

# Fund Balance / Reserve Policy

## **Purpose**

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The City desires to maintain a prudent level of financial resources to guard its stakeholders against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenditures. In addition, this policy is intended to document the appropriate Reserve level to protect the City's credit worthiness and provide adequate cash flow based upon the traditional operating cycle. Reserves are accumulated and maintained to provide stability and flexibility to respond to unexpected adversity and/or opportunities and to minimize the costs associated with short-term cash borrowing. Moody's analysis recommends the establishment of a formal reserve policy because they "minimize political considerations of adequate reserve levels and keep the municipalities more focused on providing structural balance in their operations."

## **Authority**

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The Andrews City Council is responsible for the approval of financial policies which establish and direct the operations of the City of Andrews. The City Manager is responsible for carrying out the policy directives of the City Council and managing the day-to-day operations of the executive departments, including the Department of Finance. This policy shall be administered on behalf of the City Manager by the Chief Financial Officer/Director of Finance.

## **Monitoring Performance**

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The City will measure its compliance with this policy on an annual basis during the City's budgeting process. During the course of the fiscal year the Department of Finance shall closely monitor the City's revenues and expenditures to ensure Reserves are not used beyond any planned usage. If the target level of Reserves is not met at fiscal year-end or is not likely to be met at any point within a ten-year time horizon, then during the annual budget process a plan to replenish the Reserve levels will be developed by collaboration among affected departments and the Department of Finance based on the requirements outlined in this policy.

Periodic Review of the Targets – At a minimum, during the annual financial planning/budget process staff shall review the current and ten-year projected Reserves to ensure that they are appropriate given the economic and financial risk factors the City is subject to.

## **Funding the Reserves**

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Funding of Reserve targets will generally come from excess revenues over expenditures or one-time revenues.

## **Excess of Reserves**

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In the event Reserves exceed the minimum balance requirements, at the end of each fiscal year, any excess Reserves may be used in the following ways:

1. Fund accrued liabilities, including but not limited to debt service, pension, and other post-employment benefits as directed and approved within the long-term financial plan and the annual budget ordinance. Priority will be given to those items that relieve budget or financial operating pressure in future periods;
2. Appropriated to lower the amount of bonds;
3. Increase the pay-as-you-go contributions needed to fund capital projects in the City's Capital Improvement Plan;

4. One-time expenditures that do not increase recurring operating costs that cannot be funded through current revenues. Emphasis will be placed on one-time uses that reduce future operating costs; or
5. Start-up expenditures for new programs, provided that such action is approved by the City Council and is considered in the context of multi-year projections of revenue and expenditures as prepared by the Department of Finance.

### **Designated Reserves**

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The following fund reserves are utilized by the City of Andrews:

- General Fund Reserve
- General Fund Capital and General Fund Trust Reserve
- Utility Fund Reserve
- Sanitation Fund Reserve

### General Fund Reserve

(excludes General Fund Trust)

Components of the Reserve:

- Operating Expenses – The City will maintain a Fund Balance in the General Fund equivalent to, at a minimum, fifty percent (50%) of regular ongoing operating expenditures and, at a maximum, twelve months (100%) of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year's actual expenditures will exclude significant non-recurring items. <sup>1</sup>
- Debt Service – In addition to the aforementioned reserve for operating expenses, the City will maintain a minimum level of Fund Balance in the General Fund equal to debt service payments due within the next 12 months. <sup>2</sup>

### General Fund Capital and General Fund Trust Reserve

Components of the Reserve:

- Capital Funding – The City will maintain a combined Fund Balance in the General Capital Improvement Fund and the General Fund Trust to, at a minimum, fully fund the General Fund projects identified in the first five years of the City's Ten-Year Capital Improvement Plan and, at a maximum, to fund all General Fund projects identified in the plan. For the purposes of this policy, any projects to be financed by new debt will be excluded from this calculation. <sup>3</sup>
- One-Time Emergencies – The City will also maintain a balance of \$1 million in the General Trust Fund to address one-time emergencies and unanticipated expenditure requirements. The Council may withdraw funds from the emergency reserve when the Council has declared an emergency by ordinance and after the General Fund's budgeted contingency is exhausted. The emergency reserve will be accessed only when emergency expenditures would result in a negative General Fund ending fund balance. The Council will begin to restore emergency reserves used under this policy within 24 months after their first use. <sup>4</sup>

## Utility Fund Reserve

Components of the Reserve:

- Operating Expenses – The City will maintain a Fund Balance in the Utility Fund equivalent to, at a minimum, fifty percent (50%) of regular ongoing operating expenditures and, at a maximum, twelve months (100%) of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year's actual expenditures will exclude significant non-recurring items and depreciation expense.<sup>5</sup>
- Capital Funding – In addition to the aforementioned reserve for operating expenses, the City will maintain a Fund Balance in the Utility Capital Improvement Fund to, at a minimum, fully fund the Utility Fund projects identified in the first year of the City's Ten-Year Capital Improvement Plan and, at a maximum, to fund the first two years identified in the plan. For the purposes of this calculation, any projects to be financed by new debt will be excluded.<sup>6</sup>
- Debt Service – The City will maintain a minimum level of Fund Balance in the Utility Fund equal to debt service payments due within the next 12 months.<sup>2</sup>

## Sanitation Fund Reserve

Components of the Reserve:

- Operating Expenses – The City will maintain a Fund Balance in the Sanitation Fund equivalent to, at a minimum, fifty percent (50%) of regular ongoing operating expenditures and, at a maximum, twelve months (100%) of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year's actual expenditures will exclude significant non-recurring items and depreciation expense.<sup>5</sup>
- Capital Funding – In addition to the aforementioned reserve for operating expenses, the City will maintain a Fund Balance in the Sanitation Capital Improvement Fund to, at a minimum, fully fund the Sanitation Fund projects identified in the first year of the City's Ten-Year Capital Improvement Plan and, at a maximum, to fund the first two years identified in the plan. For the purposes of this calculation, any projects to be financed by new debt will be excluded.<sup>6</sup>
- Landfill Closure – The City must maintain a reserve equal to anticipated landfill closure and post-closure expenses. This reserve is based upon engineering studies and is reported to the State of Texas annually.<sup>7</sup>
- Debt Service Fund – In addition to the above, the City will maintain a Fund Balance in the Sanitation Fund equal to debt service payments due within the next 12 months.<sup>2</sup>

## References / Sources / Justification

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- <sup>1</sup> The Government Finance Officers Association (GFOA) recommends, at a minimum, that general purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. GFOA acknowledges that a government's particular situation may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. The City of Andrews utilizes expenditures as a basis for its minimum calculation because it is more predictable than revenues. The City has established a higher six month minimum balance based upon (1) the unpredictability of its revenues, sales tax revenue in particular, (2) the perceived exposure to significant one-time outlays, such as natural disasters, (3) the potential drain upon general fund resources from other funds, (4) the potential impact on the City's bond ratings, and (5) existing commitments and assignments for pension fund liability, reliever route maintenance, etc.
- <sup>2</sup> The Municipal Securities Rulemaking Board (MSRB) states that a typical debt service reserve fund requirement might be a fixed percent of the outstanding par value or the maximum annual debt service of the issue(s). The City of Andrews has chosen to go with the latter.
- <sup>3</sup> Best practice established by the City of Fort Worth, Texas in their 2014-15 Financial Management Policy Statements.
- <sup>4</sup> GFOA's A Risk-Based Analysis of General Fund Reserve Requirements, May 2013. This factor concerns the extreme events (e.g., natural disasters) the City is vulnerable to, the public safety programs that must be funded during the occurrence of an extreme event, and the federal or state programs that would help and how long it would take to get assistance. For example, reimbursement from the Federal Emergency Management Agency (FEMA) does not always occur right away, so it is important to have reserves to absorb the cost in the meantime, and FEMA does not necessarily reimburse 100 percent of the cost of responding to an event.
- <sup>5</sup> GFOA's Determining the Appropriate Levels of Working Capital in Enterprise Funds (Best Practice) recommends that governments develop a target amount of working capital that best fits local conditions for each fund, starting with a baseline of ninety (90) days of working capital and then adjusting the target based on the particular characteristics of the enterprise fund in question. The City of Andrews has set a higher minimum based upon the following considerations: (1) large peaks and valleys in cash position during the year, (2) volatility in demand for services, and (3) difficulty in raising rates and revenues.
- <sup>6</sup> The City of Andrews Fiscal Principles & Policies states "The City maintains a pay-as-you-go philosophy regarding capital expenditures."
- <sup>7</sup> Texas Commission on Environmental Quality, Chapter 330 – Municipal Solid Waste, Subchapter K: Closure and Post-Closure.

### A Snapshot of Targeted Reserves vs Actual

<b>Reserve</b>	<b>Minimum 2016 Target</b>	<b>Maximum 2016 Target</b>	<b>Actual 6/30/16</b>
General Fund	\$ 4,100,021	\$ 7,348,579	5,773,381
General Capital & Trust	6,228,870	9,067,970	6,434,011
Utility Fund	2,753,477	7,322,155	2,887,218
Sanitation Fund	1,683,201	3,016,896	2,552,040
Total Funds Balance	\$ 14,765,569	\$26,755,600	\$17,646,650