

Committee Substitute for Ordinance No. 230157

Fund Balance and Reserve Policy
Updated GFOA Guidance

June 21, 2023

Finance, Governance and Public Safety Committee



Fund Balance and Reserve Policy

- Codified in Section 2-1954 of Code of Ordinances
 - Establishes reserve levels for the General Fund and other funds
 - Sets out replenishment procedures if fund balance falls below required levels
- Best practice for governments – GFOA
 - Recently updated guidance

GFOA Guidance

- Shift from fund balance as a savings account or rainy day fund to a risk-based approach
 - Designed to reduce volatility and uncertainty in public finances
 - Revenue instability
 - Tax stabilization
 - Loss of a major source of revenue (i.e., earnings tax)
 - Reliance on industries or employers
 - Recession

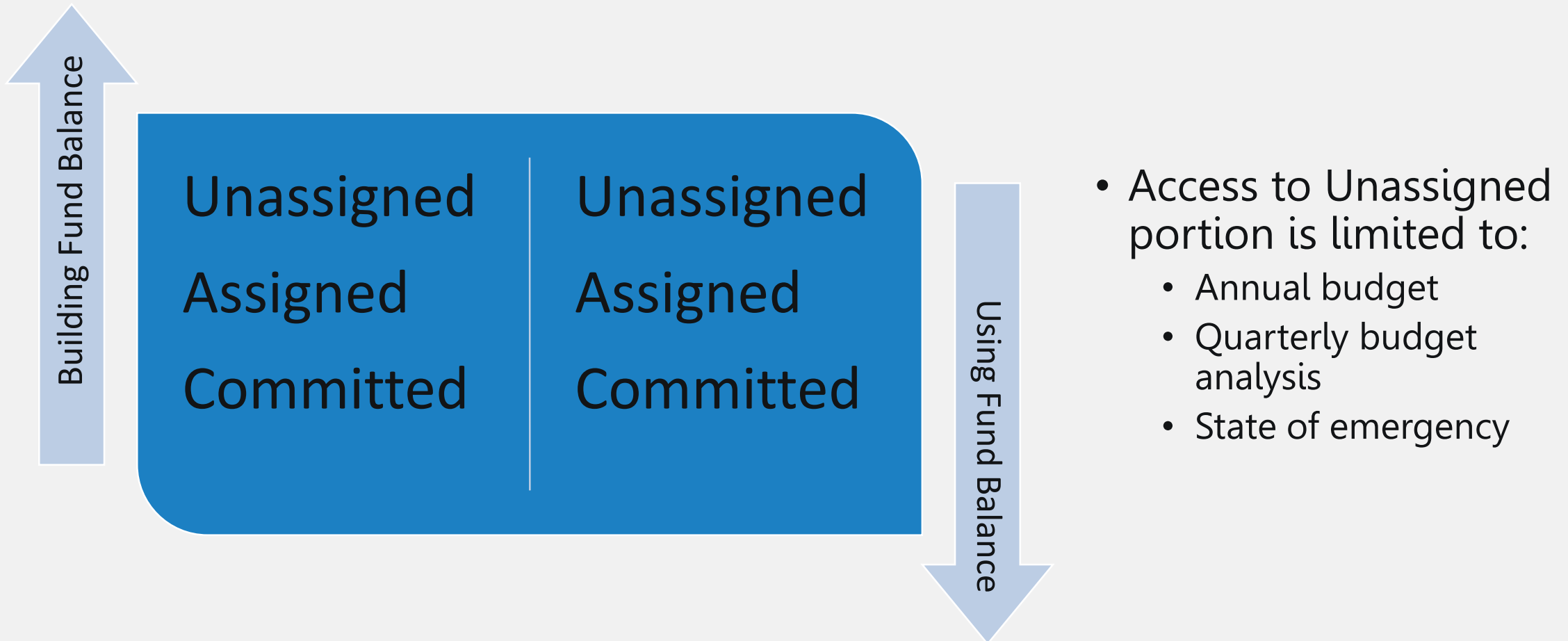
GFOA Guidance

- Other risks to public finances
 - Natural disaster (property/tax loss)
 - Cyber attack
 - Terrorism/civil disorder
 - Capital maintenance
 - Increasing costs for pension, healthcare, and legal claims
- City needs to examine each of these potential risks and determine how to mitigate/reduce
 - Commercial insurance
 - Reserve levels

Moody's Evaluation Approach

- "Aaa" rating is associated with fund balances in excess of 35% of revenues. The "Aa" rating is associated with fund balances between 35% and 25%, and the "A" rating with 25% to 15%.
- Reserve levels as a percentage of general fund operating expenditures
 - Three months of operating expenditures → 25% of general fund operating expenditures

Components of General Fund Balance



Fund Balance Policy Revisions

Current

Committed

- Emergency Reserve
- One month of operating expenditures or **8.33%**

Assigned

- Countercyclical Reserve
- One month of operating expenditures or **8.33%**

Unassigned

- Any amount over **16.67%** of operating expenditures (2 months)

Proposed (Committee Sub)

Committed

- Emergency Reserve
- **17% (about two months)**

Assigned

- Countercyclical Reserve
- **An additional 8% of operating expenditures**

Unassigned

- Any amount over **25%** of operating expenditures

Uses of Countercyclical Reserve

- Limited to:
 - reserves for tax increment financing
 - debt service stabilization
 - interest rate risk
 - capital maintenance
 - swap termination payments
 - legal claims
 - disaster recovery

Uses of Unassigned Fund Balance – Proposed

- Limited to:
 - Prepayment of debt or contributions to reduce long-term liabilities (e.g. pension)
 - Offsets to temporary revenue reductions from local, state, and federal authorities
 - One-time expenditures that do not increase recurring operating costs
 - Additional assigned reserves
 - Start-up expenditures for new programs (must have identified source of funding for ongoing costs)

Potential Credit Impact

- Financial performance makes up 30% of the overall scoring for Moody's and S&P
- Additional reserve requirement contemplated here is a credit positive so long as the amount is maintained
 - Need to monitor Five Year Financial Plan
 - Look to Priority-Based Budgeting to address structural imbalance

Ongoing Review

Based on the latest GFOA guidance, Finance will continue to review and evaluate opportunities to strengthen financial policies in the coming months. This may include:

- Reserve policy for other funds/fund types to reduce future General Fund support requirements
- Focus on budgetary reserves vs. accounting terms
- New considerations in the context of priority-based budgeting