

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item: Proposed Reserve Policy

OVERVIEW

On July 11, 2007, the Chief Financial Officer presented the proposed City Reserve Policy to the Budget and Finance Committee. At that time, the Committee requested that the IBA review the proposed policy and provide recommendations, if any, at the next meeting of the committee.

As noted in previous reports and in the proposed reserve policy, the Government Finance Officers Association (GFOA) recommends general fund reserves of no less than five to 15% of regular general fund operating revenues.

In general, the proposed reserve policy reiterates previous plans to create an increasing General Fund Reserve, targeted to reach 8% of the total General Fund by Fiscal Year 2012, and identifies several reserve requirements for other City funds, including Water and Wastewater Enterprise Funds, among others.

FISCAL/POLICY DISCUSSION

The IBA offered preliminary comments on the proposed reserve policy at the July 11, 2007 Budget and Finance Committee meeting, focusing primarily on those areas impacting the City's General Fund. These areas included the need to further review Charter Section 91 in relation to the policy, as well as the need to expand the permitted uses of the Appropriated Reserve, and to allow for the City Council to also recommend possible changes to the policy, in addition to the Mayor. The IBA and CFO have discussed the proposed reserve policy, and some particular items have been incorporated

in the revised version now being presented. The following areas remain outstanding, and recommendations are offered for consideration.

Charter Section 91

Charter Section 91, entitled “General Reserve Fund”, states the following:

The Council shall create and maintain a permanent revolving fund, to be known as the General Reserve Fund, for the purpose of keeping the payment of the running expenses of the City on a cash basis. Said fund shall be maintained in an amount sufficient to meet all legal demands against the treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes. This fund may be expended only in the event of a public emergency when it shall be determined by the affirmative vote of at least two-thirds of the members elected to the Council that such expenditures are necessary in order to insure the safety and lives and property of the City or its inhabitants.

The IBA recommends that the proposed reserve policy include language referencing Charter Section 91 and the intent that the policy is meant to comply with this section. In doing so, the IBA recommends that approvals related to the expenditure of funds for emergency purposes require at least two-thirds of the Council members, not just a majority, as the proposed policy currently states.

Additionally, further financial and legal analysis may be necessary to best determine if and how the City should comply with the language that states that sufficient funds are needed in an amount required to meet the legal demands of the Treasury for the first four months of the fiscal year. At present, the proposed policy does not address this.

Target Level for Appropriated Reserve

The proposed reserve policy does not include a target level of funding for the Appropriated Reserve for the General Fund on an annual basis. Because it is likely that unanticipated expenditures will arise during each fiscal year, and most will not be of an emergency nature, it is imperative that adequate funding be identified for this purpose. The IBA recommends that 0.5% of the total General Fund be allocated through the annual budget process, until the 8.0% target level for the Emergency Reserve is achieved in Fiscal Year 2012. For Fiscal Year 2008, 0.5% of the total General Fund budget would be approximately \$5.53 million. In following years, the Appropriated Reserve should be increased to a minimum of 1.0% of the General Fund. It should be noted that amounts for a General Fund Appropriated Reserve were not included in the Five-Year Financial Outlook, and should be incorporated in future updates. These additional funding requirements may impact funds available for programming in future budgets, but will ensure a dedicated source is available for unanticipated critical needs that arise each year.

As a comparison, the County of San Diego's Reserve Policy calls for a General Reserve of 5% of budgeted general purpose revenues to be used in the case of emergency. Additionally, the policy also calls for an appropriated Contingency Reserve of 2% of budgeted general purpose revenues to be used for unanticipated needs or revenue shortfalls, and use of these funds requires a four-fifths vote of the Board.

Long-Term Disability Fund Reserve

Included in the policy is a Long-Term Disability Fund Reserve to reach \$12 million by Fiscal Year 2012, to be funded with \$2.25 million annual increments starting in Fiscal Year 2009. This reserve need was also not included in the Five-Year Financial Outlook, and should be incorporated in future updates.

Status Reports

The IBA recommends that language be included in the proposed reserve policy that all requests for use of reserve funds should be accompanied by a current status report of the affected reserve fund. In addition, quarterly financial reports should include a status of all reserve funds, including current balances.

Effective Date of Policy – Funding for Appropriated Reserve

As described above, the proposed reserve policy does not currently include a target level of funding for the Appropriated Reserve. In addition, because the Fiscal Year 2008 Budget does not include funds for this, it is necessary that funds be allocated for this purpose prior to, or concurrently with, the adoption of the reserve policy. To facilitate funding the Appropriated Reserve this year, the City Council may want to consider allocation of the City's share of Tourism Marketing District funds, previously estimated at \$5 million, to this purpose, if the district is approved and once funds have been received. Furthermore, the IBA recommends that excess revenues that may be received during the fiscal year be directed to the Appropriated Reserve in order to begin to meet the target as described above and to fund necessary items that may arise.

Effect on Appropriation Ordinance

The Fiscal Year 2008 Appropriation Ordinance includes multiple references to Unallocated Reserve(s) or Unappropriated Reserve(s). Upon the adoption of the proposed reserve policy, it is recommended that the Appropriation Ordinance be revised or amended, as necessary, to ensure terminology is consistent, and clarification is provided to direct funds to the appropriate reserves throughout the fiscal year.

Other Technical Changes

The IBA recommends other changes to clarify that:

- Specific purposes for dedicated reserves should be approved by the City Council during the budget process, and could be for one-time capital projects which have

been pre-identified and for purposes which have been approved by the City Council.

- No deviations to the reserve policy will be allowed except as recommended by the Mayor or the City Council, and approved by the City Council.

CONCLUSION

The IBA recognizes the importance of enacting a comprehensive reserve policy in order to establish sound formal fiscal reserve policies, build adequate reserves, and to guide the City toward meeting its short-term and long-term obligations and to ensure the City maintains the highest credit rating possible.

The IBA recommends the adoption of the reserve policy with the changes as outlined in this report.

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