

To: DJE Municipal Advisors

From: Giovanna Arizpe

Re: Providence's Ten-Point ratios depict an illiquid, unprofitable, and insolvent government; broader analysis illustrates a resilient policy-focused government amid pandemic anomalies.

Date: October 27, 2023

Background

Providence's 2022 financial analysis summarizes the General Fund, governmental activities, and total primary government by utilizing Ten-Point test ratios to measure liquidity, profitability, and solvency. The ratios are compared against general standards and other cities' ratios. Table 1 provides specific information on how ratios were calculated and the resulting financial consequences. The initial analysis illustrates that Providence needs financial policy revision. However, additional considerations are included in the Discussion section and provide a nuanced interpretation of Providence's financial position.

Providence Ten-Point Test FY 2022					
	Measure	Equation	Ratio	Points	Analysis
Liquidity	Short-Run Financial Position	Unassigned General Fund Balance /General Fund Revenues	6%	-1	Providence has \$29.6 million in unassigned revenue and \$534.3 million in general fund revenues. Its 6% ratio places Providence with -1 points in the first quartile compared to other cities with a population between 100,000 and 249,999. The general rule is a ratio > 5% suggesting that while Providence is within the accepted range and can anticipate unexpected expenditures it is not as prepared as other cities.
	Liquidity	General Fund Cash + General Fund Investments/(General Fund Liabilities)	45%	0	Liquidity is 45% with \$74.8 million in general fund cash and \$534.3 million and, compared to other cities, it receives zero points. The general rule is > 100%, suggesting that there is not enough liquidity to cover near-term obligations.
Profitability	Net Asset Growth	(Change in Governmental Activities Net Position/Beginning Balance Governmental Activities Net Position)	-3.7%	-1	The change in net position for governmental activities is -\$76.3 million and governmental activities beginning balance -\$2.038 billion. The negative net asset growth of -3.7% results in -1 points. The general rule is a positive ratio and suggests Providence did not receive a return on their investments in 2022.
	Operating Margin	(Net (Expense) Revenue for Governmental Activities/Total Governmental Activities Revenues) X -1	56%	0	Net revenue for governmental activities is -\$538.8 million and total revenue is \$966 resulting in a ratio of 56% and results in zero points. The general rule is positive and suggests Providence is covering its operating expenses with its operating revenues but not nearly as well as other cities.
	Own Sources Revenues	(Primary Govt. Operating Grants and Contributions)/ Primary Government Revenues	40%	-1	Providence's primary operating grants are \$435.7 million, and its government revenue is \$1.14 billion. With 40% of its revenue coming from other sources the city receives -1 points. The general rule ratio is >10% suggesting that Providence is heavily relying on government grants.
Solvency	Near-Term Solvency	(Primary Govt. Liabilities)/Primary Govt. Revenues	367%	-1	Primary government liabilities are \$4.02 billion and total primary government revenues are \$1.01 billion, making the near-term solvency ratio 367%. The general rule is <150% and suggests Providence cannot meet its near-term obligations with its annual revenues.
	Debt Burden	(Total Primary Govt. Debt/Population)	\$19,434	-1	Total long-term debt is \$3.71 billion and has a population of 190,934. The debt incurred per capita is \$19,434. There is no general standard for this data, but compared to other cities, it receives -1 points.
	Coverage Ratio 1	Governmental Fund Debt Service/General Fund Expenditures	17%	-1	Governmental fund debt service is \$69.6 million and general fund expenditures are \$417.6 million providing -1 points with its 17% ratio. The general standard is >25% and suggests Providence will have difficulty repaying governmental fund debt.
	Coverage Ratio 2	(Enterprise Funds Operating Revenues)/Interest Expense	-7	-1	Enterprise funds operating revenue is \$127 million and interest expenses are \$18.5 million. The general standard is >1 providing Providence's ratio of -7 with -1 points and depicts that it cannot rely on business-type operating revenues to pay off interest.
	Capital Asset Condition	(Ending Net Value of Primary Govt. Capital Assets - Beginning Net Value)/Beginning Net Value	-6%	-1	The net investment in capital assets is \$858.3 million and the beginning balance of capital assets is \$914.5 million. The general standard is a positive amount. The ratio of -6% suggests that the city is not investing in its capital assets and gives the city -1 points.
Total Ten-Point Test Score				-8	

Table 1. Ten-Point Test Ratios and Analysis

Liquidity

Providence's liquidity ratio meets general standards and suggests that Providence can cover its near-term obligations. Providence's short-run financial position shows that the city does not have funds for unexpected expenses. An example of Providence's inability to anticipate unexpected expenditures and its liquidity shortfall is its acceptance of ARPA funding to stabilize General Fund COVID-19 losses.

Profitability

Providence's operating margin ratio meets general standards. However, all other ratios rank in the bottom quarter of cities. The analysis shows a reliance on operating grants and inability to generate enough revenue through taxes and fees. Providence's dependence on grants is concerning because grants are inconsistent and unreliable sources of continuous revenue. Not having consistent revenue can negatively affect Providence's future expense payments and could disincentivize purchasing bonds and consequently affect its future solvency.

Solvency

Providence's solvency ratios do not meet general standards and are ranked in the bottom 25% of cities. Solvency ratios are debt- and obligation-focused, suggesting that Providence could have difficulty paying near-term and long-term debts as they come due. Defaulting on debts dissuades potential investors from purchasing bonds and would cripple Providence's access to loan instruments and would affect paying for city infrastructure investments.

Discussion

Providence's Ten-Point test reveals an inability to meet general standards with a comparatively poor city performance. However, more representative analysis includes Providence's investments and funds for future projects, its prioritization of tax relief to its citizens and businesses, and its ability to sustain profitable business-type activities.

Providence invested and maintained a balance of \$115 million in the Capital Projects fund for housing and community improvements. Moreover, Providence has an insured reserve of \$24.3 million outside of the general funds to assist in catastrophic claims. Additionally, Providence ended the year with a total surplus of \$217.7 million. A modified near-term solvency ratio that includes all government activity funds provides a ratio of 96% ($\$975,000/1,013,000$) and results in an improved score of +2 points. This, updated to include allocation of capital project investment funds, its reserve retention, and its total positive fund balance demonstrates Providence's ability to financially provide for its policies.

Providence's ARPA funding for COVID-19 losses and its refraining from increasing property taxes and providing tax relief for several city businesses illustrates the city-wide economic deterioration. Increasing taxes contradicts Providence's policy to maintain a city that works and its decision to provide financial assistance is consistent with its policy. The inability to increase taxes stagnates Providence's revenue and explains the city's reliance on grants for funding. However, Providence can increase taxes at a more opportune time and regain revenue to pay for its debts.

Providence's business-type activities earned \$31 million in revenue, roughly half of the governmental activities' deficit, and further depicts a functioning government. While business-type activities cannot subsidize government's core operations, Providence can create legislation or have a voter referendum to allocate funds in a dire emergency.

Conclusion

Providence's Ten-Point test score reveals the need for improvement and strategy to achieve a statistically functioning governmental activities balance. Additional financial information reflects an effective government that prioritizes policies through sustaining fund reserves, investing in its people and infrastructure, and maintaining profitable business-type activities.

	Cities			
	First Quartile	Second Quartile	Third Quartile	Fourth Quartile
Providence Population: 190,934	-1 Point	0 Points	+1 Point	+2 Points
Population 100,000 to 249,999				
Short-Run Financial Position	< 8%	8% to 15.9%	16% to 24.9%	> 24.9%
Liquidity	< 43%	43% to 116.9%	117% to 280.9%	> 280.9%
Net Asset Growth	< 0.27%	0.27% to 2.38%	2.39% to 5.39%	> 5.39%
Operating Margin	> 54%	44.9% to 54%	36.9% to 45%	< 36.9%
Own-Source Revenues	>11%	7.9% to 11%	3.9% to 8%	< 3.9%
Near-Term Solvency	> 274%	199.9% to 274%	139.9% to 200%	< 139.9%
Debt Burden Per Capita	> \$2,641	\$1,613 to \$2,641	\$1,064 to \$1,612	< \$1,064
Coverage 1	> 10.11%	6.13% to 10.11%	3.62% to 6.12%	< 3.62%
Coverage 2	< 4.10	4.10 to 6.73	6.74 to 11.61	> 11.61
Capital Asset Condition	<-0.32%	-0.32% to 2.24%	2.25% to 4.86%	> 4.86%

Table 2. Ten-Point Test Population Comparison by Quartile

RATIO	WHAT IT TELLS US	FORMULA
Short-Run Financial Position	How much in unrestricted resources do we have as a percent of our revenues? Rule of Thumb: >5%	$\frac{\text{Unassigned General Fund Balance}}{\text{General Fund Revenues}}$
Liquidity	Will cash and investments cover near-term obligations? Rule of Thumb: >100%	$\frac{\text{General Fund Cash} + \text{General Fund Investments}}{\text{General Fund Liabilities (excluding Deferred Inflows)}}$
Net Asset Growth	What is the return on shareholders' investments? Rule of Thumb: Positive	$\frac{\text{Change in Governmental Activities Net Position}}{\text{Net Position, Governmental Activities}_{t-1}}$
Operating Margin	Do operating revenues cover operating expenses? Rule of Thumb: Positive	$\left(\frac{\text{Net Revenue (Expense)}_{\text{Governmental Activities}}}{\text{Total Revenues}_{\text{Governmental Activities}}} \right) \times 1$
Own Source Revenues	How much does this organization depend on government? Rule of Thumb: < 10%	$\frac{\text{Primary Govt. Operating Contributions}}{\text{Primary Govt. Revenues}}$
Near-Term Solvency	How well can this government meet its near-term obligations with annual revenues? Rule of Thumb: < 150%	$\frac{\left(\frac{\text{Total Liabilities (Excluding Deferred Inflows)}}{\text{Total Revenues}} \right)_{\text{Primary Govt.}}}{\text{Primary Govt.}}$
Debt Burden	How much more money has this government borrowed so far? Rule of Thumb: It depends!	$\frac{(\text{Total Long Term Debt})_{\text{Primary Govt.}}}{\text{Population}}$
Coverage 1	How easily can this government repay its debts as they come due? Rule of Thumb: <25%	$\frac{(\text{Debt Service})_{\text{Governmental Funds}}}{(\text{Expenditures})_{\text{General Fund}}}$
Coverage 2	How easily can this government's business-type activities repay their long-term debt obligations as they come due? Rule of Thumb: >1	$\frac{(\text{Operating Revenue})_{\text{Proprietary Funds}}}{(\text{Interest Expense})_{\text{Proprietary Funds}}}$
Capital Asset Condition	Is this government investing in its capital assets? Rule of Thumb: Positive	$\frac{\text{Net Investment in Capital Assets}_{t-1} - \text{Net Investment in Capital Assets}_{t-2}}{\text{Net Investment in Capital Assets}_{t-1}}$

Table 3. Ratio Rule of Thumb

(Source: Financial Strategy Public for Public Management by Kioko and Marlow)