

**DATE:** November 6, 2007  
**TO:** Mayor and City Council  
**FROM:** Director of Finance and Internal Services  
**SUBJECT:** Review of City's General Fund Reserve Policy

## **RECOMMENDATION**

That the Council reviews and comments on this report.

## **BACKGROUND**

Staff is in the process of reviewing the City's fiscal policies. One element of this comprehensive review is the General Fund reserve policy. Staff has discussed the current policy with the Council Budget and Finance Committee in order to prepare recommendations to be presented during the budget process. During the budget process, staff will present several fiscal policy recommendations to Council. Examples of these policies include: long range financial planning, capital replacement programs, risk management reserves, etc.

The City Council adopted a policy for establishing, maintaining, and using General Fund reserves for economic uncertainty and liquidity in June 1989. A copy of this Resolution 89-180 is provided as Attachment A.

## **DISCUSSION**

It is essential that governments maintain adequate levels of fund balance (net available assets) to mitigate current and future risks, such as revenue short falls and unanticipated expenditures. Fund balance levels are a crucial consideration in long-term financial planning.

The City's reserve policy outlines the intent to earmark two categories of reserves in the General Fund, *to the extent practical and feasible*, and the guidelines for use of the financial reserves. The two categories are described below.

1. Economic Uncertainty Reserve – To provide for continuation of essential services to the public during periods of economic decline. When presenting proposed budgets to the City Council, the City Manager shall include a recommendation for the amount which is the greater of \$5,000,000 or 10% of the annual appropriations.

2. Liquidity Reserve – To provide for cash liquidity during periods of seasonal imbalance between receipts and disbursements. When presenting proposed budgets to the City Council, the City Manager shall include a recommendation for the amount which is the greater of \$2,500,000, or 5% of the annual appropriations.

Current General Fund Balances

The General Fund total projected fund balance, for June 30, 2008, is \$19.6 million. The total fund balance is broken down into the following categories:

Reserved Fund Balance	\$ 925,000
Fund Balance Designated for:	
Economic Uncertainty	7,000,000
Liquidity	3,500,000
Redevelopment Agency Loan	1,336,000
Hotel Conference Center	1,250,000
Police Staffing	1,000,000
Contingencies	4,585,000
<b>TOTAL FUND BALANCE</b>	<b>\$19,596,000</b>

The FY 2007-08 General Fund Budget includes an Economic Uncertainty Reserve of \$7 million and a Liquidity Reserve of \$3.5 million. The City has carried these reserve limits for over 10 years. However, the City currently has annual General Fund appropriations of \$108 million; therefore, the reserve amounts fall short of the recommended amounts by \$5.7 million, as follows:

- Economic Uncertainty Reserve – 10% of the \$108 million annual appropriations equals a recommended reserve of \$10,800,000, currently \$7 million. (short \$3,800,000).
- Liquidity Reserve – 5% of the \$108 million annual appropriations equals a recommended reserve of \$5,400,000, currently \$3.5 million. (short \$1,900,000).

## Governmental Finance Officers Association (GFOA) Recommended Practices

GFOA recommends that governments establish a formal policy on the level of unreserved fund balance that should be maintained in the general fund. The adequacy of the reserve should be assessed based upon a government's own specific circumstances.

GFOA recommends, at a minimum, that governments maintain no less than five to fifteen percent of regular general fund revenues, or no less than one to two months of regular general fund operating expenditures.

The City of Hayward FY 2007-08 General Fund revenue is estimated at \$105 million. Applying the GFOA reserve recommendation, based on revenue level, a reserve of \$5.25 - \$15.75 million is recommended.

The City of Hayward averages \$9.4 million in monthly general fund expenditures. Applying the GFOA reserve recommendation, based on general fund monthly operating expenditures, a reserve of \$9.4 - \$18.8 million is recommended.

Such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of reserves in the general fund at any one time.

In establishing a policy governing the level of unreserved fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unreserved fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile).
- The availability of resources in other funds as well as the potential drain upon general fund resources from other funds (i.e., the availability of resources in other funds may reduce the amount of unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund).
- Liquidity (i.e., disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (i.e., governments may wish to maintain higher levels of unreserved fund balance to compensate for any portion of unreserved fund balance already designated for a specific purpose).

### Effects on the City's Credit Rating

Credit rating agencies carefully monitor levels of fund balance and unreserved fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws

and regulations often govern appropriate levels of fund balance and unreserved fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Recently the City refinanced general fund debt (Certificate of Participations). As part of the refinancing process, staff worked with the rating agencies, Standard & Poor's, and Fitch. One of the reasons the City received a strong rating from these agencies was because of our general fund reserve policy. They made positive comments regarding the City's financial policies, especially the levels established in our current reserve policy.

**FISCAL IMPACT**

As noted above, the General Fund has a total projected fund balance of \$19.6 million. Currently, \$7 million is designated for economic uncertainty and \$3.5 million is designated for liquidity.

The current policy suggests that the City increase these reserves by a total of \$5.7 million. The current financial picture can not accommodate these higher reserves; however staff will assess the amounts available during the coming two-year budget process and recommend increasing reserves to the maximum amounts possible.

The table below summarizes the various recommended practices:

<b>Reserve</b>	<b>Current Balances</b>	<b>Should be per City Policy</b>	<b>2-months Operating Exp</b>	<b>GFOA (5-15% of revenue)</b>
<b>Economic Uncertainty</b>	<b>\$7,000,000</b>	<b>\$10,800,000</b>	<b>\$18,800,000</b>	<b>\$5,250,000 to \$15,750,000</b>
<b>Liquidity</b>	<b>\$3,500,000</b>	<b>\$5,400,000</b>		
<b>Emergency</b>	<b>0 designated</b>	<b>To be determined</b>		
<b>Other Contingency</b>	<b>4,585,000</b>			
<b>Total</b>	<b>\$15,085,000</b>	<b>\$16,200,000</b>	<b>\$18,800,000</b>	<b>\$15,750,000</b>

**PUBLIC CONTACT**

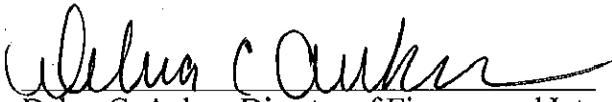
In June 1989, the City Council adopted this reserve policy. During the preparation of each budget, the City Manager makes recommendations to Council related to reserves.

This report was presented to the Council Budget and Finance Committee on October 24, 2007.

**SCHEDULE**

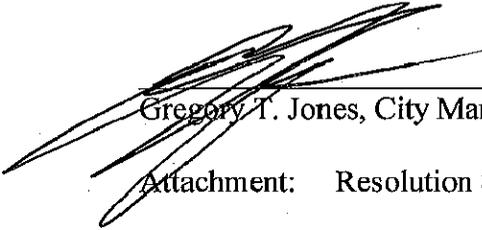
Staff will utilize Committee and Council comments to develop recommendations for the FY 2008-10 Budget.

Prepared by:



Debra C. Auker, Director of Finance and Internal Services

Approved by:



Gregory T. Jones, City Manager

Attachment: Resolution 89-180-City Reserve Policy



# CITY OF HAYWARD AGENDA REPORT

AGENDA ITEM 12e

WORKSESSION ITEM \_\_\_\_\_

TO: Mayor and City Council

FROM: City Manager

SUBJECT: Policy for Establishment and Use of Reserves

DATE: June 13, 1989

## RECOMMENDATION:

Adopt a resolution determining City policy and guidelines for establishment and use of financial reserves<sup>1</sup>.

## BACKGROUND:

In 1981-1982, the City of Hayward experienced the effects of an economic recession, the first to occur following the passage of Proposition 13 in 1978. Proposition 13 changed the traditional methods of financing municipal services while providing relief and protection to property owners from uncontrolled property taxes. It left city governments dependent upon revenue sources that were sensitive to economic and business cycles for financing essential public services, including services such as police and fire protection. The recession of 1981-1982 caused revenues for City government to decline by a substantial margin while the costs of providing services continued to rise from the effects of increased demands and inflation. In response, the City was forced to reduce many services to the public and eliminate others.

In the years following, the City has struggled to recover from these effects both to restore services to the levels provided previously and to establish prudent fiscal policies to avoid a recurrence of this situation in the future. While there is no guarantee of immunity against recurrence of these conditions in the event of future severe recessions, the City now has established financial reserves that would cushion the effects and enable a gradual adjustment to take place. Additionally, the City has improved its financial monitoring and reporting practices to enable an earlier warning of potential downturns.

In the Proposed Budget for 1989- 1990, General Fund reserves have been established totaling nearly 20% of the General Fund annual operating requirements. These reserves include a \$5 million Reserve for Economic Uncertainty, \$2.5 million Liquidity Reserve and \$1.4 million Reserve to cover

1. The Resolution will be distributed on Monday, June 12, 1989

outstanding debt obligations. The City Council has long recognized the importance of maintaining such reserves to cover unforeseen needs and emergencies, as an important source of revenue in earnings from prudent investments and as a hedge against economic recession.

The past seven years have seen the longest peacetime economic expansion period in the nation's history. This prolonged economic expansion has caused the major sources of revenue from Sales and Property taxes to expand and allow the accumulation of these reserves while, at the same time, restoring service levels to those enjoyed prior to 1981.

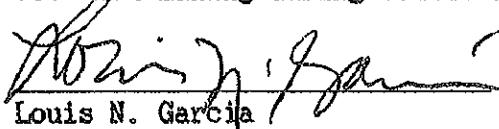
Having achieved this objective, it is important now to anticipate the possible need for these Reserves for the purposes intended. In the past two years, there has been anticipation that recession may soon occur. History indicates such recessions are normal and inevitable. In 1982, the recession then resulted in a drop in Sales Tax revenues of more than \$1 million and layoff of dozens of City employees. Future recessions could result in revenue fluctuations of even greater magnitude.

The attached resolution would establish guidelines and priorities for the maintenance of reserves at specified levels and for the application of these reserves in times of need. Two reserves are established at a minimum of \$7.5 million or 15% of the annual operating budget. These are the Reserve for Economic Uncertainty and the Cash Liquidity Reserve.

The Reserve for Economic Uncertainty is established to recognize the dependence of the City on revenue sources that fluctuate with the economic cycle and which support essential services that are entirely independent of those cycles. The liquidity Reserve is established to recognize that within the fiscal year, revenues are received in uneven seasonal patterns that do not match the relatively even pattern of disbursements, producing seasonal variations in available cash. Prior to 1987, the City met these variations with temporary short-term borrowings known as TRANS. In 1986, the Federal government passed as Tax Reform Act which made these temporary borrowings unfeasible. Thus, the City must maintain an adequate level of cash reserve to cover the seasonal shortfall periods.

Priorities for the application of these Reserves are intended primarily to protect levels of essential services to the public through the retention, for as long as practical, of employees who provide such services. At the same time, some flexibility in defining essential the services and in determining which employees are critical to the continuation of such services is provided.

Adoption of these guidelines and priorities now, before the need becomes critical, will improve future financial planning and enable more effective decision making during critical periods.

  
Louis N. Garcia  
City Manager

## HAYWARD CITY COUNCIL

RESOLUTION NO. 89-180 C.S.Introduced by Councilmember SWEENEY AKGRESOLUTION ESTABLISHING A POLICY FOR THE  
MAINTENANCE AND USE OF THE RESERVE FOR ECONOMIC  
UNCERTAINTY AND LIQUIDITY RESERVE FUNDS

WHEREAS, since adoption of Article XIII A of the California Constitution the City of Hayward has become increasingly dependent upon revenues from sales taxes, user fees, and service charges to provide general government services including police and fire services, maintenance of public streets, buildings, and other public facilities and assets, library services, transportation and land use planning, code enforcement, community and economic development efforts, and social program support; and

WHEREAS, these sources of revenue are more sensitive to general economic cycles than previous ones, resulting in positive revenue growth during favorable economic periods and contraction of revenue during economic downturns; and

WHEREAS, the need for general governmental services is not sensitive to economic cycles and demand for services often will rise during periods of economic decline; and

WHEREAS, prudent fiscal management requires that adequate levels of financial reserves be maintained during periods of financial growth to allow for continuation of services during temporary periods of economic decline and to prevent disruption of essential services to the public; and

WHEREAS, as is the case for most local government agencies, there has historically been a variation between the relatively even pattern of City expenditures and the uneven pattern of revenue receipts to it and this variation was addressed in the past by short-term borrowing through issuance of Tax and Revenue Anticipation Notes; and

WHEREAS, the 1986 Tax Reform Act has limited the use of these traditional means of short-term cash management practices to cover the annual fluctuations in cash receipts and disbursements.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Hayward hereby adopts the following statement of policy in response to these concerns.

"It is the policy of the City of Hayward to establish and maintain adequate financial reserves in order to avoid the negative effects of economic cycles upon essential services to the public and to assure that annual fluctuations in revenue receipts do not impede the City's ability to meet its expenditure obligations. The City shall maintain a General Fund Reserve for Economic Uncertainty and a General Fund Liquidity Reserve for these purposes.

"During periods of economic sufficiency, these reserves shall be used as a source of supplemental revenue through prudent investments and earnings under policies of the City Council and for meeting short-term cash flow deficiencies. During periods of economic downturns, when revenues fail to meet the normal operating requirements of essential public services, or when need for disbursements temporarily exceeds receipts, these reserves may, upon the recommendation of the City Manager and the authorization of the City Council, be used in accordance with the standards set forth herein.

"(a) Reserve For Economic Uncertainty. To the extent practical and feasible, the City of Hayward will maintain the Reserve for Economic Uncertainty in the amount of the greater of \$5 million or 10% of its most recent annual operating budget to provide for continuation of essential services to the public during periods of economic decline. When presenting proposed budgets to the City Council in accordance with the requirements of Section 1201 of the City Charter, the City Manager shall include a recommendation in each proposed annual budget for the amount to be appropriated to this Reserve.

"When, as the result of an economic downturn, projected or actual revenues are insufficient to meet the normal operating requirements of essential services, expenditures from the Reserve for Economic Uncertainty may be recommended by the City Manager and approved the City Council, subject to the following priorities:

"(1) Maintenance of Staffing. The first priority for allocation of the Reserve for Economic Uncertainty shall be for the maintenance of staffing levels in those essential services provided to the public where the demand for or need for such services is not affected by the change in economic conditions. The

objective is to avoid or reduce the necessity for lay-offs in personnel in such positions.

- "(2) Job or Hiring Freezes. This policy anticipates that prudent management practices and preservation of resource during fiscally tight periods may indicate the need for freezes in the hiring or filling of designated vacant or newly established positions. This policy is not intended to limit or discontinue the use of this measure, as it is deemed appropriate, to maintain more essential services to the public.
- "(3) Fees and Charges. As permitted by law and consistent with prevailing practices among municipal agencies, those services for which user fees and service charges are collected from the beneficiaries of such services shall be supported as fully as practicable from such user fees and charges before resorting to use of the Reserve.
- "(4) Restoration of Reserves. As economic recovery occurs, and revenues return to levels considered normal for the support of essential services, balances in the Reserve for Economic Uncertainty shall be restored in a timely manner, consistent with the maintenance of essential services.
- "(5) Essential Service. For purposes of this policy, essential services and appropriate levels of such services shall be determined from time to time by the City Council upon the recommendation of the City Manager.
- "(b) Liquidity Reserve. To the extent practical and feasible, the City of Hayward will maintain a General Fund Liquidity Reserve in the amount of the greater of \$2.5 million or 5% of its most recent annual operating budget to provide for cash liquidity during periods of seasonal imbalance between receipts and disbursements. When presenting proposed budgets to the City Council in accordance with the requirements of Section 1201 of the City Charter, the City Manager shall include a recommendation in each proposed annual budget for the amount to be appropriated to this Reserve. Expenditures from the Liquidity

Reserve may, upon the recommendation of the City Manager and the authorization of the City Council, be used in accordance with the priorities established for the Reserve for Economic Uncertainty."

IN COUNCIL, HAYWARD, CALIF. June 13, 1989

ADOPTED BY THE FOLLOWING VOTE:

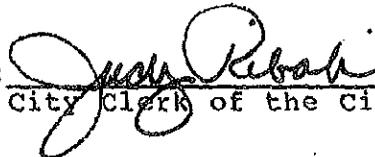
AYES: COUNCILMEMBERS: JIMENEZ, ARAGON, CAMPBELL, COOPER, SWEENEY, WARD

MAYOR: GIULIANI

NOES: COUNCILMEMBERS: NONE

ABSENT: COUNCILMEMBERS: NONE

ATTEST:



City Clerk of the City of Hayward