



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jennifer A. Maguire

SUBJECT: CITY COUNCIL POLICY -
RESERVES AND FUND BALANCE

DATE: May 29, 2013

Approved

Date

5/29/13

RECOMMENDATION

Amend City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy, to incorporate changes to Section 3 (Contingency Funds or Accounts) and 4 (Fund Balance) as described in the Analysis section below.

BACKGROUND

The Operating Budget and Capital Improvement Program Policy sets forth the guiding principles for the preparation and administration of the City's operating budget and capital improvement program. This policy includes direction associated with Contingency Funds or Accounts and the use of Fund Balance in the General Fund.

ANALYSIS

Amendments to Sections 3 and 4 of City Council Policy 1-18 are recommended to accomplish the following:

- Update the Contingency Reserve language to refine the purpose of the reserve and to specify that any use of the General Fund Contingency Reserve shall require a two-thirds vote of approval by the City Council consistent with the San José Budget Principles that were originally approved by the City Council on March 18, 2008 and revised on September 9, 2008.
- Update the Cash Reserve Fund and Emergency Reserve Fund descriptions to be more consistent with the City Charter.
- Replace the Economic Uncertainty Reserve reference with the broader Budget Stabilization Reserve reference. In the 2013-2014 Proposed Budget, the establishment of a General Fund Budget Stabilization Reserve of \$4.0 million is recommended. Given the size of the City's budget and the relatively small General Fund Contingency Reserve, this proposed reserve is considered a prudent investment, serving as a small buffer, or bridge funding to balance the budget, if necessary. Previously, the City had an Economic Uncertainty Reserve that contained funding as high as \$15.8 million to address unforeseen changes in revenues as a

result of deteriorating economic conditions. That reserve was replenished and used over the past decade to address small portions of the City's significant General Fund budget shortfalls. The Budget Stabilization Reserve is recommended to replace the Economic Uncertainty Reserve and would be broader in scope, temporarily addressing fluctuations in revenue associated with economic conditions as well as other unforeseen and unbudgeted revenue and expenditure changes that can not be rebalanced within existing budgeted resources in any given year in order to protect against reducing service levels when these fluctuations occur.

- Amend the allocation of excess General Fund fund balance that is not necessary to address a projected deficit in the following year to the Budget Stabilization Reserve, unmet/deferred infrastructure and maintenance needs, and/or other one-time urgent funding needs. These broader uses would replace the Economic Uncertainty Reserve as well as the unfunded capital needs for approved projects, the FT&E for any capital projects that are funded with voter-approved bonds, and the City equipment sinking fund.

City Council Policy Revisions

Following are the recommended policy revisions, with stikeouts used to identify eliminated text and bold used to signify new text:

3. Contingency Funds or Accounts

Four different contingency funds or accounts are established:

a) Contingency Reserve

For the General Fund, a Contingency Reserve ~~amount~~, which is a minimum of 3% of the operating budget, is established. The purpose of this reserve is to meet unexpected circumstances **arising from financial and/or public emergencies that require immediate funding that cannot be met by any other means. Any use of the General Fund Contingency Reserve shall require a two-thirds vote of approval by the City Council.** ~~, such as a General Fund revenue shortfall.~~

Appropriate levels of contingency funds will be determined and maintained in the capital and special funds.

b) Cash Reserve Fund (~~Earmarked Reserve~~)

An adequate revolving fund (Cash Reserve Fund 002) shall be determined and maintained at an adequate level as determined by the City Council. The purpose of this reserve fund is for the payment of any authorized expenditures of the City for any fiscal year in anticipation of and before the collection of taxes and other revenues of the City for such fiscal year. ~~that can be spent throughout the year as the City Council authorizes shall be established.~~

c) Emergency Reserve Fund

An adequate emergency reserve fund (**Emergency Reserve Fund 406**), as mandated by the City Charter, shall be determined and maintained **at an adequate level as determined by the City Council**. The purpose of this reserve fund is to meet any public emergency involving or threatening the lives, property, or welfare of the people of the City or property of the City.

d) Economic Uncertainty Reserve Budget Stabilization Reserve

For the General Fund, a Budget Stabilization Reserve may be maintained at an adequate level as determined by the City Council. The purpose of this reserve is to provide budget stability when there are fluctuations that result in lower than projected revenues and/or higher than projected expenditures that cannot be re-balanced within existing budget resources in any given year. This reserve would provide a buffer, or bridge funding, to protect against reducing service levels when these fluctuations occur. ~~An adequate reserve shall be maintained. The reserve shall include the revenues realized from the sale of surplus City properties, excluding those that have been designated for specific project funding as of October 1, 2004. As of July 1, 2009, revenues realized from the sale of surplus City properties may also be used for the backlog of unmet/deferred infrastructure and maintenance needs, asset management program costs, and to pay down General Fund debt at the recommendation of the City Manager and approval by the City Council.~~

4. Fund Balance

The appropriation of carryover fund balance must be approved judiciously. This should ensure that ongoing expenditures will be budgeted only to the extent that proven revenue streams exist.

In the annual budget, and in subsequent reports, there will be a presentation on fund balances and their anticipated uses.

- a) The first increment of any General Fund “Ending Fund Balance” identified in the City Manager’s Annual Report shall be split 50% for unmet/deferred infrastructure and maintenance needs in the areas of: 1) transportation; 2) technology infrastructure and software upgrades; 3) fleet replacement; and 4) building facilities at the recommendation of the City Manager and approval by the City Council, and 50% to offset any projected deficit for the following fiscal year, after necessary appropriation adjustment actions to rebudget funds, correct errors, or reflect updated cost information have been accounted for in the fund balance reconciliation.
- b) If the projected deficit is less than the amount allocated for this purpose, the remaining funds shall be allocated for the following uses:
 - 1) ~~Economic Uncertainty Reserve. Budget Stabilization Reserve.~~
 - 2) ~~Unfunded Capital needs for approved projects.~~
 - 3) ~~FT&E for any capital projects that are funded with voter approved bonds.~~

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- ~~4) City equipment sinking fund.~~
 - 2) Unmet/deferred infrastructure and maintenance needs.**
 - 3) Other one-time urgent funding needs.**
- c) Annual surplus funds shall not be used for ongoing expenditures, unless those expenditures can be accommodated in Year Two and possibly Year Three of the five-year financial forecast. Any available carryover balance should only be used to offset one-time costs or to increase revenues.



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