



MEMO

Finance Department

DATE: 3/1/2024

TO: Edward Enriquez, *Assistant City Manager/CFO/Treasurer*
Kristie Thomas, *Finance Director/Assistant CFO*

FROM: Meline Carranza, *Debt and Treasury Manager*

CC:

RE: Interfund Loan Policy

Purpose:

To establish a framework for the approval and administration of interfund loans.

Policy:

Periodically it may be advantageous to borrow internally using interfund loans as opposed to using the external debt market. Interfund loans generally carry a variable interest rate equal to the City's pooled investment portfolio rate of return, which ensures that the lending fund does not suffer any economic penalty for making the loan. This internal interest rate is typically less than the cost of external borrowing using a public debt offering. The borrowing fund therefore incurs a savings in interest expense while the lending fund's interest revenue remains as it would have been had the loan not been made. In addition, the administrative burden pertaining to continuing disclosure requirements is eliminated.

The Assistant City Manager/CFO/Treasurer is the custodian of all funds under the control of the City (including the Successor Agency of the former Redevelopment Agency and other component units) and is responsible for the administration of existing interfund loans and ensuring that new interfund loans are made within appropriate guidelines. This policy establishes those guidelines, subject to waiver in unusual circumstances at the discretion of the City Manager.

Interest Rate Charged

Interfund loans should be made with an annual variable interest rate charged equal to the City's pooled investment portfolio rate of return during the same fiscal year. Any loan made with an interest rate lower than the City's pool rate should be made from the City's General Fund, which need not earn interest due to the unrestricted nature of the General Fund. Any loans made at an interest rate other than the City's pool rate should specifically disclose the interest rate to be charged when City Council authorization is obtained for the loan.

Repayment Term

In general, the repayment term of interfund loans should be limited to five years. However, to the extent that longer-term loans are needed for specific projects a longer loan term may be appropriate. The loan term should be specifically disclosed when City Council authorization is obtained for the loan.

Funds that May Make Loans

In general, interfund loans may be made from the City's larger internal service funds (Liability Insurance Trust Fund and Workers' Compensation Insurance Trust Fund) and larger enterprise funds (Sewer Fund, Electric Fund, and Water Fund). Other funds may be considered subject to specific circumstances. The lending fund should not be indicated when City Council authorization is obtained for the loan (language would indicate "a fund to be designated by the Chief Financial Officer").

However, any unusual loans, particularly those involving restricted funds, should have the terms clearly defined including the lending fund when City Council authorization is obtained for the loan. Restricted funds should only be used when specific authorization exists to allow loans to be made using the restricted funds (e.g. the Municipal Code allows the Regional Park Fund to make loans to the Local Park Fund).

Pursuant to authority delegated by the City Council to the Chief Financial Officer on July 8, 2008, the Chief Financial Officer may change the lending fund for any interfund loan at any time based on the changing cash needs of the City. Changes to the lending fund for any loan must be disclosed to the City Council in the Monthly Investment Summary and Financial Report provided to the City Council in the month following the change, consistent with the direction of the City Council's Finance Committee on September 8, 2008.

Assignment of a loan to the Electric Fund or Water Fund requires prior approval from the Board of Public Utilities and must be fully compliant with their Reserve Policy.

Financial Condition of Borrowing Fund

In general, interfund loans should only be made to funds that do not have sufficient cash on hand for the stated purpose of the loan. The projected future condition of the borrowing fund should also be taken into consideration in making this determination. If cash expenditures for a given purpose may compromise the fiscal health of the fund in the near- or long-term while a regular payment on an interfund loan would not do so, then an interfund loan is likely appropriate.

Funds that are frequently in the bond market should typically issue bonds in lieu of borrowing through interfund loans. Interfund loans would therefore typically be made to smaller funds that are not frequently in the bond market. However, larger funds may request interfund loans if there is a good reason for the loan's use, such as a lack of bonding capacity at the time that the loan is made or a sufficiently short duration to the borrowing to not necessitate the issuance of longer-term debt. For example, a borrowing of five years or less that will be repaid from a specific source may be more

appropriately financed by an interfund loan while a capital improvement to construct new facilities may be more appropriately financed by the issuance of long-term debt.

Financial Condition of Lending Fund

Due to the sizable cash reserves of the City's larger internal service and enterprise funds for which there is no short-term use, they are the most appropriate source of borrowing for interfund loans. To prevent cash shortages in an emergency and to preserve flexibility, typically no more than 50% of the total cash reserves of the City's internal service and enterprise funds should be involved in interfund lending at any one time. In this way, flexibility is maintained to allow for the transfer of interfund loans to other funds should reserves need to be accessed that are tied up in interfund transactions. Additionally, typically no single lending fund should have more than 75% of its cash balance tied up in interfund transactions at any one time, though at the discretion of the CFO this may be deemed appropriate in certain circumstances.

Permitted Loan Purposes

Loans may be made for any purpose deemed appropriate by City staff, with the approval of the City Council. Loans for operating costs are not permitted. Loans should generally be for capital improvements, land acquisition, or equipment purchases. The specific purpose of an interfund loan will be disclosed when City Council authorization is obtained. Any material change in the use of the loan proceeds should be approved by the City Council prior to the funds being repurposed. For example, if a sizable portion of a loan's proceeds will be redirected to a different project, then City Council approval should be obtained. Minimal changes in the use of a loan's proceeds or failure to use a small amount of the proceeds for the stated purpose does not necessitate repayment of the unused or redirected balance or notification to the City Council. Reasonable discretion should be exercised in making this determination.

Accounting Treatment

Interfund loans should be recorded in the books of the City and reported in the Annual Comprehensive Financial Report (ACFR) consistent with accounting principles generally accepted in the United States and guidelines promulgated by the Governmental Accounting Standards Board (GASB). Interfund loans will be reviewed annually by the City's external auditors for compliance with these requirements.

Procedure

Responsibility	Action
Borrowing Department	1. Requests approval by the Chief Financial Officer and/or City Manager for unusual elements of the loan contemplated. 2. Prepare City Council report requesting interfund loan, to include the following information: • A recommendation specifying the borrowing fund, the term of the loan, the interest rate to be charged, and the purpose of the loan. • Details in the Council Report's fiscal impact section outlining any special circumstances surrounding the loan.
Responsibility	Action
City Council	3. Approves the interfund loan.
Responsibility	Action
Finance Division	4. Assigns the interfund loan to the appropriate lending fund. 5. Records the interfund loan based on the terms outlined in the minutes of the City Council meeting approving the loan. 6. Reports any subsequent changes in the lending fund to the City Council through the Quarterly Investment Summary Financial Report