



## **Takoma Park City Council Meeting – October 11, 2017 Agenda Item 2**

### **Work Session**

Overview of City Financial Reserve Policies and Appropriate Reserve Levels

### **Recommended Council Action**

Hear presentation on the City's reserve policies and criteria for appropriate reserve levels and ask clarifying questions to help prepare for future Council action.

### **Context with Key Issues**

Both Councilmembers and staff wish to have policies in place regarding the level and purpose of the City financial reserves before FY19 budget preparation begins in late January. This is a complex issue and there is not just one right answer that is suitable for every municipality. However, there is guidance provided by the Government Finance Officers Association (GFOA) on this topic.

Takoma Park has several reserves of different types, including an Emergency Reserve, Equipment Replacement Reserve, Facility Maintenance Reserve, Housing Reserve, bond reserve, and unappropriated ("unassigned") funds.

For many years, we have used a rule of thumb that there should be at least \$3 million in unassigned funds in the General Fund at the time of budget adoption. That amount was identified as an approximation of the funds needed to cover monthly cash fluctuations over the course of the fiscal year. However, personnel costs and the overall budget have increased since that amount was set. It would be wiser to peg this level of funds to annual need. The GFOA standard for unassigned reserves is 17% of the total General Fund Expenditure amount or a minimum of two months of regular operating expenditures.

Other reserves exist to ensure that funds are available for obligations (such as bond payments), expensive equipment and facility needs, major City goals and emergencies. The amounts in the reserves can be changed by Council action. This might occur in the event of a costly emergency (such as a natural or manmade disaster or significant national financial downturn), but the City remains legally obligated for some payments, such as bond payments. In times of a financial downturn, maintaining the City's infrastructure is in the best long term interests of the City, even if we need to reduce services or lay off personnel.

In establishing appropriate reserve levels, the Council should ensure that funds are available for major City operations and obligations through the expected and unexpected variability that may occur.

Finance Director Susan Cheung has prepared background information including a memo and two spreadsheets. One of the spreadsheets shows the GFOA guidelines and information that she has gathered from several Maryland municipalities. There is an associated document that provides some

definitions of the terms used. The other spreadsheet shows the fluctuations of the City's cash balances month by month, with some fixed payments (notably bond payments) projected into the future. We will refer to this information in the presentation.

**Council Priority**

Fiscally Sustainable Government

- Adopt financial policy to determine the appropriate level of designated reserves.

**Environmental Impact of Action**

None.

**Fiscal Impact of Action**

Depends on policy chosen by Council.

**Racial Equity Impact**

Unknown.

**Attachments and Links**

- September 5, 2017 Memo From Finance Director Susan Cheung
- Reserve Requirement in Maryland Cities (spreadsheet)
- Financial Terms
- Insured Money Market Account Balance Analysis

**TO:** Suzanne Ludlow, City Manager

**FROM:** Susan Cheung, Finance Director

**Date:** September 5, 2017

**RE:** Fund Balance and Reserve Policy

The following information is in response to the request for information to guide the adoption of a Fund Reserve Policy for the City of Takoma Park. As part of gathering the information I have inquired about the reserve requirements in several cities in Maryland.

In 2017, with the issuance of bond debt totaling \$9 million, there is concern of sufficiency of reserve funding for increased cash out-flow due to bond payments. In particular, the increased capacity of capital improvement projects, equipment replacement and unassigned fund balance are areas which need to be addressed. Adopting a reserve policy based on the GFOA model or the best practices among the cities in Maryland should be considered by the City of Takoma Park.

The City's existing reserve policy is included in the City's Charter under Fund Balance. The reserve policy developed should be an addition to the following existing reserve provisions.

**Section 804 Reserve Provisions**

(a) **Emergency Reserve.** A separate reserve established to be used exclusively for emergency expenditures necessary for the health, safety or welfare of persons, or actions necessary to perform essential governmental functions. Such Emergency Reserve should be no less than \$250,000, and each fiscal year thereafter shall increase by a percentage equivalent to the percentage increase in the Consumers Price Index (CPI) for Washington-Baltimore area.

(b) **Equipment Replacement Reserve.** A separate reserve for the replacement of major capital items is created which differs from the purpose of the Emergency Reserve. Major capital items that have a purchase value higher than or equal to 0.5% of the total budget revenues, at the time of purchase, should be included in this reserve. Each year's budget should include transfer to the reserve from the Fund Equity, based on the purchase price and the estimated useful life of each item, necessary to maintain the reserve at a level sufficient to replace the covered items.

## **GFOA Recommendations**

GFOA makes recommendations for best financial practices which cover appropriate levels of fund balance, asset maintenance and replacement and capital planning. The recommendations are applicable to the City when discussing the reserve policy. The summary of these recommendations are as follows:

1. Establish a policy to address the level of unassigned fund balance within the general fund. Minimum levels are recommended to be no less than two months of regular operating expenditures.
2. Establish a policy for a system that will allow for regular review of the condition of assets and devise a plan and budget for maintenance and replacement.
  - Funds for maintenance and replacement of assets should be allocated in a multi-year capital plan that should include projections of estimated useful lives and replacement costs.
  - Reports regarding replacement plans and allocation of funds should be given on a routine basis to elected officials and should be made available to the general public upon request.

## **Other City Reserve Requirement**

As shown in the attached survey of five other cities in Maryland, the select group has maintained a General Fund Reserve Fund from 15% to 50% of the total expenditures. As these practices represent the various standard and practices, a brief review of how the City compares will be useful:

- As a general rule, the percentage size of the reserve is in inverse proportion to the size of the revenue base, in other words, the bigger and more diverse the revenue base, the smaller the reserve percentage. This is generally true for larger governments (including counties, states and large cities) that enjoy fiscal stability and strength, but it varies among smaller cities.
- In the five selected samples, City of Gaithersburg and City of Cumberland are the two exceptions to the general rule. The City of Cumberland with the annual budget of 27 million keeps \$831,789 (3% of the budgeted expenditure) in the unassigned reserve fund; while the City of Gaithersburg with annual budget of 231 million keeps over 57 million (25% of the budgeted expenditure) in the unassigned reserve. When compared to the five cities, the City of Takoma Park's reserves are more in line based on the size of the budget.
- Among the cities, the City of Takoma Park's total GF Fund Reserve (36%) to total expenditure is the closest to the reserve target of City of Cumberland and City of Gaithersburg

that maintain 33% and 32% respectively. The City of Frederick is the lowest (15%) and the City of College Park is the highest (50%) in the ratio of GF Fund Reserve to the total expenditure.

- In consideration of the GFOA standard, the City of Takoma Park and City of Greenbelt are comparable in the Unassigned Reserve ratio. The City maintains 5 million in the Unassigned Reserve which is 15% of the total \$33 million operating expenditure. The City of Greenbelt also maintains 5 million but the Unassigned Reserve balance is 18% out of \$27 million total expenditure. The required GFOA standard is 17% or two months of the total budgeted expenditure.
- Although, there are a number of very significant differences between the five cities both in the budgeted expenditures and total reserve balances, the principle of maintaining 25% of the total expenditure in the General Fund Unassigned Reserve is common among the cities. City of College Park, City of Cumberland, and City of Gaithersburg are all in line with the theory of 25% Unassigned Reserve ratio. In reality, only City of College Park and City of Gaithersburg are able to keep up with the policy principle.

### **Summary**

There are various approaches that the City could take to mitigate the effects of unexpected economic decline or natural disaster while maintaining its fiscal health. Provided below are two approaches that could be used independently as a template for the City's consideration in development of a reserve policy.

1. Increase Existing Reserves: an increase to unassigned reserves by 1 percent each year to a total of 5 percent in aggregate would strengthen current policies in a manageable pace.
2. Adopt the GFOA standard and increase the unassigned reserve to 17% of the total budgeted expenditure. Another option would be to follow the best practice among the cities in Maryland and develop an unassigned reserve based on the 25% of the total budgeted expenditure.

In conclusion, establishing a new reserve basis or increasing existing reserves can be a positive development for the City. Planning over a period of years will allow the City to spread the cost over time rather than being forced to commit funds all at once. A well-designed reserve policy will prepare the City for periods of uncertainty.

**Reserve Requirement in Maryland Cities**

	City of Takoma Park	GFOA Standard	City of College Park	City of Cumberland	City of Greenbelt	City of Frederick	City of Gaithersburg
<b>Contact Person</b>	Finance Director: Susan Cheung	Senior Manager:Shayne Kavanagh	Finance Director: Gary Fields	Finance Director: Ken Tressler	City Treasurer: Jeffrey Williams	Finance Director: Katie Barkdoll	Finance Director: Stephenie Walker
<b>City Information</b>							
<b>Population</b>	17,000		32,000	20,000	24,000	70,000	68,000
<b>FY17 Expenditure Budget</b>	33 Million		18 Million	27 Million	27 Million	156 Million	67 Million
<b>FY16 Total Assets-Governmental Funds</b>	27 Million		40 Million	45 Million	44 Million	53 Million	124 Million
<b>FY16 Total GF Fund Reserve</b>	12 Million		9 Million	9 Million	6 Million	24 Million	75 Million
<b>% GF Reserve to Expenditure</b>	36%		50%	33%	22%	15%	32%
<b>FY16 General Fund Unrestricted Reserve</b>	5 Million		8 Million	830,789	5 Million	14 Million	57 Million
<b>% Unassigned Reserve to Total Expenditure</b>	15%		44%	3%	18%	9%	25%
<b>Unassigned Reserve GFOA Standard</b>	5.5 Million		3 Million	4.5 Million	4.5 Million	26 Million	38.5 Million
<b>% to Total Expenditure</b>	17%		17%	17%	17%	17%	17%
<b>Types of Reserve Accounts</b>							
	<b>Fund Equity-Unrestricted Reserve</b> <b>Equipment Replacement Reserve</b> <b>Facility Maintenance Reserve</b> <b>Emergency Reserve</b> <b>Street Improvement Reserve</b> <b>Housing Reserve</b>	Depends on the City's local condition and fund policy requirement	<b>Fund Equity-Unrestricted Reserve</b>	No separate and distinct reserve targets within the fund balance	<b>Capital Projects Fund</b> – balance of \$230,340 – identified projects - \$5.6 million, or 4.1%. State grants and other funding will be sought to supplement the City's reserves for these priorities.	<b>Rainy Day Reserve Fund</b>	<b>General Fund Reserve Fund</b>
					<b>Equipment Replacement Fund</b> - \$185,413 – replacement cost of current equipment - \$3.4 million, or 5.5%. This balance is not acceptable. It will take several years to improve this fund balance relative to the equipment currently listed in the City's capital assets.	<b>Budget Stabilization Fund</b>	
<b>General Fund Reserve Standard</b>							
<b>Unrestricted Reserve</b>	* <b>Unrestricted General Fund</b> -Estimate at 3 Million during proposed budget	At the minimum of two months of General Fund operating fund	25% of the following year's General Fund Expenditure	It is the goal of the City to achieve and maintain an Unassigned General Fund fund balance of 25% of expenditures. The City considers a balance of less than 5% to be cause for concern, barring unusual or deliberate circumstances.	The City of Greenbelt has a guideline of 10% fund balance for its General Fund. There is no other guideline involving the reserve balance	The City of Frederick maintains a Rainy Day Reserve Fund	It's basically 25% of the 3 year average of expenditures should be in general fund fund balance.
<b>Restricted Reserve</b>	* <b>Equipment Reserve</b> -Restricted Reserve at the balance of \$3.8 Million annual replenishment of \$600,000 * <b>Emergency Reserve</b> -Restricted Reserve at the balance of \$455,000		Basically it is 25% of the following year's General Fund expenditure budget. The City did not have any problems over the past few years of maintaining that balance.	The City will likely drop the target to a more reasonable figure - probably in the 17%-18% range (approx. 2 months).	There is nothing in the City's code that requires minimum fund balances or reserves	The policies also allow for a Budget Stabilization Fund, however the City currently do not have a balance in that reserve at this time. There is no any other reserve funds.	
<b>Restricted Reserve</b>	* <b>Facility Maintenance Reserve</b> -Restricted at the balance of \$596,000, replenishment when necessary		The City does not have any additional reserve requirements.		When this deficit is applied to the General Fund, the fund balance is 10.6%, above the 10% guideline, but well below the 14.3% shown in the budget. The Greenbelt City Council is aware of this presentation deficiency and will be addressing the matter in coming fiscal years.		

## **Note: Financial Terms in the Reserve Requirement in Maryland Cities**

**Expenditure Budget**-Expenditure budget is generally composed of the current period operating budget, and a capital budget, which shows the financial plans for long-term capital improvements, facilities, and equipment. The two budgets may be consolidated in order to balance the total amount of estimated revenue available.

**Assets Size**-Total assets that appear on the city's balance sheet are the sum of all current and noncurrent assets. The total asset figure is based on the historical or book value of the listed assets. Total assets in government wide statement should include the deferred outflows of resources, and the total assets in the Governmental Funds should include General Fund, and all major and non-major funds.

**Total GF Fund Reserve**-A reserve fund is basically a savings account or other highly liquid assets set aside by a business or government to meet the future costs of operation and any other unexpected costs.

**% GF Reserve to Expenditure**-a ratio of General Fund Reserve to the total budgeted expenditure.

**General Fund Unrestricted Reserve**-Operating reserves or unrestricted fund balances in the General Fund are similar to retained earnings or owners' equity in business enterprises. These are liquid funds, usually accumulated over the years available for use by the city at the discretion of the council.

**% Unassigned Reserve to Total Expenditure**-a ratio of unrestricted fund balance to the total budgeted expenditure.

**Unassigned Reserve GFOA Standard**- Government Finances Officers Association (GFOA) recommends that government to establish a formal policy at the appropriate level of regular general fund operating revenues with the main focus on unrestricted fund balance.

Insured Money Market Account Balance Analysis

A/C 381121

	2016												2017						
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	
Beginning Balance (Include First Sweep)	11,044,582	12,776,725	11,901,795	11,838,624	10,832,152	10,716,897	10,170,385	7,583,579	9,427,250	9,162,034	13,726,947	14,160,478	11,223,742	13,637,370	13,927,956	13,335,842	12,358,309	11,831,108	
<b>Withdrawal</b>																			
<b>MMK</b>																			
Sweep & Other Withdrawal	(220,792,969)	(236,439,188)	(272,758,077)	(237,384,777)	(217,986,683)	(221,626,202)	(172,775,827)	(218,084,959)	(193,787,262)	(233,591,462)	(273,620,036)	(283,515,360)	(255,458,687)	(261,268,374)	(322,425,455)	(257,318,007)	(52,290)	(224,283)	
Payroll																			
Maryland State Retirement												(560,772)							
Payroll	(591,082)	(607,310)	(574,901)	(573,490)	(590,437)	(551,071)	(915,798)	(598,227)	(579,179)	(568,568)	(557,883)	(847,334)	(611,751)	(572,788)	(569,761)	(603,212)	(572,264)	(817,074)	
Total																			
<b>Accounts Payable</b>																			
Bond Payment	(11,954)		(164,436)			(166,954)			(21,296)			(9,652)			(164,296)				(164,653)
Police Retirement	(1,296,482)											(1,189,854)							
Worker's Compensation							(693,342)					4,258							
AP payments	(301,441)	(1,262,937)	(1,076,476)	(1,151,019)	(583,097)	(846,564)	(1,255,626)	(1,845,127)	(586,624)	(848,982)	(1,193,955)	1,067,559	(1,535,064)	(765,651)	(1,131,082)	(600,567)	(1,024,962)	(991,266)	
Special Revenue Funds																			
AP payments	(14,514)	(52,765)	(117,229)	(41,909)	(17,850)	(65,741)	(108,908)	(92,315)	(57,101)	(97,336)	(15,095)	(41,957)	(21,213)	(53,111)	(118,196)	(13,591)	(38,092)	(310,593)	
CCF																			
Bank Fee	(18)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)
<b>Deposit</b>																			
Property Tax	4,188,713	292,875	92,883	295,335	92,622	84,391	53,943	378,255	421,240	5,849,000	739,764	263,206	4,187,455	633,490	11,036	118,774	60,690	82,206	
Income Tax		117,314	876,089	18,328		1,438,198				145,740	969,308		31,851	632,787	36,590		632,787	722,131	
Sweep & Other Deposits	220,551,890	237,077,102	273,658,996	237,831,081	218,970,209	221,187,450	172,415,429	222,086,065	194,345,026	233,676,540	274,111,448	281,883,539	255,821,057	261,684,253	323,769,071	257,439,091	466,950	281,381	
Total	224,740,603	237,487,291	274,627,968	238,144,744	219,062,831	222,710,039	172,469,373	222,464,320	194,766,266	239,671,280	275,820,519	282,146,745	260,040,363	262,950,531	323,816,696	257,557,865	1,160,427	1,085,718	
<b>Ending Balance</b>	<b>12,776,725</b>	<b>11,901,795</b>	<b>11,838,624</b>	<b>10,832,152</b>	<b>10,716,897</b>	<b>10,170,385</b>	<b>7,583,579</b>	<b>9,427,250</b>	<b>9,162,034</b>	<b>13,726,947</b>	<b>14,160,478</b>	<b>11,223,742</b>	<b>13,637,370</b>	<b>13,927,956</b>	<b>13,335,842</b>	<b>12,358,309</b>	<b>11,831,108</b>	<b>10,408,937</b>	
<b>Bank Statement Balance</b>	12,776,725	11,901,795	11,838,624	10,832,152	10,716,897	10,170,385	7,583,579	9,427,250	9,162,034	13,726,947	14,160,478	11,223,742	13,637,370	13,927,956	13,335,842	12,358,309	11,831,108	10,408,937	



						2018											
Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
10,408,937	11,663,693	10,766,295	10,421,355	10,920,506	11,419,656	10,151,601	10,294,783	10,463,978	10,736,619	10,493,088	10,772,112	10,193,958	10,455,321	10,692,832	10,938,072	11,052,517	11,318,184
(230,983)	(99,867)	(151,856)	(151,856)	(151,856)	(151,856)	(164,301)	(156,804)	(147,531)	(153,489)	(153,694)	(153,923)	(154,182)	(154,472)	(154,800)	(153,612)	(153,213)	(153,923)
(632,490)	(649,175)	(629,607)	(629,607)	(629,607)	(570,000) (629,607)	(658,231)	(638,375)	(639,111)	(637,853)	(638,884)	(640,043)	(641,348)	(642,815)	(642,082)	(640,064)	(640,275)	(600,000) (640,420)
		(116,391)			(7,351) (1,189,854)				(534,460)		(167,351)				(141,932)		(4,975) (1,190,000)
(603,196)											(693,000)						
(1,733,314)	(1,133,910)	(823,691)	(773,451)	(773,451)	(773,451)	(1,000,746)	(1,001,931)	(910,508)	(882,583)	(889,945)	(904,506)	(920,888)	(939,318)	(931,303)	(922,623)	(912,709)	(912,985)
(27,297)	(20,916)	(60,227)	(60,227)	(60,227)	(60,227)	(76,186.74)	(76,342)	(72,854)	(77,793)	(81,101)	(61,977)	(64,867)	(68,529)	(69,221)	(69,971)	(70,783)	(71,663)
(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)
70,448	383,578	1,062,686	1,062,686	1,062,686	1,062,686	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67	991,666.67
			145,740	969,308			117,314	876,089	18,328		738,198	700,000			145,740	969,308	
3,808,412	622,912	374,165	905,884	82,316	1,051,624	1,051,000	933,686	174,911	1,032,672	1,051,000	312,802	351,000	1,051,000	1,051,000	905,260	81,692	1,051,000
3,878,859	1,006,489	1,436,851	2,114,310	2,114,310	2,114,310	2,042,667	2,042,667	2,042,666	2,042,667	2,042,667	2,042,667	2,042,667	2,042,667	2,042,667	2,042,667	2,042,666	2,042,667
<b>11,663,693</b>	<b>10,766,295</b>	<b>10,421,355</b>	<b>10,920,506</b>	<b>11,419,656</b>	<b>10,151,601</b>	<b>10,294,783</b>	<b>10,463,978</b>	<b>10,736,619</b>	<b>10,493,088</b>	<b>10,772,112</b>	<b>10,193,958</b>	<b>10,455,321</b>	<b>10,692,832</b>	<b>10,938,072</b>	<b>11,052,517</b>	<b>11,318,184</b>	<b>9,786,865</b>
11,663,693	10,766,295	10,421,355	10,920,506	11,419,656	10,151,601	10,294,783	10,463,978	10,736,619	10,493,088	10,772,112	10,193,958	10,455,321	10,692,832	10,938,072	11,052,517	11,318,184	9,786,865