



To: Honorable City Council
From: John Moreno, City Manager
By: Kim Sao, Finance Director
Date: July 9, 2024

SUBJECT: ADOPTING THE FUND BALANCE POLICY

BACKGROUND

On May 9, 2023, the City Council adopted Resolution 23:017, establishing the City's Fund Balance Policy ("Policy"). The Policy was established to improve the City's financial health and management of its funds. The Policy had the following General Fund reserve levels, Committed by the City Council.

Reserves Committed by City Council Authority

Operating Reserve

- Purpose: While other resources are set aside to mitigate revenue shortfalls for various emergencies and unforeseen circumstances, this Operating Reserve is established as a last resort contingency. To emphasize, the Operating Reserve is the base budget to be used as a final course of action, when all else fails.
- Target Level: The General Fund shall maintain a base (minimum) operating fund reserve for an effective and non-disruptive operation of city services. The City will set aside 50% of the annual General Fund Adopted Operating Expenditure Budget. If the Operating Reserve is anticipated to be less than this policy, then it shall be noted in the City's Budget document and a plan will be developed by Finance staff to address the target level.
- Events or Conditions Prompting Its Use: This reserve shall be used when all other reserves in the committed, assigned, and/or unassigned categories are insufficient to balance the annual operating budget to meet core services.

Economic Uncertainty Reserve

- Purpose: This committed reserve is held to mitigate annual revenue shortfalls due to a fluctuating economy, unforeseen natural disaster, or actions by the state/federal government. This reserve shall be used to support core city services.

- Target Level: 10% of the General Fund Adopted Operating Expenditure Budget
- Events or Conditions Prompting Its Use: Access to this reserve shall be triggered by a resolution declaring a state of emergency for the City or when there is a significant decrease of more than 10% in the General Fund revenues.

Infrastructure and Facility Emergencies

- Purpose: This committed reserve is set aside for a catastrophic emergency that requires the repair or rebuilding of the City’s streets, hard-scape, facilities, communication and technology systems, or other City-owned properties.
- Target Level: 10% of the General Fund Adopted Operating Expenditure Budget
- Events or Conditions Prompting Its Use: This reserve may be utilized to provide resources to meet emergency expenditures in the case of flood, fire, earthquake, or other disasters.

DISCUSSION

The General Fund operating budget has increased significantly in FY 2023-24 and FY 2024-25, and maintaining the 70% reserve level with the larger operating budget is preventing the use of funds on desired operating programs and significant capital improvement projects. Staff recommends combining the 10% Infrastructure and Facilities Emergencies and the 10% Economic Uncertainty into one reserve category called the Emergency and Economic Uncertainty Reserve and strive to maintain a 10% reserve level.

The table below reflects the change from the current reserve target to the proposed reserve target.

| GENERAL FUND | Current Target | Proposed Target |
|--|--------------------------------|--|
| Committed (By City Council) | | |
| Operating Reserve | 50% of Operating Budget | 50% of Audited Operating Expenditures |
| Infrastructure and Facility Emergencies | 10% of Operating Budget | - |
| Economic Uncertainty | 10% of Operating Budget | - |
| Emergency and Economic Uncertainty Reserve | | 10% of Audited Operating Expenditures |
| Total Committed | 70% of Operating Budget | 60% of Audited Operating Expenditures |

Staff also recommends calculating the reserve level based on the most recent audited operating expenditures, rather than the current or proposed operating budget, and excluding significant one-time costs from the calculation for the following reasons:

First, budgeted expenditures are typically greater than actual expenditures. While a reserve based on the budgeted operating expenditures cannot reflect the true operating

costs, a reserve level based on audited operating expenditures is a more accurate representation of actual operating needs. Calculation of the committed balance will be done as part of the fiscal year closing and calculated based on the actual expenditures of the year being audited.

Secondly, calculation of the committed reserve should be based on operating expenditures that exclude significant one-time cost of programs or services that do not reflect the ongoing and normal operation of the City.

SUMMARY

The Fund Balance Policy establishes fund balance classifications that create a hierarchy based on the City's spending constraint. We believe that the updated Policy will continue to reduce financial risk and improve financial reporting, while providing flexibility for spending needs and management of the reserves to mitigate future uncertainties. The City's Fund Balance Policy establishes the amount the City will strive to maintain in its fund reserve, the conditions under which the reserve may be spent, and directions to replenish reserves once used. Due to past experiences in recovering from extreme events such as the recession of 2008 and the COVID-19 pandemic, the City finds it prudent to maintain a higher reserve of up to 60% of its General Fund operating expenditures than the Government Finance Officers Association (GFOA)'s recommended minimum of 17% (two-months) reserve.

FISCAL IMPACT

None.

VISION, MISSION, VALUES, AND STRATEGIC OUTCOMES

The City's Vision, Mission, and Values set the standard for the organization, establish priorities, uniformity and guidelines; and provide the framework for policy decision making. The Strategic Outcomes were implemented to provide a pathway to achieving the City's Vision. This item aligns with Strategic Outcome No 6: Efficient, Effective, and Fiscally Responsible - Deliver an efficient and effective City government in a fiscally responsible, transparent and collaborative manner.

RECOMMENDED ACTION

Read by title only and adopt Resolution No. 24:027.