MANAGEMENT OF PUBLIC FUNDS

THE ADOPTION OF RESERVE POLICIES IN CALIFORNIA CITIES

by
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Introduction

Most people would agree that it is prudent to set aside sufficient savings to respond to an unexpected catastrophic event. The catastrophic event usually results in a reduction in income or a requirement to make an unforeseen expenditure not covered by the insurance they buy. People purchase insurance to handle the unforeseen financial stress that may result from such incidents as a major health problem or an automobile accident.

But, when determining the appropriate amount to set aside for events not covered by insurance, how much is too little and how much is too much? In other words, what is the prudent or correct amount? How much would be enough to make them feel secure? How much would be so excessive that it would reduce the quality of their lives today? There is an inverse relationship between the quality of life issue when viewed relative to the value of savings and the person's perception of security. Somewhere along the "quality of life" continuum is the point at which the right balance is achieved. And for each person it is a personal and individual decision.

This decision also needs to be made in the context of certain criteria for that particular individual including job security, health, insurance levels, liabilities, and the individual's tolerance of risk. A person with a high-risk tolerance would not require as much savings as a person whose risk tolerance is lower. Because a savings plan is so important to individual and families, there are professionals that make a living helping people develop them.

But what about cities? Shouldn't they also have a plan? It is expected that this research will conclude that they should and further that most finance professionals will agree with that statement. But, again, when determining the amount to set aside, how much is too little and how much is too much? In other words, what is the "prudent" or right amount for that individual city? How much would be enough to cover certain unanticipated events and develop a sense of security for the organization and the community? On the other hand, at what level would the constituency begin to question it as too much? What is the risk tolerance of the organization and the community? And what criteria should be used in making that decision? It is likely that if you asked 100 city finance professionals these questions, very few would provide the same mix of answers. The elements that are right for one city are entirely wrong for another. These are the things this research project demonstrates.

And when should these cities start saving? In "Managing Fiscal Slack: You Have a Surplus… Now What?" which appears in the June 2000 issue of Government Finance Review, Ronald D. Picur concludes that the recent economic boom has rendered state and local government with burgeoning surpluses that must be addressed. He further states that, among other things, this provides a prime opportunity for setting aside adequate reserves in the general fund for the future when the economy declines. It is imperative that cities take advantage of good economic times to set aside for that rainy day, which is bound to be facing them in the future.

Picur further states that the general rule of thumb for adequate reserves is 5 or 10 percent of annual revenue or one or two months of spending. Although cities do have a unique opportunity with the improved economy to set aside adequate reserves, the research will likely conclude, at least for California cities, that the question of an appropriate level of reserves is not that easy to generalize. And some cities will identify prudent reserve levels to be in the range he cites, but they will not represent a compelling majority.

In Urban Political Cultures, Financial Stress, and City Fiscal Austerity Strategies, Cal Clark and B. Oliver Walter (1991) define fiscal austerity strategies and measure the direct and indirect effects of independent variables on them. They conclude that public policy has a way of making greater demands on scarce resources therefore resulting in frustration for public administrators as they attempt to manage in a way to counteract that force. This research project will provide the basis from which a convincing argument can be developed by public administrators, establishing the need for adopting a policy to set aside specific reserves before addressing public demands that might otherwise consume those funds. It will also demonstrate that:

1. Reserve policies are important to cities.

2. A mix of criteria needs to be considered when developing reserve policies.

3. Fund type needs to be considered when developing reserve policies.

Because of varying service-delivery and revenue-collection methods from state to state, this research focuses on California cities. It is likely that cities in other states might find the research helpful in establishing parameters for addressing the need for reserve policies provided there is a clear understanding of the differences between the way they provide services and collect revenues and the methods employed in California cities.

In "Rethinking Local Government", (Public Management 73, 1991, pp. 2-4), Jan Winters discusses changing the way government does business. She highlights eight symptoms of new and changing circumstances and concludes that in order to remain solvent local government must be ready to respond to the challenges of a changing society. She further states that governments that remain stagnant will be the losers in the high-stakes game of economic viability. This article is another demonstration that there is a trend of practitioners that have recognized that taking care of precious resources by recognizing the need to be flexible and innovative are the guidelines under which the successful public administrator of the future will operate.

Objectives of Project

Guidelines which could assist cities in setting reserve level policies generally do not exist. The final outcome of this project will be the development of a product that will support finance professionals in California cities when they formulate and recommend reserve level policies to best fit the cities they work in.

In Evaluating Financial Condition, a 1994 publication by the International City/County Management Association (ICMA), p. 198, one of the appendices includes a discussion on analyzing reserves. The discussion offers the following commentary:

> There are no rules for determining which kinds of reserves a government should have or what level of funding should be in any reserve. Much depends on the kinds of natural disasters or hardships that the jurisdiction is subject to and the adequacy of its insurance coverage, the flexibility of the jurisdiction's revenue base, the overall financial health of the local government, state regulations, and national economic conditions.

The need for reserves is determined primarily by the degree of risk associated with revenues and revenue sources, and by the likelihood of major contingencies and the amount of funds required to respond to them. The following are questions managers can ask to see how well their community is protected against risk, as well as how much flexibility is available to meet special needs.

- What is the potential for revenue shortfalls – that is, how stable is the tax base in the face of adverse economic conditions?
- How much of the budget now depends on intergovernmental funds, and what are the chances that these funds might be terminated?
- What is the present policy on equipment replacement? Would replacement of a large item, such as a fire truck or road grader, severely distort the budget or disrupt service?
- What kinds of insurance protects the government against loss from legal suits or destruction of assets? Will the insurance cover all the loss or only a portion of it?
- What kinds of losses might the government suffer from natural disasters? What federal or state programs can help?
- How much and how quickly could the government borrow in the event of a problem?
- How much liquidity is usually available in the government's accounts?

In Part 2 of the same publication, governments are encouraged to develop sub-indicators for the fund balances (reserves) of each individual fund in order to detect trends that may signify an unhealthy decline. The publication goes on to identify a formula for determining the unreserved fund balance as a percentage of net operating revenue for the purpose of measuring the fund balance level.

Although measuring fund balance as a percentage of net revenue is one alternative, another measurement is as a percentage of operating expenditures. After all, aren't reserves built so cities can prevent an interruption or decline in the day-to-day delivery of services? And so it makes sense to set aside a certain percentage of the cost of providing those services in case there is a decline in revenue.

In 1998, the National Advisory Council on State and Local Budgeting (NACSLB), in conjunction with the Government Finance Officers Association of the United States and Canada (GFOA) published a booklet entitled, Recommended Budget Practices, A Framework for Improved State and Local Government Budgeting. In that booklet, the NACSLB advocates establishing a policy for what they call stabilization funds (p.17). The publication states that "A government should develop policies to guide the creation, maintenance, and use of resources for financial stabilization purposes."

The NACSLB advocates a policy for stabilization to "protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures." It also encourages the inclusion of those policies in public documents. They encourage a policy that identifies the use of these funds for temporary cash flow shortages, emergencies, unanticipated economic downturns, and one-time opportunities. The degree of emphasis that should be placed on these criteria shall be explored in this study. The reference to one-time opportunities is especially noteworthy as it may help a government achieve its goals.

Why Not Just Raise Taxes or Fees If We Need More Money?

Cities in California have limited ability to raise funds by increasing tax rates or raising fees. It began in 1978, when the voters of the State of California, tired of state and local government balancing their budgets on the backs of the taxpayers, overwhelmingly passed an initiative that is commonly known as Proposition 13. Another impetus was the State of California's perceived "obscene" surplus. The public's reaction to the State's surplus provides an example of the downsides of setting reserve policies that are too high and/or allowing reserves to build too much. Taxpayers expect government to use taxes to provide essential services, not to create huge savings accounts.

The initiative resulted in Article XIII A to the Constitution of the State of California. Prior to the passage of Proposition 13, budgeting for a city in California was relatively simple. The city would determine the costs of providing service, project the revenue they would receive from all sources other than property tax and then set a property tax rate that would collect an adequate tax to handle the difference. Cities in California were relatively immune from events that might impact their ability to provide services.

Financial problems related to the economy or natural disasters such as floods or earthquakes were easily resolved by just raising the property tax rate the following year. If a city needed to raise more money than was politically palatable in one year through the tax rate, they had that ability by selling General Obligation Bonds which would be repaid over time by including the repayment of the bond debt in the annual property tax rate. Proposition 13 also drastically reduced cities' ability to issue general obligation bonds.

In a January 1994 <u>Money Magazine</u> article, "The Tax Revolt That Wrecked California Schools, Services and Criminal Justice are Failing for Lack of Funds. It is a Warning for America.", syndicated columnist Richard Reeves states:

> The rising real estate prices, 70% from 1975 to 1978, were making homeowners rich – on paper. But their property taxes were inflating in lockstep – and those tax bills had to be paid promptly in cash. Politicians let the state's share of the money pile up in the capital, Sacramento – a golden heap higher than $5 billion – while people with relatively fixed incomes worried about losing their homes because they could not keep up with the exploding taxes. A lot of Californians were mad as hell and ready to listen to an angry old man name Howard Jarvis, who invented a state initiative called Proposition 13. The result was a tax revolt. Prop. 13 was approved by 65% of state voters on June 6, 1978, reducing and effectively capping property taxes – and making it damned near impossible to raise other taxes.

Proposition 13 produced some major changes, leaving cities with limited ability to raise revenue to meet the growing demands of their constituency. The major changes introduced by Proposition 13 included:

1. A reduction of ad valorem property tax to 1% of the 1985 assessed value.

2. The removal of cities' ability to impose any changes in the ad valorem property tax rate, except for the repayment of previously issued general obligation bonds.

3. A restriction on the increases in assessed values to 2% per year (except upon the sale of property).

4. A requirement of 2/3 voter approval to issue General Obligation Bonds.

The first few years after the passage of Proposition 13 were difficult for many California cities that found a major source of income significantly reduced. Cities in California became very creative in methods of raising revenue. Much focus was placed on developing fees to cover services that lent themselves to a fee structure. These included fees related to the services provided by planning, engineering and building departments as well as fees related to usage of parks and recreation services. A new industry was born as cities began to mimic private sector cost accounting to identify the cost of providing those services in order to establish fees to continue to support them.

In "This Tax Revolt Turned Out to be Revolting", (Aug 1994) author Frank Lalli, Managing Editor of Money Magazine states that "Its [Proposition 13] $5-billion-a-year residential property tax savings has been wiped out by $5 billion in fees – including $75 for picnics in public parks."

But it didn't stop at Proposition 13. Proposition 4, passed in 1979 on the heels of Proposition 13, resulted in Article XIIIB of the Constitution of the State of California (commonly known as the Gann Limit or Spending Limit), restricts state and local governments' ability to appropriate from the proceeds of taxes based on a certain formula which allows for only a marginal increase in that limit annually. The Gann Limit also requires that, to the extent a government charges for a service beyond the cost of providing the service, the excess fee shall be included in the tax limitation calculation.

There have been numerous other measures restricting tax and fee raising authority of state and local government in the ensuing years in California. The most recent was Proposition 218, approved by the California voters in November 1996. Proposition 218 added restrictions to other taxes, fees and assessments, making it necessary to ask for voter approval for many of them.

It is clear that the ability of cities to raise additional funds in response to unforeseen emergencies has been drastically reduced by these measures making it more critical than ever for them to have adequate reserves to respond to an unforeseen event. However, very little has been done to help cities determine the level of reserves that should be maintained for the unforeseen event that might require emergency spending.

Prior to Proposition 13, cities' need for reserves was defined primarily by truly catastrophic loss. Political reality dictated not raising taxes without a specific connection to increased service levels. Because cities have focused throughout the 1980's adjusting to reduced income under the constraints introduced because of Proposition 13, and throughout the 1990's coping with additional revenue-raising restrictions and further dwindling resources brought on by the recession, the issue of reserve level policies has been overshadowed by those challenges.

It is difficult to focus on how much to save when your ability to provide just the basic services is being threatened.

Lessons learned during the economic downturn of the 1990's, however, combined with the ever-climbing number of revenue-raising restrictions, point to the importance of establishing reserves to reduce the budgetary impacts of bad economic times and to continue the delivery of basic services during an unforeseen emergency.

If we make the assumption that the answers from cities will support the question of appropriate reserve levels, we could reasonably conclude that finance professionals will differ in their opinions of not only what criteria should be addressed, but also how much emphasis to place on each of them. So, this research attempts to answer the following questions:

1. Should cities have reserve policies?

2. If so, does political climate affect the levels of reserves that are deemed appropriate?

3. Should different fund types be treated differently?

4. What criteria should be considered when determining the appropriate level of reserves to establish in reserve policies?

CHAPTER 2

RESEARCH PARAMETERS

Before describing the research methodology and data analysis employed to answer these questions, we must identify the research parameters. The first step is to establish the definition of "Reserves". In the context of this research project, reserves mean the ***non-obligated balance that is available at the end of each budget year***. These are part of the fund balance but are not the portion of the fund balance that is legally set aside for other purposes. We will also need to establish against what criteria city finance professionals' opinions will be measured? The criteria will include the four shown below, however, additional criteria may surface upon review of questionnaire responses.

1. Cash-flow needs
2. Exposure to natural disasters
3. Exposure to economic impacts
4. Vulnerability to actions of the State

Cash-Flow Needs

Cash flow is measured by observing the cash inflow and outflow. It would be unlikely to find a city where the inflow of cash is completely matched, month by month, with the outflow. For example, property taxes are collected by the counties in California in December and then again in April. The Counties then disburse the cities' share of the property taxes shortly thereafter, so the inflow from property taxes is not evenly distributed month by month throughout the year. The costs supported by property taxes, such as police services, are likely to be distributed more consistently throughout the year, so there is some vulnerability from a cash-flow perspective where a city may not have the cash on hand to match the expenditures on a month-to-month basis. In the case of a "fictitious city", Table 1 demonstrates the vulnerability of what can happen when cash inflow does not match cash outflow.

TABLE 1
CASH-FLOW FOR A FICTITIOUS CITY

Cumulative in Thousands of Dollars

Month	Cash Inflow	Cash Outflow	Excess (Short)
July	110	110	0
Aug	260	220	40
Sept	340	340	0
Oct	420	460	(40)
Nov	500	585	(85)
Dec	750	705	45
Jan	840	825	15
Feb	930	955	(25)
Mar	1,025	1,080	(55)
Apr	1,280	1,205	75
May	1,370	1,330	40
June	1,455	1,455	0

The fictitious city represented in Table 1 has enough inflow of cash to cover the outflow for the full year in total, but has four months of the year when it is vulnerable and does not have an adequate amount to cover costs. For cash-flow purposes, theoretically this city should set aside a reserve level that is equal to the maximum cumulative deficit in any given month, which in this case occurs in November for $85,000. If this city had set aside $85,000, November would not be in the red. In order to determine the level of cash to set aside for reserve purposes, however, one may want to look at three to five years to make sure that a full understanding of the potential impacts of cash-flow patterns is achieved.

While the research project will not attempt to answer the question of how much is adequate, keeping in mind that this is a individual decision from city to city, in Chapter 3 it will attempt to measure the *importance* of the considering the criteria of adequate reserves to cover cash-flow needs compared to other criteria.

Exposure to Natural Disasters

California cities are not strangers to natural disasters. It has been said that while most people do not think California has seasons, it really does; fire season, earthquake season and flood season. These are examples of natural and manmade disasters that can be extremely costly for cities. These disasters often cause damages of great magnitude to public and/or personal property to which a city may be required to respond.

A variety of articles published by the San Jose Mercury News in late 1991 and early 1992, identified costs of the Oakland Hills Fire, which raged through the Oakland Hills on October 20, 1991, as over $5 billion. Almost 3,000 homes were destroyed and 25 people died. The financial impact to the City of Oakland in addressing such a horrific event must have been overwhelming.

And again, while this research project does not attempt to determine the ideal reserve level for all cities for potential catastrophic events, it does attempt to measure the importance of considering that criteria when establishing reserve policies.

A city that has experienced a major earthquake because of its proximity to a fault line may think that adequate reserves to respond to a natural disaster is very important because it has a substantial exposure to that particular disaster. The Federal Emergency Management Administration (FEMA) is usually ready to provide financial assistance to cities that experience significant natural disasters; however more often than not, FEMA's estimation of the cost to fix the damage is far lower than the actual cost and it typically takes many years to finally settle on the amount a city will receive. FEMA relief should be considered when evaluating reserve policies, but the degree to which it can be relied upon to come to the aid of the disaster is one that each individual city must determine. Some cities will expect a significant contribution from FEMA in the event of a disaster, while others with a lower risk tolerance may prefer to look at that potential aid from a more conservative perspective.

Exposure to Economic Impacts

The recession experienced in California in the early 1990's is a prime example of economic impact. Another example would be a city that is heavily reliant upon sales tax generated from an auto mall that could abruptly announce closure. Cities must decide for themselves their degree of vulnerability and the importance of setting aside reserves to respond to economic downturns. Cities with more diversity in their revenue source mixes will generally need less of a reserve to respond to economic impacts than those that are heavily reliant on single or limited sources of income. This project will attempt to measure the degree of importance for cities regarding the economic impact criteria.

In 1994, in order to determine the effects of the defense industry's downsizing on the economy and real estate markets of a local community, Kenneth Leventhal & Company completed an in-depth study of El Segundo, a city located in Southern California near the Los Angeles International Airport. El Segundo is a community whose income is closely tied to the defense industry. In 1994, 70% of the occupied industrial space in El Segundo was occupied by industry related to defense. Because of its lack of diversification, when the defense industry downsized in the early to mid 1990's, it made a major impact on El Segundo's local economy. Even at that early date, the report indicates an increase in the vacancy rates and a decrease in the rental rates of the local industrial and office space. This is a prime example of a community that should consider a substantial reserve level to offset its exposure to economic impacts.

Vulnerability to Actions of the State

California cities have found themselves vulnerable to actions taken by the State of California. A prime example occurred in the early 1990's, when the State of California, in response to recessionary impacts, balanced its budget by transferring over $1 billion in property tax from cities, counties and special districts to schools, to reduce the State's contribution to schools from other sources. Since that initial shift through the 2000/01 fiscal year, the total that will have been shifted is approaching $30 billion.

While counties make up the majority of the shift at $22 billion, $4.5 billion is from cities and another $265 million is from redevelopment agencies. This type of state action constitutes the same unforeseen contingency as a natural disaster or economic downturn. While there has been some legislation proposed that would provide permanent (this term is used loosely) protection for what has traditionally been considered local revenue, so far nothing has been passed that will really afford the much needed protection for cities.

In March 2000, the Speaker's Commission on Local Government Finance produced a final report regarding local government finances. On page 74, the report discusses the "Shock Absorber Problem". The "Shock Absorber Problem" is identified as the business cycles that occurs in California resulting in fat years and lean years. The report goes on to describe a great spending spree on the part of the State during the fat years and the surprise and embarrassment that occurs during the lean years and the result when the State uses local governments as fiscal shock absorbers to balance its books.

Perhaps the State of California should seriously consider a policy to set aside a certain cushion as protection against economic uncertainties and then initiate a public education program to educate the public as to why such reserves are being maintained.

Political Culture

It is expected that city finance professionals will likely have different points of view regarding what level of reserves is tantamount to hoarding taxpayers' money and what level is prudent. This project will recognize that it is possible to find differences in opinions and provide an additional dimension which will measure the role of political culture in establishing the level of adequate reserves. There really is no right or wrong answer. Cities must define their own political culture as the foundation from which their own reserve level policy should be developed. It is also important to recognize that while certain criteria may need to be considered when setting reserve policies, it may not be necessary, nor politically advisable, to reserve 100% for every contingency considered. It is very unlikely that all contingencies would arise at once requiring the need to exhaust the entire reserve.

In this chapter, "reserves" were defined. Then the criteria which will be scrutinized within the context of this project was identified to include cash flow, exposure to natural disasters, exposure to economic impacts, and vulnerability to actions of the state. It was also acknowledged that other criteria important to cities may surface as a part of the study and that "political culture" may play a big part in making those policy decisions. Each of these will be examined in the context of the political climate that is an inherent part of any city's decision making process. Now that the parameters of the study have been identified, research methodology and data analysis can be examined.

CHAPTER 3

RESEARCH METHODOLOGY AND DATA ANALYSIS

Since the material available to formulate solutions to these compelling issues is very limited, interviews with certain finance professionals and a comprehensive opinion survey were utilized. Four finance professionals participated in the interviews. The survey was conducted to include chief finance professionals in California cities with populations of 10,000 to 200,000.

Interviews with Finance Professionals

One of the resources used in this project was to interview three California city finance professionals and one Financial Advisor. The finance professionals selected are all at the department head level, have been active in professional organizations that support either governmental finance or public administration including the League of California Cities (LCC), the California Society of Municipal Finance Officers (CSMFO) and the Government Finance Officers Association (GFOA), are personally known and respected by many of their colleagues, and are considered "seasoned" in their profession. They are Mary Bradley, Finance Director at the City of Sunnyvale, Bill Statler, Finance Director at the City of San Luis Obispo and Irwin Bornstein, Director of Administrative Services/Treasurer at the City of Mission Viejo. These interviews were performed during June and July 2000 and included the same basic questions. The financial advisor interviewed is Larry Rolapp of Fieldman Rolapp & Associates, a financial advisory firm located in Costa Mesa.

Mary Bradley was the first to be interviewed. Mary has been the Director of Finance for the City of Sunnyvale, California since 1995. Prior to Sunnyvale, Mary served in a similar capacity for the City of Pasadena, California from 1987 to 1995.

She has served on the Board of Directors of the CSMFO, including one year as President and in various capacities on the Intergovernmental Relations and Career Development Committees. In 1994, she was appointed to the LCC Committee on Local Government Reform and is currently the President of the Fiscal Officer's Division of the LCC.

Mary Bradley agreed that establishing reserve policies is a good idea. In fact she stated that "it is essential because every effective organization needs financial policies to manage by, particularly if they are substantially dependent on revenues coming from others." She added that establishing a reserve policy is particularly crucial because government, left to its own devices, will spend all of its money.

Mary shared that the City of Sunnyvale does 20-year budgeting including projection of reserves from year to year. The 20-year approach has the effect of levelizing the ups and downs of reserves, which can be impacted dramatically by changes in economic conditions. When the economy is good, public officials have the opportunity to build reserves so when the economy take a turn for the worse, they can rely on those reserves to maintain service levels.

Reserve policies must result because of a commitment of the governing body. Setting aside reserves is difficult for the public to see when compared to the brick and mortar of a much needed capital improvement project, so it takes a true appreciation of the importance of establishing reserves on the part of public policy makers. Especially since it most likely will have no real or present value to them as politicians. In Sunnyvale, Mary concludes, "I don't know how the policy makers were initially convinced to establish reserve policies, but now it's a way of life around here and is embraced by both the politicians and the citizens. When individuals run for City Council in our city, they endorse the Sunnyvale system."

Mary did not think that a reserve policy should include a course of action if reserve levels either get too high or fall below the stated target. It was her opinion that because public officials need flexibility to respond to what could be a whole host of reasons why the reserve levels are not following projections, the policy should be more tactical allowing the action to be more strategic.

Mary makes some very good points about the values of long-range planning. The further out we look, the more likely it is that we can keep balances from experiencing those volatile ups and downs. She is especially insightful about not including a course of action in the policy itself if reserve levels either get too high or fall below the stated target to provide the flexibility public administrators may need to respond to the uniqueness of the emergency being addressed.

On July 7, 2000, another telephone interview was conducted with Irwin Bornstein, the Director of Administrative Services/City Treasurer for the City of Mission Viejo. Irwin has been in that capacity since 1988. Prior to Mission Viejo he was the City Controller for the City of Whittier for six years. He holds a Bachelor of Arts degree in Economics and Political Science from UCLA and an MBA from Stanford.

He served on the CSMFO Board of Directors from 1986-1992 including a year as President in 1990. He has also been actively involved in a number of CSMFO committees including the Budget and Management Reporting Committee and the Membership/ Administration Committee. He additionally served as Chair of the Southern Chapter of CSMFO. He served as President of the Fiscal Officers Department of the League of California Cities and is currently serving his fourth year on the League's Revenue and Taxation Policy Committee. He was recently elected to the GFOA Board of Directors and served on its Budget Committee for six years from 1995 to 2000. He is a Certified Public Accountant and has been a speaker at many state and national conferences on a variety of finance-related issues.

Irwin strongly agreed that reserve policies are important because they create a longer-term planning process. Those policies, according to his statement, should be well thought out in advance and include under what circumstances reserves should be tapped. It was his opinion that by including a course of action in the policy itself, you allow tough choices to be debated when the organization is not in crisis which leads to a more objective and reasoned policy.

According to Irwin, the City of Mission Viejo adopts a two-year budget and a seven-year general fund master financial plan. Both include projections of fund balances (reserves). Irwin stressed the benefits of looking at reserves from a long-range perspective to ensure that the city is not living off of them and that the reserves are set aside for their intended purpose.

As for the issue of reserve policies from a political perspective, Irwin states that public policy makers are elected to make those critical decisions and first and foremost must use their best judgement to reflect the will of the community. He adds that while funds that might otherwise be set aside in a reserve could be spent to deliver a certain popular service or build a particular desired project in the current year, the funds could also be valuable "in the bank" to avoid having to cut services in a year the economy turns down. He also stated that you can usually explain the importance of reserves to the public by putting it in terms of household budgeting. People need a cushion for an unforeseen emergency, and governments do, too. Reserves are important to get you through those dry periods.

Irwin concluded by adding that an organization's reserve policy really needs to reflect the organization's tolerance for risk – the risk that sufficient funds may not be there to address an unforeseen emergency, spending need or decline in revenues. There's really not a right or wrong answer as to the appropriate level of reserves. A good reserve policy is one that reflects the unique circumstances of that particular community.

Again, the long-term benefits of setting reserve policies are stressed. Unlike Mary, however, Irwin thinks the policy *should* include a course of action if reserve levels either rise above or fall below the target. And he makes a good argument that it might be better to have these difficult decisions made when not in the middle of a crisis.

Bill Statler was interviewed on July 14, 2000. Bill has served as the Director of Finance/City Treasurer for the City of San Luis Obispo for the past twelve years. Previously, he served for ten years as the Chief Financial Officer for the City of Simi Valley. Bill received his Bachelor of Arts degree in political science from the University of California, Santa Barbara, and pursued graduate studies in public administration at the University of California, Los Angeles. Bill is on the board of directors of the CSMFO, and is the Senior Advisor on its Technology Committee. He is also the CSMFO President-Elect for 2001. Bill has served as the League of California Cities' Fiscal Officer Department's representative on its Environmental Quality, Administrative Services and Community Services Policy Committees. He also served on the LCC's Proposition 218 Implementation Guide Task Force.

Not surprisingly, Bill thought establishing reserve policies was an excellent idea. In fact, he added that it is probably in the top five of the most important things a city can do to ensure fiscal health. In the context of a balanced budget policy, it tells you when you have too little and even when you have too much. He stated that, "Having a policy forces you to think about the underlying reasons why you set that limit in the first place which is probably more important than the number you arrive at. It makes you analyze each of the reasons you have a policy at all."

According to Bill, the City of San Luis Obispo includes projected fund balances (reserves) in their budget document by starting with fund balances that can be tied back to audited numbers. He added, that from a budgeting perspective, there are really three numbers that are ultimately important to the public: Where did it start, how did it change and how did it end up? You can only project that ending number with relative accuracy if you have a precise number to start with.

Bill stated that members of the governing body establish reserve policies in lieu of funding competing demands because they want to be good stewards of the finances of the governmental agency. He added that cities should have an articulated minimum and maximum reserve level. Having a minimum allows the city to respond to a downturn in the economy or cover a major unforeseen contingency in a construction project without having to make drastic decisions that may have an immediate impact. Having a maximum prevents the city from building its reserves beyond a reasonable amount.

When asked if cities should include a course of action if reserves either get too high or too low, he felt that it should not be specific. If reserves start to decline, you really have only two choices: either raise revenues or reduce costs.

Financial advisor, Larry Rolapp, was interviewed on June 28, 2000. Larry is President/Managing Principal of Fieldman, Rolapp & Associates. ("FRA"). He has been the Managing Principal since 1986, and a principal since 1980. Mr. Rolapp is a Certified Independent Public Financial Advisor (CIPFA) and has been a financial advisor for 23 years.

The firm provides municipal financial planning, structuring and capital debt financial advice to government. The firm's practice is focused primarily in California and Nevada. Larry was specifically selected to be interviewed because of his probable opinion about the reaction of rating agencies on reserve policies. Rating agencies, such as Moody's and Standard & Poor's, are often involved in providing a bond credit rating when cities wish to issue bonds.

The rating on the bonds has an influence on the interest rate the city will have to pay on the bonds. There is an inverse relationship between the rating on the bonds and the interest rate a City is charged to sell them. The higher the bond rating, the lower the interest rate and therefore the lower the costs.

Larry agreed with the three city finance professionals that cities should have reserve policies. He acknowledged their reserve policies should fit the circumstances for each community and each governmental entity. He added that the 'appropriate' level of reserves is impacted by the size of the operating budget, the amount and profile of municipal debt, the policies relative to an agency's investments, the local goals and objectives of the community and the city council. The 'appropriate' level of reserves is also determined by any geographical or environment risk contingencies or opportunities.

When asked what impacts, if any, a city's reserves and reserve policies have on rating agencies, it was Larry's opinion that they have a significant impact. He added that the level of reserves is a major factor in the rating agencies' credit analysis as well as a gauge of how well the local government plans and manages its operations. He concluded that if the level of reserves is too low, it negatively impacts the rating agency's outlook of government's ability to repay debt. If reserves are below a level perceived by the rating agencies as adequate, a reduced rating will result in an increase in the cost of borrowing.

It's clear that Larry thinks reserve policies play a major role in the bond-rating process. And it is interesting to note that, as far as he has observed, rating agencies never think the reserve level of the city they are rating is too high.

First of all, the city is presenting information to them to receive a rating to borrow money (sell bonds) and secondly, although it seems as though they might question the *need* to borrow money if the reserves were too high, their main focus when analyzing a city's credit worthiness is the city's ability to repay debt.

Christy Myers, Senior Vice President for Evensen-Dodge, a municipal financial advisory firm, reported in a June 2000 article in American City and County, "Improving a credit rating", that the City of White Bear Lake, Minnesota was able to improve the credit rating issued by Moody's. One of the elements cited as being responsible for the improved rating was "ample reserves." The city's overall general fund balance totaled 54 percent of general fund revenue in 1998, which we will see later, is quite high compared to the California cities represented in this study.

Reserve Policy Questionnaire

In addition to the interviews, a comprehensive opinion questionnaire was sent out to all cities within a population range between 10,000 and 200,000. There are 470 incorporated cities in California and as of January 1999, according to the California State Department of Finance's January 1999 estimated populations, 329 of them fell in the population range targeted.

Most cities have either a Finance Director or someone acting in that capacity. The questionnaire was mailed directly to that person, whenever possible. The number of questionnaires returned was 205 or 62%.

The questionnaire focuses many of its questions on the professional opinion of the person being surveyed. A copy of the questionnaire can be found in Appendix A.

The first section of the questionnaire focused on personal traits about the person answering the questionnaire. They include gender, age, education level and how they rate themselves in their own level of conservatism or liberalism.

For the question of gender, 198 of the 205 respondents answered. Of those, 65 percent were male while 35 percent were female. When asked to provide age, 189 of the respondents complied. The age ranges and the average ages between those 189 male and female respondents are shown in Table 2.

TABLE 2
AGE RANGES OF MALE AND FEMALE RESPONDENTS

	Male		Female	
Age	Number	%	Number	%
27 – 39	22	18%	9	14%
40 – 49	48	39%	41	62%
50 – 59	47	38%	16	24%
Over 60	6	5%	0	0%
Total	123	100%	66	100%

Average Age Male 48 Female 46

There was very little difference in the average age when comparing males and females as shown in Table 2. One interesting observation with this statistical comparison is that 76% of the females are 49 years of age or younger, while only 57% of the males fall in that age group. Forty-two percent of the respondents 49 years of age or older are female compared to 35% of the group as a whole. No female was older than 55, while 21 of the males fell into the "above 55" age group on up to age 78. Based on these statistics, if the majority of the respondents stay in this field throughout their careers, you may be able to conclude that females are gaining ground in this profession.

The respondents possess a high level of education. More than 98% of those responding have four or more years of college. When the respondents were asked to provide their education levels, 194 of the 205 respondents responded. See Table 3.

TABLE 3
EDUCATION LEVEL OF RESPONDENTS

Education Level	Number of Respondents
High School Only	1
High School plus One year of College	2
High School plus Four Years of College	60
High School plus Five Years of College	31
High School plus Six Years of College	60
High School plus More than Six Yrs of College	41
Total	194

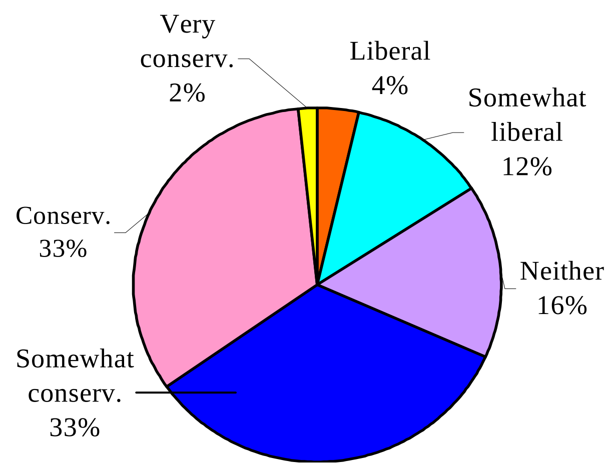
To determine if there was a difference in the education levels of the females compared to the males that responded to the education question, the answers were cross-tabulated. A great number of both groups had either four years of college or more as shown in Table 4.

TABLE 4
COMPARISON OF EDUCATION LEVEL WITH GENDER OF RESPONDENTS

	Male	Female	Total
High School Only		1	1
HS + 1 yr of College	2		2
HS + 4 yrs of College	37	23	60
HS + 5 yrs of College	20	11	31
HS + 6 yrs of College	43	17	60
HS + more than 6 Yrs of College	25	15	40
Total	127	67	194

For the final question of a personal nature, respondents were asked to rate themselves in terms of their level of conservatism and liberalism. It is not surprising, given the nature of their jobs, that the majority (68.4%) of the respondents that answered the question, answered that they were either very conservative, conservative or somewhat conservative as shown in Figure 1.

FIGURE 1
SELF EVALUATION:
LIBERAL OR CONSERVATIVE



The balance of the respondents was split 50/50 between those that rated themselves liberal or somewhat liberal and those that thought they were neither liberal nor conservative. No respondents rated themselves as very liberal.

To determine if there was a connection between age and the level of conservatism or liberalism, those results were cross-tabulated as shown in Table 5. One hundred eighty-seven (187) of the respondents answered both questions.

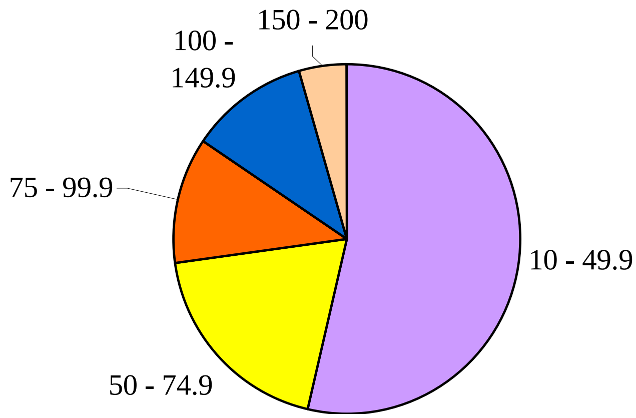
The 27-39 and the 60-78 age groups saw themselves as slightly more conservative than the middle two age groups or the group as a whole. It should be noted that the 60-78 age group is very small and therefore may not be representative of that age group overall.

TABLE 5
CROSS-TABULATION:
SELF-EVALUATION BY AGE GROUP

	age group				
self-evaluation	27-39	40-49	50-59	60-78	Total
liberal	1	5	1		7
somewhat liberal	3	10	10	1	24
neither cons.nor liberal	4	16	8		28
somewhat conservative	9	29	23	1	62
conservative	13	28	19	3	63
very conservative	1	1		1	3
Total	31	89	61	6	187

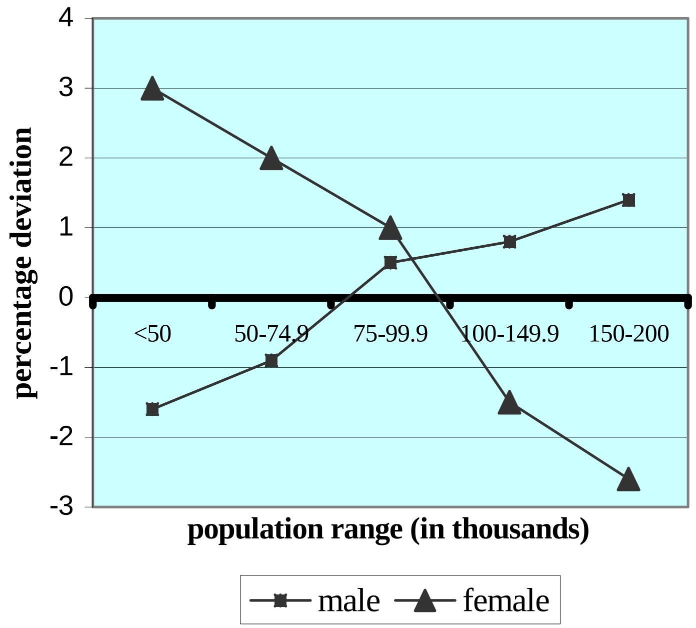
As stated earlier, the survey results came from cities with populations between 10,000 and 200,000. The 205 cities break down as demonstrated in Figure 2. Fifty-four percent of the cities fall within the 10,000 to 49,999 range. As Figure 2 clearly shows, as the population gets larger, the group gets smaller. The results between gender and population of city were cross-tabulated to determine if there was a difference between the concentration of males versus females when viewed in terms of city population.

FIGURE 2
POPULATION RANGES OF CITIES
(in thousands)



Average populations were then charted at zero and the deviation by gender was charted. See Figure 3. The results show that, when compared to the average, females were more often found in smaller cities and males were more often found in larger cities.

FIGURE 3
GENDER DEVIATION FROM POPULATION RANGE AVERAGE



Should California Have Reserve Policies?

When asked whether or not they agreed that California cities should have reserve policies, all 205 respondents provided an answer as shown in Table 6. One hundred eighty-nine (189) or 92.1% of them either *somewhat agreed*, *agreed* or *strongly agreed* that California cities should have reserve policies. Only seven of them, 3.4%, either *somewhat disagreed, disagreed* or *strongly disagreed*. Nine of them, 4.4%, *neither agreed nor disagreed.*

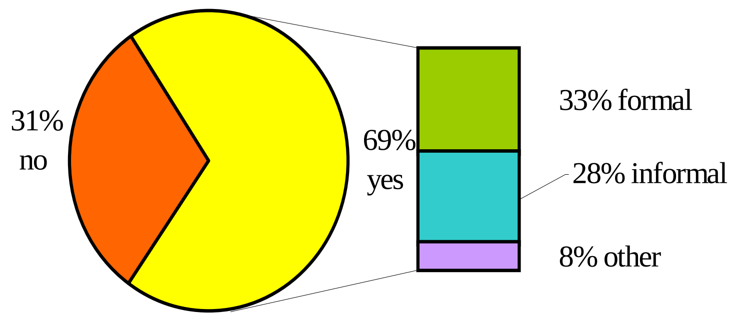
.TABLE 6
CALIFORNIA CITIES SHOULD HAVE RESERVE POLICIES

	Frequency	Percent	Cumulative Percent
strongly agree	115	56.1	56.1
agree	60	29.3	85.4
somewhat agree	14	6.8	92.2
neither agree nor disagree	9	4.4	96.4
somewhat disagree	1	.5	97.1
disagree	5	2.4	99.5
strongly disagree	1	.5	100.0
Total	205	100.0	100.0

The conclusion that is drawn from those results is that it is important, in the opinion of city finance professionals, that cities adopt reserve policies. It is not surprising that the vast majority of finance professionals answered this question in this manner given the nature of their role of stewardship over the city coffers.

Each of the respondents were also asked whether or not his/her individual city had a reserve policy. Not surprisingly, as shown in Figure 4, 142 (69%) cities responded that they had a reserve policy. Sixty-three (63) of the 205 respondents or 31% said that his/her city did not have a reserve policy; however, 25% of those said that they were in the process of developing one. One hundred forty-two (142) or 69% of the cities had a reserve policy. Formal, adopted written policies made up 33% of the total, while “yes, informal” were at 28% and “yes, other” were at 8 %.

FIGURE 4
DOES YOUR CITY HAVE A RESERVE POLICY?



A comparison was then made between those respondents that said California cities should have reserve policies and those that actually reported having them. Interestingly enough, 54 of the 189 respondents that said cities should have reserve policies did not have them and only 16 of those were in the process of developing one. On the other hand, of the seven respondents that said California cities should *not* have reserve policies, three of them had a policy while four did not. It is not usually up to the chief finance officer’s discretion whether or not a city has a policy. The governing body typically determines policy issues, although staff members generally play a significant advisory role.

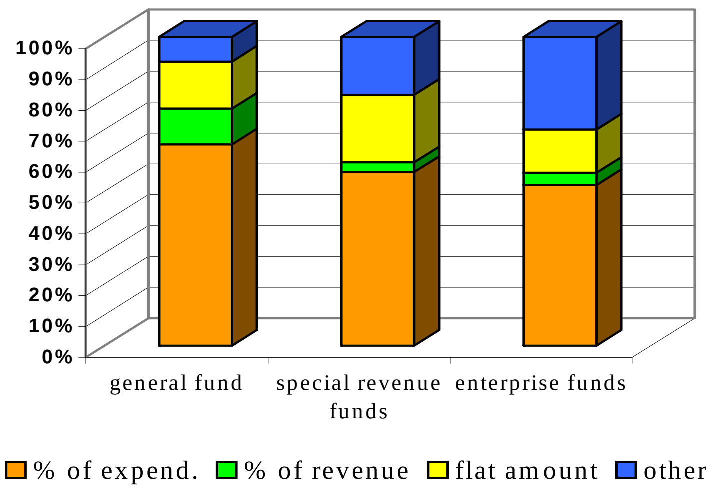
In “Fiscal Stress in Local Government: A Case Study of the Tri-cities in the Commonwealth of Virginia (Petersburg – Hopewell – Colonial Heights Tri-cities)” authored by Yaw Agyeman Badu and Sheng Yung Li (The Review of Black Political Economy 20, 1994, pp. 5-17), the authors state that beginning with the fiscal crisis in New York City in 1974 and subsequent crises in Oakland, Cincinnati, Detroit, Baltimore, and other cities, counties and school districts, the causes, impacts and management of fiscal stress have become a national concern.” While the article does not discuss reserve level policies per se, it does conclude, using a regression model, that fiscal stress can be measured. My research project will attempt to conclude that there is a sound methodology in determining prudent reserve levels.

Numerous articles have been written about fiscal stress in local government as witnessed by the New York City experience. As resources dwindle, governments are forced to dip into reserves to cover their costs. More focus should be placed on identifying and preserving an economic cushion, which could absorb the shock of such a fall.

In “Retrenchment and Recovery: American Cities and the New York Experience” (Brecher and Horton, Public Administration Review 45, 1985, p. 74), the authors conclude that "urban economic decline is neither a continuous nor inevitable process and that local government policy can play an important role in reversing such decline.”

For those respondents that said their cities did have a reserve policy, they were asked how the policy is expressed. They were asked to provide this information by fund type. Sixty percent of those that said they had a policy said they express it as a percentage of operating expenditures as shown in Figure 5, supporting the theory that California cities are more likely to express their reserves as a percentage of operating expenditures

FIGURE 5
MY CITY'S RESERVES ARE EXPRESSED AS:



Respondents were asked to briefly describe their city's policy. Although not many responses were received for this question (101 did not respond), the following breakdown gives you an idea of the range of answers that were provided.

TABLE 7
RESERVE POLICY RANGES

Method of Measurement	Range
As a flat amount	\$1 to \$20 Million
As a % of either revenues or expenditures	2% to 150%

The respondents provided a number of complete policies related to reserves. They are included in Appendix B. In response to the question on the questionnaire, however, 104 respondents provided a wide variety of brief statements regarding their policies. The answers reflected the earlier question, which asked how the reserves were expressed. The most common policies (in brief) are shown in Table 8.

TABLE 8
MOST COMMON RESERVE POLICIES (IN BRIEF)

Number of Respondents	Policy (In Brief)
15	10% of operating expenditures
11	15% of operating expenditures
10	20% of operating expenditures
9	25% of operating expenditures
6	50% of operating expenditures

City governments utilize fund accounting as the standard method of accounting. They are also expected to comply with the pronouncements set forth by the Governmental Accounting Standards Board (GASB), which are endorsed by the CSMFO and the GFOA.

In fund accounting, different funds and fund types are used to record transactions, depending upon the type of transaction. For the purpose of this study, I have focused on the general fund, special revenue funds and enterprise funds. The General Fund (a governmental fund) is usually the fund in which a city records discretionary activity and is often considered the primary fund of the government unit.

Special revenue funds are used to record transactions of a special nature. An example of a special revenue fund, is a Gas Tax Fund or a Community Development Block Grant (CDBG) Fund. Each of these funds receives revenues from a specific source with a condition that the revenue be spent on specific programs or functions. Enterprise funds are typically utilized in fund accounting for activities that generally pay for themselves, such as a water utility fund.

Respondents were asked if they thought that the category of a fund should be considered when determining the reserve policy for that fund. One hundred eighty-nine (189) of the 204 (92.6%) respondents to this question either *strongly agreed, agreed* or *somewhat agreed* that it should.

The respondents were asked to provide the amount budgeted in their cities' annual operating budgets by fund category. There was a wide spread of funds between the fund categories being explored as shown on Table 9. Figure 6 shows the percentages in each range and compares them by fund type.

The respondents reported 232 General Funds. Although most of the cities have only one General Fund, four reported multiple General Funds. Almost 13% of the General Fund annual operating budgets (30) were larger than $50 million, but the largest group (58) reported them between $10 and $20 million. The other 154 General Fund annual operating budgets were split as shown on table 9.

Probably because of their limited funding nature, 79% of the 1,173 special revenue fund budgets were reported to be in the $0 - $10 million range. The respondents reported 20% in the $10 - $20 million range, with the balance (1%) reported at $30 million or greater.

TABLE 9
RANGES OF ANNUAL OPERATING BUDGETS
BY FUND TYPE

Range	General Funds	Special Revenue Funds	Enterprise Funds	Total
$0 - $3m	20	797	817	1,634
$3 - $10m	52	125	177	354
$10 - $20m	58	237	295	590
$20 - $30m	37	6	43	86
$30 - $50m	35	6	41	82
> $50 mil	30	2	32	64
Total	232	1,173	1,405	2,810

The pattern reflected for the 1,405 enterprise funds reported shows a pattern similar to that of the special revenue funds, in that 92% fell within the three lowest budget groups and the balance fell in ever diminishing numbers in the next three ranges. Enterprise funds are also usually limited in nature, so you might expect to see the budget amounts similar to those in the special revenue funds, which are also typically limited in nature and less than the General Fund, which is typically more broad in terms of the services it supports.

Whether or not certain criteria should be considered when establishing reserve policies was discussed earlier. The specific criteria that were identified are 1) cash flow, 2) exposure to natural or other disasters, 3) exposure to economic conditions and 4) vulnerability to State actions which results in reduction of income. Respondents were also provided the opportunity to supplement this list with other criteria they thought was important. The additional criteria provided is as follows:

- Ability of Council to review and adjust accordingly - Council direction/actions/ opinion/education level - political issues and considerations.
- Unanticipated needs/projects - to sustain quality service/meet service demands/ contingencies/cost overruns – ability to respond to contractor actions.
- Insurance deductibles.
- Capital replacement - project or program facilitation pool - asset condition.
- Opportunity - ability - deterrent to overspending - management policy.
- Reliance on Reserves to generate investment income for operations.
- Increasing public safety contract costs/labor negotiations.
- Community sentiment/expectations - bad information.
- Indenture requirement - improved bond ratings - long term liabilities/debt.
- Size of annual budget - predictability of income and expenditure requests.
- The overall flexibility and capability of the management system to provide resources to match fortuitous events without special reserves for contingencies.

Respondents were then asked to rank the importance of considering these criteria when developing reserve policies. Not too surprisingly, the respondents provided a wide range of rankings to this question as shown in Table 10.

TABLE 10
RANKING OF IMPORTANCE
OF SELECTED CRITERIA

	Cash Flow	Econ. Cond.	Natural Disasters	State Actions	Other
Least Important	33	21	17	8	51
Less Important	43	30	55	41	16
Avg Importance	35	34	55	76	5
More Important	41	51	47	58	4
Most Important	50	64	25	17	13
Total	202	200	199	200	89

One conclusion that is clear, is that a large number of the respondents (115) said that exposure to economic conditions was either more important or most important. Another observation was made that vulnerability to actions of the State and exposure to natural/other disasters seemed to cluster around the area of average importance. "Other" clearly wins the distinction of least important for those that provided an "other" rating. Finally, cash flow was somewhat evenly spread throughout the ratings.

The State of California has recently emerged from the deepest and longest recession in the state's history. Is it surprising that exposure to economic conditions is ranked as so important? The main conclusion that can be made from these numbers, however, is that it is an individual decision for each city.

Not to be confused with establishing the *importance* of each of the criteria, the respondents were then asked if fund type makes a difference when deciding the emphasis to be placed on the criteria provided. For example, what percent of emphasis should be placed on cash flow for the general fund? Should that same percentage apply to the special revenue funds or the enterprise funds? Again, respondents were offered the opportunity to define and rank the criteria of "other", whatever "other" might be for their city.

To provide meaningful data on the answers provided on this topic, each fund type was analyzed individually. For the general fund, 185 respondents provided answers as shown on Table 11.

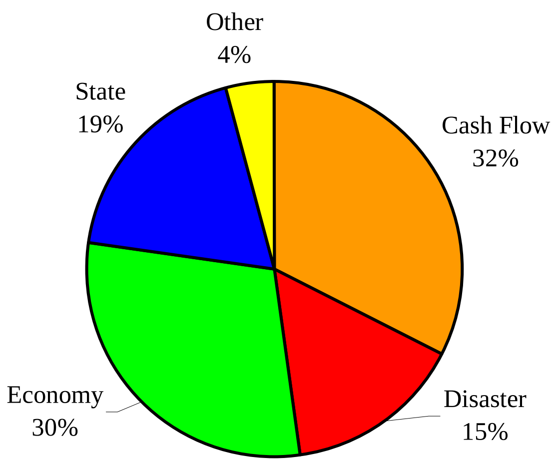
TABLE 11
EMPHASIS OF SELECTED CRITERIA:
GENERAL FUND RESERVE POLICIES

% Range	Cash Flow	Disaster	Economy	State	Other
0%	5	17	3	16	142
1 - 10%	38	90	29	56	24
11 - 20%	32	43	40	53	7
21 - 30%	32	18	52	40	6
31 - 40%	20	5	24	14	1
41 - 50%	28	9	23	4	4
51 - 60%	12	1	6	1	0
61 - 80%	17	2	8	1	1
81 - 100%	1	0	0	0	0
	185	185	185	185	185

By taking the mean for each criteria, a general fund model was produced as illustrated in Figure 6. The general fund model shows that "cash flow" (32%) and "economic uncertainties" (30%) ranked relatively equal. "Vulnerability to state action" made up 19% of the emphasis with "vulnerability to disaster" following close behind at 15% and finally "other" at only 4%.

It is likely that, because many general funds have property taxes as one of their major revenue sources (which is received primarily in December and April), cash flow would be an important criterion to consider. Certain general fund revenue sources are also sensitive to declines in the economy, including, but not limited to, property tax (particularly if devaluation of property occurs), sales tax (because people are more reluctant to spend during an economic downturn) and transient occupancy (hotel/motel) tax (because vacancy rates go up as people travel less).

FIGURE 6
General Fund Model



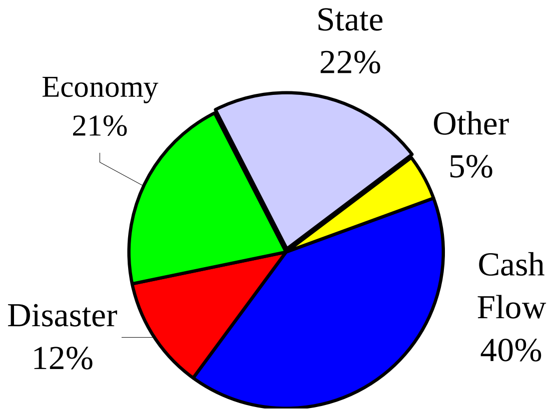
For special revenue funds, the mix is somewhat different. One hundred eighty-three (183) respondents reported having special revenue funds. Table 12 shows the distribution of the answers among the selected criteria.

TABLE 12
EMPHASIS OF SELECTED CRITERIA:
SPECIAL REVENUE FUND RESERVE POLICIES

% Range	Cash Flow	Disaster	Economy	State	Other
0%	6	48	31	32	133
1 - 10%	29	69	38	41	21
11 - 20%	28	32	42	27	6
21 - 30%	18	11	27	28	5
31 - 40%	13	6	14	18	2
41-50%	28	6	14	19	4
51 - 60%	13	0	3	3	0
61 - 80%	23	1	3	4	1
81 - 100%	15	0	1	1	1
	173	173	173	173	173

Figure 7 represents the model that was developed using the mean for each criterion for special revenue funds. The respondents felt that almost twice as much emphasis (40%) should be placed on “cash flow” as any other criteria. “Vulnerability to state actions” and “economic uncertainties” nearly tied for a distant second at 22% and 21%, respectively, while “vulnerability to disaster” came in at 12%. Again “other” finished last at 5%.

FIGURE 7
Special Revenue Fund Model



Although the respondents were not asked to provide reasons why these particular criteria were distributed in this manner, one could speculate that since special revenue funds include Community Development Block Grant Funds (which receive reimbursement after the fact) and Assessment Districts (receive property related assessments primarily in December and April), they could be very sensitive to cash flow issues.

The enterprise fund type produced a model that was again, different than the other two. There were 155 respondents that provided an answer for the enterprise fund question. Table 13 shows the distribution of the answers between each of the criteria.

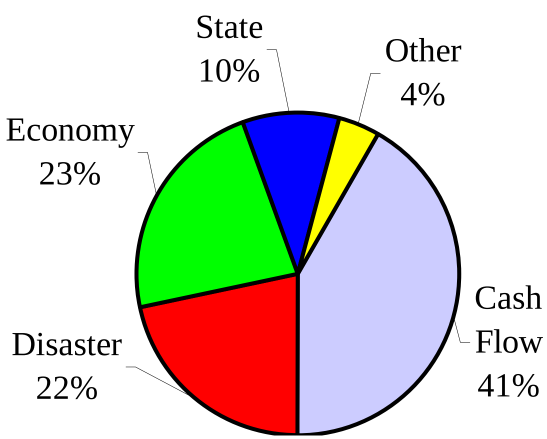
TABLE 13
EMPHASIS OF SELECTED CRITERIA: ENTERPRISE FUND RESERVE POLICIES

% Ranges	Cash Flow	Disaster	Economy	State	Other
0%	9	15	21	60	123
1 - 10%	20	49	33	54	15
11 - 20%	15	37	38	22	7
21 - 30%	19	21	26	10	3
31 - 40%	22	14	15	7	3
41-50%	25	11	13	1	3
51 - 60%	14	4	5	0	0
61 – 80%	19	2	3	1	1
81 – 100%	12	2	1	0	0
	155	155	155	155	155

Figure 8 shows the model that was developed for enterprise funds using the mean established by the respondents. While cash flow is nearly the same percentage as in the special revenue fund model at 41%, "vulnerability to disaster" and "economic uncertainties" were very close at 22% and 23%, respectively. "Vulnerability to state actions" was not quite the concern for this fund type as the other types at 10% and again, "other" trailed at 4%.

The nature of enterprise funds is that they are designed to behave somewhat like a business. The entity sells a product or service (such as water, sewer, recreation services) and uses the revenue to support the costs associated with providing the service.

FIGURE 8
Enterprise Fund Model



To the extent that the product is delivered before the fee is collected (such as in the case for some utilities), cash flow would be a strong consideration. Economic issues, on the other hand, would be of particular concern if the product or service being provided is one of a "discretionary" nature like recreation services since consumers are likely to cut those expenditures during hard times more quickly than they would for non discretionary expenditures, like rent or utilities.

And finally, in terms of major disasters, an earthquake, for example, could severely impact the government's ability to deliver services if major damage occurred to essential infrastructure such as water lines or wastewater treatment facilities.

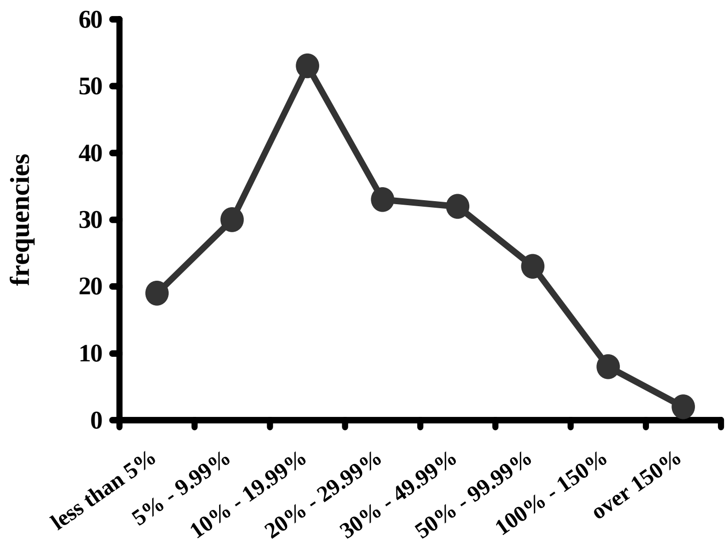
This information is not provided to suggest that all cities could adopt these models and develop their policies accordingly. It is offered only to demonstrate the importance of considering the selected criteria in the context of the fund and/or fund type for which the policy is being developed in addition to taking into account the unique circumstances for each individual city including the political climate and the overall culture of the community.

General Fund Reserve Levels Reported

Respondents were asked to describe their reserve levels at June 30, 1999 as a percentage of annual expenditure by fund type. For the General Fund, less than 10% (19) of those that responded reported reserves of less than 5%. Fifty-nine percent (118) fell in the 10% to 49.99% range. Only 5% were above 100% as shown in Figure 9.

In the interview with Bill Statler, he stated that he had heard someone state that a reserve level of 5% to 10% was ideal and that more than 10% was excessive. He didn't think that necessarily works for California cities because they are not as dependent upon property taxes, which is a very stable source of income, as they are in many other states. If it can be assumed that the cities in the study have reserve levels appropriate to them, then he is correct. Seventy-five percent of the cities report a General Fund reserve of more than 10%.

FIGURE 9
General Fund Reserves
as a % of Expenditure



CHAPTER 4

CONCLUDING REMARKS

The results of this research demonstrate that a vast majority of finance professionals think that cities should develop reserve policies. It is also clear that certain criteria should be examined when formulating a reserve policy; however, there is a wide range of opinions regarding the degree of importance that should be placed on each of them. It is also clear that selecting the criteria to be considered varies from city to city depending upon the experience and political culture of that particular city. Each city should look to the past to determine which criteria should be considered when developing a policy to protect the future. At the very least, they should consider the following four criteria when formulating policies for their city:

- Cash Flow
- Exposure to Natural Disasters,
- Exposure to Economic Impacts
- Vulnerability to Actions from the State.

Cash flow should be considered in formulating a reserve policy because the monthly inflow of cash is unlikely to match exactly to the outflow resulting in a negative cash position for some months. To provide a clear understanding of the impact of uneven cash flow patterns, a government should chart cash flow for at least a three-year period.

The vast majority of cities have some exposure to natural disasters. It could be proximity to an earthquake fault or terrain that is susceptible to erosion during heavy rains. Each city needs to evaluate its own vulnerability by exploring the possible financial impacts of such an event including the level of insurance upon which they can rely.

All cities suffer when there is a down turn in the economy. Lack of diversity in income sources increases the level of vulnerability. Cities are wise to focus their growth toward development that will provide a diversified structure of income sources. When developing reserve policies, cities should explore their own economic vulnerability.

There is some effort being made to protect traditional municipal income sources from actions of the State of California, but so far cities are relatively helpless to defend against a repeat of the state take-aways experienced in the early to mid 1990's. History has also shown that when the state does take away local revenues, local agencies have not been very successful in convincing the state to reverse the action when the situation that prompted it no longer exists.

The results also conclude that the fund type should be a factor when developing reserve policies. There are certain characteristics, including revenue and spending patterns that are inherent to particular fund types. Because of these distinctions, the uniqueness of the fund type needs to be given consideration when formulating the policy affecting that fund.

Appendix B includes reserve policies or other documents related to reserves generously provided by 26 California Cities. Since it is common practice for local governments to share documents, these policies and resolutions were included for use by other finance professionals in the development of reserve policies that work best for their agencies.

By establishing reserves at the level that has been thoughtfully determined to be right for a particular city, public officials have the opportunity to continue the delivery of day-to-day services when a catastrophic event occurs requiring those reserves to be tapped. Having an adequate reserve on hand also provides them time to formulate an action plan rather than triggering a knee-jerk reaction that may not be in the best interest of the city.

Public officials have been given the task of preserving the public trust and making decisions that are in the best interest of their city. A reserve policy is one of the most important policies a city can adopt to ensure the fiscal health of the city. By keeping a close watch on the reserve levels compared to the adopted policy, public officials can be forewarned of trends that may jeopardize the city's ability to provide essential services to the community.

APPENDIX A

RESERVE LEVEL POLICIES QUESTIONNAIRE

This questionnaire is being sent to primary finance professionals in all California cities with populations between 10,000 and 200,000. The populations have been obtained from the California State Department of Finance estimates for January 1999. The purpose of the survey is to provide the basis from which a model will be developed to assist cities in setting reserve level policies based on a city's particular needs. It is hoped that, for those cities wishing to establish reserve level policies, the model will become a valuable tool. In order to lend credibility to the result of this study, a large percentage of returned questionnaires is needed. Your help is vital to the achievement of that goal. As a finance professional myself, I am requesting your assistance in making the results of the study meaningful and furthering the final objective.

The questionnaire seeks to obtain the opinion of finance professionals in California cities regarding reserve level policies, whether your city has one or not. All questions should be answered keeping in mind that your *opinion* as a professional is a critical element in the outcome of the survey. For the purpose of this questionnaire, reserves are defined as the non obligated money that is available at the end of the budget year. The impetus for this study is the research project required for my MPA with California State University, Northridge. Please return the completed questionnaire by September 26, 1999. The questionnaire has been pre-addressed to make its return very convenient. Just fold the questionnaire so that my mailing address is on the outside, tape it closed and it's ready to be stamped and mailed. If you are enclosing additional material, you may want to use an envelope.

Confidentiality will be maintained for the four questions number A through D or far all questions if so indicated by you. Your help is truly appreciated. I can be reached by email at alawrence@ci.camarillo.ca.us or by phone at (805) 388-5320 if you have any questions or need clarification.

Anita Lawrence
Director of Finance
City of Camarillo

Name: ______________________________

Title: ______________________________

City: ______________________________

Phone: ______________________________

Email: ______________________________

These first four questions, A through D, will be held in strict confidence. They are being asked solely to determine if there is a correlation between the answers given in the questionnaire and certain characteristics about the person answering.

A. My gender is [ ] male [ ] female.

B. My age is _________.

C. My highest level of education is (circle 1):

Less than 12 12 13 14 15 16 17 18 18+

D. I consider myself:

[ ] very conservative
[ ] conservative
[ ] somewhat conservative
[ ] neither conservative nor liberal
[ ] somewhat liberal
[ ] liberal
[ ] very liberal

1. My city's population, based on State of California Dept. of Finance estimate for Jan. 1999 is:

[ ] under 10,000
[ ] 10,000 to 49,999
[ ] 50,000 to 74,999
[ ] 75,000 to 99,999
[ ] 100,000 to 149,999
[ ] 150,000 to 200,000
[ ] over 200,000

2. California cities should have reserve policies.

[ ] strongly agree
[ ] agree
[ ] somewhat agree
[ ] neither agree nor disagree
[ ] somewhat disagree
[ ] disagree
[ ] strongly disagree

3. Fund category should be a consideration when determining the reserve level policy for a fund.

[ ] strongly agree
[ ] agree
[ ] somewhat agree
[ ] neither agree nor disagree
[ ] somewhat disagree
[ ] disagree
[ ] strongly disagree

4. My city's annual operating budget is (place a number in each box that represents the number of funds under each type that meets that funding level).

	Fund Types		
	General Fund	Special Revenue	Enterprise
Under $1 million	[ ]	[ ]	[ ]
$1 - $3 million	[ ]	[ ]	[ ]
$3 - $6 million	[ ]	[ ]	[ ]
$6 - $10 million	[ ]	[ ]	[ ]
$10 - $15 million	[ ]	[ ]	[ ]
$15 - $20 million	[ ]	[ ]	[ ]
$20 - $30 million	[ ]	[ ]	[ ]
$30 - $40 million	[ ]	[ ]	[ ]
$40 - $50 million	[ ]	[ ]	[ ]
$50 - $75 million	[ ]	[ ]	[ ]
$75 - $100 million	[ ]	[ ]	[ ]
over $100 million	[ ]	[ ]	[ ]

5. Please rank the importance of considering the following criteria when establishing reserve policies with 1 being the least important and 5 being the most important.

___ normal cash flow (rate of inflow vs.outflow).
___ exposure to natural/other disasters (i.e. fires, floods, earthquakes, riots).
___ exposure to economic conditions (i.e. heavy reliance upon single income source).
___ vulnerability to State action which results in reduction of income.
___ other (explain) __________________

6. This question seeks to determine the variance, if any, between fund types. Please indicate the percentage of emphasis that should be placed on the criteria for each fund type.

	Fund Types		
	General Fund	Special Revenue	Enterprise
1. Cash Flow	_______	_______	_______
2. Disaster Exposure	_______	_______	_______
3. Economic Exposure	_______	_______	_______
4. State Action	_______	_______	_______
5. Other (explain)	_______	_______	_______
Total	100%	100%	100%

7. Based on a percentage of annual expenditures, my city's reserve levels at June 30, 1999 are estimated to be at the following levels (expenditures shall include transfers to other funds when the funds to be transferred are to be used for annual operating expenditures). Please check all percentage ranges for each fund type that applies.

	Fund Types		
	General Fund	Special Revenue	Enterprise
Less than 0%	______	_______	_________
0% to 2.49%	______	_______	_________
2.5% to 4.99%	______	_______	_________
5% to 7.49 %	______	_______	_________
7.5% to 9.99%	______	_______	_________
10% to 14.99%	______	_______	_________
15% to 19.99%	______	_______	_________
20% to 24.99%	______	_______	_________
25% to 29.99 %	______	_______	_________
30% to 39.99%	______	_______	_________
40% to 49.99%	______	_______	_________
50% to 59.99%	______	_______	__________
60% to 79.99 %	______	_______	__________
80% to 99.99%	______	_______	__________
100 to 124.99%	______	_______	__________
125 to 149.99%	______	_______	__________
150 to 174.99 %	______	_______	__________
175 to 199.99%	______	_______	__________
200% or more	______	_______	__________

8. In terms of your answer to question 7, please rate your reserve levels for each fund type based on your opinion of its degree of conservatism with a rating of 1 being not at all conservative and a rating of 5 being extremely conservative.

___General Fund ___Special Revenue Funds __Enterprise Funds

9. Does your city have a current reserve policy?

[ ] No
[ ] No, but we are currently developing one.
[ ] Yes, an informal policy.
[ ] Yes, a formal, written policy adopted by the City Council.
[ ] Yes, other. (explain) ____________________

10. If you answered yes to question 9, please briefly describe your policy.

____
____

11. Which fund types are included in your policy?

[ ] no policy
[ ] General Fund
[ ] Enterprise Funds
[ ] Special Revenue Funds
[ ] Other (please identify)______________________________
____

12. My city's reserve policy is expressed as follows:

	Fund Types		
	General Fund	Special Revenue	Enterprise
No Policy	[ ]	[ ]	[ ]
As % of expenditures	[ ]	[ ]	[ ]
As % of revenue	[ ]	[ ]	[ ]
As flat amount	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]

Explanation of other _________________________________

13. How would you rate your City's policy in terms of its degree of conservatism? (Rate with 1 being not at all conservative and 5 being extremely conservative). N/A = no policy

______________	General Fund
______________	Enterprise Funds
______________	Special Revenue Funds
______________	Other Funds (describe)
	_____________________

14. I have enclosed a copy of my City's policy and agree to have it included in the appendix of your report as a sample policy.

[ ] yes [ ] no

15. I understand that the information in this survey, except for A through D, may become available for other cities to review, however, I request that the information I provide be kept strictly confidential.

[ ] yes, please keep information confidential.
[ ] no need to keep information confidential.

APPENDIX B
CITY RESERVE POLICIES

Note: Many cities have extensive financial policies; however, the policies provided in this section reflect only those related to reserves. Many thanks to the following cities for providing policies or resolutions for this research project.

City of San Luis Obispo
City of Mission Viejo
City of Brea
City of Costa Mesa
City of Redondo Beach
City of Pleasanton
City of Murrieta
City of San Leandro
City of Yuba City
City of Bellflower
Town of Danville
City of Arcata
City of Coronado
City of Encinitas
City of Beverly Hills
City of Chula Vista
City of San Clemente
City of Monterey Park
City of West Sacramento
City of Manhattan Beach
City of Santa Rosa
City of Half Moon Bay
City of Indio
City of King City
City of Atwater
City of Arcadia
City of Camarillo

City of San Luis Obispo
Budget and Fiscal Policies

FUND BALANCE DESIGNATIONS AND RESERVES

A. **Minimum Fund and Working Capital Balances**. The City will maintain fund or working capital balances of at least 20% of operating expenditures in the General Fund and water, sewer and parking enterprise funds. This is considered the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:

1. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
2. Contingencies for unseen operating or capital needs.
3. Cash flow requirements.

B. **Equipment Replacement**. For General Fund assets, the City will establish and maintain an Equipment Replacement Fund to provide for the timely replacement of vehicles and capital equipment with an individual replacement cost of $15,000 or more. The City will maintain a minimum fund balance in the Equipment Replacement Fund of at least 20% of the original purchase cost of the items accounted for in this fund. The annual contribution to this fund will generally be based on the annual use allowance which is determined based on the estimated life of the vehicle or equipment and its original purchase cost. Interest earnings and sales of surplus equipment as well as any related damage and insurance recoveries will be credited to the Equipment Replacement Fund.

C. **Future Capital Project Designations.** The Council may designate specific fund balance levels for future development of capital projects which it has determined to be in the best long-term interests of the City.

D. **Other Designations and Reserves.** In addition to the designations noted above, fund balance levels will be sufficient to meet funding requirements for projects approved in prior years which are carried forward into the new year; debt service reserve requirements; reserves for encumbrances; and other reserves or designations required by contractual obligations, state law, or generally accepted accounting principles.

City of Mission Viejo
Reserves

General Fund Reserves

A. A Contingency Reserve account will be budgeted every two years, and appropriated annually to provide for unanticipated expenditures of a nonrecurring nature and/or to meet unexpected increases in costs.

B. An Economic Uncertainty Reserve account will be budgeted every two years, and appropriated annually to avoid the need for service level reductions in the event an economic downturn causes revenues to come in lower than budget.

C. An Exposures Reserve will be maintained for the purpose of setting aside resources for costs not covered by the City's insurance programs, such as claim costs within the City's deductibles, self-insured retentions and/or major costs associated with disasters and other events which will not be reimbursable from insurance or from the Federal or State government. The amount of this reserve will be analyzed every two years to determine the appropriate funding level.

D. A Reserve for Infrastructure, which will receive residual fund balance not apportioned to the Reserve listed under Sections A through C and Sections H and I, will be maintained to fund future infrastructure and other one-time expenditures, such as for capital projects that were not anticipated in the biennial budget process or could not be entirely financed from current revenues.

E. Reserve for Encumbrances and Continuing Appropriations are established at the end of every fiscal year to reserve fund balance in the amount equal to the City's unpaid obligations and unfinished projects at year-end.

F. Other reserves, such as for cash flow, in the event that current cash flow needs exceed combined fund balances, or anticipated costs for service enhancements, will be established each fiscal year as needed.

G. Combined unappropriated fund balance and appropriated reserves in the General Fund will not be allowed to fall below 15% of the current year General Fund operating budget. Funding levels of all General Fund reserves will be reviewed during periods of economic stagnation to avoid reductions in operating service levels.

Other Reserve Funds

H. A Computer, Equipment, Furnishings and Vehicle (CEFV) Replacement Fund will be maintained, at a rate of 100% accumulation depreciation, and as a separate fund, to fund to replacement costs of existing equipment, vehicles, computers and office furnishings when they reach the end of their useful lives.

I. A Facility Rehabilitation/Replacement Fund will be maintained, at a rate of 60% of accumulated depreciation, as a separate fund, to fund the rehabilitation or replacement costs of existing City buildings, recreational facilities, and parks/sportfields fixtures when they reach the end of their useful lives.

J. A minimum fund balance of 30% of estimated Gas Tax revenues, excluding those revenues from Orange County Transportation Authority (OCTA) Fund exchange agreement, for the current year will be set aside as a reserve for street repair emergencies and other unanticipated traffic safety projects.

City of Brea
General Fund Reserve Policies

The City will maintain General Fund contingency reserves at a level at least equal to 13% of the General Fund expenditures. The primary purpose of this reserve is to protect the City's essential service programs and funding requirements during periods of economic downturn (defined as a recession lasting two or more years), or other unforeseen catastrophic costs not covered by the contingency reserve.

- ♦ Expenditures cannot exceed revenues.
- ♦ The City will increase the General Fund contingency reserves by at least 0.25% annually.
- ♦ Utility Rates and Fees

The City will maintain adequate reserves in each of the enterprise funds to protect these essential City programs. Water Fund reserves should equal a minimum of three months of fund expenditures. Sewer Fund reserves should equal one year's operating expenditures.

City of Costa Mesa
Financial Policies (Goals)
FY 2000-2001

The City will maintain a minimum designated General Fund Reserve for Working Capital equal to 25% of its operating budget.

- *General Fund*

  The General Fund Reserve for Working Capital will be maintained at a level equal to 25% of its operating budget for the fiscal year. This reserve amount represents the ideal level of reserves that bond rating agencies and bond insurance companies recommend cities maintain to deal with local disasters, emergencies, and/or unexpected appropriation needs. Under optimum conditions, the General Fund Reserve for Working Capital should be maintained at 25% of the current year's operating budget. As a result, staff will incorporate a plan to increase the General Fund Reserve for Working Capital to 25% into subsequent year's proposed budgets over a reasonable period of time.

  Such unforeseen expenditures can, and do, occur at any time. Examples of such expenditures incurred by the City or which may be incurred by the City are as follows:

  - ▪ Federal/State budget cuts (such as the State issuing IOUs, Educational Revenue Augmentation Fund (ERAF) transfers, Vehicle License Fee reductions, reallocation of Sales Tax revenues under the Connell "SMART" proposal, etc.);

- Local revenue shortfalls due to a downturn in the local economy (i.e. the recession of the early 1990s and its impact on local units);
- Increase in demand for specific services;
- Legislative or judicial mandates to provide new or expanded services or programs without new or fully off-setting revenues;
- One-time City Council approved expenditures;
- Unexpected increases in inflation (Consumer Price Index); and,
- Natural disasters (earthquakes, fires, or other general infrastructure failures).

- *Special Revenue Funds*

  Where possible, reserves for Special Revenue Funds (such as the Gas Tax Fund) will be adopted at the same levels as the General Fund, as long as they do not interfere with legal or grantor requirements.

- *Debt Service Funds*

  Reserve levels for Debt Service Funds will be established as prescribed by the bond covenants adopted at the time of the issuance of debt.

City of Redondo Beach Reserves Policy

a) The City shall maintain a "minimum reserve" for contingencies, equivalent to 7.5% of the General Fund's current fiscal year's budget. Maintaining this minimum "reserve" will also allow the City to continue to earn a certain level of investment earnings and provide sufficient cash flow reserves. The minimum reserve requirement will be subject to an annual, or whenever necessary, review by the City Council.

b) Undesignated fund balances shall be used for one-time expenditures, preferably only on capital improvement items.

c) The remaining undesignated fund balances, after all "reserve" requirements are met, may be transferred to the Capital Projects Fund or may be used to increase the funds set aside for capital equipment replacement, subject to Council approval. This process will be annually reviewed with the Mayor and City Council.

d) The City Council may alter reserve requirements anytime, as necessary.

e) The "reserves" or fund balances designated for claims and judgements shall be maintained at appropriate levels as authorized by the City Council.

f) The "reserves" or fund balances designated for compensated absences shall be maintained at appropriate levels as authorized by the City Council.

g) Council approval will be required before expending funds designated for contingencies or any of the available fund balances.

City of Pleasanton
General Finance Policies

Reserve Policies

- The City will establish, dedicate and maintain reserves annually to meet known and estimated future obligations.

- The City will establish Specific Reserve Accounts which include but are not limited to designated reserves for the following:

  - Reserve for Economic Uncertainties equal to 10% of General Fund Revenues
  - Totally funded workers compensation
  - Liability insurance
  - Estimated cost of retirees medical payments
  - Depreciation and replacement of vehicles and major equipment
  - Major maintenance and renovations of buildings, parks and landscape maintenance

- The City will establish reserves for replacement of facilities and infrastructure.

- The City will establish reserves for cash flow purposes.

City of Murrieta
Contingency Reserve Policy

Introduction

Fiscal stability is an important factor to any City. It is Council responsibility to maintain a sufficient level of reserved contingency funds to provide for the continuation of services in the event of natural or fiscal emergency.

Purpose

Establish a Contingency Reserve Fund balance to maintain a stable tax and revenue structure and provide for the orderly provision of services to the Citizens of Murrieta.

Policy

It is the policy of the City Council of the City of Murrieta:

1. To establish a Contingency Reserve Fund balance of thirty-five percent (35%) of the operating expenditures of the General Fund, Fire District Fund, and Library Fund, which would be sufficient to finance operations for a period of 4-5 months.

2. Moneys set aside in the Contingency Reserve Fund shall not be reduced below thirty- five percent (35%) of operations level without prior approval of the City Council.

3. Each fiscal year during the budget process, the Contingency Reserve Fund will be re-evaluated by City Council to determine if adequate levels of reserve are maintained based on the economic conditions of the area.

4. The Contingency Reserve Fund would be available only as a *temporary* revenue source to be used while an orderly financial plan for cost-reduction or revenue enhancement is developed.

City of San Leandro

Fund Balance Designations and Reserve Management

a) The City will maintain fund or working capital balances of at least 20% of operating expenditures in the General Fund and Enterprise Fund (Water Pollution Control Plant, Refuse, Golf, Marina, and Storm Water). This is considered the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:

   i) Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
   ii) Contingencies for unseen operating or capital needs.
   iii) Cash flow requirements.

b) For General Fund assets, the City will establish and maintain Equipment Replacement Funds (Information Services, Garage, and Building Maintenance) to provide for the timely replacement of vehicles, capital equipment, and major building maintenance projects. Under the City's current definition of capital outlay, this includes items with an individual replacement cost of $2,500 or more. The City will maintain a minimum fund balance in the Equipment Replacement Funds of at least 20% of the original purchase cost of the items accounted for in these funds. The annual contributions to the Funds will generally be based on the annual use allowance (depreciation), which is determined based on the estimated life of the vehicle or equipment and its original purchase cost. Interest earnings and sales of surplus equipment as well as any related damage and insurance recoveries will be credited to the Equipment Replacement Fund.

c) Reserves for replacing capital improvements and equipment (capital assets) will be accumulated over the life of an asset on a "pay-as-you-use" basis.

d) The Council may designate specific fund balance or reserve levels apart from 3a above for future development of capital projects, which it has determined to be in the best long term interests of the City.

e) In addition to the designations noted above, fund balance levels will be sufficient to meet funding requirements for projects approved in prior years which are carried forward into the new year; debt service requirements; reserve for encumbrances; and other reserves or designations required by contractual obligations, state law, or generally accepted accounting principles.

f) Long-term financial planning methods will continually be evaluated and implemented, such as a muti-year capital improvement program, and the use of muti-year revenue and operating expense forecasting techniques.

g) Opportunities for consolidation of resources and activities with other agencies and jurisdictions will be actively pursued.

City of Yuba City
Financial Policies
Detailed Discussion

The city will maintain a minimum designated General Fund reserve equal to 5% of its operating budget. Staff will submit a five-year plan to increase the designated General Fund reserve to 10% over the next five years.

- **General Fund**

The General Fund will maintain a 5% reserve which is based on the projected fund balance at the beginning of the fiscal year. This reserve amount represents the minimum reserve that bond rating agencies and bond insurance companies recommend cities maintain to deal with local disasters, emergencies, and/or unexpected appropriation needs. Ideally, cities are encouraged to maintain General Fund reserves in the 10% to 20% range. As a result, staff will submit a five-year plan to increase the General Fund reserve to 10% over the next five years.

Such unforeseen expenditures can, and do, occur at any time. Examples of such expenditures incurred by California cities over the past ten years include:

- Federal/State budget cuts (such as the State issuing IOUs, Educational Revenue Augmentation Fund [ERAF] transfers, Vehicle License Fee reductions, reallocation of Sales Tax revenues, etc);
- Local revenue shortfall due to a downtown in the local economy (the recession of the early 1990s significantly impacted many cities);
- Increase in demand for specific services;

- Legislative or judicial mandate to provide new or expanded services or programs without new or off-setting revenues;
- One-time City Council approved expenditures;
- Unexpected increase in inflation (Consumer Price Index [CPI]); and,
- Natural disaster (flood, major fire, evacuation, etc.).

▪ **Special Revenue Funds**

Where possible, reserves for Special Revenue Funds (such as the Gas Tax Fund) will be adopted at the same levels as the General Fund, as long as they do not interfere with legal or grantor requirements.

- **Debt Service Funds**

Reserve levels for Debt Service Funds will be established as prescribed by the bond covenants adopted at the time of the issuance of debt.

City of Bellflower
General Fund Contingency Reserve Policy

Proposed Policy Statement – The City will maintain a General Fund Contingency Reserve equal to not less than 20% of the appropriation budget total within the General Fund. This reserve can only be used with City Council approval and is intended to meet unforeseen contingencies such as emergencies, revenue shortfalls, mandates or unanticipated inflation. It is not intended for routine capital projects or general operations.

Discussion – Sound financial management includes a practice of maintaining an adequate General Fund reserve for contingencies. Such unforeseen situations and developments may include emergencies, revenue shortfalls, legislative or judicial mandates, an unexpected increase in inflation, and other conditions that reduce resources and increase costs.

In an effort to ensure the contingency of public service so as to not affect or threaten the public health, safety and welfare of the City of Bellflower, staff recommends that a General Fund Contingency Reserve be established and maintained at 20% (approximately $3,100,000) of the General Fund appropriation budget total. This reserve will allow the Council to have the fiscal discretion to temporarily finance expenditures while an orderly financial plan for cost-reduction or revenue enhancement is developed. This reserve level will be reviewed periodically to ensure that it is consistent with changing fiscal conditions of the City.

City of Danville
Resolution No. 35-98

Defining The Purpose and Uses of the General Fund Operating Reserve

WHEREAS, it is prudent fiscal management for public agencies to reserve funds which can be used in the event of financial emergencies; and

WHEREAS, the Town of Danville had a policy of maintaining a General Fund operating reserve of 20% of the fiscal year operating budget to be used in such emergencies; and

WHEREAS, the Town Council retains control over the circumstance under which the operating reserve can be used; now, therefore, be it

RESOLVED that Danville Town Council formalize its policy of maintaining an operating reserve of 20% of the fiscal year operating budget against the General Fund fund balance; and be it further

RESOLVED that the 20% operating reserve be used only in the event of a financial emergency, as determined by the Town Council; and be it further

RESOLVED that the Town Council decide, by passage of a Town Council resolution during a financial emergency, to draw upon the operating reserve; and be it further

RESOLVED that the operating reserve be reimbursed during the same fiscal year, if possible, and if this is not possible, that the Town Council adopt a plan before the close of the fiscal year to reimburse the operating reserve as soon as possible.

APPROVED, by the Danville Town Council at a regular meeting on February 17, 1998.

City of Arcata
Financial Reserve Policy

To maintain the fund balance and retained earnings of the various operating funds at levels sufficient to protect the City's creditworthiness as well as its financial positions from unforeseeable emergencies, the City will strive to maintain the following minimum balances:

***General Fund Undesignated Fund Balance* –** The City shall strive to maintain the General Fund undesignated fund balance at 10 percent of current year budget expenditures. After completion of the annual audit, if the undesignated fund balance exceeds 10 percent, the excess must be specifically designated for subsequent year expenditures or transferred to the Capital Projects Fund.

***Enterprise Funds* –** In other enterprise operating funds, the City shall strive to maintain positive retained earnings positions to provide sufficient reserves for emergencies and revenue shortfalls. Additionally, in the Water and Wastewater Funds the following reserves and designations will be established:

1. Reserve for Plant Replacement – 80% of annual appropriation will accumulate in this reserve. (For purpose of this calculation, annual appropriation does not include debt service and capital project expenditures).

2. Designation for Major Equipment Replacement – 10% of annual appropriation will accumulate. (For purpose of this calculation, annual appropriation does not include debt service and capital project expenditures).

***Internal Service Fund* –** The City shall not regularly maintain positive retained earnings in internal service funds. When an internal service fund builds up retained earnings, the City shall transfer it to other operating funds.

***Debt Service Fund* –** The City shall maintain sufficient reserves in its debt service funds which shall equal or exceed the reserve fund balance required by bond documents.

City of Coronado
Size and Use of Reserve Funds

PURPOSE: Sound financial management dictates that the City maintain appropriate reserves for emergency use, for capital projects and for obligations accruing on a current basis that will be paid in the future. This policy statement articulates the minimum reserve balances that should be maintained and the appropriate uses of reserve funds.

POLICY: It is the policy of the City of Coronado to establish and maintain reserve funds as follows:

Unallocated General Fund Reserve

The Unallocated General Fund Reserve shall be maintained at a dollar level at least equal to 50% of current fiscal year General Fund appropriations plus interfund transfers to Library Services, Insurance, Employee Benefits and Retirement Funds. The primary purpose of this reserve is to ensure the financial ability of the City to provide essential services following a major disaster. Such a disaster could include earthquake, flood or catastrophic fire. An additional use of the reserve is to provide cash flow financing of the adopted budget prior to receipt of scheduled revenues. Since a disaster could require expenditures on an immediate basis, and since cash flow financing requires a high degree of liquidity, the two-thirds of the minimum reserve amount identified above will be maintained in liquid investments consistent with adopted investment policy.

Monies in the reserve not required to meet the liquidity standard may be loaned to the Community Development Agency for valid CDA purposes including construction of Capital Projects. To better account for these capital project loans, General Fund reserve monies to be expended for this purpose will first be transferred to the Capital Improvement Fund and subsequently loaned to the CDA. Investment of Reserve monies in this manner will allow citizens to benefit from capital projects and the General Fund to be repaid for the improvement at some future point in time.

Workers' Compensation Reserve

A Workers' Compensation Reserve shall be established and maintained at an amount equal to the incurred expenses remaining unpaid for all open claims. Incurred expenses will be established by the City's Workers' Compensation administrator. The purpose of this reserve is to pay Workers' Compensation expenses resulting from the City's self insured status.

Liability Insurance Reserve

A Liability Insurance Reserve shall be established and maintained equal to the greater of three times the City's SIR (self insured retention) or the net reserves for liability losses and expenses for all open claims. Net reserves will be established at least annually by the City's liability administrator. The purpose of this reserve is to pay liability and property damage expenses resulting from the City's self insured status.

Vehicle Replacement Reserve

A Vehicle Replacement Reserve shall be established and maintained equal to the accumulation depreciation on all City rolling stock. Depreciation schedules shall be developed by the Public Services Department and reviewed annually by the Administrative Service Department. The purpose of this reserve is replacement of rolling stock upon the completion of its useful life.

Capital Improvement Reserve

A Capital Improvement Reserve shall be established and maintained equal to the estimated cost of all capital improvement projects approved and funded by the City Council through the regular budget process. The purpose of this reserve is to pay all costs associated with designing, constructing and/or acquiring approved and funded capital improvements.

City of Encinitas
Maintaining and Using the General Fund Reserve

I. Philosophy

Sound financial management includes a practice of maintaining an appropriate reserve for contingencies. This reserve level shall be periodically reviewed to insure that it is consistent with the conditions faced by the City.

II. Method

A. Establishing the Reserve: The City Council directs the City Manager to take the necessary steps to establish and maintain a Contingency Reserve in the General Fund. The target amount for this reserve shall be $5,500,000.

B. Use of Reserves for Disasters: The primary reason for reserve shall be as a contingency against natural disasters. The two disasters most frequently faced by cities in California are earthquakes and flooding. Provisions for use of the reserve in emergency circumstances are provided for in the Municipal Code.

C. Use of Reserves for Capital Projects: In the event the reserve exceeds the amount established in II.A above, reserves may be utilized in the funding of capitals projects. These would be one-time expenditures. The ability to pay for the ongoing cost of operation of any facility constructed would also be considered. While such approvals could be authorized by Council during the year, most decisions would be made during the reviews of new

Work Projects in April, with final approval in June each year.

D. Use of Reserves for Operations: In the event the reserve exceeds the amount established in II.A above, reserves may be utilized in the funding of ongoing operations. Reserves should only be used to fund operations during times of poor economic growth. Evaluating constrained revenue growth shall focus on the three major General Fund revenue sources of sales and property taxes and State vehicle subventions. The level of service being funded by reserves should not exceed projections of current year revenues that would be available given the previous five year average growth of the above three revenue sources. In no instance would such calculation project more than a conservative 5% growth. The amount drawn from reserves should also consider the reserve target as established by II.A above, as compared to the current reserve balance.

City of Beverly Hills
Conceptual Financial Policies

General Fund

1. It is a goal of the City to obtain and maintain a general operating reserve of 10% of operating expenditures (excluding debt service, fund transfers and support of tourism and social service agencies) which is separate from the designated reserve known as "BH 100."

2. Interest generated by funds accumulating for "BH 100" should be allocated to and maintained within the "BH 100" designated reserve.

3. The "BH 100" designated reserve should be allowed to grow until it is a significant percentage of the annual General Fund operating budget. However, per Resolution 96-R-9354, the designated reserve known as "BH 100" is always available for emergencies.

4. In the fiscal year 1997-98 and 1998-99, the City should transfer $2.5 million and $3.0 million, respectively, from the General Fund to the Capital Improvement Fund for capital projects. It is a long term goal of the City to allocate a minimum of 3.0% of annual General Fund operating revenues for capital projects.

5. One-time revenue windfalls (i.e., PERS refund) should be designated as a reserve or used for one-time expenditures. The funds should not to be used for on-going operations. To the extent such funds are not required for current expenditures, capital improvements and/or operating reserves, such funds should be transferred to designated reserves ("BH 100").

6. To the extent practicable, the City shall not increase the rate of recurring expenditures until a reasonable expectation of adequacy of revenues is determined.

7. Prior to adding new or expanding service levels, the City shall evaluate the full cost impacts of such changes.

Debt Service Funds

8. Interest generated from debt service reserve monies should be allocated to payment of debt service.

Recreation and Parks Construction Tax Fund

9. The first use of Recreation and Parks Construction Tax Fund monies should be park improvements. The second use should be park operations (maintenance).
10. The "transfer out" of tax revenue from the Recreation and Parks Construction Tax Fund to the General Fund ($1,000,000 in 1996-97) should be reduced to $500,000 in fiscal year 1997-98 and eliminated in 1998-99 and subsequent years.

Capital Improvement Fund

11. Capital projects to be covered by this fund should include acquisition, construction and major replacement for extending the life or use (i.e., painting or replacing a roof) of City facilities, equipment and infrastructure.
12. The Capital Improvement Fund should be the source or funds for projects that do not have another dedicated source of funding.

13. On an annual basis, $50,000 to $100,000 should be allocated to Departmental requests for small ($15,000 to $20,000) building maintenance-related projects that can be accomplished in one year. These projects should compete among themselves each year for the allocation of funds.

Gas Tax Fund

14. The first priority for the use of gas tax-generated revenue should be street improvements.

Proposition A and Proposition C Funds

15. The transit services provided by the City should not exceed the revenue generated by Proposition A and Proposition C for transit programs.

16. The first use of Proposition C funds should be operating the City's transit program. The second use should be capital acquisition and construction of transit corridors.

Enterprise and Internal Service Funds

17. Enterprise finds will be used to finance and account for the acquisition, operation and maintenance of City facilities and services that are entirely, or predominantly, self-supporting from user charges. The operations of an enterprise fund are accounted for in such a manner as to show a profit or loss similar to comparable private enterprise operations. Revenues generated within enterprise funds remain in the fund for future-year projects (generally capital projects).

18. Internal Service Funds are used to account for the financing of services and equipment provided by one department to another department on a cost-reimbursement basis. Internal Service Fund budgets are charged back to other City departments, based on the services provided by staff in the internal service department, operational expenditures, and the cost of

depreciation of equipment.

19. Revenues derived from user charges, or derived as a result thereof, shall be used only for expenses reasonably related to provision of those services.

20. User rates shall be established at a level sufficient to cover current operating requirements, capital maintenance and replacement, debt service requirements, provide rate stability and maintain reasonable reserves.

21. It is recognized that there is an on-going requirement for maintenance of existing capital assets (infrastructure). User rates shall include adequate funds to provide specifically for the purpose of maintaining the existing quality of capital improvements. For the Water Enterprise Fund, this should equal 2% of the present value of the water system. For other funds, capital spending shall be established by agreement of the City Council and Public Works Commission.

22. Sufficient reserves shall be maintained to prevent extended disruption of service in the event of natural disasters or other interruptions of revenue collections. Adequate reserves shall be defined by agreement of the City Council and Public Works Commission.

23. Capital projects (infrastructure) may consist of expensive, but non-recurring, improvements. In such cases, payment in cash may present an inappropriate burden upon current ratepayers. Accordingly, capital financing (long-term debt) shall be used to provide funding for projects with long service lives. The term of debt service shall not exceed the expected useful life of the project.

City of Chula Vista
General Fund Minimum Reserve Level

BACKROUND

In order to prudently protect the fiscal solvency of the City, it is important to maintain some minimum level of reserves. Reserves are important in order to mitigate the negative impact on revenues from economic fluctuations, to fund unforeseen expenditure requirements, to provide a minimum level of cash investment interest revenue, and to avoid the need to borrow for each cash management purpose. Although the City has historically considered the need to maintain minimum reserve levels when arriving at budgetary decisions, it is felt that a written policy establishing a target minimum reserve level would assist both the Council and Management to focus on this important fiscal consideration in order to insure the continued fiscal solvency of the City.

PURPOSE

The purpose of this Policy is to establish a target minimum reserve level for the City’s General Fund.

POLICY

The City will attempt to maintain an undesignated fund balance available for appropriation (Reserves) in the General Fund of at least eight percent of the operating budget.

DISCUSSION

For the purpose of this Policy, Reserves are defined as unrestricted resources available for appropriation or spending. In a technical sense, reserves would be defined as the difference between the City's liquid assets and short-term liabilities, less any assets restricted by either legal requirements or Council action.

City of San Clemente
Fiscal Policy

Reserve Policies

The city will maintain General Fund Contingency Reserves at a level at least equal to 5% of general fund operating expenditures. The primary purpose of this reserve is to protect the City's essential service programs and funding requirements during periods of economic downturn (defined as a recession lasting two or more years), or other unforeseen catastrophic costs not covered by the Contingency Reserve.

A Council Contingency Reserve will be established to provide for non-recurring unanticipated expenditures or to set aside funds to cover known contingencies with unknown costs. The level of the Council Contingency Reserve will be established as needed but will not be less than 1% of General Fund operating expenditures annually.

Council approval is required before expending General Fund or Contingency Reserves.

The City will establish an account to accumulate funds to be used for payment of accrued employee benefits for terminated employees. The level of this reserve will be established based on an annual projection of employee retirements.

Self-insurance reserves will be maintained at a level which, together with purchased insurance policies, adequately protect the City. The City will maintain a reserve of three times its self insurance retention for those claims covered by the insurance pool (of which the City is a member). In addition, the City will perform an annual analysis of past claims not covered by the insurance pool, and reserve an appropriate amount to pay for uncovered claims.

The City's enterprise funds will maintain a minimum reserve level at least equal to 8% of operating expenditures. The primary purpose of this reserve is to set aside funds to provide for unanticipated or emergency expenditures that could not be reasonably foreseen during the preparation of the budget.

City of Monterey Park
Management and Budget Policies

RESERVES

- Unreserved, undesignated General Fund fund balance will be maintained at 10% of the General Fund annual operating budget.

- An economic Uncertainty Reserve Account will be appropriated annually to compensate in the event an economic downturn causes revenues to come in lower than budget. This reserve is established at 2% of the ongoing general fund revenues. The funding of this account will be reviewed each year during the midyear fiscal review.

- A reserve for future Capital Projects account should be established to capture accumulated, nonrecurring or unanticipated revenues or expenditures savings, and will be carried forward from year to year to provide resources for the City Council to fund future infrastructure and other onetime expenditure needs of the City.

- An Equipment Replacement Reserve account will be maintained to fund future equipment replacement. The City Manager will analyze the adequacy of this reserve annually and recommend adjustments as required to the City Council.

- The City will maintain adequate reserve to fund annual paid and committed claims in the General Liability Fund and Workers' Compensation Fund, scheduled vehicle maintenance and replacement in the Auto Shop Fund and accrued leave liability in the Separation Benefit Fund.

City Of West Sacramento
General Operating Reserve

1. To further ensure the long term financial health of the City and prepare for the unexpected contingencies, it is the intent of the City:

   A. That the General Reserve for emergencies will be no more than fifteen percent and no less than ten percent of total General Fund reoccurring operating costs. Excess funds shall be transferred to the General Equipment Fund.

   B. That the General Long-Term Debt Fund be used to fully fund liabilities for such programs as paid employee leave, Unemployment Insurance and Health Insurance for retired employees. It is intended that interest earnings on the reserve be used to fund these programs and that any excess earnings shall be transferred to the General Equipment Fund.

City of Manhattan Beach
Reserve Policies

The City utilizes a variety of accounting funds for recording revenues and expenditures of the City. At each fiscal tear-end, budgeted/appropriated expenditure authority lapses with very few exceptions, such as capital project spending and operating expenses that have been incurred but not paid (encumbered). The remaining dollars left in each fund that are undesignated and unencumbered constitute available reserves of the City. It is appropriate that reserve policies for the City be established for each of the various funds, that the purpose of these reserves be designated, and that dollars available in excess of the reserve amounts be appropriately and effectively utilized.

GENERAL FUND

The General Fund reserve will be maintained in an amount at least equal to 20% of the annual General Fund budget. This Reserve will only be used in the case of significant financial or other emergency. Reserves in excess of the 20% will be available for spending on capital equipment or other one-time General Fund expenditures. Additional reserves in excess of the 20% may be transferred to the City's Capital Improvement Fund.

GENERAL FUND CONTINGENCY ACCOUNT

A contingency account equal to ½ of 1% of the City's General Fund budget will be maintained annually in the City Council's budget. This account will be available for unanticipated, unbudgeted expenditures and will require City Council approval to spend. The purpose of this account is to provide some flexibility for unforeseen events without the necessity to spend from the

City's reserves.

ENTERPRISE FUNDS

The City's Enterprise Funds will maintain reserves equal to four months of operating expenses and one year of estimated capital spending.

FLEET MANAGEMENT FUND

Through the use of the Fleet Management Fund, The City will annually budget sufficient funds to provide for the orderly maintenance, repair and replacement of the City's vehicles. This fund is supported by charges to user departments which are adjusted annually based on the department's proportionate share of estimated fleet management expenses. Sufficient reserves will be maintained in the fund to provide for the scheduled replacement of fleet vehicles at the end of their useful lives.

RISK MANAGEMENT FUND

The City maintains a self-insurance fund for the purpose of property, liability, and workers' compensation expenses. This fund pays insurance premiums, benefit and settlement payments, and administrative and operating expenses. The Risk Management Fund is supported by charges to other City funds for the services it provides. These annual charges for service shall reflect historical experience and shall be established to approximately equal the annual expenses of the fund. A separate fund balance shall be maintained for liability and workers' compensation reserves at a level which will adequately fund the City's potential loss exposure in each area as determined by historical loss data.

City of Santa Rosa
Contingency Reserve of the General Fund

I. BACKROUND

The City of Santa Rosa maintains contingency reserves for all major operating funds. The general practice among cities is to maintain a reserve for the General Fund which is sufficient to meet three months of operating needs or more.

II. PURPOSE

To establish a policy which will provide an adequate contingency reserve for the City's General Fund.

III. POLICY

A. A contingency reserve for the General Fund shall be maintained at a level of between 20 and 25 percent of the General Fund revenues.

B. By January 15 of each year and following publication of the audited financial statements, the City Manager shall report to the City Council the General Fund contingency reserve level as a percentage of actual revenues in the General Fund.

C. If the City Manager's report indicates that the General Fund contingency reserve level is below 20 percent, the report shall contain a plan to increase the General Fund contingency reserve to greater than 20 percent.

D. If the City Managers report indicates that the General Fund contingency reserve level is in excess of 25 percent, the report shall propose the appropriation of General Fund contingency reserve funds in excess of 25 percent to projects within the Capital Improvement Program.

City of Half Moon Bay
General Fund Reserve Amount Policy

Policy Objective:

- To improve financial performance
- Assist the Council in exercising fiduciary responsibilities
- Maintain financial solvency
- Provide for sufficient cash flow
- Protect against economic uncertainty
- Provide a reserve for emergency

Policy:

- The City shall maintain an unencumbered General Fund reserve equal to a minimum of twenty percent (20%) of annual operational expenditures. The General Fund balance shall be exclusive of all reserves not anticipated to be readily available for use in emergencies and contingencies.

- Should the fund balance fall below the target, the Manager shall prepare a plan for consideration by the City Council to implement actions within a twelve-month period to rebuild the fund balance.

- General Fund balance above the target goal may be used to fund one-time capital expenditures or programs that achieve one of the following: does not increase ongoing costs; results in a cost savings over the life of the purchase or program; and/or produces an increase in revenue in excess of the expenditure.

City of Indio
Reserve Policies

- The City/Agency/Other Entities will establish, dedicate and maintain reserves annually to meet known and estimated future obligations

- The City/Agency/Other Entities will establish Specific Reserve Accounts which include but are not limited to designated reserves for the following:

  - Reserve funds for economic Uncertainties established during "Budget Sessions" to meet General Fund Reserve Goal. Using FY 2000 as a base line the fund balance was 4% of general fund expenses.
  - Totally funded workers compensation
  - Liability insurance
  - Estimated cost of retirees medical payments
  - Depreciation and replacement of vehicles and major equipment
  - Major maintenance and renovation of buildings, parks, and landscape maintenance

- The City / Agency / Other Entities will establish reserves for replacement of facilities and infrastructure.

- The City / Agency / Other Entities will establish reserves for cash flow purposes.

City of King City
Fiscal Policies

<u>RESERVE POLICIES</u>

A. Adequate reserves shall be maintained for all known liabilities, including payable employee leave balances, workers' compensation, and self-insured retention limits.

B. Adequate reserves shall be maintained for all lease purchases. For each lease purchase, the City will make a down payment equal to one annual payment from current revenues. The balance of the lease purchase obligation shall be fully reserved.

C. The City will endeavor to maintain an operating reserve equal to 25 percent of the General Fund Operating Budget to cover economic uncertainties and to allow the City time to react so as not to make rash reactionary decisions in case of budget shortfalls.

D. The City will endeavor to maintain a reserve equal to 25 percent of the future City finances Capital Projects scheduled in the four out-years of the Six-year Capital Improvement Program to cover variances in project revenues and expenditures.

E. The City will endeavor to maintain reserves in the Enterprise Funds equal to 25 percent of operating budgets.

F. Annual General Fund Year-end operating surpluses shall be allocated in the following priority order until all desirable reserve levels are achieved.

1. Liability reserves.
2. Operating Budget reserve.
3. Capital Improvement Program reserve.

H. Reserve requirements will be reviewed annually and may be increased or decreased, or adjusted by an amount necessary to meet future identified, one-time, and specific expenditures requiring the accumulation of funds over a given period.

City Council
of the City of Atwater

Resolution No.1450-98

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF ATWATER FORMALIZZING CITY GOAL FOR CREATING AND MAINTAINING AN UNDESIGNATED DEDICATED GENERAL FUND RESERVE SET ASIDE, APPROVING A FORMULA FOR CALCULATING THE AMOUNT OF UNDESIGNATED DEDICATED RESERVE SET ASIDE AND ESTABLISHING FORMAL CRITERIA FOR THE EXPENDITURE OF SUCH FUNDS

WHEREAS, The City of Atwater is dedicated to prudent management of public finances; and,

WHEREAS, The City of Atwater is dedicated to ensure fiscal responsibility and accountability in the expenditure of City funds; and,

WHEREAS, The City of Atwater previously establish goals for accumulating and maintaining an undesignated General Fund reserve set aside; and

WHEREAS, The City Audit and Finance Committee reviewed and made recommendations regarding an undesignated dedicated General Fund reserve set aside for the City of Atwater as set forth in this resolution.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Atwater does hereby reaffirm its goal for establishing, accumulating and maintaining an undesignated dedicated General Fund reserve set aside;

BE IT FUTHER RESOLVED that the City Council of the City of Atwater does hereby determine and establish the following criteria regarding the undesignated dedicated General Fund reserve set aside:

1. Utilizing the 1998-99 fiscal year as the base year, establishes a goal for accumulating and maintaining a "target" threshold for an undesignated dedicated General Fund reserve set aside of twenty percent (20%) of the 1998-99 total General Fund expenditures ($6,153,464) which equates to $1.2 million and maximum threshold of twenty-five percent (25%) of the 1998-99 total annual General Fund expenditures ($6,153,464) which equates to $1.5 million;

2. Utilizing the 1998-99 fiscal year as a base year; establishes the goal that the undesignated dedicated General Fund reserve set aside shall not fall below ten percent (10%) of the 1998-99 total General Fund expenditures (6,153,464) which equates to $600,000;

3. Directs that a minimum of $200,000 be set aside each year during the annual budget process in the undesignated dedicated General Fund reserve set aside until the "target" threshold has been met;

4. That a four fifths (4/5) vote of the whole City Council be required for any appropriation and expenditure of funds from the undesignated dedicated General Fund reserve set aside;
5. That funds contained in the undesignated dedicated General Fund reserve set aside not be appropriated for expenditures related to employee pay and benefit considerations or to make up for short-term/incremental revenue shortfalls to balance the budget. Rather, to the extent possible, such shortfalls shall be addressed through expenditure cuts and revenue enhancements; and,

6. That, in addition to funds reserved in the undesignated dedicated General Fund reserve set aside, that an undedicated General Fund balance of no less than $500.000 designated as "working capital" shall also be maintained.

BE IT FUTHER RESOLVED that the City Council of the City of Atwater does hereby determine that appropriate reservations shall be established in all other City funds.

The foregoing resolution is hereby adopted this 26th day of October 1998.

City of Arcadia
Financial Policies

General Fund

The General fund is used to account for all general revenues of the City not specifically levied or collection for other City funds, and for the expenditures related to the rendering of general services by the City. It shall be a City goal that in any fiscal year, for this fund, current year revenues shall equal or exceed current year expenditures. This "pay as you go" approach strives to match any increase in expenditures with a corresponding increase in revenues and/or decrease in revenues is matched with a decrease in expenditures. [Revenue enhancements could be in the form of increases fees or assessments]. Any cost cutting measure could be a reduction of capital purchases, a reduction in the work force (personnel reductions) either through attrition, hiring freezes or actual lay-offs. Any year end operating surpluses will revert to unappropriated fund balance.

In an effort to ensure sound financial management and to assure that the City Council has some discretion in their financial decision making options, it will be a City goal to maintain an undesignated fund balance in the General Fund equivalent to 20% of the General Fund annual appropriations. This reserve may be reduced with a majority City Council vote to fund certain unforeseeable financial conditions such as one time expenditure or as transition funding in a recessionary economy, or other budget shortfall stop gap measure of a temporary nature.

The 20% reserve is established as a goal specifically because we believe that this is a minimal level necessary to provide a measure of financial protection in the event the General Fund experiences a loss of revenue or an unexpected major increase in expenditures. Such reserves would be available only as a temporary resource available and to be used while an ordinary financial plan to address any long term condition is developed.

Special Revenue Funds

Special Revenue Funds are used to account for revenue derived from specific taxes or other earmarked revenue sources (other than for major project) that are restricted by law or administrative action to expenditures for specified purposes, Balances in these funds shall be established at specified amounts and committed for approved projects in accordance with legal and/or contractual requirements.

Capital Improvements Project Funds

Capital Improvement Project Funds are established to account for resources used for the acquisition and for construction of capital facilities by the City except for those financed by proprietary funds. All fund balances shall be designated for existing or proposed infrastructure needs of the City.

Debt Service Funds

The Debt Service Funds are used to account for the payment of interest and principal on general debt of the City and related entities. All resources are legally designated for and shall be restricted to payment of long-term debt.

All proprietary funds (i.e., water, transit, etc.) shall be operated in a manner similar to private enterprise. As such, all costs (including direct and indirect personnel costs and depreciation) of providing services shall be finance or

recovered through user charges.

Enterprise Funds

The Enterprise Funds, Water and Transportation are used to account for City operations that are financed and operated in a manner similar to private business enterprises. These activities will be supported by their own rates and/or grants and shall not be subsidized by the General Fund. Charges will be assessed against these funds at a reasonable rate for services provided to these activities by General Government.

Internal Service Funds

Internal Service Funds are used to account for the financing of goods or services provided by one Department/Division to other Department/Divisions of the governmental unit on a cost reimbursement basis.

The City shall maintain an appropriate reserve in the Liability/Workers' Compensation Insurance Fund, Employees Health Insurance Fund and the Employees Self-funded Life Insurance Fund to reflect projected needs.

In the Insurance Funds, i.e., Liability/Workers' Compensation Fund, Employee Health Insurance Fund and the Employees Self-funded Life Insurance Fund, the City shall maintain a minimum reserve to assure sufficient resources to cover any unforeseen expected claims.
Reserves in these funds shall be established at levels equal to or exceeding the projected claims expenses for a 3 to 4 month period.

City of Camarillo
Reserve Levels

PURPOSE

The City shall maintain unappropriated fund or working capital balances in the General Fund, Water Fund, Sanitary Fund, certain Special Revenue, Debt Service and Internal Service Funds, and the Capital Improvement Fund. This policy is developed to consider the minimum level necessary to maintain the City's credit worthiness and to adequately provide for:

- Economic uncertainties and other financial hardships or downturns in the local or national economy.
- Local disasters or catastrophic events.
- Future debt or capital obligations.
- Cash flow requirements.
- Legal requirements.

POLICY

General (001), Water (990) and Sanitary District Funds (871): The City will maintain a minimum reserve level of 50% of the operating budget for the following funds. For the purpose of this policy statement, the budget shall include appropriations for operating expenditures plus transfers to other funds for operations, excluding transfers for capital projects.

Fund Name and Number:	
General Fund	001
Water Utility Fund	990
Camarillo Sanitary District	871

Special Revenue Funds: For all Maintenance District Funds, except those that operate on a citywide basis, the City shall target a reserve level of 50% of the operating budgets for cash flow purposes. For the purpose of this policy statement, the budgets shall include appropriations for operating expenditures.

Fund Name and Number:	
Spanish Hills	234
Mission Oaks MD-1A	235
Wittenberg	236
Presley	237
Sares/Regis	239
Vista Las Posas	240
Adolfo Glen	246
Armitos Storm Basins	247
Mission Oaks Industrial	248
Adolfo Glen III	249

Debt Service Funds: Reserve levels for Debt Service Funds shall be established as prescribed by the bond covenants adopted at the time of the issuance of debt.

Internal Service Funds:

Risk Management Fund (501): A Risk Management Reserve shall be established and maintained equal to the sum of the following elements:

- three times the self-insured retention for liability claims, plus
- 100% of the greatest deductible for any single property damage coverage, plus
- 25% of the annual appropriation for workers' compensation.

Information Services Fund (503): A Computer Replacement Reserve shall be established and maintained to ensure the timely replacement of computer equipment and software. The reserve level shall be the greater of 100% of the accumulated depreciation or a schedule defined by the City Council adopted Information Systems Master or Strategic Plan.

Vehicle & Equipment Fund (504): A Vehicle & Equipment Replacement Reserve shall be established and maintained equal to 130% of the accumulated depreciation.

Human Resources Fund (507): A Reserve level of 25% of the operating budget, excluding depreciation, for cash flow purposes shall be established and maintained in the Human Resources Fund.

City Hall (508), Corporation Yard (509) and Police Facility (510) Funds: A Rehabilitation/ Replacement Reserve will be established and maintained, at a rate of 40% of accumulated depreciation, to fund cash flow and the rehabilitation or replacement costs of existing City buildings and facilities.

Capital Improvement Fund (411): The City shall establish and maintain a designated fund balance in the Capital Improvement Fund equal to the discretionary contribution for the future capital improvements outlined in the Five-Year Capital Improvement Plan based on the following schedule:

For projects whose anticipated

expenditure date from discretionary sources is:	Balance shall be:
In year one of the plan	100%
In year two of the plan	80%
In year three of the plan	60%
In year four of the plan	40%
In year five of the plan	20%

PROCEDURE

The Finance Department shall perform a reserve analysis to be submitted to the City Council upon the occurrence of the following events:

- City Council deliberation of the annual budget,
- presentation of the annual financial report,
- midyear budget review, and
- when a major change in conditions threatens the reserve levels established within this policy.

If the analysis indicates projected or actual reserve levels that fall either 10% below or 10% above the levels outlined in this policy, at least one of the following actions shall be included with the analysis:

- an explanation of why the reserve levels are not at the targeted level, or
- an identified course of action to bring reserve levels to the minimum prescribed.

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