible and accessible to the public.

In addition to meeting city needs, it is also important to know that the City has the financial capacity to pay for this project. Compare the City's position today with its relative financial position in 1967 when the present city hall was built.

In 2016 Berea will borrow up to \$10.4M from Rural Development at an interest rate of 3.125% to fund this project. Last year, General Fund revenue was \$11,374,248. Therefore, this loan amounts to 91% of the city's 2015 general fund revenue.

In 1967 Berea borrowed \$317,000 from HUD for 40 years at 4.125% interest to build the present city hall. That year total general fund revenue was \$219,526. Therefore, the 1967 loan amounted to 156% of Berea's annual general fund receipts. (But even that loan was paid off in 30 years). This comparison indicates that Berea is in a better position to pay this loan than it was in 1967.

BUT, despite this evidence of short term soundness and capacity, Berea, like most other governments and businesses today, also faces a number significant long term challenges that will repeatedly test our **ability to plan and mobilize**, and our **willingness to sacrifice short term gain for long term security and resilience.**

All of our departments, but especially those that require employees with specialized knowledge and training, face **personnel challenges** involving competitive pay, retention, and recruitment. The city also faces an increasing need for enhanced **cyber security**. Our public works department will be challenged by periodic **flooding** and routine **storm water management**. BMU will continue working to **remediate Owsley Fork dam** and seek approval for several long term strategies to increase the city's **future raw water capacity**.

However, the long term challenge that will dominate 2016 is the choice of a wholesale electric supplier.

As you know, in April 2014, the City Council authorized giving KU, our current wholesale supplier, a five year notice to terminate our existing wholesale contract. In all, thirteen Kentucky cities considered terminating. Two, Bardstown and Nicholasville, remained with KU. Eleven, Barbourville, Bardwell, Benham, Berea, Corbin, Falmouth, Frankfort, Madisonville, Owensboro, Paris and Providence, gave notice.

At that time, the plan was for Berea to join the ten other Kentucky cities to form the Kentucky Municipal Energy Agency through which to obtain wholesale electric power collectively at lower cost than KU could provide.

However, when the inter-local agreement that would have allowed Berea to participate in KMEA was brought before Council in June 2015, it was tabled. Later that month, Council voted for Berea to seek bids individually for wholesale power from KU and other established suppliers.



Those bids have been returned. A preliminary analysis indicates that wholesale electric power can be purchased from sources other than KU that could save BMU customers up to \$10M over five years when compared to the expected KU wholesale electric rate. In this context it is important to remember that the wholesale cost of electricity is roughly 80% of a customer's bill.

The purchase of wholesale electric power is complicated. But the two most important issues in selecting a future provider are probably cost and risk, with risk including both certainty of **delivery** and the volatility of **market cost**.

Focusing on cost and risk, Berea seems to have three choices: 1) sign a new contract for 5 to 8 years with KU and accept an annual cost adjustment in rates; or 2) sign a new contract for 3 to 5 years with one of the new bidders at a market rate but subject to great uncertainty as to future cost at the contract's end; or 3) join KMEA and sign a new contract with a range of providers at market rate with lower risk as to market price at the end of the contract .

KU would seem to be the default choice. The city has had a long history with KU. Two of the original 13 cities chose to stay with KU. A KU contract would have low delivery risk. But a KU contract could be \$10M more expensive because a new contract with KU would likely involve increasingly higher electric rates each year as KU assessed its 10.7% profit margin, passed on its income tax bill, and continued to pass along costly infrastructure improvements as it moves away from coal as its primary source of generation.

But signing a new contract with one of the new bidders to save up to \$10M would save money in the early years but would expose the city to sizable a risk of higher market costs when that contract expired in 2024.

Therefore, the only responsible way to consider signing a new contract at lower market rates would be to hedge the market risk by joining KMEA. That is the \$10M dilemma: KU or KMEA. We still need more information to make an informed choice.

Some have raised legitimate questions about the length of KU's proposed contract. Others have questioned a potential conflict of interest of our consultants. Still others argue that information about KMEA should not be considered at all because it is obviously newly formed, without a record, unfamiliar to us, and not to be trusted.

As citizens and customers you have an important role to play in this decision and possibly 10 million reasons to demand that your decision-makers proceed with caution; collect all information possible; and consider all reasonable alternatives.

You should insist that city leaders ask the hard questions; challenge all assumptions dispassionately; and demand that they make the best choice for BMU customers and the citizens of Berea whether it is KU or KMEA or some other power provider. We all have a lot riding on this choice.