



City Council Memorandum

City of Arts & Innovation

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: SEPTEMBER 6, 2016

FROM: FINANCE DEPARTMENT WARDS: ALL

**SUBJECT: REVIEW AND ADOPTION OF GENERAL FUND RESERVE POLICY BASED ON
THE FINANCE COMMITTEE'S RECOMMENDATIONS**

ISSUE:

Review and adopt a proposed General Fund Reserve Policy based on recommendations from the Finance Committee.

RECOMMENDATIONS:

That the City Council:

1. Review and adopt the attached proposed General Fund Reserve Policy setting the minimum reserve level at 15% with 10% in the Emergency Reserve and 5% in the Contingency Reserve (Attachment 1);
2. Set an “aspirational” goal of twenty percent total General Fund Reserves (15% in the Emergency Reserve and 5% in the Contingency Reserve) for the future;
3. Direct staff to return to the City Council in one year (in September 2017) for status of compliance with this policy; and
4. Direct staff to return to the City Council in three years for a formal review of this policy.

COMMITTEE RECOMMENDATION:

The Finance Committee met on February 10, 2016, with Chair Soubirous, Vice Chair Burnard and Member Perry present, to consider the General Fund Reserve Policy. After discussion the Committee unanimously voted to recommend that the City Council: 1) endorse the proposed General Fund Reserve Policy, requiring City Council action for any future changes to the substantive elements of the policy as further defined in the staff report; (2) directed staff to return to the City Council in one year for status of compliance with this policy; 3) request a formal review of the policy in three years; and (4) set an aspirational goal of twenty percent General Fund Reserves for the future.

BACKGROUND:

It is standard practice in local governments throughout the United States to have a reserve for cash flow needs ("working capital") and/or economic contingencies in one or more funds. Most common are reserves in a government entities' general fund, capital-intensive enterprise funds, and insurance trust funds. For these funds, it is common for unanticipated expenses or economic downturns to have adverse and potentially significant financial impacts absent resources set aside specifically for such occurrences.

DISCUSSION:

While the City of Riverside has maintained sufficient cash flow in various funds for many years, a General Fund Reserve Policy has never been formally approved by the City Council. In an effort to continue to enhance the City's robust set of fiscal policies, enhance transparency, and ensure that these policies are aligned with the City Council's strategic direction, this report is being brought forward for City Council consideration.

Beyond the reasons already listed, establishing formal reserve policies is recommended by the Government Finance Officers Association, and encouraged by the bond rating agencies of Fitch, Standard & Poor's, and Moody's. The rating agencies view government entities very favorably when they establish and maintain reserve policies, particularly at times of fiscal uncertainty.

Recommended Policy Elements

Staff recommends that the following key elements be included in the proposed General Fund Reserve Policy:

1. Differentiate between three categories of reserves :
 - A. The "Emergency Reserve", used for unanticipated emergencies and/or unforeseen major unavoidable expenditures;
 - B. The "Contingency Reserve", used for funding needs during economic downturns, and in cases of unforeseen sudden revenue loss; and,
 - C. The "Surplus Reserve" for monies set aside above the appropriated expenditures and the percentages set for the two other reserves;
2. Specify how and when each of these reserves may be accessed;
3. Specify when these reserves are permitted to be below the policy level, for how long, and in what way(s) they are to be replenished; and
4. Provide a framework through which the reserves may be accessed by the City Council for purposes other than an emergency or an economic downturn.

In establishing the attached General Fund Reserve Policy, these elements were considered resulting in the following types of reserves:

The Emergency Reserve is recommended to be set each June 30 at 10% of the upcoming fiscal year's General Fund expenditure budget. This reserve would only be utilized in a time of an emergency, as defined in the Policy, which must be declared by the two-thirds majority of the City Council. In the event that an emergency is declared and the reserve is accessed, once the emergency has passed, staff would present a situation-specific plan to the City Council for replenishing the reserve over a period not to exceed three years. The occurrence of an emergency that would require access to this portion of the reserve would be an extremely unusual and infrequent occurrence, such as a major natural disaster or a major unforeseen settlement.

The Contingency Reserve is recommended to be set each June 30 at 5% of the upcoming fiscal year's General Fund expenditure budget. This reserve would only be accessible to address unforeseen sudden revenue loss that could not be balanced with other measures. The reserve is intended to provide a "bridge" to facilitate a measured and thoughtful reduction in expenditures during times of economic downturn, rather than making immediate and drastic budget cuts without the time for proper evaluation. Approval of the two-thirds majority of the City Council would be required to access the reserve. Thereafter, staff would be required to present a plan to the City Council to restore the Economic Contingency Reserve to the 5% level over no more than a three year period.

The Surplus Reserve is recommended if General Fund Reserve balances greatly exceed the total 15% requirement of the Emergency Reserve and Contingency Reserve. While it is unlikely this would occur in the short term, the City can use this reserve to gradually increase the reserve levels to the "aspirational" goal of 20%. However, if these reserves reached above 25%, staff would be required to provide Council a report on how to use these additional funds for one-time needed expenditures and bring the balance in this reserve below the 25% maximum level.

In addition, any appropriation from reserves that causes the reserve balance to drop below 15% must be backfilled in subsequent fiscal years, with a plan drafted by staff and approved by the City Council.

Further, any report requesting an appropriation from reserves, regardless of whether it brings the balance below the 15% level, must include an analysis of the impact of the appropriation on the General Fund Reserve balance.

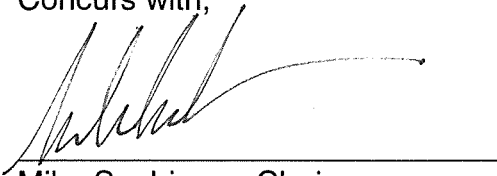
FISCAL IMPACT:

The changes proposed in this policy are anticipated to have a positive fiscal impact on the City's bond ratings. At the same time, there is a direct fiscal impact associated with the General Fund

Reserve Policy. The current General Fund Reserve Level is forecast in the FY 2016-18 at 10% for the Emergency Reserve and 1.5% in the Contingency Reserve. However, as part of the five-year financial plan, staff anticipates that the Contingency Reserve will be restored to 5-6% by year five, for a total General Fund reserve of 15-16%.

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Certified as to
availability of funds: Scott G. Miller, Interim Finance Director/Treasurer
Approved by: Marianna Marysheva-Martinez, Assistant City
Approved as to form: Gary G. Geuss, City Attorney

Concurs with;

A handwritten signature in black ink, appearing to read "Mike Soubirous", written over a horizontal line.

Mike Soubirous, Chair
Finance Committee

Attachments:

1. Recommended General Fund Reserve Policy
2. Presentation



City of Riverside General Fund Reserve Policy

Approved by the City Council on _____

PURPOSE:

To 1) provide funds to address any significant and unanticipated financial needs of the General Fund on an emergency basis; and 2) provide additional resources to assist in maintaining stable service levels in times of fluctuating revenues and/or unanticipated expenditures.

POLICY:

Maintaining healthy reserves in the General Fund is a critical component of the City's sound financial management practices. This policy therefore establishes minimum required reserve balances for the General Fund in two categories with a goal to bring reserves to a total 20% level by FY 2019-20:

- A. An Emergency Reserve equal to 10% of the General Fund expenditure budget; and
- B. A Contingency Reserve equal to 5% of the General Fund expenditure budget

For purposes of this policy, these reserve levels are to be established annually as part of the budget process utilizing the preliminary General Fund budget for the year(s).

Emergency Reserve

The Emergency Reserve is established for the purpose of addressing any extremely unusual and infrequent occurrences, such as a major natural disaster or a major unforeseen settlement. Utilization of the emergency reserve requires declaration of an emergency by a two-thirds majority of the City Council, and specification of the maximum dollar amount to be used. In the event that the Emergency Reserve is accessed, staff must present a plan to the City Council following the termination of the emergency to return the Emergency Reserve to the 10% minimum level with an aspirational goal of 15% by FY 2019-20. The proposed timeline for restoring the reserve level must not exceed three years.

Contingency Reserve

The Contingency Reserve is established for the purpose of providing a "bridge" to facilitate a measured and thoughtful reduction in expenditures during times of economic downturn, rather than making immediate and drastic budget cuts without the time for proper evaluation. Utilization of the economic contingency reserve, including specification of the maximum dollar amount to be used, requires approval by a two-thirds majority of the City Council. Once utilization of the Economic Contingency Reserve has been terminated, staff must present a plan to the City Council to return the Economic Contingency Reserve to the 5% minimum level over no more than a three year period.

Surplus Reserves

While it is anticipated that ongoing needs of the City will prevent the General Fund Reserve balance from greatly exceeding the total 15% (or 20%) requirement of the Emergency Reserve and Contingency Reserve, it is likely that excess funds will be on hand from time to time. These funds are termed Surplus Reserves in this policy. If at any time the Surplus Reserves exceed 10% of the general fund expenditure budget during a fiscal year (for a total of a 25% General Fund Reserve balance), staff must present a plan to the City Council with options for appropriate uses for the excess funds to bring the General Fund Reserve balance to the 25% level or below. These uses could include deferred capital projects, vehicle or equipment purchases, or other expenditures of a one-time nature.

Utilization of Reserves for other Purposes

It is recognized that from time to time there may be reasons to utilize General Fund reserves for special projects, programs, and purchases of a one-time nature. In these instances, the following requirements apply to a request for a supplemental appropriation from reserves based on the then current balance in the overall reserve levels (Emergency Reserve + Economic Contingency Reserve + Surplus Reserves).

- A. When Surplus Reserves are to be utilized for the requested appropriation, and any such appropriation is one-time in nature, the City Council may appropriate the funds in the context of the City's overall financial needs as presented by staff.
- B. When no Surplus Reserves exist, the City Council may appropriate funds from the Contingency Reserve for purposes other than those outlined in the Contingency Reserve section of this policy:
 - 1. with a two-thirds approval;
 - 2. for projects that are one-time in nature;
 - 3. in the context of the City's overall financial needs as presented by staff; and
 - 4. with a requirement that staff incorporate an appropriation to reserves in the subsequent fiscal year's budget in order to restore the Economic Contingency Reserve to the 5% level.
- C. Any report requesting a supplemental appropriation from reserves must include an analysis of the impact of the appropriation on the General Fund Reserve balance.

PROCEDURE:

Responsibility

Action

Finance Department	<ol style="list-style-type: none">1. The Budget and Revenue Division calculates the required minimum Reserves established by this policy, and evaluates the degree to which the balance is above or below the required level.2. The Budget and Revenue Division, when appropriate, incorporates any required appropriations to reserves into the proposed budget when the reserve balance is below the target established in this policy, in consultation with the Chief Financial Officer.3. The Budget and Revenue Division, when appropriate, makes recommendations through the Chief Financial Officer to the City Manager and the City Council as to appropriate one-time expenditures that would reduce the total reserve balances when their balances exceed 25% of general fund expenditures.4. The Budget and Revenue Division analyzes requests for General Fund Reserve appropriations based on this policy, and provides recommendations through the Chief Financial Officer to the City Manager and the City Council on the appropriateness of the request and the requested amount.
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**REVIEW AND ADOPTION OF GENERAL
FUND RESERVE POLICY BASED ON THE
FINANCE COMMITTEE'S
RECOMMENDATIONS**

Finance Department

***City Council
September 6, 2016***

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Background

1. Having reserve policies are standard best practices for government agencies
2. Reserves and reserve policies are key elements of sound financial planning
3. Reserve policies are mandated according to Government Accounting Standards Board Pronouncement 54
4. Robust reserve policies are highly recommended by the Government Finance Officers Association
5. Reserve Policies are most common for:
 - a. General Funds
 - b. Certain Internal Service Funds
 - c. Insurance Trust Funds
 - d. Enterprise Funds



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Why Have Reserve Funds?

1. Provides funds to address emergencies or unanticipated expenses
2. Supports Cash Flow needs within each Fund
3. Sometimes used as part of replacement reserves
4. Aligns with the City Council's strategic direction of a 2 Year Budget and a 5 Year Economic Plan
5. Provides credit rating agencies and others with comfort that management will adhere to fiscal policies and have funds to pay bond debt
6. Crucial to keeping balance in lean revenue years and to use for contingency purposes



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Riverside - Recent History

1. The reserve has been up and down- at times as low as 9% and reaching as high as over 30%
2. In recent years, there has been a gradual decline as Riverside weathered the recession and the economy has been slow to come back
3. Use of Reserves has included:
 - a. Spending from the reserve for mid-year supplemental items
 - b. Operating losses in the years revenues did not equal expenditures
 - c. Significant increases in the General Fund budget resulting in a declining percentage on paper without a decline in the dollar amount of the reserve



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Riverside - Current Status

1. General Fund reserve for June 30, 2016 is projected to be at approximately 11.5%
2. While the FY 2015/16 budget was supposed to appropriate monies to the reserve to keep the balance at 15%, significant impacts to revenues with expense increases prevented that from occurring
3. FY 2016-17 year projections indicate a smaller draw on reserves unless revenues come in lower than estimated; with a stabilized reserve projected in FY 2017-18
4. Finance Committee recommended formalizing a reserve policy and seek City Council concurrence with policy elements



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Recommended Policy Elements

1. Differentiate between three categories of reserves:
 - a. Emergency Reserve (10%)
 - b. Contingency Reserve (5%)
 - c. Surplus Reserve (>15% and <25%)
2. Specify specific criteria for use of each
3. Specify procedure used when drawing upon reserves and how they are to be replenished
4. Specify what excess reserves balances are and how that balance is to be utilized
5. Require super-majority vote to use reserves
6. Try to work toward a 20% reserve goal level



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Emergency Reserve

1. Set each new budget year at 10% of the next FY's GF operating expenditure budget
2. Only to be utilized in times of a City Council-declared emergency situation such as a major natural disaster or unforeseen emergency by a 2/3rds vote
3. Approved Plan for reserve replenishment would be required:
 - a. Requires staff to submit plan for Council approval
 - b. Requires replenishment within three years



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Contingency Reserve

1. Set each new budget year at 5% of the next FY's operating expenditure budget
2. Only to be accessed in times of economic downturn as determined by the City Council with a 2/3rds majority vote
3. Reserve replenishment would:
 - a. Requires report from staff on the plan to replenish the reserve
 - b. Requires replenishment within three years
4. Contingency Reserves may not be accessed for supplemental economic purposes



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Surplus Reserves

1. When reserves exceed 15%, additional monies up to 25% would go into the surplus reserves
2. If Reserves climb over 25%, staff would be required to make recommendations to the City Council to reduce reserves below the 25% level for possible expenditures such as:
 - a. Deferred capital projects
 - b. Unfunded Liabilities
 - c. Vehicle or equipment purchases
 - d. Other one-time expenditures



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Summary

- In general, this policy requires a GF Reserve balance of 10% in Emergency Reserve and 5% in Contingency Reserve. Any appropriation reducing the balance below these amounts requires a 2/3 vote by the City Council with the following caveats:
 1. Requires staff to develop plans and submit to Council for approval to replace reserve expenditures below the combined 15%
 2. Balance must be increased to 15% as part of the following fiscal year's budget adoption process
 3. Could/would essentially require budget cuts in an equivalent amount to replace reserves absent additional revenue
 4. Appropriations from reserves are for specific things only



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Recommendations

That the City Council:

1. Review and adopt the attached proposed General Fund Reserve Policy setting the minimum reserve level at **15%** with 10% in the Emergency Reserve and 5% in the Contingency Reserve;
2. Set an "aspirational" goal of **20%** total General Fund Reserves (15% in the Emergency Reserve and 5% in the Contingency Reserve) for the future;
3. Direct staff to return to the City Council in one year (in September 2017) for status of compliance with this policy; and
4. Direct staff to return to the City Council in three years for a formal review of this policy.



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