

RESERVE AND FUND BALANCE POLICY

GENERAL FUND

CHAPTER 5.01

SUBJECT: RESERVE POLICY, GENERAL FUND	NUMBER: TITLE 5, CHAPTER 5.01
ADOPTED DATE: 1/7/2006	RESOLUTION NUMBER: 06-0299
LAST AMENDED: 3/29/16	RESOLUTION NUMBER: 2016-03-29-1501
COUNCIL POLICY CONTACT: City Manager	CITY DEPARTMENT CONTACT: CFO, Administrative Services Department, City Treasurer

POLICY

BACKGROUND

Section 1903 of the City Charter and Chapter 19.03 of the Stockton Municipal Code require that the City Council adopt a reserve policy that is intended to prudently protect the fiscal solvency of the City. The former City Council Policy was adopted in 2006 and had not been updated since the City entered the severe fiscal crisis. During the Bankruptcy, the City Council adopted Annual Budgets with reserves that were consistent with the Court approved Plan of Adjustment, which were based upon the Long-Range Financial Plan (“L-RFP”). In March 2016, an updated policy was adopted reflecting best practices, consistent with Council goals and the L-RFP.

While appropriate at the time, the City emerged from bankruptcy and the previous current 10% reserve, as measured by the need to file bankruptcy, was inadequate and needs to be increased based upon the risks to ensure fiscal solvency. Additionally, the policy has been developed to comply with the direction set forth in Government Accounting Standards Board (“GASB”) Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions which establishes a hierarchy of fund balance classifications.

PURPOSE

It is the purpose of this policy to establish reserve targets and minimum levels of unassigned and committed fund balances to be maintained in the General Fund based upon various contingencies and risks faced by the City as determined by a review of the Government Finance Officers Association (“GFOA”) best practices,

case studies and other cities' policies to ensure that the City is able to respond to the challenges presented by changing economic conditions.

POLICY

There are almost always important limitations on the purpose for which all or a portion of the resources of a governmental fund can be used. The forces of these limitations can vary significantly, depending upon their source. Therefore, the various components of fund balance are designed to indicate "the extent to which the City is bound to honor constraints on the specific purposes for which amounts in the fund can be spent." Fund balance is categorized in five classifications, depicting the relative strength of the spending constraints placed on the purposes for which the resources can be used. In accordance with GASB Statement No. 54 the following fund balance classifications will be used in reporting activity in governmental funds.

- **Non-spendable**, amounts that are inherently non-spendable either because they are not in spendable form (inventory, prepaid items, endowment) or the portion of resources that cannot be spent because they must remain intact (long term advances, notes and loans) or are legally or contractually required to remain intact.
- **Restricted**, portions of fund balance represents amounts that can only be used for specific purposes because of limitations imposed by creditors, grantors, laws or regulations.
- **Committed**, amounts that are set-aside for specific contingencies by the governing board of an agency and requires formal action of the governing board to remove.
- **Assigned**, amounts intended to be used by the government for specific purposes. Intent can be expressed by the governing board or an official of the agency authorized by the governing board. In funds other than the General Fund this classification represents the amount that is not restricted or committed.
- **Unassigned**, (formerly called "unrestricted" or "unreserved") is the residual classification of the General Fund and includes all amounts not contained in other classifications. Unassigned fund balance is technically available for any purpose.

The following reserves will be maintained by the City. The reserves will be categorized in two priorities. Priority 1 reserves will include Working Capital and

Known Contingencies. Priority 2 reserves will include risk based reserves. The reserves are described below.

Working Capital. Two months or 16.67% of operating expenditures and transfers-out of the unassigned fund balance shall remain unspent and shall serve the working capital “reserve” in order to accommodate normal fluctuations in the timing of revenues and unforeseen operational costs. The two (2) month or 16.67% level is the GFOA recommended minimum benchmark for working capital.

Committed (or Assigned) Fund Balance Priority I - Known Contingencies.

Priority I are Known Contingencies for which fund balance must be set aside to address these contingencies. Initial Known Contingencies are funding for the City Hall after the eight (8) year lease expires, funding the increased obligations resulting from the proposed change in CalPERS assumptions which would reduce the earnings rate resulting in a one-time increase in the actuarial liability, and a program to address market conditions that result in the inability to Recruit and Retain staff.

Committed Fund Balance Priority II - Risk Based Reserves. Additional fund balance will be set-aside for four additional risk based contingencies.

- **Contingent Liabilities.** The Contingent Liabilities set-aside is to mitigate the impact of litigation expenses and other unforeseen liabilities which are infrequent and non-routine in nature and are of such magnitude that they would have a major impact upon the City’s budget. The calculation of the cost of mitigating the Contingent Liabilities will be determined annually during the budget process.
 - **Revenue Volatility.** The Revenue Liability set-aside is to mitigate the impact of large swings in revenue resulting from declines in the Property Tax, Sales Tax, and Utility User Taxes. The calculation of the amount needed will be based upon the revenue volatility in past recessions and will be determined annually during the budget process.
 - **Infrastructure Failure.** The Infrastructure Failure set-aside is to mitigate the risk of major losses in Building and Improvements, Machinery and Equipment, Infrastructure Government and Construction in Progress. The calculation of the cost of mitigating each of these categories will be determined annually during the budget process.
 - **Extreme Events.** The Extreme Events set-aside is to mitigate the risk of catastrophic losses due to earthquakes, floods, and fires, etc. which would
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require immediate funding to address and without which the City would be unable to carry out its mission.

PROCEDURES

1. Available resources as determined annually through the closing of the financial records and development of the next year's budget, will be used as a basis for funding reserve targets. These available resources or available fund balance are generally one-time in nature as derived from one-time revenues or one-time expenditure savings. Reserve targets will be set annually based upon financial elements of the Annual Budget and in consideration of the Long-Range Financial Plan. The amounts to be allocated to each reserve will be based upon the prior year financial statements from the most recent audit and will be adjusted as needed based upon the most current financial information.
 2. An amount equal to two months or 16.67% of operating expenditures and transfers-out based upon the Annual Budget and evaluated annually shall remain in the unassigned fund balance for the Working Capital reserve.
 3. The target amount to be allocated to Committed (or Assigned) Fund Balance for Known Contingencies shall be evaluated annually. Initial Known Contingencies are funding for the City Hall after the eight (8) year lease expires, funding the increased obligations resulting from the proposed change in CalPERS assumptions which would reduce the earnings rate resulting in a one-time increase in the actuarial liability, and a program to address market conditions that result in the inability to Recruit and Retain staff.
 4. The target amount for Priority II reserves to be allocated to Committed Fund Balance is equal to 95% of the available fund balance after subtracting the amounts needed for the Working Capital and Known Contingencies reserves. This portion of the Priority II reserves to establish reserves for Risk-Based areas are;
 - The Revenue Volatility reserve target will be 19 percent of the projected property, sales, utility and other taxes
 - The Infrastructure Failure reserve target will be two percent of the identified capital improvements to address deferred maintenance needs
 - The Extreme Events reserve target will be two percent of physical asset values including buildings, machinery, infrastructure and construction in process
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- Other Contingent liabilities such as unforeseen events or claims against the City will be calculated annually during the Annual Budget process
5. The remaining 5% of available fund balance not allocated to Priority I or Priority II reserves may be allocated for one-time City Council priorities.
 6. City Council approval by a majority will be required before appropriating funds designated from Priority I reserves.
 7. City Council approval by a super majority (6 out of 7) will be required before appropriating funds from Priority II reserves.

RESPONSIBILITIES

Responsibilities are held with the Chief Financial Officer

RELEVANT AUTHORITY

Section 1903 of the City Charter

RELATED ADMINISTRATIVE DIRECTIVE, CITY POLICY, CITY PROCEDURE

Not applicable

RELATED FORMS, DOCUMENTS, OR LINKS

Not applicable

FREQUENTLY ASKED QUESTIONS

Not applicable

UPDATE HISTORY

07-01-2006 – Adopted by City Council Resolution 06-0299

03-29-2016 – Adopted by City Council Resolution 2016-03-29-1501
