

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Budget & Finance Committee Agenda Date: September 26, 2007

Item Number: 2

Subject: Proposed Reserve Policy

OVERVIEW

On July 11, 2007 and July 25, 2007, the Chief Financial Officer presented the proposed City Reserve Policy to the Budget and Finance Committee. The Committee requested that the IBA review the proposed policy and provide recommendations, and the IBA issued Report No. 07-75, dated July 20, 2007, with specific recommendations. The IBA and CFO have discussed various issues related to the proposed reserve policy, and many improvements have been incorporated in the revised version now being presented. A few critical issues remain outstanding, including interpretation of Charter Section 91, funding of the Appropriated Reserve, and the time frame for adoption of the reserve policy.

FISCAL/POLICY DISCUSSION

Charter Section 91

The IBA previously noted that earlier versions of the reserve policy did not address the requirements of Charter Section 91. Revisions have since been made to include an explanation that the City Treasurer's Investment Policy together with annual short-term borrowings using Tax and Revenue Anticipation Notes satisfy the Charter requirement to provide sufficient cash to meet all legal demands, and a two-thirds (instead of majority) vote of the Council is now required to authorize expenditures for emergency purposes from the reserve. Questions remain if the amount in the reserve is considered adequate under the formula provided in the Charter, or if it is

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.

appropriate to consider the City's pooled investments in order to satisfy this need. Based on the current Fiscal Year 2008 General Fund budget of \$1.1 billion, four months, or one-third of the annual amount, would require a cash reserve of \$370 million. The target reserve level of 6% of the General Fund budget would result in a reserve of approximately \$66 million. The IBA has requested that the City Attorney's Office opine on this outstanding issue.

Appropriated Reserve

As currently written, upon adoption of the policy, the Unallocated Reserve would become the Emergency Reserve. It is intended that an Appropriated Reserve would be funded through the annual budget process to provide for unanticipated expenses during the fiscal year, however, funding for this was not included in the Fiscal Year 2008 Budget. Specific Council action would be needed to authorize the initial funding of the Appropriated Reserve.

Without a funded Appropriated Reserve, the Council is likely to be placed in a position throughout this fiscal year of waiving the newly adopted reserve policy to allow the use of the Emergency Reserve for inevitable, non-emergency purposes, as well as mid-year and year-end budget adjustments.

The last accounting received of the General Fund reserve for Fiscal Year 2007 showed approximately \$20 million was expended from the reserve for legal, audit, and investigative services, as well as mid-year and year-end budget adjustments.

While we are not advocating for mid-year expenditures and the use of reserves on a regular basis, it is a practical reality that budget adjustments will be needed to ensure a balanced budget, and additional legal costs may be unavoidable. Unused funds within the Appropriated Reserve will be directed to the Emergency Reserve at year-end. However, it would prove more difficult to access the Emergency Reserve should additional amounts be needed.

Based on this, the IBA poses the following options:

- Adopt the reserve policy to be effective only upon Council action to transfer \$10 million from the current Unallocated Reserve to create an Appropriated Reserve for unanticipated expenses during the current fiscal year. Unused funds within the Appropriated Reserve will be directed to the Emergency Reserve at year-end.
- Implement the reserve policy effective July 1, 2008 once funding has been adequately provided for an Appropriated Reserve in next year's budget.

Changes Recently Incorporated

At the request of the IBA, additional improvements have been incorporated into the revised version of the policy, including:

- Status reports will be provided with each request to use reserve funds
- Quarterly financial reports will include a status of all reserve funds, including current balances.

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. Throughout this process, the CFO has incorporated many suggestions offered by the IBA.

The IBA recommends the following:

- 1) A legal opinion from the City Attorney is requested in order to resolve outstanding issues related to the applicability and interpretation of Charter Section 91. Further changes may be needed to the policy, once the opinion has been issued.
- 2) As previously noted, 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 to ensure terminology is consistent.
- 3) Upon further review of the proposed policy, it is unclear how the recommendation for a Dedicated Reserve differs from other appropriated reserves or encumbrances, when referring to specific projects or purchases. We recommend elimination of this category, unless its need can be justified.
- 4) Adopt the reserve policy to be effective only upon Council action to transfer \$10 million from the current Unallocated Reserve to create an Appropriated Reserve for unanticipated expenses during the current fiscal year.

Alternatively, the Council could consider the adoption of the reserve policy to be effective July 1, 2008, in conjunction with an adequately funded Appropriated Reserve.

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