

## **CITY OF TAKOMA PARK, MARYLAND RESERVE POLICY**

### **Background**

A key attribute of a financially stable organization is appropriate reserves. Strong reserves position an organization to weather significant economic downturns, manage revenue reduction as a result of State and Federal legislations, and address unexpected emergencies, such as natural disasters, catastrophic events caused by human activity, or excessive liabilities or legal judgments against the organization.

### **Purpose**

Reserve funds are designed to accumulate cash for future capital expenditures and other allowable purposes. The practice of planning ahead and systematically saving for capital acquisitions and other contingencies is considered prudent financial management. Saving for future capital needs can reduce or eliminate interest and other costs associated with debt issuances. Certain reserve funds can be utilized to help protect the budget against unpredictable risks.

Planning today and saving incrementally for expected future events can help mitigate the financial impact of major, nonrecurring, or unforeseen expenditures on the annual operating budget. Establishing and funding allowable reserve funds for a clear purpose can help smooth sudden increase in the annual budget and negative impact in the real property tax levy.

The other important purpose of a reserve fund is to plan for contingencies, maintain good standing with rating agencies, generate more investment income, ensure cash availability, and create a better working relationship between governing council and staff. The policy should also define acceptable uses for reserves and how the reserve should be managed.

### **Definition of Governmental Fund Balance**

Fund balance is defined as the excess of assets over liabilities, which is an unrestricted resource in General Fund that remains part of the general government budget. The City wants to maintain a prudent level of financial reserves to guard against service disruption in the event of unexpected temporary revenue shortfalls or unpredicted one-time expenditures. The fund balance has been accumulated to meet this purpose, to provide stability, and flexibility to respond to unexpected adversity or opportunities. GASB Statements No.54 defined the reserve fund balance reported in the governmental funds in these categories:

1. Non-Spendable Fund Balance – amounts that cannot be spent either because they are in a non-spendable form or because they are legally or contractually required to be maintained intact. The City's non-spendable fund comprises prepaid expenses and inventory for trash bins.
2. Restricted Fund Balance – amounts that can be spent only for specific purposes because

of restrictions imposed externally by creditors such as debt covenants, grantors, contributors, laws or regulations of other governments or imposed by the City Charter, City Code or other enabling legislation. In the City's financial statements, the restricted funds in the various reserve accounts are set up to be used for bond or debt covenants, street improvements, rehab loans, cable and park grants.

3. Committed Fund Balance – amounts that can be used only for specific purposes determined by City Council, the City's highest level of decision-making authority, and can only be changed by a formal action by City Council ordinance. This category is for the equipment replacement reserve, the emergency reserve and the facility maintenance reserve.
4. Assigned Fund Balance – amounts that are constrained by the City's intent that they will be used for specific purposes but are neither restricted nor committed. Pursuant to the City Charter, the City Manager and the City Council are authorized to assign amounts for specific purposes. Stormwater project is dedicated to this category.
5. Unassigned Fund Balance – remaining amounts not included in the above spendable classifications. The fund balance is the portion of net resources in-excess of the non-spendable, restricted, committed and assigned fund balance.

### **Reserve Target Level**

#### **Unassigned Reserve Minimum Fund Balance**

The General fund is the main operating fund that pays for general services provided by the City, such as public safety, road and sidewalk maintenance, recreational activities and library services. The General Fund Reserve Policy incorporates the requirements of the City Charter and should be consistent with the City Council policies regarding the use of on-going sources of revenue to fund City services. Government Financial Officers Association (GFOA) requires the municipalities to maintain a minimum balance in the reserve equivalent to 60 days of operating expenses for General Fund. By applying the GFOA standard, the City's targeted unassigned reserve fund should be maintained at 17 percent of the City's General Fund total revenue.

In the event that the unassigned reserve fund balance is less than the policy anticipates, the City shall plan to adjust budget resources in the subsequent fiscal year(s) to restore the balance. Except in extraordinary circumstances, the unassigned reserve fund should not be used to fund any portion of the ongoing and routine day-to-day operating expenditures of the City. It should be used to insure adequate designated reserves, to respond to unforeseen emergencies, to provide cash flow, and to provide overall financial stability.

Fund Equity in excess of the target range (17%) is spendable and is available for appropriation. Excess equity will be appropriated primarily for unanticipated circumstances, such as a General Fund revenue shortfall affecting programs included in the current year budget.

Recommendations for the use of excess equity may be brought forward to the City Council for approval. The appropriation of the City's major reserve funds from the Unassigned Reserve is based on the budget ordinance and achieved during the fiscal year end book closing.

### **Equipment Replacement Reserve**

The City's Charter Reserve Provisions stated another separate reserve for the replacement of major capital items. The reserve is categorized as a Committed Reserve separated from the Unassigned Reserve, as prescribed in Section 804(a) of the Charter. These capital items include police fleet vehicles, public works trucks and recreation equipment and etc. Major capital items that have a purchase price greater than or equal to 0.5% of the total budget revenues, at the time of purchase, shall be included in this reserve. Each year's budget shall include expenditures in the form of contributions to the reserve, based on purchase price and the estimated useful life of each item, necessary to maintain the reserve at a level sufficient to replace the covered items. At such time, it is necessary and appropriate to replace items covered by this reserve, that year's budget shall include revenues to be drawn from the unassigned reserve to replace covered items.

If it is determined that the reserve contains insufficient funds to fully fund the replacement of one or more items, additional revenues from other sources may also be designated. The list of items covered by this reserve, along with the estimated useful life and amounts designated for replacement shall be available for public inspection. The Council shall enact by ordinance such additional criteria and procedures as are necessary to operate the Equipment Replacement Reserve. The annual targeted level of reserve replenishment is set at the annual range of \$600,000 to \$800,000. Variation of replenishment amount will depend on budget constrain.

### **Facility Maintenance Reserve**

The City's Charter Reserve Provisions do not provide clear designation for Facility Maintenance Reserve. The reserve fund was originally established as a source of fund for building and facility maintenance of the Community Center on Maple Avenue and Public Works building on Oswego Avenue. The average balance of the Facility Maintenance Reserve Fund is \$500,000. The City plans to transition to a system similar to the ERR for facilities-related items that will need to be replaced cyclically, where various components covered by the reserve fund are assigned a useful lifespan and their major component replacement costs are amortized over that useful life. These items will include things such as replacement of windows, flooring, carpeting, roofing, etc. When necessary, the City Administrator should assign fund transfer from Unassigned Reserve to replenish the Facility Maintenance Reserve Fund upon Council's approval.

### **Emergency Reserve**

The City's Charter Section 804 Reserve Provisions stated 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, as determined and

authorized by the Council by Specific ordinance. Beginning 1996, the target level of the Emergency Reserve was established at \$250,000, and each fiscal year thereafter shall increase by a percentage equal to the increase in the Consumers Price Index for all Urban Consumers in Washington DC Metropolitan areas.

### **Contingency Account**

A contingency account balance equal to 0.5 percent of the City's General Fund revenue total will be maintained annually through the non-departmental budget. This account requires the City Manager's approval if it must be made available for unanticipated, unbudgeted expenditures of a non-recurring nature and/or unexpected cost increases. Furthermore, all spending from this account should be reported to the City Council. The average contingency account balance is maintained at \$120,000.

### **Housing Reserve**

The Reserve fund is dedicated for purposes of advancing affordable housing programming identified in the City's Economic Development Strategic Plan. Projects that may be funded include the purchase of existing housing, rehabilitation or repair of existing housing, demolition of unsafe structures, land acquisition, construction of new housing, down payment assistance, subsidies for mixed-income and mixed-use developments, and predevelopment activities. The Fund is to be replenished on an annual basis mainly from the appropriation from the Unassigned Reserve. It could also use a variety of revenue sources including donations, clean and lien repayments, loan repayments, vacant property registration fees or property tax surcharges, proceeds from the sale of public property, grants and other housing related activities.

### **Restricted Bond Reserve**

Unspent Bond Proceeds are restricted funds for the use designated in the bond's Official Statement. The reserve funds are legally protected by bond covenants and can only be used in case of default by the bond issuer or to pay down principal at maturity. The requirement is established at the time of the bond issue. The amount of reserve should be recalculated annually as bonds are paid down.

### **Managing Reserve**

#### **Acceptable uses for reserves**

The City of Takoma Park uses different funds for recording revenues and expenditures at the end of each fiscal year. Operating surpluses that return to fund balance over time make up the available reserves of the City. Fund Balance use is subject to priority when expenditure may or may not be applied depends on whether the reserve balance is restricted, unrestricted

(committed, assigned, unassigned) and net assets are available. In the reserve fund usage priority, the City will first apply restricted resources.

Restricted fund balance is the part of net resources which should only be used by constitutional provisions, enabling legislation, creditors, grantors, contributors, or with the laws and regulations of other governments. Authority to restrict lies with the external parties, for example Federal Government agencies and State Government authorities.

Non-spendable fund balance is the part of net resources which cannot be spent because of their form or the fact that they must be maintained intact.

The City Council has the highest level of decision making authority hence allowing them to use the committed fund balance which is the portion of net resources only these individuals are permitted to utilize.

The portion of net resources that are meant to be used for a designated purpose is known as the assigned fund balance. The City Council has the authority to authorize the City Manager to designate the use of assigned fund balance.

The portion of net resources more than the non-spendable, restricted, committed, and assigned fund balance become the residual balance in the unassigned fund balance.

The Emergency Reserve and/or Contingency Account may be used at the discretion of the City Council in the following conditions:

1. Provide resources to make up for temporarily decreased revenues
2. Provide temporary resources in the event of an economic downturn while expenditure reductions are implemented
3. Provide resources to meet emergency expenditures in the case of flood, fire, landslides, or other disasters.

### **Reserve Deficiencies**

Once reserves are used they should be replenished in a timely fashion so that they can continue to serve as a hedge against risk and meet the other purposes the reserves were established for. If feasible, minimum fund balances shall be restored in the following year. The City's restoration of Equipment Reserve is incorporated in the budget process and approved by ordinance. At the beginning of each fiscal year, required restoration amount is transferred from Unassigned Fund to Equipment Reserve. If the reserve balance in any City fund falls below the recommended minimum level, the following budgetary strategies should be considered to replenish funding deficiencies:

1. Reducing recurring expenditures
2. Increasing current revenue streams or through developing new revenue sources

### 3. Utilizing ongoing grant funding to alleviate operating expenditure

#### **Reserve Surplus**

Reserves above the target can be used for new expenditures, with emphasis placed on one-time uses that achieve future operating cost reductions. Specifically, the excess reserves should be used for pay-as-you-go capital expenditures or to repay the existing debt. **Assignment of Fund Balance**

In the event that there is a need to assign a portion of fund balance for a specific expenditure or purpose, the authority for the assignment of the fund balance shall be designated by the Finance Director. Such assignment shall be submitted in writing to the City Administrator prior to the issuance of CAFR for the respective fiscal year. In the past, unassigned funds were transferred to the Designated for Subsequent Years due to budget deficit. GFOA also recommends that cities assign excess equity funds to a Designated for Debt Payment Reserve for maintaining a high volume of long term liabilities (Pension Funds) and debt services (Bond Issuance).

#### **Periodic Review of Reserve Policies**

The Government Finance Officers Association (GFOA) recommends, that general purpose government should maintain a practice to periodically review the reserve target as a long-range planning analysis. As the risks and drivers behind the reserve target change, it follows that the reserve target should change as well. A periodic renewal of the reserve analysis may help to increase the credibility of the target with the City's management.