

City of Manteca Fund Balance Reserve Policy

ARTICLE I. PURPOSE

The overall objective of fund balance reserve reporting is to reflect the unencumbered balance available that may be segregated by policy for various uses. In many ways, fund balance represents working capital, which can either be used as a liquidity reserve or for spending in future years. A comprehensive fund balance/reserve management policy provides guidelines for the major funds of the City of Manteca and provides a structured approach in setting reserve levels in specifically designated funds.

This fund balance reserve management policy is intended to guide prudent use of resources to provide for the much needed services to taxpayers and to maintain sound management practices. It is essential that governments maintain adequate levels of fund balance reserve to mitigate risks and provide for revenue shortfalls.

ARTICLE II. POLICY

It is the policy of the City of Manteca to provide for the continuity of City government by planning ahead for recognized economic uncertainties and major expenditures – particularly those that are unplanned. To achieve reserve goals, the City must minimize the cost of City debt through “pay as you go” policies; by exercising prudent debt and liability management policies and following sound fiscal management policies that prioritize the City’s core services. The City will establish various reserve fund balance accounts that will develop funding for emergencies, contingencies, liabilities and planned major capital expenditures. In addition, the City will adopt the provisions of Governmental Accounting Standards Board Statement (GASB) no. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

ARTICLE III. OBJECTIVES

The purpose of this Fund Balance Reserve Management Policy is to assist the City in the pursuit of the following equally important objectives:

1. Build adequate reserves that will provide the City the resources necessary for financial stabilization, particularly during times of unforeseen emergencies and economic downturns;
2. Provide a clear understanding of the goals and objectives of all funds maintained by the City – particularly those with constraints or designations making them unavailable for current expenditure, including its unassigned fund balances;
3. Provide prudent guidelines regarding the establishment, use and replenishment of City unassigned fund balance reserves;

4. Establish a process for periodic reporting and review of the City's various fund balances reserves; and
5. Enhance the City's credit ratings received from rating institutions through the establishment of clearly delineated fund balance reserve policies that promote strong fiscal management; and

ARTICLE IV. CRITERIA FOR ESTABLISHING APPROPRIATE FUND BALANCE RESERVE LEVELS

Reserve balances will be established, reviewed and analyzed using industry best practices. In establishing the appropriate fund balance reserve levels, the following criteria should be considered:

1. ***Vulnerability to extreme events and public safety concerns.*** Major extreme events to which the community could reasonably be subjected and the likelihood and potential magnitude of loss for each event.
2. ***Revenue source stability.*** Volatility of each major revenue source based on factors such as past experience and trends with that revenue, characteristics of the tax or rate payers, state or federal revenue takeaways and economic factors. Revenues that fluctuate with the growth or retraction of the economy are considered to be more volatile or elastic. The greater the percentage of elastic revenues in a fund, the greater the need for a fund balance reserve.
3. ***Expenditure volatility.*** Spikes in expenditures, usually arising from special, nonrecurring circumstances such as lawsuits; critical special projects without a funding, source; or new state or federal spending requirements and unfunded mandates. Typically recurring sources of expenditure volatility, such as health care costs would *not* be included because they should be addressed within the context of an annual budget process. An exception to this would be highly variable and difficult-to-predict costs.
4. ***Leverage.*** Identified expenditures or liabilities that may inhibit the City's financial flexibility to meet ongoing service levels. Common examples include pensions, unfunded asset maintenance and debt.
5. ***Liquidity.*** Intra-period cash flow imbalances, such as property taxes that are only received at periodic points during the year.
6. ***Dependency of Other Funds.*** Identified funds that have significant dependence on the General Fund. Dependence can be indicated by regular operating transfers or "back stopping."
7. ***Growth.*** May be a relevant factor if significant growth is probable in the next three to five years. Risk is assessed if the potential marginal costs associated with serving new growth exceed associated revenues. Additional risk may be assessed if there is a gap due to

significant timing difference between when revenues from the growth will be received and when expenditures from the growth are expected to occur.

8. **Capital Projects.** Through the use of a Capital Improvement Plan (Program), determine high-priority projects without a dedicated funding source where reserves may be required as a funding source.
9. **Discretionary Authority.** Discretionary Authority refers to the power of the governing body to quickly adjust revenues. Revenues that can be changed or modified by the action of the City Council and can be implemented within a short period of time are considered highly discretionary. Funds with greater percentages of low or moderate discretionary revenues dictate the need for higher reserve balances.

ARTICLE V. USE AND REPLENISHMENT OF FUND BALANCE RESERVE

In addition to establishing and reviewing criteria for creating fund balance reserve levels, policies should be developed to determine the appropriate reserve range levels, the criteria for the appropriate use of fund balance reserves – particularly when addressing structural imbalances – and the process necessary to replenish the fund balance reserves when used.

In developing an appropriate level of fund balance reserve, it is critical that adequate levels be maintained to mitigate current and future risks (revenue shortfalls and unanticipated expenditures) and to ensure continuation of core City services.

1. Fund Balance Reserve Range

Fund balance reserve ranges are to be established based upon a percentage of the upcoming year's budgeted expenditures. This set amount may require modification to allow for additional fund balance reserve levels as revenues decrease, expenditures increase, or other economic risks become known. Based on industry best practices, a target range for General Fund reserves is no less than 17% of expenditures and up to 25%, depending upon identified risk factors.

2. Minimum and Maximum Fund Balance Reserve Levels

The fund balance reserve level should be set such that the fund balance reserve can withstand at least two negative budgetary events. The goal of this policy is to maintain reserves at or near the 25% reserve.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance, primarily in a government's general fund to evaluate the government's creditworthiness.

3. Use of Fund Balance Reserves to Address Structural Imbalance

When an imbalance exists between budgeted revenues and budgeted expenditures, it is important that the fund balance reserves are carefully accessed and utilized cautiously and judiciously, since the fund balance reserves are a one-time non-recurring funding source. In order to maintain prudent fiscal management, any budgetary structural imbalance must be addressed promptly. At the same time, the implementation of a replenishment plan will be developed in accordance with the guidelines set forth below. A planned draw down of the unassigned fund balance should not exceed 3% of the budgeted revenues unless determined necessary by the City Manager and approved by a vote of the Council.

4. Replenishment of Fund Balance Reserve

Fund balance reserves should be funded at 100% at June 30th each year if sufficient funds are available. If sufficient funds are not available, a plan to replenish the reserves back to the minimum required amount within five years, shall be presented to the City Council, by the following year's budget.

ARTICLE VI. PRIORITIZATION HIERARCHY OF FUND BALANCE RESERVE FUNDS

The adoption of this policy shall set forth the prioritization hierarchy as outlined in Article VII of this document.

ARTICLE VII. ASSIGNED GENERAL FUND BALANCE RESERVE POLICIES

This policy sets the target for General Fund reserves based on the "unrestricted" fund balance; net of non-spendable, restricted, and designated balances. It is further recommended that the General Fund reserve balances as defined by this policy be shown as "assigned" in the City's audited financial statements per the financial reporting policies set forth in Governmental Accounting Standard Board (GASB) Statement No. 54.

1. Fiscal Stability Reserve

The City will strive to maintain an unrestricted fund balance of at least 25% of operating expenditures in the General Fund consistent with the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association in adequately addressing:

- Revenue source stability, local disasters and other financial hardships or downturns in the local or national economy.
- Contingencies for unseen operating or capital needs.
- Dependency of other funds on the General Fund.
- Cash flow requirements.

The target of at least 25% of operating expenses will be determined in conjunction with the City's budget process and will be established based on the annual adopted budget.

This committed fund balance reserve is limited for use under currently budgeted operations and should not be used to fund new programs or new positions added outside of the current fiscal year budget.

Circumstances where taking reserves below policy levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as:

- One-time uses in meeting cash-flow needs; closing a projected *short-term* revenue-expenditure gap; responding to unexpected expenditure requirements or revenue shortfalls; natural disasters and liability reductions, revenue base improvements, productivity improvements and other strategies that will strengthen City revenues or reduce future costs.
- However, reserves should not be used to fund ongoing costs or projected systemic “gaps.” Stated simply, reserves should only be used once, so their use should be restricted to one-time (or short-term) uses.
- In accordance with generally accepted accounting principles, when the unrestricted balance at fiscal year-end meets or is less than this target, the amount will be shown as “assigned” in the City’s audited financial statements.

2. Pension Stabilization Reserve

The purpose of this reserve is to mitigate the operational impact of employer contribution rate volatility, as well as to set aside funding for strategic opportunities to reduce the City’s pension liability. The City will strive to maintain an assigned fund balance of at least 5% of operating expenditures in the General Fund. This assigned fund balance shall serve as a source of funding for situations included but not limited to:

- Mitigating the impact of a significant year-over-year increase in employer contribution rates due to actions outside of the City’s control, such as low investment returns in the CalPERS portfolio and or changes to actuarial assumptions.
- Take advantage of opportunities to make non-recurring payments to CalPERS that will reduce the City’s Pension liabilities, such as paying down or paying off unfunded liabilities earlier than scheduled.

In addition to the Pension Stabilization Reserve, any un-used pension benefits, as a result of vacant positions, budgeted for each fiscal year, will be used to make a one-time payment to pay down the City’s unfunded liability.

3. Economic Development Reserve

Due to the dissolution of redevelopment agencies, enterprise zones and other incentives in the state, locally designated funds for economic development purposes is needed to promote the development job creation, downtown revitalization, city-wide marketing and

other strategies to stimulate the local economy.

The funds for this reserve assignment will come from a pro-rata portion of residual property tax generated from the former redevelopment project areas in excess of State-approved Enforceable Obligations.

At June 30th each year any Economic Development Reserve balance in excess of \$2,500,000 will be transferred to the General Fund Unassigned Reserve.

4. Public Facilities Oversizing Reserve

In June 1994, the City Council adopted Ordinance No. 998, imposing a Business License Tax on the Business of Constructing Residential Dwelling Units in the City. While the revenues generate from this tax are general in nature, the tax was adopted in conjunction with the City's Public Facilities Implementation Plan (PFIP) to fund required public facilities oversizing in the central and "core" areas of the City.

In February 2013, Council approved the updated PFIP. Per Section 2 (H)(3) of the adopted plan, 50% of the revenue received from this tax is to be transferred to the PFIP Sewer Fund to help lower the PFIP Sewer Fee. The remaining 50% of the revenue received will be assigned to the Public Facilities Oversizing Reserve. The use of these funds shall be restricted to projects identified in the City's adopted Capital Improvement Plan.

5. Capital Facilities Reserve

It shall be the policy of the City to pre-fund anticipated capital needs for General Fund Departments by establishing a dedicated assigned fund balance for major capital improvements for City-owned or operated buildings such as roofs, HVAC, parks, irrigation wells and improvements needed to comply with the Americans with Disabilities Act (ADA). This policy is primarily intended for facility capital repairs. Planning for new City facilities shall be governed by the policies set forth in the City's Government Building Facilities Fee study.

It shall be the policy of the City to establish an amount of 3% of operating expenditures in the General Fund, with a maximum reserve set at \$1,500,000, to be used exclusively for capital items described herein.

6. Technology Reserve

It shall be the policy of the City to pre-fund major anticipated capital needs for Technology replacement and upgrade needs by establishing a dedicated fund balance reserve to be funded through annual budget appropriations. Major capital needs may include, but are not limited to: Enterprise Resource Planning (ERP) software replacement, Virtual Storage upgrades/replacement and fiber optic deployment.

It shall be the policy of the City to establish an amount of three percent 3% of operating

expenditures in the General Fund, with a maximum reserve set at \$1,500,000, to be used exclusively for major hardware and software items described herein.

ARTICLE VIII. OTHER ASSIGNED FUND BALANCE RESERVE POLICIES

1. Public Safety Sales Tax Fund

The City will strive to maintain a fund balance of at least 25% of operating expenditures in the Public Safety Sales Tax Fund consistent with the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association in adequately addressing:

- a) Higher levels of fund balance may be needed if significant revenue sources are subject to instability and downturns in the local or national economy.
- b) Dependency of the Public Safety Sales Tax Fund on the General Fund.

This committed fund balance reserve is limited for use under currently budgeted operations and should not be used to fund new programs or new positions added outside of the current fiscal year budget.

Circumstances where taking reserves below policy levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as one-time uses in meeting cash-flow needs; closing a projected short-term revenue-expenditure gap; responding to unexpected revenue shortfalls.

2. Enterprise Funds

For Enterprise Funds, unrestricted net position is essential to maintain adequate levels of working capital to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees. Credit rating agencies consider the availability of working capital in their evaluations of continued creditworthiness. Based on industry best practices, the target for working capital is 90 days. If the enterprise fund has outstanding debt issues, bond covenants should be reviewed to ensure compliance with any reserve provisions. Reserves for the Water, Sewer, Solid Waste, and Transit Funds will be set at 25% of operating expenditures. Reserves for the Golf Fund will be set at 15% of operating expenditures.

3. Self Insurance Fund

The City will strive to maintain a fund balance of at least 50% of operating expenditures in the Self Insurance Fund consistent with the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association in adequately addressing:

- a) Higher levels of fund balance may be needed if significant operating expenditures are highly volatile or have unpredictable fluctuations.
- b) Dependency of the Self Insurance Fund on the General Fund.

This committed fund balance reserve is limited for use under currently budgeted operations and should not be used to fund new programs or new positions added outside of the current fiscal year budget.

Circumstances where taking reserves below policy levels would be appropriate include mitigating the impact of a significant year-over-year increase in insurance premiums, unanticipated legal expenses due to negotiated settlements, and short-term revenue-expenditure gaps.

4. Measure Q Fund

The City will strive to maintain a fund balance of at least 5% of operating expenditures in the Measure Q Fund.

Circumstances where taking reserves below policy levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as one-time uses in meeting cash-flow needs; closing a projected short-term revenue-expenditure gap; responding to unexpected revenue shortfalls.