



## Update: Options for Increasing the General Fund Reserve

Items 151, 152 City Council  
January 25, 2016

# General Fund Reserve - Background



Mayor's FY 2016 May Revision: proposed \$15.0 million for an irrevocable Pension Payment Stabilization Reserve Trust

FY 2016 Final Budget Memos:

- All Councilmembers favored increasing the City's General Fund reserves
- Thoughts varied on reserve amount, uses, and mechanism
- IBA concerned about the irrevocable trust mechanism and lack of policy
- Council authorized \$15.0 million to be kept in Excess Equity until further discussion by Committee and Council

# General Fund Reserve - Background



## October 2015 Budget and Government Efficiency Committee (B&GE):

- Financial Management presented a proposal to create a **Pension Payment Stabilization Reserve** (Option 1) used to pay for unexpected pension ADC increases as defined in the City's Reserve Policy
- Amount of Pension Reserve proposed to be \$20.8 million:  
\$16.0 million from General Fund, \$4.8 million from Enterprise Funds
  - General Fund portion from Excess Equity
  - Would leave an estimated \$15.7 in Excess Equity
- Calculated as 8% of the average of the last three years' Actuarially Determined Contribution (ADC) pension payments

# General Fund Reserve - Background



- The Mayor may recommend to appropriate from the Pension Reserve during the annual budget process
- The City Council may propose the use of the Pension Reserve, consistent with the Pension Reserve Policy and the City Charter
- If the Pension Reserve is reduced below the policy level, the Mayor will prepare a plan to replenish it as soon as conditions warrant, just like the other reserves

# General Fund Reserve - Background



- IBA supported the Mayor's Pension Payment Stabilization Reserve:
  - Irrevocable trust was replaced with Pension Reserve
  - Reserve Policy language clarified with our recommendation for defining "unexpected ADC payment"
  - We consider it prudent to identify a source of funds for unexpected changes to the ADC
- Committee requested staff and Office of the IBA to research increasing the City's **General Fund Stability Reserve** as an alternative

# General Fund Reserve – GFOA



## GFOA guidelines:

- Reserve equal to two months of expenditures or revenues
- Two months is approximately 16.7%, or an additional \$30.6 million allocation, for a total of \$189.3 million
- Would leave an estimated \$1.1 million in Excess Equity

# General Fund Reserve – S&P Assessment Guidelines/Moody's Report



- S&P's credit rating assessment for cities states:
  - 8-15% reserves: “strong”
  - Over 15% reserves: “very strong”
- Moody's November 2014 Report: “Anatomy of Successful US Cities”
  - 34 of the largest US cities (including San Diego) have recently improved or maintained their credit quality since the Great Recession – Moody's calls them “successful cities”
  - Characterizes successful cities as having strong financial management that supports revenue growth and improved reserve positions
  - Successful cities' median reserves had grown to 18.6% in 2013, from 14.5% in 2008

# General Fund Reserve – Rating Agencies' Comments



- Three recent rating agency reports spoke positively about the City's improved financial position, our increased 14% reserves, strong fiscal management, conservative financial policies, and strong financial disclosure practices
- Moody's noted City's key credit challenge – overall reserve level falls below median for the current rating category. Notes that rating could increase through growth in reserves

# Increasing the General Fund Stability Reserve – Option 2



- If the Committee is interested in increasing the General Fund Reserve, IBA suggests increasing Reserve from 14% to 16%:
  - 8% Emergency Reserve
  - 8% Stability Reserve (increase from 6%)
- 16% of General Fund Revenues or \$22.7 million increase over current General Fund Reserves
  - Close to GFOA guideline of 16.7%
  - Would leave an estimated \$9.0 million in Excess Equity

# Increasing the General Fund Stability Reserve – Option 2



If the Committee is interested in increasing the General Fund Stability Reserve, the IBA recommends updates to the City Reserve Policy

- Better define uses of Stability Reserve:
  - Unexpected pension ADC increases
  - One-time funding for critical capital or operating needs
- Replenishment plan prepared within one year of use

# Increasing the General Fund Reserve



- Opportune time to increase reserves: most recent projection for Excess Equity is \$31.7 million
- Options: creating a Pension Reserve or increasing the General Fund Stability Reserve—both are prudent approaches
- Pros and cons for either option, however both could:
  - Be used as a funding source to mitigate unexpected changes to the ADC
  - Bring the City closer to GFOA-identified reserve level best practices
  - Likely be reviewed as favorable by rating agencies

# Option 3 – Approve Both Proposals to Achieve Dual Purposes



- Split \$22.7 million in Excess Equity to increase the Stability Reserve and create a new Pension Payment Stabilization Reserve
- Would leave an estimated \$9.0 million in Excess Equity
- Brings City to 15% reserve, closer to GFOA standards, and establishes a \$14.7 million Pension Fund (including Enterprise Funds portion)
- Additional funding can grow the Pension Fund in the future

# Comparison of Three Options to Increase the General Fund Reserve



(\$ in millions)	Option 1: Pension Reserve	Option 2: Increased Stability Reserve	Option 3: Approve Modified Proposal	
			Pension	Stability
<b>General Fund Contribution<sup>1</sup></b>	\$16.0	\$22.7	\$11.3	\$11.3
<b>Enterprise Funds' Contribution</b>	\$4.8	-	\$3.4	-
<b>Total Funding Increase Over Current Reserve Amount</b>	<b>\$20.8</b>	<b>\$22.7</b>	<b>\$14.7</b>	<b>\$11.3</b>
<b>Mechanism</b>	Create new, separate reserve	Increase existing Stability Reserve from 6% to 8%, for a total General Fund Reserve of 16%	Create new, separate reserve	Increase existing Stability Reserve from 6% to 7%, for a total General Fund Reserve of 15%

<sup>1</sup>The General Fund contribution of each reserve increase would come from Excess Equity, which was projected to be \$31.7 million in the Mayor's FY 2016 First Quarter Budget Monitoring Report.