

Gas Well Revenues Financial Strategy

**Town Hall Meeting
May 21, 2007**

Meeting Purpose

- Obtain public input on preferred gas well revenues “spend and/or save” financial management policy
- Inform and Communicate
 - Committee Charges
 - Current Policy
 - Asset Restrictions
 - Investment and Use Strategies
 - Criteria for Expenditures



Committee Charges

Council Resolution 3475-04-2007, April 17, 2007

- The Gas Well Revenues Financial Management Strategies Ad Hoc Committee is charged with considering and making recommendations to the City Council on the following gas well revenue financial management strategies and issues:



Committee Charges

[continued]

1. Formulate most prudent **financial strategy** to **leverage** one time **windfall**.
2. Determine the most effective **expenditure to investment** model to assure funding **perpetuity**.



Committee Charges

[continued]

3. Establish **endowment management** plan including **interest spending** and **reinvestment policy** to strategically assure **corpus growth**.
4. Determine most fiscally prudent **expenditure criteria** for application to adopted spending policy.



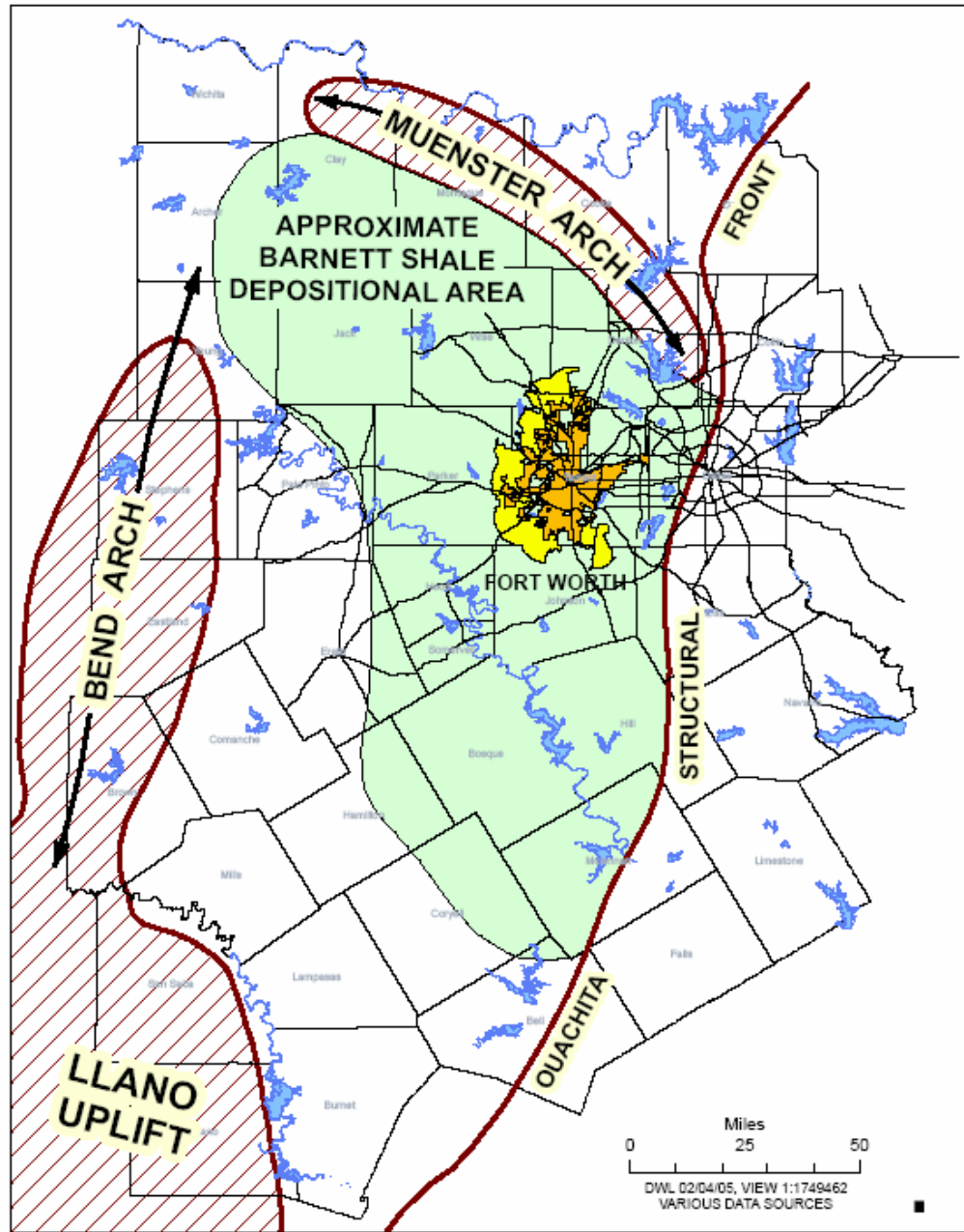
Committee Charges

[continued]

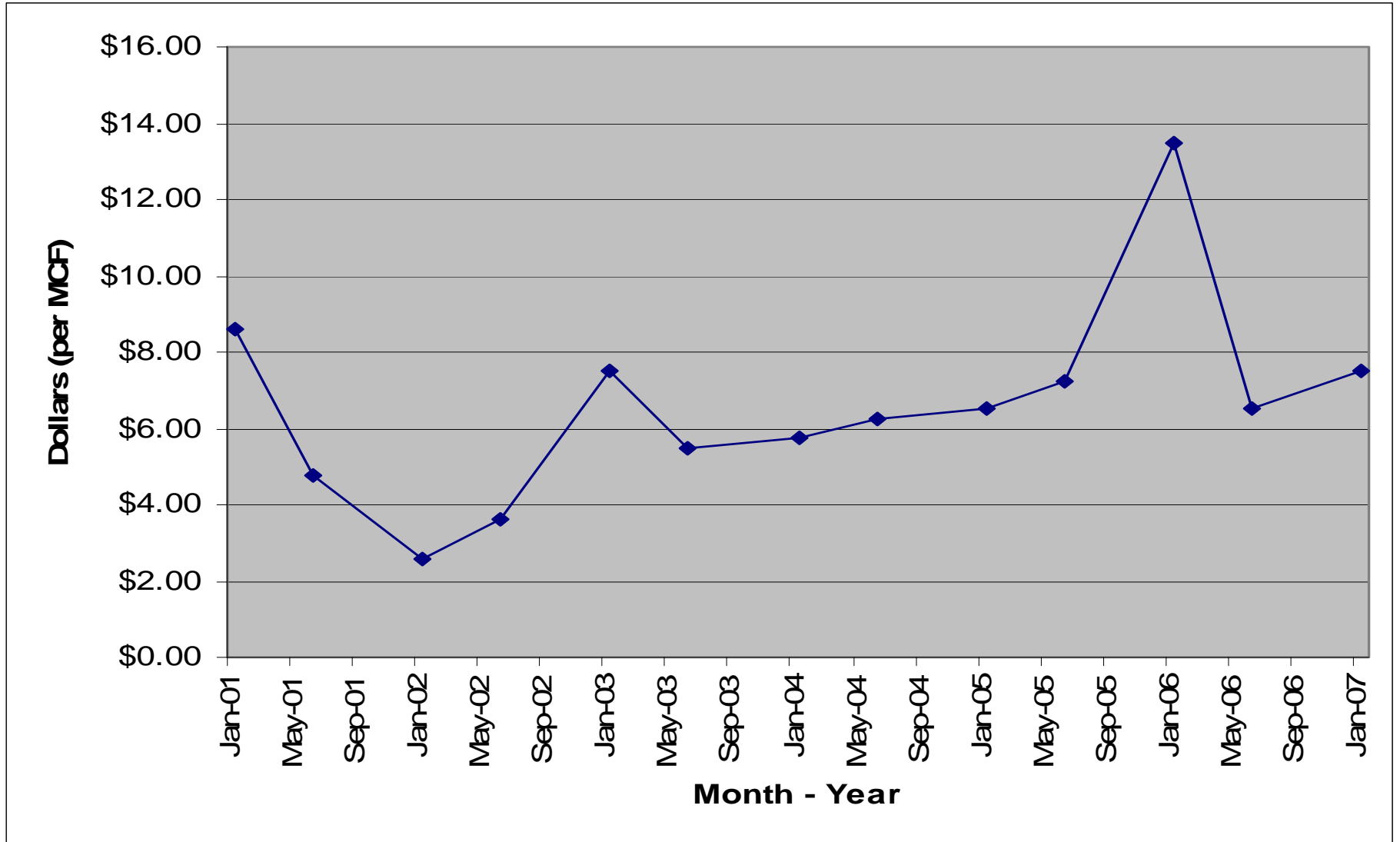
5. Review, consider and evaluate **Council Proposal 265** - Amendment to the City Policy Concerning the Allocation of Gas Well Drilling Revenues and Amendments to State Law [for public funds investments].



BARNETT SHALE LOCATION MAP



Natural Gas Prices 2001-2006



Current Financial Management Policy Revenue Allocations M&C G14767 – April 26, 2005

- Aviation – restricted
- Water & Sewer Fund – restricted
- Lake Worth - restricted
 - Lake – designated to Water & Sewer Fund
 - Dry land – designated to Lake Worth Gas Well Revenue Fund
- General City Properties - designated to Capital Projects Reserve Fund*

*ROW revenues earmarked for streets CIP



Current Revenue Allocations (Continued)

- Park land- bonus dedicated to well park. Royalties dedicated to citywide park CIP fund [2/3's] and park endowment fund [1/3]
- Nature Center-bonus and royalties dedicated wholly to Nature Center
- Park land easements-designated by M&C for park site planning, design and/or development (not currently specified in Policy)



Current Bonus and Royalties Distribution for Parks

Bonus to Well Park - 100%

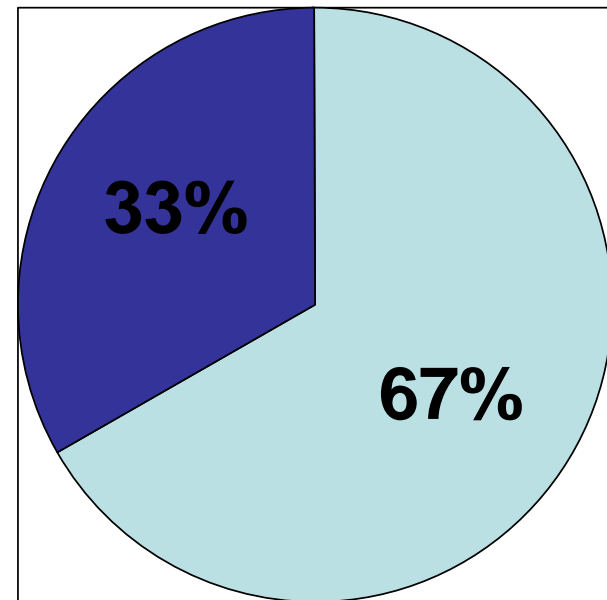
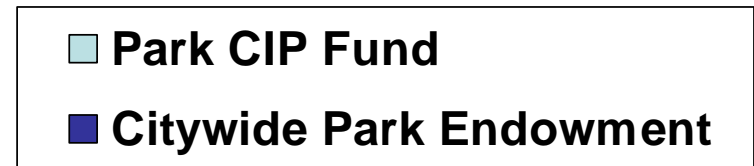
Royalty Allocation

- 2/3 to Citywide Park CIP Fund
- 1/3 to Citywide Park Endowment Fund*

Endowment Fund Annual Interest

- 75% allocated to Citywide Park CIP Fund
- 25% reinvested into Citywide Park Endowment Fund corpus

*Until Endowment fund reaches \$10 million per M&C G15715, adopted May 8, 2007



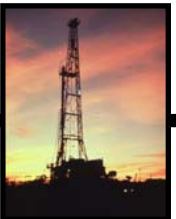
Issues

- Revenues from most city properties are unconditionally or conditionally restricted by federal /state regulations, local policy, ordinance, or deed.
- Current and projected bonuses and royalties exceeding original estimates
- Revenue volatility and uncertainty
- Significant amount of near term needs in citywide infrastructure
- One time opportunity for long term investment and financial legacy



Assets Unconditionally Restricted

- Aviation – U.S. Dept. of Transportation, Federal Aviation Administration policy
- Parks
 - U.S. Dept. of Interior, National Park Service and/or Texas Parks and Wildlife Department grant policy.
 - Property deed or lease restrictions



Assets Conditionally Restricted

- Water and Sewer – Master Ordinance including bond covenants, coverage factors, and reserve policy requirements [20%]
- Solid Waste – Enterprise fund policy (currently earmarked for debt service)
- Golf – Enterprise fund policy, deed restrictions and property lease restrictions



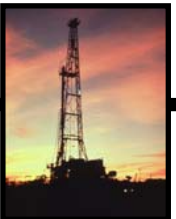
Revenue Volatility

- **Bonus** dollars received only after **bid award** and contract **execution**.
- **Royalty** dollars received only if gas well **successful**.
- **Royalty** dollars dependent on gas **volume produced**.
- **Royalty** dollars dependent on natural gas **market rates**.



Assumptions

- 8910 Mineral Acres (Excluding Nature Center)
- 15-20 Year Well Life
- 25% Royalty
- \$5 MCF Market Rate
- 225,000 MCF/Acre Reserve
- 20% Gas Recovery from Reserve



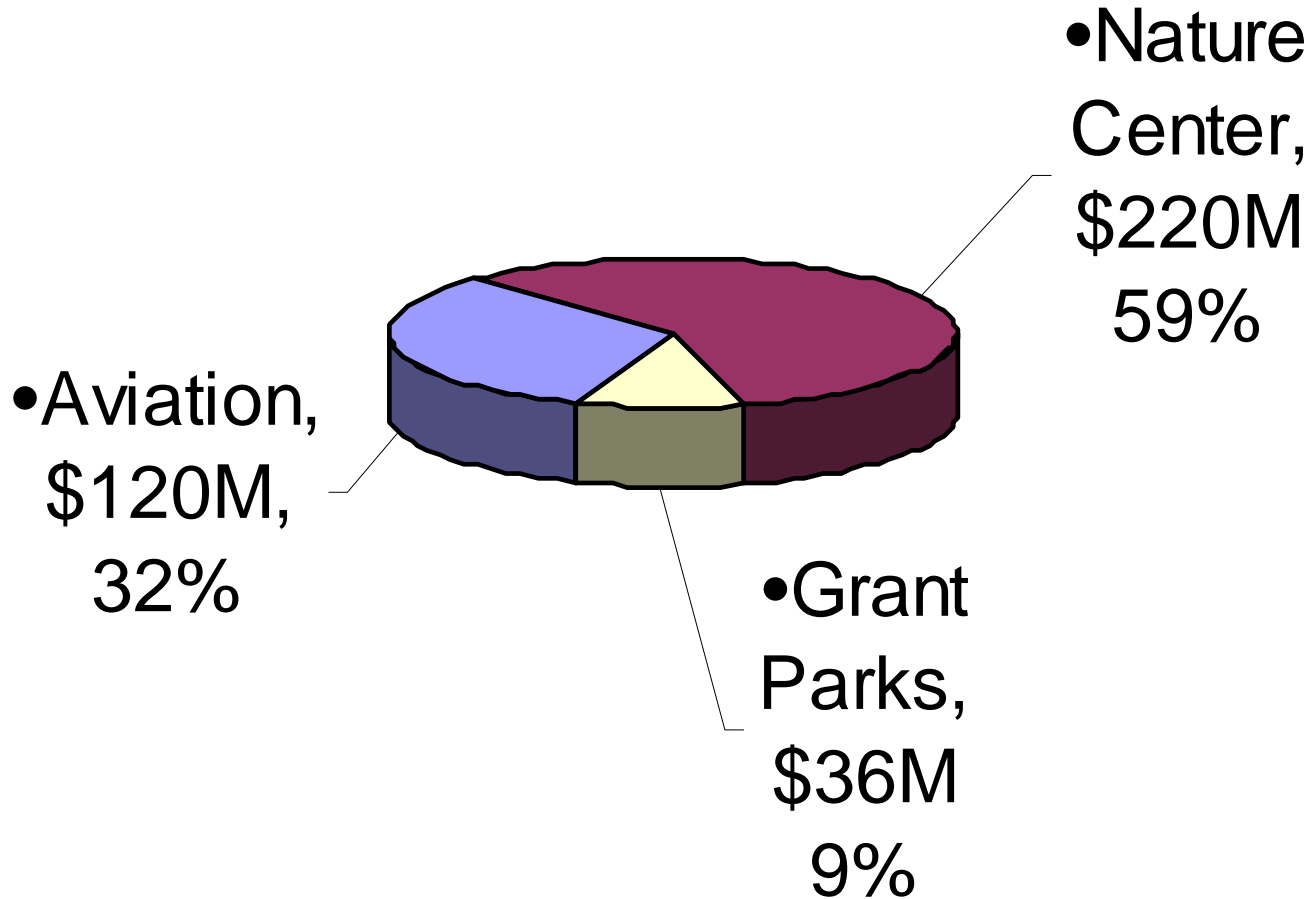
20 Year Potential Revenues from Unconditionally Restricted Assets (000's omitted)

• Aviation	\$120,000
• Nature Center	\$220,000
• Grant Parks	<u>\$36,000</u>
TOTAL	\$376,000

**Note: Estimated amounts rounded for illustrative purposes
and are subject to change**



20 Year Potential Revenues from Unconditionally Restricted Assets



20 Year Potential Revenues from Assets with Potential Flexibility (000's omitted)

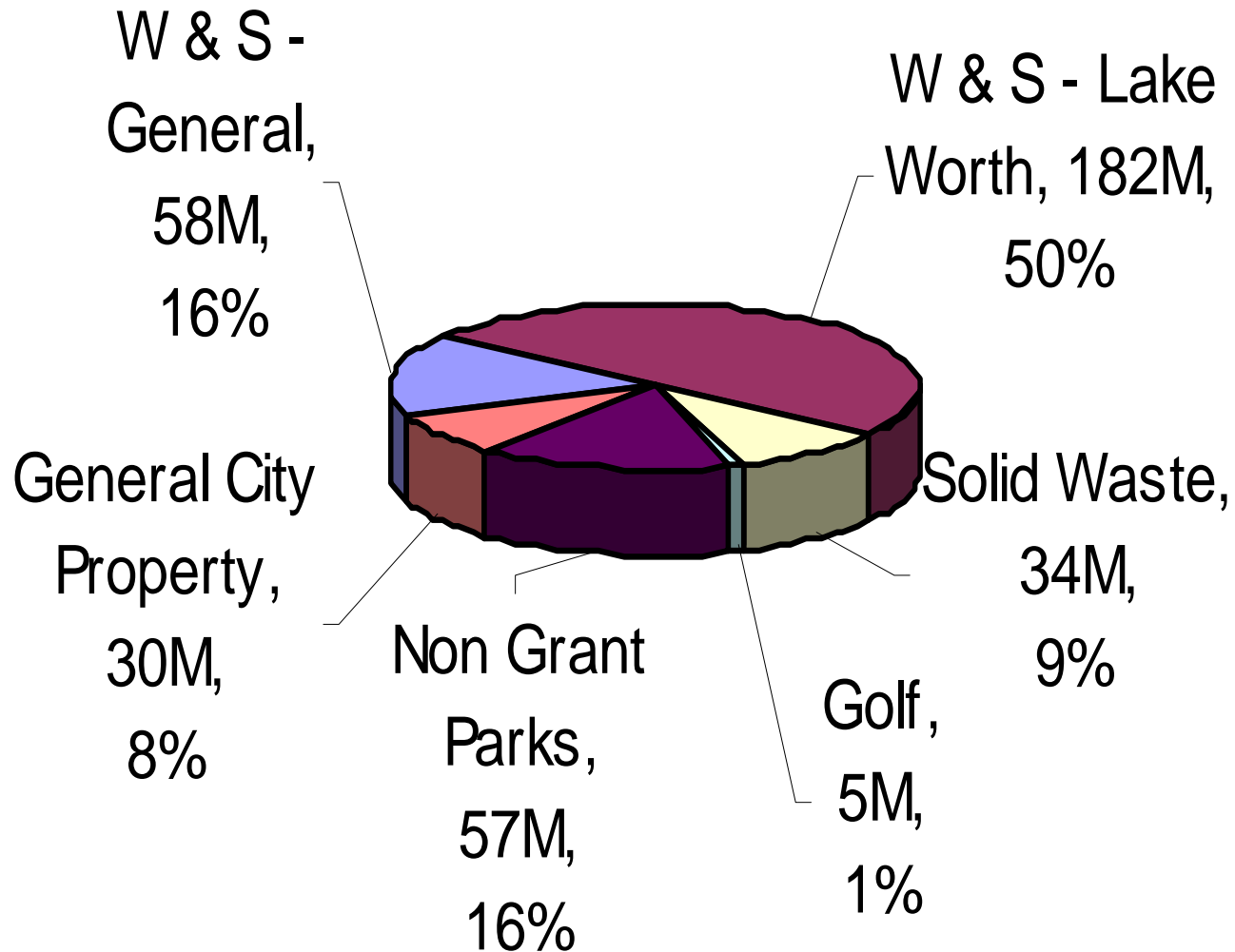
• W & S - General	\$ 58,000
• W & S - Lake Worth	\$182,000
• Solid Waste	\$ 34,000
• Golf	\$ 5,000
• Non Grant Parks	\$ 57,000
• General City Property	\$ <u>30,000</u>

Total **\$366,000**

Note: Amounts rounded for illustrative purposes



20 Year Potential Revenues from Assets with Potential Flexibility



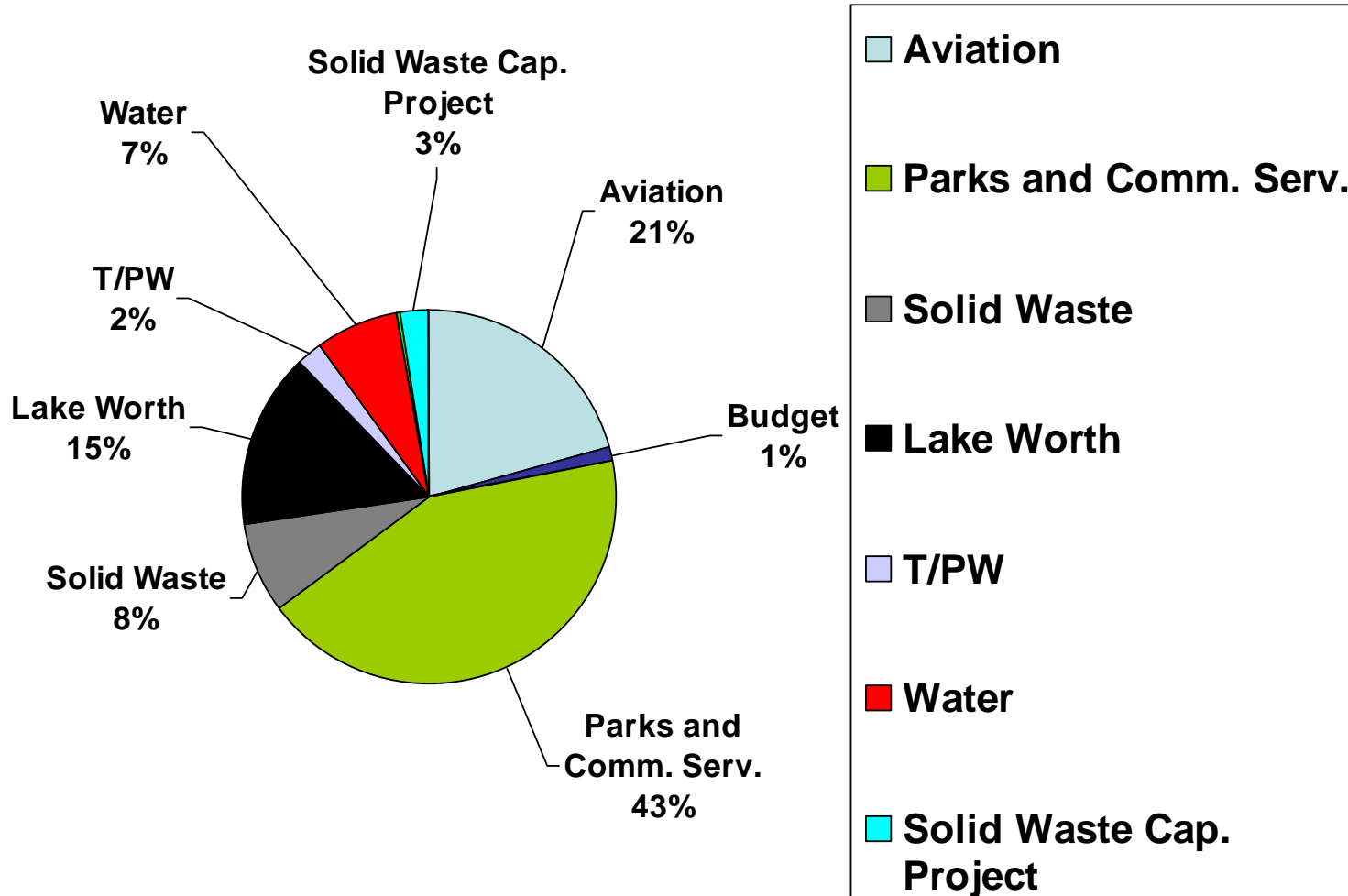
Gas Well Revenue and Balances

All Funds From 4/1/2005 to 2/28/07 Reported in the May 1, 2007 Memo to Mayor and City Council

Department	Fund Name	FY 07 Beginning Balance	YTD Revenues	YTD Expenditures	Balance 2/28/07
Aviation	Capital Projects	\$2,922,606	\$83,030	\$280,218	\$2,725,418
Budget	Capital Project Reserve	\$63,436	\$67,683	\$0	\$131,119
Environmental Management	Environmental Management	\$5,879	\$0	\$0	\$5,879
Parks and Community Services	Park Gas Lease Project	\$3,860,383	\$2,647,242	\$965,400	\$5,542,225
Environmental Management	Solid Waste	\$1,012,265	\$0	\$0	\$1,012,265
Lake Worth Trust	Lake Worth Trust Fund	\$0	\$1,993,611	\$0	\$1,993,611
Special Gift	Special Gift	\$8,190	\$0	\$0	\$8,190
Transportation and Public Works	Contract Street Maintenance	\$250,600	\$286,063	\$245,981	\$290,682
Water	Water & Sewer	\$748,375	\$184,146	\$0	\$932,521
Housing	FW Housing Finance Corp.	\$800	\$9,707	\$0	\$10,507
Engineering Services	Engineering Services Fund	\$17,448	\$27,000	\$20,597	\$23,851
Environmental Management	Solid Waste Capital Project	\$0	\$325,387	\$0	\$325,387
Risk Management	Risk Management	\$5,500	\$0	\$0	\$5,500
		\$8,895,482	\$5,623,869	\$1,512,196	\$13,007,155

Revenues Received

May 1, 2007



Investment Strategies and Considerations

Strategies

- Long Term - Save
- Long and Near Term – Save & Spend
- Near Term – Spend

Considerations

- Current infrastructure needs
- One time unforeseen resource
- Revenue risk and volatility
- Endowment “real” asset value over time i.e. inflation
- Funds/Asset restrictions



Public Education and Communication Challenges

- Revenue distribution and expenditure/investment policy (as adopted and possibly amended)
- Restrictions incurred by:
 - Federal and state policies and regulations
 - Bond covenants and reserve policies
 - Property deed restrictions



Public Education and Communication Challenges

[continued]

- Revenue difference in lease revenue and ad valorem tax revenues
- Rise/decline of revenues over time
- Revenue stream over 20 years i.e. revenues not all received at one time



Endowment Funds

- Effective long term investment strategy
- Used by charities, universities, foundations, hospitals and cultural institutions
- Insures a reliable revenue stream in perpetuity
- Requires financial discipline
- Management of Institutional Funds Act investment flexibility (5-6% rate of return) vs. Public Funds Investment Act (3-4% rate of return)



Criteria for Endowment Sustainability

- Long range financial management strategy a must
- Spending levels must be conservative and disciplined
- Continued revenue stream needed
- Market return on investments a major factor
- Sufficient time to grow corpus necessary
- “Real” value of corpus-actual asset value less inflation-must be maintained



Example of 100% Re-investment of Interest Earned @ 5% Compounded Annually

- \$10,000,000 @ 5% = \$500,000 in the first year
- Five years beginning with \$10 Million generates \$2,762,815 in interest
- Ten years beginning with \$10 Million generates \$6,288,946 in interest
- Twenty years beginning with \$10 Million generates \$16,532,977 in interest
- Total after 20 years Principal and Interest is \$26,532,977



Estimated City Capital Needs Immediate and over next 10 Years*

Parks and Recreation	\$400,000,000
Transportation	\$2,800,000,000
Drainage	\$662,184,000
Libraries	\$72,246,000
Economic Dev.	\$431,088,000
Arts and Culture	\$257,456,000
Police and Fire	\$184,952,400
Municipal Facilities	\$298,127,000
Housing	\$27,000,000
Public Health	\$3,455,000
Water and Sewer	\$611,478,000
Total	\$5,747,986,400

*Source Comprehensive Plan or Departments as of 2006



Some Potential Programs

[mentioned]

- Homeless Trust
- Housing Trust
- Arts Endowment



Investment Models

Alberta, Canada Heritage Savings Trust Fund:

- Initial investment of \$1.5 billion Canadian dollars in 1976
- Current value: \$16.3 billion Canadian dollars
- Over 23 years has generated \$22 billion, in Canadian dollar income and an overall return of 9.5%.
- To create savings account, leverage opportunities to reduce debt, improve quality of life, facilitate economic stability and diversity
- Invest in equity investments, loans to provincial governments, long term capital projects, stocks and money-market securities, debt or equity to enhance Canada's energy sector



Investment Models

[Continued]

Alaska Permanent Fund

- Initial investment of \$900 million in 1980
- Current value: approx. \$39 billion
- Over its lifetime, fund has earned \$20 billion in income, with a return of 12.2%
- Investments in real estate, International & U.S. stocks and bonds, long-term capital investments to provide basic services to communities



Investment Models

[Continued]

Tyler, TX

- Initially revenues were allocated to entities where wells existed (e.g. airport enterprise fund for airport gas well)
- Began placing revenue in Oil and Gas Fund three years ago
Interest from fund reinvested. Fund is not used for general expenditures

Midland, TX

- Revenues are segregated into the water and sewer fund
- Council appropriates revenue to meet city's needs



Council Proposal 265

- 25% of revenues for immediate (current budget fiscal year) capital infrastructure need
- 25% of the revenues will be allocated to general fund needs and will be used for proportionate reduction of FW ad valorem tax rate



Council Proposal 265

[continued]

- 50% of the revenues will be allocated to endowment funds to be saved for future generations for ten years. From the eleventh year forward 50% of the subsequent earnings will be used for capital improvement and operations of the respective endowments. The remaining 50% of subsequent earnings will remain in the fund and be reinvested.
- Work to amend the Public Funds Investment Act to allow investment strategies similar to private endowments but that still limit risk to the fund.



City Manager's Comments on Council Proposal 265

- Does not recommend use of gas well lease revenues and gas well related taxes to pay operating expenses due to the volatility of the revenue source.
- This temporary increase in revenues should be treated as excess above and beyond the base operating and capital budget.
- An amendment to the Public Funds Investment Act could occur in this session or the next.



City Manager's Comments on Council Proposal 265

Does not recommend:

- 1) Reliance upon gas revenues to pay debt service.
- 2) Reliance upon gas revenue to pay operating expenses.
- 3) Reducing fees for service based on temporary increases in revenues from gas production.



City Manager's Comments on Council Proposal 265

Does not recommend (continued):

- 4) Reducing the property tax rate based on a temporary increase in property values related to mineral interests.
- 5) Implementing the financial strategies that erode the “real” value asset of the endowment fund principle due to inflation, investment, or spending policies, by not reinvesting a sufficient amount of the interest earned by the fund.



Recommended Criteria for Gas Well Revenues Financial Management Strategy

Informal Report 8829

- Prudent financial management policy involving one time capital costs and long range financial investments in perpetuity
- Avoid reliance on gas well revenues to:
 - pay operating expenses
 - incur debt
 - reduce fees for service
 - reduce the property tax rate



Criteria for Use of Gas Well Revenues as Recommended by the City Manager Informal Report 8829

All Items Cash Funded

- Replenish fund balance reserve (required first)
- Outstanding bond principle lump sum payment
- Capital projects with minimum 10-year useful life
- Grant matches to leverage funds for capital projects



Criteria for Use of Gas Well Revenues as Recommended by the City Manager Informal Report 8829

[continued]

- Capital equipment with a minimum 10 year useful life
- Technology with a minimum 5 year useful life
- Equipment/Fleet revolving replacement fund



Mineral Valuations

Year	2003	2004	2005	2006
Property Tax Accounts	345	476	998	1587
Appraised Value	\$33,504,120	\$56,683,790	\$139,170,950	\$314,752,260
Potential Revenue	\$289,811	\$490,315	\$1,203,829	\$2,706,869



Summary and Public Input

- Committee charges
 - Current policy
 - Asset restrictions
 - Investment and use strategies
 - Criteria for expenditure
-
- Seeking input on potential "spend and save" policy which would most effectively leverage gas well revenues from the Barnett Shale windfall.



We Welcome your Input

Please send recommendations and
comments to:

gaswellrevenuecommittee@fortworthgov.org

