



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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Justin P. Wilson
Comptroller

January 31, 2011

Honorable Tony R. Aikens, Mayor
City of Lenoir City
P.O. Box 445
Lenoir City, TN 37771

Dear Mayor Aikens:

It was a pleasure meeting you recently at the state Capitol. I appreciate the fact that you and several members of the board of aldermen and the utility board met with representatives of the State Treasurer's Office and the Comptroller's Office in order to seek our advice regarding the financial affairs of the city.

As discussed, while both the governmental and utility funds of the city are in a positive financial position at this time, because of the significant increase in the payments of principal on the city water and sewer system's outstanding long term debt in the 2011-2012 fiscal year, the utility's projected cash flow will not be sufficient to retire the debt when due. Taking into consideration that some of the city utility funds have excess cash, the question was posed as to whether such excess funds could be transferred to the water and sewer fund.

I understand that at the time the city applied for their last SRF Loan #09-238, which was approved on September 3, 2009, the city agreed to a rate increase as of July 1, 2011. It was the opinion of the staff of the Office of State and Local Finance that such a rate increase was necessary to both fund the additional principal and interest on long term debt and have adequate funds to pay for the operation of the water and sewer system. The loan approval was contingent upon the implementation of the rate increase. I further understand that representatives of the city recently informed the staff of the Office of State and Local Finance that the city no longer plans to honor its commitment to place the rate increase into effect. Based on projected numbers for the system's operating revenues and expenses, the system will not generate a sufficient cash flow to pay both operating expenses and the principal and interest on long term debt. You have inquired as to

whether there was any possibility of transferring excess funds from other municipal utilities to subsidize the operation of the water and sewer fund.

Municipalities in the State of Tennessee are authorized in various sections of the *Tennessee Coded Annotated* to establish utility funds, i.e., water, sewer, gas and electric. Each section of the code authorizing the establishment and operation of each utility specifically restricts the use of the revenues generated by a utility to the payment of all operating costs, including depreciation, and the retirement of debt, including interest. Each section also contains a provision specifically prohibiting the transfer of any excess funds from a municipally operated utility any other fund for the purpose of subsidizing its operation. This would certainly include the use of such transferred funds for the retirement of general long term debt. A penalty for making such illegal transfers is ouster of the public officials involved in such transfers. An additional section of the code specifically states that a municipality shall not operate a utility for the purpose of subsidizing the cost of operating a general government.

If such funds were illegally transferred from a utility fund, state statutes mandate that such funds be repaid immediately. If the municipality is unable to immediately repay the illegal transfer, the Comptroller's office may approve, subject to such conditions as it may require, a repayment plan to the utility fund with a maximum life of five years with no less than 20% of the illegally transferred funds per year at the highest rate of interest on the investments of the utility funds. Our office has the responsibility to see that such repayments be made on a timely basis. Such would have a very negative impact on the city's financial affairs and may generate a lot of less than flattering publicity.

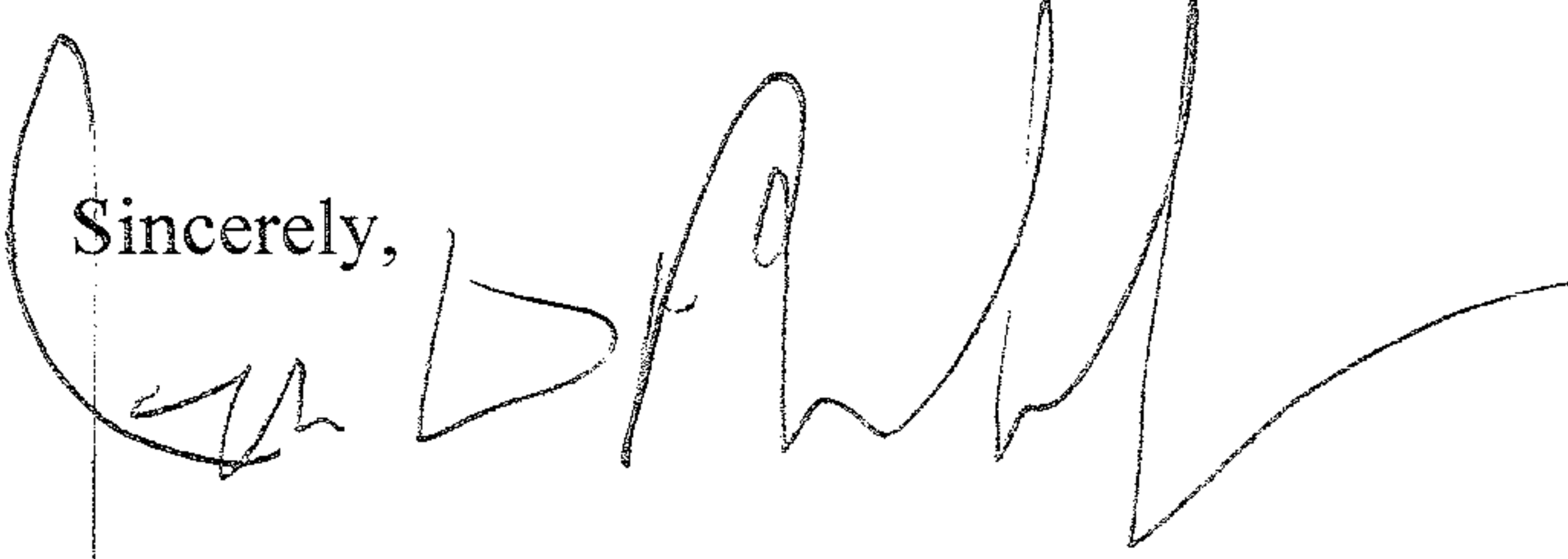
The intent of the legislature was to make sure that municipal operated utilities charge rates at least sufficient to cover their costs of operation but are not to be used as a source of operating funds for the general government.

In order to generate sufficient funds to pay for the water and sewer funds costs of operations and to retire the debt scheduled to mature next year, the city has limited options to choose from. The first is an increase in the user rates; the second is a reduction in operating expenses; and the third is a combination thereof. In reviewing your last set of audited financial statements, I noted that the city provide a very attractive set of benefits, both salary and fringe, to its employees, which appears to be above the level provided by most local governments in the state. Although it may be difficult, you may wish to consider some reduction as one of the areas related to the reduction of overall operating costs.

As I'm sure you are aware, the state has faced similar problems in the last few years in that as a result in the downturn in the economy, state revenues fell to an all-time low. In order to balance our budget, drastic cuts were made in our operating budget. Although

there has been a slight upturn in the economy, we are still operating on significantly reduced funding levels and will be for several years to come.

Should you wish, I will be happy to provide member of my staff to assist you in determining how to address this problem. Please feel free to contact me should you feel we can be of assistance.

Sincerely,


Justin P. Wilson