Council Agenda Report

From: Deanne Purcell, Interim Director of Administrative Services

Subject: Reserve Level Policy

Date: December 6, 2016

Facts

1. The September 28, 2016 workshop on Employee Compensation and Unfunded Liability included a discussion on the unfunded accrued liability (UAL) for employee pensions. The presentation was followed by direction from the City Council to present options for paying down the UAL.

2. A separate discussion regarding the use of reserves to fund a commercial and residential loan program through local banks took place during the June, 2016 budget discussions. Council authorized staff to pursue options and develop a pilot program with Heritage Oaks Bank, returning to the Council with options and a recommendation.

3. Any consideration of either 1) the pay down of the UAL or 2) investment in a local loan program requires a full understanding of the appropriate level of General Fund Reserves needs to be determined.

4. Reserves act as a risk management tool. General Fund reserves can be maintained to address the following needs:
   a. Cash flow requirements, since revenues and expenditures are distributed differently throughout the year (property taxes, for example, are received in two payments from the County)
   b. Revenue shortfalls caused by economic uncertainties (including recessions), state actions (such as the termination of redevelopment agencies), etc.
   c. Uninsured losses
   d. Disasters (such as earthquakes)
   e. Claims and legal judgments
   f. Capital asset repair and replacement
   g. Debt service and mandated debt service reserves
   h. Unanticipated capital and operating expenditures

5. Under the City's current fiscal policies, General Fund Reserves are to be maintained at no less than 15% of annual operating expenditures, excluding debt service and operating capital (see Attachment 1). Given that this year's operating expenditures are approximately $30M, that means a minimum of $4.5M should be held in General Fund reserves.

6. Current reserve objectives establish separate reserve requirements for unanticipated emergency and contingency needs (set at 2%) held in separate funds. Separate replacement funds are also maintained for Information Technology and for Vehicles/Equipment.

7. The appropriate reserve levels should be subject to periodic review. Staff undertakes a periodic analysis of known and anticipated risks. For example, the City does include in its fiscal forecast an analysis of economic uncertainty and its impact on City revenues. We also are reasonably able to

anticipate the level of reserves needed for small events (such as claims for trip and falls) that occur from time to time. It is not possible, however, to determine the level of reserves necessary for rare and catastrophic events such as earthquakes, as the frequency and severity cannot be anticipated with a reasonable degree of accuracy.

8. Staff has reviewed reserve policies adopted by other cities. While specific reserve policies vary greatly across cities, several elements appear in numerous adopted policies, consistent with best practices and prudent fiscal management. The most common General Fund Reserve level established by policy for the cities that were reviewed was 20%.

9. The net resources of the General Fund in excess of nonspendable, restricted, committed, and assigned requirements (i.e., the minimum as set by policy) are classified as unassigned fund balance. Allocation of the General Fund unassigned fund balance can include items such as the pay down of unfunded liabilities and local loan program.

Options

1. Do nothing (i.e., retain required reserves at 15% of operating expenditures excluding debt service and operating capital.
2. Approve change in General Fund Reserves to 20% of operating expenditures excluding debt service and operating capital.
3. Approve a different change in General Fund Reserves levels and policies.

Analysis and Conclusions

Determination of the appropriate level of General Fund Reserves is a policy decision, a judgment call that is based on the level of risk the City is willing to tolerate, balanced against the advantages of using the funds to provide needed services. The policy should formally establish: (1) the required level of reserves; and (2) guidelines for use of available funds in excess of reserve requirements (i.e., the unassigned fund balance).

The current approach, adopted in 2002, establishing the minimum at 15%, has served the City well. However, the best overall assessment is that risks to the City have increased in recent years, for several reasons, including:

- A recession is overdue.
- The risks of another earthquake on the San Andreas Fault are increasing.
- The City has less flexibility in withstanding a major economic or fiscal shock that it did before the Great Recession. Given the reduced number of positions in the City and the increasing demands placed on City services, the Layoff Prevention Plan and other contingencies will no longer be as effective as they were.

An increase in reserves from 15% to 20% equates to approximately $1.5M that could not be used for programs and other City services, other than in an emergency. Given the current level of unassigned fund balance, this would not be a current constraint.

A Council decision on the appropriate level of reserves will serve as a foundational factor in determining if the City should pay down any unfunded liability or participate in a local loan program with Heritage Oaks or another local bank. These matters are scheduled for Council consideration on December 20. Any change in reserve levels approved by Council will be brought back to Council as part of a formal policy change.

Fiscal Impact
No immediate impact. There could be a negative future impact on programs and services if the City were to incur a significant reduction in the unassigned fund balance. There could be a positive future impact on programs and services if and when an emergency, requiring the use of reserves, does occur.

Recommendation
Direct the City Manager to update the current Fiscal Policy, establishing a General Fund Reserve equal to 20% of operating expenditures, excluding debt service and operating capital.

Attachments
1. Analysis of General Fund Reserves
2. Current City Fiscal Policy, adopted March 19, 2002.

EXHIBIT A

CITY OF PASO ROBLES
ANALYSIS OF GENERAL FUND (GF) RESERVES

	FY 2015-16 ACTUAL	FY 2016-17 REVISED	FY 2017-18 ADOPTED	FY 2018-19 FORECAST	FY 2019-20 FORECAST	FY 2020-21 FORECAST
Beginning GF Balance	$22,141,639	$ 26,257,838	$ 22,315,175	$ 22,766,727	$ 23,316,854	$ 23,950,612
Operating Balance/(Deficit)	4,116,199	(3,942,663)	451,552	550,128	633,758	585,067
Ending GF Balance	26,257,838	22,315,175	22,766,727	23,316,854	23,950,612	24,535,680
LESS:						
Restricted Fund Balance		6,055,187	6,100,000	6,100,000	6,100,000	6,100,000
GF Reserve (20% of operating)		5,758,296	5,772,880	5,938,002	6,114,866	6,299,525
Total GF Reserves		11,813,483	11,872,880	12,038,002	12,214,866	12,399,525
% of Expense		29%	31%	30%	30%	30%
Unassigned GF Balance		**$ 10,501,691**	**$ 10,893,847**	**$ 11,278,852**	**$ 11,735,746**	**$ 12,136,154**

CITY OF EL PASO DE ROBLES

FISCAL POLICY

I. GOAL STATEMENT

El Paso de Robles fiscal policy is established to assure that the City's finances are managed in a manner that will (1) provide for the delivery of quality services and products cost effectively, (2) provide for an acceptable level of services and products as the community grows, (3) ensure that the City is living within its means, and (4) provide reserves for unbudgeted needs that might arise from time to time.

II. GENERAL OBJECTIVES:

1. The City will maintain sound financial practices in accordance with State law, and direct its financial resources toward meeting the City's goals as identified and prioritized by the City Council.

2. The City will develop and maintain financial management programs to assure its long-term ability to pay the costs necessary to provide the services required by its citizens; i.e. two-year budget, four-year and ten-year financial plans.

3. The City will maintain accounting systems in conformance with generally accepted accounting principals as promulgated by the most current issue of National Council on Governmental Accounting Statement 1, the practices and methodologies contained in the Municipal Finance Officers Association publication "Governmental Accounting, Auditing, and Financial Reporting", and pronouncements issued by the Governmental Accounting Standards Board.

4. The City will maintain a financial records management information system capable of tracking revenues and expenditures by line item, by source, by fund, by department or any other format deemed necessary or desirable.

5. The City will establish and maintain an investment policy in accordance with State laws that stress financial safety and liquidity over yield (Attachment #1).

6. The City will establish and maintain a purchasing policy and procedures (Attachments #2 and #3).

III. REVENUE OBJECTIVES:

1. The City will strive to diversify and stabilize its revenue base, reducing dependency upon any single revenue source.

2. The City will implement the adopted economic development strategic plan and/or economic development element to the General Plan in order to increase and broaden its revenue base.

3. The City will maximize the availability of revenue proceeds through responsible collection and auditing of amounts owed the City.

4. The City will seek Federal and State grants and reimbursements for mandated costs whenever possible.

5. The City will investigate potential new revenue sources, particularly those that will not add to the tax burden of residents or local businesses.

6. General Fund revenues shall be pooled and allocated according to Council goals and established policy. Enterprise funds and other legally restricted sources shall be allocated according to their respective special purpose.

7. The City will establish and maintain a user fee policy (to be developed as attachment #4) that:

   a. Imposes user fees when appropriate to capture the cost for the delivery of services and goods; and
   b. Attempts to establish levels of cost recovery that support all costs including administrative overhead and depreciation; and
   c. Determines the minimum frequency of user fee reviews.

8. The City will maintain and further develop methods to track major revenue sources and evaluate financial trends.

9. The City will prepare periodic financial reports of actual revenue received for review by the City Council.

IV. EXPENDITURE AND BUDGETING OBJECTIVES:

1. Budgeted expenditures shall reflect the Council's goals.

2. The operating budget will be prepared in the context of a four-year financial plan wherein appropriations for two fiscal years are adopted (Two Year Budget).

3. In the context of the operating budget, operating expenditures and revenues shall be balanced over the term of the four-year financial plan.

4. A ten-year financial plan will be developed for the purpose of identifying future financial challenges. It shall be updated every two years concurrent with the development of an updated four-year financial plan.

5. The City will deliver services and goods in a cost effective manner, including utilizing the services of volunteers where it is economically and operationally viable.

6. Surplus fund balances (and working capital in enterprise funds) may be used to increase reserves, fund Capital Improvement Projects, fund capital outlay or be carried forward to fund one-time special project/program expenses provided that the reserving requirements are met (refer to VI).

7. Operating expenditures, exclusive of debt service, within the General Fund or Enterprise Funds will not be directly supported by any debt financing, connection fees, development impact fees, or Enterprise Fund interest income.

8. Expenditures shall include funding of retirement systems, maintenance and replacement of capital and operating assets, and the components of the cost allocation plan.

9. The City will maintain and further develop methods to track expenditures and evaluate financial trends in order to identify potential problems.

10. The City will prepare periodic financial reports of expenditures for review by the City Council.

11. The Council may appoint an ad hoc committee, as needed, to:

    a. Review the proposed two year budget/four year financial plan and make findings and recommendations to the Council; and
    b. Review the cost allocation plan and make recommendations for any necessary adjustments to the Council; and
    c. Review all new fees and revenue enhancements and make recommendations to the Council.

V. BUDGETARY CONTROLS:

1. Once adopted, operating appropriations shall not be subsequently adjusted unless specifically authorized by resolution identifying the fund from which the appropriation is to be made, the amount of the appropriation and budgetary account number.

2. The City Manager may authorize the transfer of appropriations from one program to another within the same department and fund.

3. The City Manager may take necessary actions to keep expenditures from exceeding revenues, including but not limited to establishing a budget freeze, postponing hiring of approved positions, implement layoffs and/or reduced workweek.

4. The City Manager may review and approve all change orders in accordance with adopted purchasing procedures.

5. The City Manager may approve purchase orders for budgeted expenditures and un-budgeted purchase orders in accordance with adopted purchasing procedures.

6. Agenda staff reports having a budgetary impact of $10,000 or more shall require the review of the Director of Administrative Services. Review comments shall be provided to the City Manager.

7. For the purpose of budget control, operating capital is defined as equipment or furnishings having a useful life of two years or more and a cost of $5,000 or more. Property, plant, or an improvement costing $25,000 or less shall also be budgeted as operating capital. Property, plant or an improvement with an estimated cost of $25,001 or more shall be considered a capital improvement and be budgeted as such.

8. Professional service contracts for one-time projects where the cost exceed $25,000 shall be tracked separately from routine operating expenditures.

9. Annually, a report estimating the year-end results shall be presented to the Council in October following the close of the fiscal year being reported. Said report shall compare revenue estimates with actual collections, appropriation budgets with actual expenditures and revenues to expenditures in major budgetary funds. This report shall be followed with a presentation of the Comprehensive Annual Financial Report to the Council before January 1st.

10. Semi-annually, there will be comprehensive review of the operations to date in comparison to the existing budget. Projections of revenues and expenditures through the end of the fiscal year will be prepared and reviewed by the City Manager with a report submitted to the City Council by their first meeting in March.

VI. RESERVING OBJECTIVES:

In order to address unanticipated emergency and contingency needs of the City, and secure the continued financial well-being of the City, various reserves shall be maintained as follows:

1. Reserve for Contingencies - provides a fund from which appropriations may be made to meet minor, additional needs not specifically provided for in the current operating budget. Reserve for contingencies should be set at 2% of the annual General Fund operating expenditure budget excluding debt service and operating capital.

2. Reserve for Self Insurance - provides funding of a risk management program whereby the City obtains insurance contracts for catastrophic losses, but maintains relatively high deductible or retention limits on operating equipment

and maintains no insurance contracts on certain exposures. Minimum reserves shall be established by the JPA.

3. Reserve for Capital Asset Replacement - provides a sinking fund based on equipment depreciation for the replacement of capital and operating assets.

4. Reserve for Debt Service – provides funds in accordance with debt issuance documents; i.e. official statement and trustee agreement. Amount of reserve is established by bond covenants.

5. General Fund – unappropriated fund balance should be maintained at 15% of operating expenditures excluding debt service and operating capital.

6. Enterprise Funds – unappropriated working capital should be maintained at 15% as a reserve for contingencies; i.e. unanticipated fluctuations in revenue collections or operating expenditures.

VII. CAPITAL IMPROVEMENT PROGRAM

The Capital Improvement Program will be developed to protect the City's investment in capital infrastructure and facilities through timely and adequate maintenance and replacement of those assets.

1. The Capital Improvement Program should include all capital infrastructure and facilities required and/or anticipated during the General Plan build-out timeline. However, the Capital Improvement Program need only specifically identify those projects necessary to maintain an acceptable level of service delivery for the next four years including the project's cost and funding sources.

2. The Capital Improvement Program will be updated bi-annually in conjunction with the two-year operating budget.

3. The City will grant priority to funding projects that support economic development or will have a direct influence on achieving productivity/revenue gains for the City.

4. The Capital Improvement Program will reflect the various master plans and related studies identifying infrastructure needs of the City.

5. Various fees and charges identified by various plans; i.e. AB 1600 Plan (analysis of infrastructure needs of the City and the fees and charges necessary to meet said needs) shall be reviewed and modified as necessary every two years.

6. The City will prepare periodic financial reports of actual expenditures for review by the City Council.

VIII. DEBT OBJECTIVES:

1. The City will finance (borrow) only capital improvements or special non-recurring expenditure projects that cannot be financed from current revenues and sources.

2. When capital projects are financed, the City will amortize the debt within a period not to exceed the expected useful life of the project.

3. The City will limit the debt ratio (debt guaranteed by the General Fund) to 10%. The debt ratio is calculated by dividing the total debt, interest and principal, by total operating, recurring revenues.

4. Whenever possible, the City will investigate the use of special assessment, revenue or other self-supporting bonds to limit the General Fund obligation for debt service payments.

5. The City will not use long-term debt for current operations.

6. The City will not use short-term borrowing to support routine operations. However, it may be used to meet temporary cash flow needs.

7. The City shall always fully disclose the financial condition of the City to rating agencies and shall annually distribute financial disclosure reports in accordance with bond covenants.

8. The City will strive to maintain or improve the City's bond rating.

9. The use of inter-fund loans to fund the cost of financing capital improvements is discouraged.

10. If inter-fund loans are undertaken, formal promissory notes shall be established that carry an interest cost equal to the most current interest yield percentage paid by the Local Agency Investment Fund. The interest cost shall be re-calculated annually based upon the Local Agency Investment Fund rate for the quarterly period ending June 30th each fiscal year.