CITY OF PACIFIC GROVE

300 Forest Avenue, Pacific Grove, California93950

AGENDA REPORT

TO:	Honorable Mayor and Members of the City Council
FROM:	Tori Hannah, Administrative Services Director
MEETING DATE:	March 7, 2018
SUBJECT:	Budget and Financial Management Policy 400-6, Reserves
CEQA:	Does not constitute a "Project" under California Environmental Quality Act (CEQA) Guidelines Section 15378.

RECOMMENDATION

Approve a resolution increasing the City's reserve levels in Budget and Financial Management Policy 400-6 to a minimum of 35%, with reserve allocations consistent with the General Fund Reserve Policy Report.

DISCUSSION

The City Council's current Budget and Financial Management Policy 400-6 establishes a General Fund Reserve target level of at least 10% of the annual operating budget, unless otherwise approved by City Council for specific purposes. As part of the City's strategic goal of maintaining financial sustainability, a review of reserve policy levels was conducted to determine the appropriate level of reserves to support cash flow and manage risk. Staff retained the assistance of a consultant, William Statler, to assist in evaluating the City's current reserve policy levels. The initial information was presented at the January 17, 2018 Council Meeting, along with a follow-up report (Attachment 1).

This presentation and report referenced Best Practices identified by the Government Finance Officers Association (GFOA, Attachment 2), comparable City information, as well as financial benchmarks to assist the City in determining the appropriate level of reserves. In addition, the consultant referenced GFOA's structured approach for assessing risk, which includes the evaluation of the following eight factors:

- Vulnerability to extreme events and public safety concerns
- Revenue source stability
- Expenditure stability
- Leverage, such as pension liabilities, unfunded asset maintenance, and debt
- Liquidity (cash flow)
- Dependence on other funds for the General Fund
- Growth and new development
- High priority, unfunded capital projects

While the assessment's initial conclusion indicated that the City should increase reserve levels to 40%; the City's vulnerability to extreme events factor was reduced from a significant to a moderate level. This altered the recommended reserve level to 35%. In addition to this level

being similar to the actual reserve levels of benchmark cities, it is also relatively close to recent City trends that are identified in a February presentation by Moody's rating services (Attachment 3). This trend to increase reserve levels could be attributed to a greater emphasis on fiscal sustainability after the last economic downturn, as well as setting aside funds to assist with budget stabilization due to rising pension costs.

This increased reserve level will assist the City with cash flow needs, future economic downturns, and rising costs of pension liabilities; while also providing an immediate resource for emergencies and potential strategic opportunities. The updated policy will also include a provision to assist in replenishing reserves and reporting requirement to indicate compliance with policy levels (Attachment 4).

The City's fiscal year-end reserve balance for the General Fund was approximately $11.6 million, with approximately $11.4 million classified as *unassigned* fund balance. While the Fiscal Year 17/18 Adopted Budget estimated a drawdown of $1.9 million of reserves to assist in funding capital improvements, preliminary mid-year estimates indicate that it could be closer to $1.2 million. This would yield a projected Fiscal Year 17/18 ending *unassigned* General Fund balance of close to $10.2 million. Based on the Fiscal Year 18/19 forecasted amounts, a 35% reserve level would require a reserve balance of approximately $8 million. It is estimated that there should be additional general fund amounts available to allocate for projected shortfalls in the Capital Improvement Program budget, provide for additional pension stabilization, or assist with other Council priorities.

OPTIONS

The City could choose to retain the current level of reserves; however it is below GFOA's recommended Best Practices and is below the benchmark levels. The City could also elect to retain an alternate level of reserves; however there is information to support establishing the reserve policy level at a minimum of 35%.

FISCAL IMPACT

There is no fiscal impact. This administrative in nature and assists with future fiscal sustainability.

GOAL ALIGNMENT

Financial Sustainability

ATTACHMENTS

1. General Fund Reserve Policy Report
2. GFOA Best Practices
3. Moody's Presentation (Excerpt)
4. Draft Budget and Financial Management Policy 400-6
5. Resolution 18-

RESPECTFULLY SUBMITTED:

Tori Hannah, Administrative Services Director

REVIEWED BY:

Ben Harvey,City Manager

GENERAL FUND RESERVE POLICY

February 28, 2018

William C. Statler
Fiscal Policy ■ Financial Planning ■ Analysis ■ Training ■ Organizational Review

General Fund Reserve Policy

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February 28, 2018

City of Pacific Grove
GENERAL FUND RESERVE POLICY

The purpose of this report is to review the City's current reserve policy and make recommendations for change as appropriate. Provided in Appendix A is the recommended General Fund reserve policy, which covers six key areas:

- Sets the minimum General Fund reserve target using the structured approach developed by the Government Finance Officers Association of the United States and Canada (GFOA) in assessing risk factors (www.gfoa.org/financialpolicies).

  Based on this assessment, the recommended target minimum is 35% of operating and debt service expenditures. This is a reduction from the initial recommendation of 40% presented to the Council in January 2018, which reflects lowering the City's vulnerability to "extreme events" from a severe potential magnitude to a more moderate level.

- Identifies when it is appropriate to use reserves below the target amount.

- Provides a strategy for restoring the reserve if it falls below the target minimum.

- Presents guidelines for accounting and financial reporting of the reserve.

- Discusses other areas where the Council may decide to set reserve amounts.

- Compares actual versus target.

PROPOSED POLICY OVERVIEW

Minimum Reserve Target

The recommended policy sets the target minimum unassigned General Fund balance at 35% of operating and debt service expenditures. This is largely based on the structured assessment methodology for setting reserve levels developed by the GFOA in considering a city's exposure to the following eight fiscal risk factors, which are discussed in greater detail later in this report:

- Vulnerability to extreme events and public safety concerns
- Revenue source stability
- Expenditure volatility
- Leverage, such as unfunded pensions and asset maintenance
- Liquidity (cash flow)
- Dependence of other funds on the General Fund
- Growth: revenue and expenditure imbalance
- Unfunded high priority capital projects

Depending on the results of this assessment, the GFOA methodology provides recommended targets ranging from a minimum of 16.6% of expenditures (60 days cash flow) to circumstances where more than 35% might be warranted. Based on the City's circumstances, the GFOA's structured methodology recommends a target of 26% to 35%. Accordingly, based on a "rating" at the upper end of the scale combined with benchmark results for comparable cities, this report recommends a target of 35% of operating and debt service expenditures.

This compares with the City's most recent audit results for the fiscal year ended June 30, 2017, where the City had an unassigned General Fund balance of $11.4 million (55.1% of actual operating and debt service expenditures); and the 2017-18 Budget, which projects that the ending unassigned General Fund balance will be $8.5 million (40.4% of operating and debt service expenditures).

Uses and Restoration of the Reserve

In addressing future circumstances where the reserve may be less than the target amount, the proposed policy recommends that the City strive to restore reserves to the policy minimum within five years. As revenues versus expenditures improve, the policy recommends that the City allocate at least half to reserve restoration, with the balance available to fund asset replacements, unfunded liabilities, capital improvement projects, service level restorations or new operating programs.

The policy also addresses circumstances where taking reserves below policy levels would be appropriate in responding to the risks that reserves are intended to mitigate, such as:

- Meeting cash flow needs during the fiscal year.

- Closing a projected short-term revenue-expenditure gap.

- Responding to unexpected expenditure requirements or revenue shortfalls.

- Making investments in unfunded liability reductions, economic development and revenue base improvements, productivity improvements and other strategic opportunities that will strengthen City revenues, reduce future costs or achieve high-priority City goals.

- Where a fiscal forecast shows an ongoing structural gap: providing a strategic bridge to the future.

On the other hand, the policy notes that the City should avoid using reserves to fund ongoing costs or projected systemic "gaps." Stated simply, reserves can only be used once, so their use should be restricted to one-time (or short-term) uses.

Accounting for the Reserve

The policy sets the reserve target based on the unassigned General Fund balance: net of non-spendable, restricted, committed or assigned balances. This intuitively makes sense: non-spendable and externally restricted funds are not readily available to meet the risks that the reserve is intended to mitigate. (This is also the recommended approach by the GFOA in its publication *Financial Policies*).

It should also be net of other commitments or assignments, so it is available to meet its intended purposes.

Based on the unassigned fund balance, two things can be readily determined from the audited financial statements after calculating the policy target based on actual operating expenditures:

- Whether the City has achieved its policy goal.
- And the amount (if any) that reserves (unassigned fund balance) exceed or are less than the policy goal.

General Fund Balance Classifications

Under generally accepted accounting principles set by the Government Accounting Standards Board (GASB) in Statement No. 54, General Fund balance is classified into five components:

- ***Non-Spendable.*** Amounts that are not in spendable form, such prepaid items or inventories.
- ***Restricted*.** Amounts subject to *externally* enforceable restrictions imposed by outside third parties.
- ***Committed*.** Amounts whose use is constrained internally by the agency itself for specific purposes set by the governing body.
- ***Assigned*.** Amounts intended for specific purposes as determined by the governing body or others it has formally designated.
- ***Unassigned.*** Residual classification of spendable amounts available for other purposes.

As discussed below, the City's target reserve should be reported as part of the "unassigned" fund balance.

Status Summary: Actual Versus Target

Lastly, the policy provides a status summary of the policy target with the actual reserve amount. If the projected reserve is less than the target minimum, the strategy for achieving policy restoration should discussed. This comparison should be updated at least annually and included with the policy.

It should be noted that comparing policy with actual is a useful approach for all fiscal policies in demonstrating effective steward of City assets. It keeps fiscal policies – and compliance with them – on the City's financial management radar on an ongoing basis.

Continuing to Include the Reserve Policy in the Budget Document

Having a clearly stated reserve policy has its greatest value during the budget preparation, review and adoption process. According, this report recommends continuing the City's practice of including the reserve policy in the budget document itself (along with other significant budget and fiscal policies).

DISCUSSION

The Power of Fiscal Policies

As we know from experience over the past 25 years, with the recession and recoveries of 1992-94, 2003-05 and the Great Recession beginning in 2008, good times come and go. But an organization's values shouldn't. And that's what fiscal policies are all about: articulating your financial management values before they are place under stress.

Stated simply, clearly articulated policies – and being guided by them – are the best way of ensuring long-term fiscal health. While the strength of the local economy and related General Fund revenues are important, no city is immune from economic downturns. In navigating tough fiscal times, effective financial management is the most critical factor for long-term fiscal success; and clearly articulated policies provide an essential framework and foundation for effective decision-making.

Fiscal policies are important in both good times and bad. The roots of fiscal adversity for most governments take hold in the good times, by making commitments that are not sustainable. They rarely surface in the "bad" times, when most agencies act on the "First Rule of Holes" (when you find yourself in one, stop digging).

They are both preventative and curative:

- Clearly articulated policies – and following them – help prevent problems from arising in the good times.

- And provide more effective responses when the inevitable bad times occur.

They are most powerful when it put in place before the need for them arrives, recognizing that not all financial decision-making situations can be reasonably anticipated.

Policies should be set based on the agency wants to be, which may not be where it is today. However, setting the course for where it wants to be significantly enhances its ability to get there. Accordingly, each policy should include a brief "compliance status." And if it is not there yet, the policy should provide the agency's plan for getting there. (As discussed above, the proposed reserve policy includes this component.)

Policies Versus Plans. Planning is essential for success. However, plans change over time as actual results replace assumptions. But fiscal policies are the "north star" guiding the preparation of plans. They help making tough decisions easier by articulating values before

they are put placed under stress by adverse circumstances. An organization can reasonably do something else, but policies are a powerful starting point for asking: but for "this" unexpected circumstance, what would we have otherwise done?

Lastly, of all the fiscal policies that cities should set, minimum reserve targets are among the most important.

Prudent Reserves Reflect Ability to Manage Risk, Not Fiscal Strength Per Se

Reserves – whether large or small – do not per se reflect on a city's financial capacity or underlying fiscal strength. There are much better indicators than reserves for this, most notably the ability over time for ongoing revenues to adequately meet day-to-day service needs, capital improvement goals and debt service requirements.

Stated simply, reserves are a risk management tool: how much can things go differently than the organization otherwise thought they would before it must take corrective action? Reserves can also serve as a bridge to the future, providing time to develop and implement thoughtful solutions.

Typical risks that reserves help mitigate include economic uncertainties, such as downturns in the economy and external revenue hits (like State takeaways); responding to local disasters; contingencies for unforeseen operating or capital needs; strategic opportunities; and cash flow.

What's the Right Amount? It depends on each agency's unique fiscal circumstances and capacity for risk. In answering this question, there are three sources to consider:

- Rating agency recommendations.
- Benchmarking: policies in comparable cities with a reputation for being well-managed.
- GFOA structured assessment approach.

❶ Rating Agency Recommendations

All three of the major rating agencies – Moodys, Standard and Poors and Fitch – identify reserve policies as one of their most important factors in assessing an agency's financial management and assigning bond ratings. While they do not provide recommended minimums, they are interested in their basis and the agency's track record in following them.

❷ Benchmark Analysis: Policies in Comparable Cities

When carefully prepared, benchmark analysis can be a powerful tool in assessing a wide-range of topics, including staffing, performance, financial condition, policies, organizational structure – and in this case – reserve policies. However, making meaningful comparisons requires carefully selecting both the data that will be collected ("metrics") and the benchmark cities to ensure they represent as close a match to the City as possible, recognizing that a "perfect" match is not possible.

This means that along with selecting comparably sized cities, it is important to select cities that share other important service, economic, geographic and demographic characteristics with Pacific Grove as well. Additionally, to avoid a "race to the bottom," comparison cities should also be selected that have a reputation for being well-managed and leaders in the use of "best practices."

Selecting Benchmark Cities. While the process in selecting benchmark cities is discussed in greater detail in Appendix B, the following outlines key selection criteria:

- Similar population: between 7,500 and 25,000 population (Pacific Grove: 15,498)
- Coastal location
- Tourism important component of local economy
- Distinct sense of place
- Similar scope of services
- Reputation for being well-managed and using "best practices"

Of the 482 cities in California, 129 are larger than 7,500 in population and smaller than 25,000. Of these, 36 are located in coastal areas. In screening for tourism as an important part of the local economy, 18 of them had ratios of transient occupancy tax revenues to general purpose revenues greater than 10%, based on the most recent financial reports from the State Controller's Office. (For Pacific Grove, which is one of these, the ratio was 30%.)

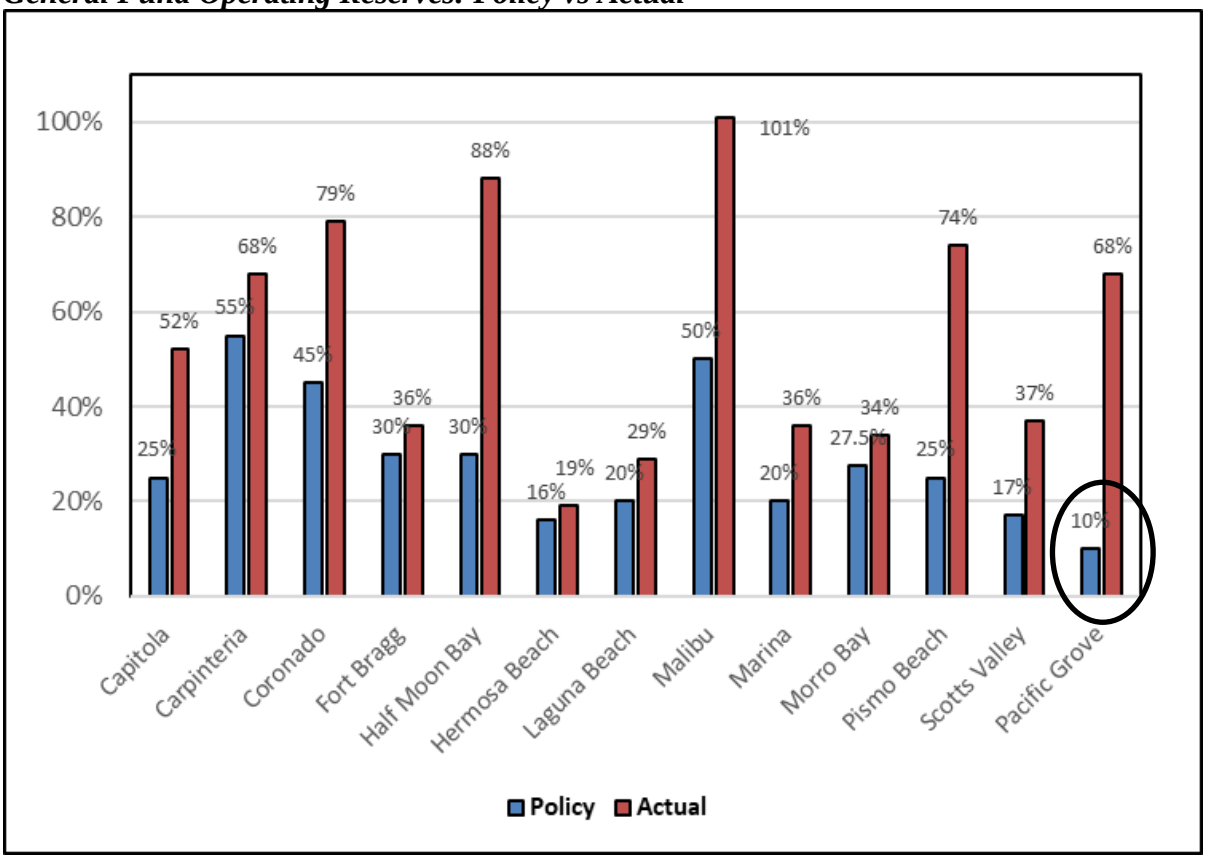
A detailed look at these 18 cities for similar demographic and service delivery characteristics resulted in the following twelve comparison cities (population in parenthesis):

- Capitola (10,162)
- Carpinteria (13,943)
- Coronado (24,453)
- Fort Bragg (7,772)
- Half Moon Bay (12,591)
- Hermosa Beach (19,616)
- Laguna Beach (23,505)
- Malibu (12,742)
- Marina (21,528)
- Morro Bay (10,762)
- Pismo Beach (8,247)
- Scotts Valley (12,163)

While not "exact" matches, these agencies closely reflect the City's demographics, economy and scope of services. While coastal, they are geographically diverse, located throughout the State; and their average population is 14,800 (closely reflecting Pacific Grove's population of 15,500).

Benchmarking Results. A detailed matrix of current reserve policies and actual results (based on the most recent audited financial statements) in these twelve cities (along with Pacific Grove) is provided in Appendix B, summarized as follows:

General Fund Operating Reserves: Policy vs Actual



For Pacific Grove, this chart reflects the current reserve policy and basis for calculating it.

As reflected in this summary:

- "Operating" reserve policies range from 16% to 55% of expenditures or revenues (excludes "other reserves," which are in place in all the benchmark cities).

- All meet or exceed their target policy minimum, with actual reserves ranging from 19% to 101%.

- At 10%, the City's reserve policy is below all of these other cities, while actual reserves at 68% (as defined under the current policy) are higher than the average of 51%.

❸ GFOA Structured Assessment Methodology

The GFOA has developed a structured assessment methodology for setting reserve levels in considering an agency's exposure to the following eight fiscal risk factors:

1. ***Vulnerability to Extreme Events and Public Safety Concerns.*** Major extreme events the community could reasonably be subject to and the likelihood and potential magnitude of loss for each event.

2. ***Revenue Source Stability*.** Volatility of each major revenue source based on factors such as past experience and trends with that revenue, characteristics of the tax or rate payers, state or federal revenue takeaways and economic factors.

3. ***Expenditure Volatility*.** Spikes in expenditures, usually arising from special, non-recurring circumstances such as lawsuits; critical special projects without a funding source; or new state or federal spending requirements and unfunded mandates.

4. ***Leverage*.** Common examples include unfunded pensions and unfunded asset, as well as outstanding bonded indebtedness and compensated absences. Is the source of leverage very large? Does it have an off-setting funding source or asset?

5. ***Liquidity (Cash Flow)*.** Intra-period cash imbalances, such as property taxes that are only received at two major points during the year (December and June).

6. ***Dependence of Other funds*.** Are there other funds that have a significant dependence on the General Fund?

7. ***Growth*.** Is significant growth a realistic possibility in the next three to five years? This includes assessing likely potential marginal costs associated with serving new growth compared with marginal revenues and resulting gaps.

8. ***Capital Projects*.** Are there high priority projects without a funding source, where reserves may be looked to as a funding source?

As discussed in greater detail in Appendix C, the methodology uses a scale of 5-1 in assessing how important reserves are in mitigating each risk:

5: Very important
4: Important
3: Neutral
2: Unimportant
1: Very unimportant

Since there are eight mitigation factors, total scores will range from 8 (the least risk) to 40 points (greatest risk). Along with these eight risk factors, the methodology also considers:

- City size (assumes larger cities have more mitigation strategies than smaller ones)
- Other reserve/contingency funds
- Borrowing capacity
- Benchmark study results

Depending on the results of this assessment, the GFOA methodology provides recommended targets ranging from a minimum of 16.6% of expenditures (60 days cash flow) to circumstances where more than 35% might be warranted.

The following summarizes the GFOA's rating scale.

GFOA Reserve Rating Scale

Rating	Target Minimum General Fund Reserve
8 -16	Minimal risk to retain through reserves. Consider target equal to the GFOA minimum recommended reserve of 16.6% (two months cash flow) of revenues/expenditures.
17-24	Low to moderate level of risk to retain through reserves. Consider reserve target of 17% to 25%.
25-31	Moderate to high level of risk to retain through reserves. Consider reserve target of 26% to 35%.
32-40	High level of risk to retain through reserves. Consider reserve target greater than 35%.

As detailed in Appendix C, the City's rating under this methodology is 31, which indicates that the target minimum should be 35% (the upper end of this scale).

Six of the assessment factors were largely responsible for this rating:

- Revenue stability
- Expenditure volatility
- Cash flow (see sidebar and Appendix D)
- Unfunded liabilities
- Unfunded capital projects

During the Council reserve policy briefing on January 17, 2018, concerns surfaced that the rating under the GFOA structured assessment methodology overstressed the risks posed by "extreme events" such as fire, flood, drought, earthquake or bluff stabilization. Accordingly, the risk of extreme events has been reduced to "neutral" to reflect a more moderate vulnerability to these types of events. This revised assessment, resulted in a reduction in the recommended reserve target from 40% to 35%,

The other two factors (dependence of other funds on the General Fund and growth) were not significant in this rating.

Mitigating Cash Flow with TRANS

At the Council reserve policy briefing on January 17, 2018, the concept of using Tax and Revenue Anticipation Notes (TRANS) surfaced as a possible mitigation for cash flow needs.

TRANS are short-term borrowings by local government agencies who are not able to meet their cash flow needs during the year. They are typically issued early in the fiscal year and repaid before year-end.

At one time, many TRANS were issued as an investment strategy, since the proceeds could be invested at higher yields than their tax-exempt interest rate. However, this favorable variance between interest costs and yields has not been the case since the Great Recession.

Stated simply, while incurring debt to meet cash flow needs is an option, it is preferable to avoid it if possible. Moreover, TRANS are not free: there are financing and interest costs in issuing them.

Appendix D provides a cash flow analysis for the General Fund, which shows the need for 20% to cover several low points in the fiscal year, most notably in November and May prior to the receipt of property tax revenues (the City's most important General Fund revenue source).

COMPARISON WITH EXISTING POLICY

The City's current reserve policy is provided in Appendix E. The following summary compares the proposed and existing policies:

Policy	Proposed	Current
Target Minimum	35%	10%
Basis	Operating and debt service costs	Operating costs
Reserve Definition	Unassigned fund balance	Unrestricted fund balance
Reserve Restoration	• Within 5 years • At least 50% of improved financial condition to reserve; balance available for other purposes	• No timeframe • Prioritizes restoration of reserves to their policy levels before allocating resources to fund new or improved services
Appropriate Reserve Use	• Responding to risks that reserves are intended to mitigate (with examples) • Where fiscal forecast shows an ongoing structural gap: in providing a strategic bridge to the future	Broad definition based on reserve purpose

The differences between the current and proposed reserve policy are addressed below under Alternatives.

ALTERNATIVES

Setting the Minimum Target Reserve at Lower or Higher Amounts than 35%

Based on both the benchmarking results and the GFOA structured assessment methodology, the risks facing the City warrant a reserve that is greater than 10%. This report recommends 35% of operating and debt service costs. However, the Council is the ultimate "decider" in balancing risks and reserves. Stated simply, the City's fiscal resources do not exist to amass large fund balances but rather, to deliver important services that help make Pacific Grove a good place to live, work and play. On the other hand, prudent reserves are essential in helping assure stability in the delivery of services.

Accordingly, the Council could reasonably set reserves at levels that are lower or higher than the recommended target.

Lower Target than 35%. As noted above, during the Council reserve policy briefing on January 17, 2018, concerns surfaced that the initial rating under the GFOA structured assessment methodology overstressed the risks posed by "extreme events" such as fire, flood, drought, earthquake and bluff stabilization. Accordingly, the risk of extreme events has been

reduced to "neutral" in the assessment to reflect a more moderate vulnerability to the impacts of these events. This resulted in a reduction in the recommended reserve target from 40% to 35%. However, the GFOA recommendation with the revised score ranges from 26% to 35%. Accordingly, 30% would be a reasonable target in falling in the middle of this range.

Higher Target than 35%. The benchmark results show four cities that set their policy above 35% (Carpinteria: 55%; Coronado: 45%; Fort Bragg: 30% to 45%; and Malibu: 50%). Moreover, actual reserves for all the benchmark cities averaged 51%. Also, assessing "extreme events" as "significant" (rather than "neutral") would move the City's rating into the "more than 35%" tier. Accordingly, a target higher than 35% would also be reasonable.

Using a Different Basis for Determining the Reserve

As outlined in Appendix B, each of the benchmark cities define the basis for the reserve – what the target percentage applies to – differently, depending upon whether expenditures (operating, capital, debt service or transfers) or revenues are the basis. The following summarizes the bases used for each benchmark city as well as Pacific Grove.

City	Basis	Includes	Excludes
Capitola	Normal Expenditures	• Operating • Debt service	• Major capital projects • Significant one-time operating costs, such as major studies or plans • Transfers out
Carpinteria	Expenses	• Operating • Capital projects • Debt service	• Transfers out
Coronado	Expenditures and Uses	• Operating • Capital projects • Debt service • Transfers out	
Half-Moon Bay	Annual Expenditures	• Operating • Capital projects • Debt service	• Transfers out
Hermosa Beach	Expenditures	• Operating • Capital projects • Debt service	• Transfers out
Morro Bay	Three-Year Average of Actual Revenues	Of the twelve benchmark cities, only one that uses revenues as basis for applying the target.	
Pismo Beach	Expenditures	• Operating • Capital projects • Debt service	• Transfers out

Scott's Valley	Operating Expenditures and Net Transfers	• Operating • Net result of transfers in and out	• Capital projects • Debt service

While stated differently, four of the benchmark cities (Fort Bragg, Laguna Beach, Malibu and Marina) use operating expenditures as the basis, which is also the case for the City.

Where the base is narrower (such as just operating costs), the same target percentage will result in a smaller reserve; conversely, where the base is broader (including capital, debt service and/or transfers), the same target percentage will result in a larger reserve.

In the case of the City, it makes sense to include debt service costs in the base:

- Like operating costs, debt service costs are ongoing. (Debt service costs are included in majority of the benchmark cities that use expenditures as the basis.)

- And in the case of the City, this is especially true. The primary debt service cost is for pension obligation bonds, which were issued in 2006 and will not mature until 2029. These bonds were issued in-lieu of higher annual pension payments to CalPERS. In short, albeit in a different form, these reflect the City's annual pension costs: if not for the bonds, these same costs would be included with the City's operating costs as payments to CalPERS.

On the other hand, capital projects can vary from year-to-year, and the reserve should be relatively stable. And interfund transfers are internally determined by the City: overall City resources are unaffected by them. Accordingly, the recommended policy excludes capital project and transfer and includes operating and debt service costs as basis for determining reserve levels.

Showing the Reserve as "Assigned" in Financial Statements

On one hand, it makes intuitive sense to consider the recommended reserve as "assigned" for fiscal stability, cash flow and contingencies. However, these purposes fall into a category that GASB calls "revenue stabilization, working capital needs, contingencies or emergencies;" and unless they are specifically classified as restricted or committed (which would not be appropriate in this case), GASB 54 states that they "… should be reported as unassigned in the general fund."

Defining Reserves as the Unrestricted Fund Balance

As discussed above, GASB defines organizes the unrestricted General Fund balance (net of non-spendable and restricted amounts) into three categories:

- Committed
- Assigned
- Unassigned

During the Council reserve policy briefing on January 17, 2018, interest surfaced in retaining the current policy in defining the unrestricted balance (committed, assigned and unassigned balances combined) as the "reserve."

The primary concern was that the unrestricted balance was simpler to identify in the audited financial statements in comparing the policy with actual results. In fact, the total for the unrestricted balance is not typically provided in audited financial statements (and this is the case for the City), whereas the unassigned balance is separately identified. Moreover, as noted above, GASB 54 indicates that "operating reserves" like these should be classified as "unassigned." Lastly, unless the City formally commits or assigns balances for specific purposes, all of the fund balance will be shown as "unassigned" anyway.

Moreover, in its structured assessment methodology, the GFOA recommends that the minimum fund balance target be exclusive of other commitments or assignments.

That said, while this report recommends using the unassigned balance, it is not unusual for cities to define reserves for policy purposes as the potentially larger (depending on the size of the amounts classified as committed or assigned), unrestricted balance.

In the City's case, through June 30, 2017, there is no significant difference between the unrestricted and unassigned balance: of the $11.6 million in the unrestricted General Fund balance, only a small, 2% portion ($279,700) was classified as "assigned" for social service programs (no funds were shown as committed). Accordingly, the distinction will be important in the future if the City expands its use of fund balance assignments and commitments. (The proposed policy provides for this.)

Restoring the Reserve

In those cases where reserves are drawn down below target levels, the current policy prioritizes restoration of reserves to their policy levels before allocating resources to fund new or improved services, without regard as to when that might happen. The proposed policy provides a target restoration timeframe of five years and provides the Council with more flexibility in balancing reserves with other priorities.

Identifying Appropriate Uses of the Reserve

Compared with the current policy, the proposed policy provides greater guidance on appropriate uses of the reserve. As discussed above, one of the key benefits of clearly stated fiscal policies is making tough decisions easier. Accordingly, consistent with the intended purpose of reserves, the proposed policy provides examples of when their use would be appropriate.

Segregating the Reserve into Separate Components

The proposed policy sets a unified reserve target of 35% to meet the aggregate of the risks it is intended to meet. Since not all factors are likely to come into play at the same time, this approach makes sense: "pooling" purposes serves to lower the overall reserve amount that might otherwise be needed to meet each of the risk factors individually. Moreover,

budgeting and accounting for the reserve is simpler and more straightforward, as is communicating its purpose to the community and organization.

That said, there may be some interest in separating the need for the reserve into specific categories. In that case, the following are recommended:

- Cash Flow: 20%
- Fiscal Stability: 10%
- Contingencies/Strategic Opportunities: 5%

CONCLUSION

Establishing a reserve policy – and being guided by it – is among the most important of the City's fiscal policies by mitigating financial risks. Based on the results of the benchmarking analysis and the GFOA structured assessment methodology, this report recommends that the minimum reserve target be set at 35% of operating and debt service expenditures.

Along with the recommended target, it sets guidelines for when it is appropriate to use reserves below the target amount; restoring the reserve if it falls below the target minimum; accounting and financial reporting of the reserve; and for at least annually comparing actual results versus the target. It also discusses alternatives for the City's consideration for each of the key recommendations.

William C. Statler

Fiscal Policy ■ *Financial Planning* ■ *Analysis* ■ *Training* ■ *Organizational Review*

APPENDIX

A. Proposed General Fund Reserve Policy
B. Benchmark Analysis: Policies in Comparable Cities
C. General Fund Reserve Risk Factors: GFOA Structured Assessment Methodology
D. Cash Flow Analysis
E. Current General Fund Reserve Policy
F. Consultant Background

Appendix A: Proposed General Fund Reserve Policy

Reserves for Fiscal Stability, Cash Flow and Contingencies

The City will strive to maintain a minimum unassigned fund balance of at least 35% of operating and debt service expenditures in the General Fund for fiscal stability, cash flow and contingencies/strategic opportunities. This is based on the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association of the United States and Canada (GFOA) in adequately addressing:

- Revenue source stability, local disasters and other financial hardships or downturns in the local or national economy.
- Contingencies for unseen operating or capital needs, including strategic investment opportunities.
- Unfunded liabilities such as self-insurance, pensions and retiree health obligations.
- Dependency of other funds on the General Fund.
- Institutional changes, such as State budget takeaways and unfunded mandates.
- Cash flow requirements.

Whenever the City's General Fund unassigned fund balance falls below this target, the City will strive to restore reserves to this level within five years. As revenues versus expenditures improve, the City will allocate at least half to reserve restoration, with the balance available to fund asset replacements, unfunded liabilities, capital improvement projects, service level restorations or new operating programs.

Circumstances where taking reserves below policy levels would be appropriate include responding to the risks that reserves are intended to mitigate, such as:

- Meeting cash flow needs during the fiscal year; closing a projected *short-term* revenue-expenditure gap; responding to unexpected expenditure requirements or revenue shortfalls; and making investments in unfunded liability reductions, economic development and revenue base improvements, productivity improvements and other strategic opportunities that will strengthen City revenues, reduce future costs or achieve high-priority City goals.

- Where a forecast shows an ongoing structural gap, in providing a strategic bridge to the future.

On the other hand, the City should avoid using reserves to fund ongoing costs or projected systemic "gaps." Stated simply, reserves can only be used once, so their use should be restricted to one-time (or short-term) uses.

Future Capital Project or Other Long-Term Goal Assignments or Commitments

The Council may also commit or assign specific General Fund balance levels above the reserve target for future development of capital projects, unfunded liabilities or other long-term goals that it determines to be in the best interests of the City.

Appendix A: Proposed General Fund Reserve Policy

Other Commitments and Assignments

In addition to the 35% target noted above, unrestricted fund balance levels will be sufficient to meet funding requirements for programs or projects approved in prior years which are carried forward into the new year; debt service reserve requirements; commitments for encumbrances; and other restrictions, commitments or assignments required by contractual obligations, state law or generally accepted accounting principles.

Status: In Compliance. *For the last audited financial statements for the fiscal year ended June 30, 2017, the City had an unassigned General Fund balance of $11.6 million (56.6% of actual operating and debt service expenditures); and the 2017-18 Budget projects that the ending unassigned General Fund balance will be $8.5 million (40.4% of operating and debt service expenditures).*

Appendix B: Reserve Policy Benchmarks

The following presents the results of the benchmark analysis of reserve policies in twelve comparable California cities. It is followed by a summary of how these benchmark cities were selected.

City	General Fund Operating Reserve		Other Reserves
	Policy	Actual*	
Capitola	25% of Normal Expenditures (Emergency Reserve: 10%; Contingency Reserve: 15%)	52.4% (Net of other reserves)	• Facilities Reserve • PERS Contingency Reserve
Carpinteria	55% of Expenses	67.7% (Net of other reserves)	• Capital Asset Replacement • Special Projects
Coronado	45% of Expenditures and Uses	78.8% (Net of other reserves)	• Vehicle and Equipment Replacement • Liability and Workers' Compensation Insurance • Employee Benefits
Fort Bragg	30% to 45% of Operating Expenditures (Emergency Reserve: 10% to 15%; Economic Stabilization: 5% to 10%; Operating Reserve: 15% to 20%)	36.0% (Net of other reserves)	• Litigation • Facility Repair and Maintenance • Fleet and Equipment Replacement • Information Technology
Half Moon Bay	30% of Annual Expenditures	88.2% (Net of other reserves)	• Main Street Bridge Contingency • Measure J
Hermosa Beach	16% of Expenditures	18.5% (Net of other reserves)	• Insurance • Equipment Replacement • Pension Stabilization
Laguna Beach	20% of Operating Expenditures	28.6% (Net of other reserves)	• Solid Waste • Open Space • Parking • Capital Projects
Malibu	50% of Operating Budget	100.9% (Net of other reserves)	• Facilities and Equipment Replacement

Appendix B: Reserve Policy Benchmarks

City	General Fund Operating Reserve		Other Reserves
	Policy	Actual*	
Marina	20% of Operating Expenditures	36.3% (Net of other reserves)	• Vehicle & Equipment Replacement • Benefits • Facilities
Morro Bay	27.5% of Three-Year Average of Actual Revenues	33.8% (Net of other reserves)	• Facility Maintenance
Pismo Beach	25% of Expenditures	74.3% (Net of other reserves)	• Facilities • Capital Projects • Risk Management
Scotts Valley	17% of Operating Expenditures and Net Transfers	37.0% (Net of other reserves)	• Capital Projects
Pacific Grove	10% of Operating Expenditures	68.1%	• Insurance

** Based on most recent on-line audited results, which is the fiscal year ended (FYE) June 30, 2017 for most cities, except for Laguna Beach, Malibu, Marina and Morro Bay, where the most recent on-line reports are for FYE June 30, 2016. For Pacific Grove, this chart reflects the current reserve policy and basis for calculating it.*

SELECTING THE BENCHMARK CITIES

Overview. When carefully prepared, benchmark analysis can be a powerful tool in assessing a wide-range of topics, including staffing, performance, financial condition, policies, organizational structure – and in this case – reserve policies. However, making meaningful comparisons requires carefully selecting both the data that will be collected ("metrics") and the benchmark cities to ensure they represent as close a match to the City as possible, recognizing that a "perfect" match is not possible.

This means that along with selecting comparably sized cities, it is important to select cities that share other important service, economic, geographic and demographic characteristics with Pacific Grove as well. Additionally, to avoid a "race to the bottom," comparison cities should also be selected that have a reputation for being well-managed and leaders in the use of "best practices."

Selection Criteria. The following outlines key selection criteria in identifying benchmark cities in comparing their reserve policies with the City:

- Similar population: between 7,500 and 25,000 population (Pacific Grove: 15,498)
- Coastal location
- Tourism important component of local economy
- Distinct sense of place
- Similar scope of services
- Reputation for being well-managed and using "best practices"

Appendix B: Reserve Policy Benchmarks

Selection Process. There were three key steps in selecting the benchmark cities:

- Identify cities between 7,500 and 25,000 population and screen for coastal location.
- Assess fiscal importance of tourism via ratio of transient occupancy tax (TOT) revenues to general purpose revenues.
- Select "candidate cities" and screen for scope of services and "good governance."

Step 1: Population and Location

Of the 482 cities in California, 129 are larger than 7,500 in population and smaller than 25,000. Of these, 36 are located in coastal areas.

Step 2: Fiscal Importance of TOT Revenues

In screening for tourism as an important part of the local economy, 18 of these 36 cities (including Pacific Grove) had ratios of TOT revenues to general purpose revenues greater than 10%, based on the most recent financial reports filed with the State Controller's Office. The table below shows the results of this analysis, organized by the highest to lowest ratios.

Coastal Cities: 7,500 to 25,000 Population					
City	Population	County	%TOT/ Gen Rev	TOT	Gen Rev
Pismo Beach	8,247	San Luis Obispo	48.1%	9,199,947	19,138,026
Half Moon Bay	12,591	San Mateo	42.7%	5,935,558	13,884,675
Morro Bay	10,762	San Luis Obispo	38.0%	3,910,721	10,295,824
Fort Bragg	7,772	Mendocino	37.2%	1,947,703	5,230,695
Carpinteria	13,943	Santa Barbara	30.7%	2,379,751	7,739,353
Coronado	24,543	San Diego	30.3%	13,818,817	45,638,387
Pacific Grove	15,498	Monterey	30.0%	5,364,317	17,865,054
Laguna Beach	23,505	Orange	21.2%	10,754,654	50,698,964
Marina	21,528	Monterey	18.1%	2,549,531	14,047,292
Emeryville	11,854	Alameda	17.2%	6,894,846	40,137,804
Fortuna	11,989	Humboldt	14.1%	610,627	4,327,381
El Segundo	16,717	Los Angeles	13.8%	7,597,007	55,229,692
Arcata	18,374	Humboldt	12.7%	1,365,897	10,767,869
Malibu	12,742	Los Angeles	12.3%	2,619,857	21,287,880
Capitola	10,162	Santa Cruz	11.7%	1,451,513	12,358,899
Scotts Valley	12,163	Santa Cruz	11.2%	1,011,432	9,019,345
Tiburon	9,508	Marin	10.9%	836,400	7,698,075
Hermosa Beach	19,616	Los Angeles	10.8%	2,762,444	25,554,468
Seal Beach	24,890	Orange	7.7%	1,655,376	21,534,448
Arroyo Grande	17,736	San Luis Obispo	7.1%	966,384	13,582,403
Larkspur	12,572	Marin	6.6%	1,006,550	15,253,736
Sebastopol	7,579	Sonoma	6.6%	483,738	7,374,134
Port Hueneme	22,808	Ventura	6.5%	508,800	7,833,738
Grover Beach	13,438	San Luis Obispo	5.4%	363,352	6,786,768
Corte Madera	9,486	Marin	4.7%	841,919	17,744,256
Mill Valley	14,910	Marin	3.6%	772,894	21,536,550
Millbrae	23,168	San Mateo	3.6%	772,894	21,536,550
Pinole	18,975	Contra Costa	2.8%	459,393	16,122,345
El Cerrito	24,600	Contra Costa	0.8%	139,084	18,454,498
Rio Vista	9,019	Solano	0.5%	23,055	4,566,687
Fairfax	7,571	Marin	0.4%	28,039	6,787,037
Albany	18,988	Alameda	0.0%	-	15,072,532
Palos Verdes Estates	13,663	Los Angeles	0.0%	-	9,735,474
Rolling Hills Estates	8,059	Los Angeles	0.0%	-	4,901,363
San Anselmo	12,937	Marin	0.0%	-	13,749,102

Appendix B: Reserve Policy Benchmarks

Step 3: Scope of Services and "Good Governance"

The next step was to analyze the key services provided by each of these 17 top candidate cities and provide a high-level screen for "good governance."

The matrix below shows whether the candidate cities provide a similar scope of services as the City by focusing on four key services: police, fire, library and parks/recreation services.

It also provides two high-level screens for "good government" and "best practices" among the candidate cities.

- Are their budgets and audits posted on their web sites? (Failure to do so not only makes accessing reserve information and actual results about them difficult but placing these documents on the city's web site is a "best practice;" and in many cases, the lack of current audited financial statements on web sites is because they do not exist.)

- Have they received awards for excellence for their budgets and annual financial reports from either the California Society of Municipal Finance Officers (CSMFO) or the Government Finance Officers Association of the United States and Canada (GFOA)?

Top 17 Benchmark Candidates

			Key Services				On-Line		GFOA-CSMFO Award	
City	County	Population	Police	Fire	Library	Parks & Recreation	Budget	Audit Reports	Budget	Audit Reports
Arcata	Humboldt	18,374	x			x	x			
Capitola	Santa Cruz	10,162	x			x	x	x	x	x
Carpinteria	Santa Barbara	13,943	*			x	x	x	x	x
Coronado	San Diego	24,543	x	x	x	x	x	x		x
El Segundo	Los Angeles	16,717	x	x	x	x		x		
Emeryville	Alameda	11,854	x	x		x	x	x		x
Fort Bragg	Mendocino	7,772	x	*		x	x	x	x	x
Fortuna	Humboldt	11,989	x			x	x	x		
Half Moon Bay	San Mateo	12,591	*			x	x	x	x	x
Hermosa Beach	Los Angeles	19,616	x	x		x	x	x	x	x
Laguna Beach	Orange	23,505	x	x		x	x	x		x
Malibu	Los Angeles	12,742	*			x	x	x		x
Marina	Monterey	21,528	x	x	x	x	x	x		
Morro Bay	San Luis Obispo	10,762	x	x		x	x	x		x
Pismo Beach	San Luis Obispo	8,247	x	*		x	x	x	x	x
Scotts Valley	Santa Cruz	12,163	x			x	x	x		x
Tiburon	Marin	9,508	x				x	x		
Pacific Grove	Monterey	15,498	x	*	x	x	x	x		

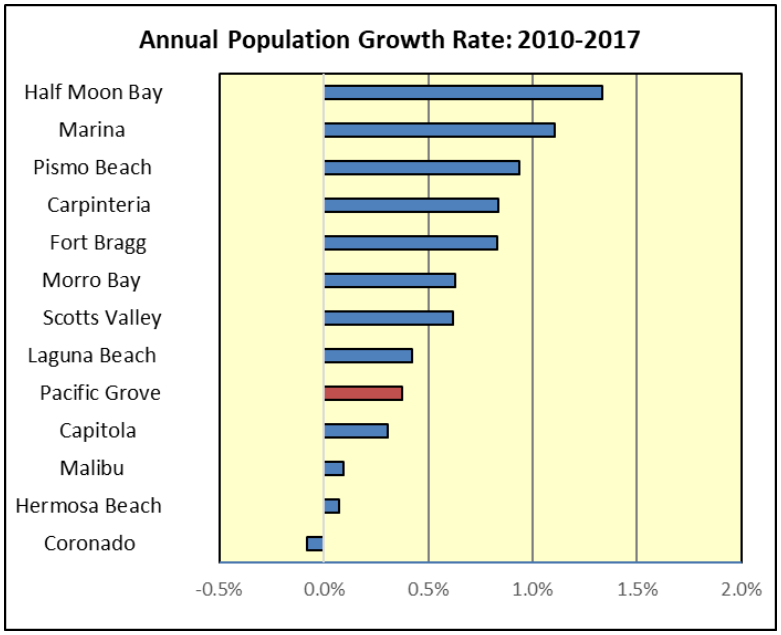
Contract for Service	*
Recommended Benchmark Cities	

Initially, the goal was to select six to eight benchmark cities. As reflected in this report, this was expanded to twelve cities, largely based on the difficulty in narrowing the candidates. While judgment is needed in selecting the benchmark cities based on "best fit," five of the 17 candidate cities were excluded for the following reasons:

Appendix B: Reserve Policy Benchmarks

- *Arcata* does not have recent audited financial statements on its web site.
- TOT revenues in *El Segundo* and *Emeryville* are largely driven by business travelers rather than tourists.
- There are better service and "good governance" matches than *Fortuna*.
- *Tiburon* only provides one of the key services.

One other similarity is worth noting: all of these are "slow growth" cities. As reflected in the chart below, the annual population growth since 2010 for each of these benchmark cities, as well as Pacific Grove, was under 1.5%. In fact, for ten of the cities, it was under 1%; and the average for all the cities was 0.6%. (One city, Coronado, had a small decrease of 0.1%.)



Final Selection. The selection process resulted in the following twelve comparison cities (population in parenthesis):

- Capitola (10,162)
- Carpinteria (13,943)
- Coronado (24,453)
- Fort Bragg (7,772)
- Half Moon Bay (12,591)
- Hermosa Beach (19,616)
- Laguna Beach (23,505)
- Malibu (12,742)
- Marina (21,528)
- Morro Bay (10,762)
- Pismo Beach (8,247)
- Scotts Valley (12,163)

While not "exact" matches (which is not possible), these agencies closely reflect the City's demographics, economy and scope of services. While coastal, they are geographically diverse, located throughout the State; and their average population is 14,800 (closely reflecting Pacific Grove's population of 15,500).

Lastly, these cities meet a high-bar for "good governance" in that they all had clearly stated General Fund reserve policies.

Analyzing the General Fund Reserve Risk Factors

The sections below provide guidance on analyzing the risk factors described in Chapter 4 on general fund reserves. Each heading corresponds to a worksheet in the Excel workbook that is available at www.gfoa.org/financialpolicies. The blue cells in the sheet are entry cells. There should be no need to type in other cells. Complete the sheets starting with the left-most and continue all the way to the final sheet at the right.

The first eight sheets ask you to analyze each risk factor in the book. First, you identify your basic sources of risk. Then you assess the level of risk you face. Next, you identify other available risk mitigation approaches. The sections below provide more specific guidance on how to accomplish this for each risk factor. Finally, you decide how important it is for your government to retain risk through general fund reserves. The level of importance is indicated by assigning a 1 through 5 score, where 5 indicates the greatest need to retain risk. Each sheet contains guidelines to help you decide the most appropriate score for each risk factor.

The ninth and final sheet helps you to zero in on a final reserve target by summarizing the results of the prior eight sheets and bringing in other drivers of reserve size. Note that this sheet does not provide you with a precise suggested target. Rather it suggests a broad range and strategies for arriving at a final target.

Below is more specific guidance for analyzing the risk factors in the first eight sheets.

Vulnerability to extreme events and public safety concerns

Identify Risks. List out the major extreme events to which the community could reasonably be subjected. This could include both natural and man-made events. Public safety professionals may have a community disaster preparedness plan that could help identify these risks; linking the reserve analysis to such a plan would increase the credibility of the resulting policy.

Assess Risks. Consider the potential magnitude of loss for each event. The magnitude of loss should be based on past experiences with similar extreme events or reasonable estimates based on the disaster preparedness plan (note that the estimate is not necessarily a worst-case scenario).

Identify Other Risk Mitigation Approaches. If extreme events a are serious risk for the community, also consider risk transfer options. Might more comprehensive insurance coverage be a better option than very high levels of fund balance? If the source of risk is man-made, such as the potential for an accident at a hazardous chemical plant, might the chemical company be able to take greater responsibility for the risk they pose to the community? Also consider how quickly federal assistance can be accessed and the speed with which funds spent responding to a disaster might be reimbursed.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to extreme events.

Revenue Source Stability

Identify Risks. Start by listing out major revenue sources.

Assess Risks. Consider the volatility of each source, based on factors such as past experience and trends with that revenue, characteristics of the tax or rate payers, and economic factors.

Identify Other Risk Mitigation Approaches. Think about other approaches that the government has to deal with declining revenues. This might include means to easily reduce variable costs or the ability to access other sources of funding.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to revenue stability.

Expenditure Volatility

Identify Risks. Start by listing sources of potential spikes in expenditure (usually arising from special, non-recurring circumstances) that could be expected to occur within the next three to five years. Examples might include lawsuits against the government or critical special projects without a funding source. Typically, recurring sources of expenditure volatility, such as health care benefit costs, would not be included because they should be dealt with in the context of an annual budget process. An exception to this might be highly variable and difficult-to-predict costs, such as energy or fuel (in the case of a fleet).

Assess Risks. Enumerate a reasonable estimate of the potential cost of each source (i.e., the magnitude of the risk), taking into account the probability of it occurring (i.e., an unlikely event is less of a risk than a more likely event of similar potential loss).

Identify Other Risk Mitigation Approaches. Think about other approaches to dealing with these expenditure spikes. For example, the finance officer may find that some events (like an essential special project) have a very high chance of occurring, but will not occur for a number of years into the future. In this case, the finance officer could suggest a “sinking fund” where the project would be gradually funded over time. This could be made a commitment or assignment within the fund balance to help differentiate it from funds used to manage more uncertain risks. A similar approach could be used for known lawsuits.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to expenditure spikes.

Leverage

Identify Risks. Start by listing major sources of leverage. Common examples include pensions, unfunded asset maintenance, and debt.

Assess Risks. Then assess each source's implications for the organization's future financial flexibility by consider the size of the obligation. Is the source of leverage very large? Does it have an off-setting funding source or asset?

Identify Other Risk Mitigation Approaches. It is often better to use other approaches to risk management on these sources of leverage, rather than retaining the risk through reserves. For example, if unfunded asset maintenance is a problem, then the finance officer might use an asset maintenance plan (or other suitable estimate) to demonstrate the magnitude of the risk and encourage the governing board create a special set-aside to begin funding this liability – and avoid managing this risk with general fund reserves. In another example, if unfunded pension liabilities are an issue, the organization should develop a strategy to pay down those liabilities. In this situation, the finance officer could point out how pension liability constrains the financial flexibility of the organization, thereby decreasing the reserve's ability to manage other types of risk.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to leverage.

Liquidity

Identify Risks. List major sources of intra-period cash imbalances. A good example is property taxes that are only received at one or two points during the year.

Assess Risks. Describe the size of the problem created by these sources of imbalance. Does it have the potential to significantly interfere with operations?

Identify Other Risk Mitigation Approaches. To what extent can tools like internal borrowing or tax anticipation notes provide a cost-effective alternative to keeping a reserve?

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to liquidity.

Other Funds' Dependency

Identify Risks. Start by listing other funds that have significant dependence on the general fund. Dependence will usually be indicated by regular operating transfers that are an unusually high percentage of the receiving fund's expenditure budget.

Assess Risks. Assess the level of reserves in these other funds. Are reserves low? If so, is this fund subject to potential risks that could require a substantial draw on reserves? If so, is the general fund expected to backstop this fund?

Identify Other Risk Mitigation Approaches. A major point for the finance officer to explore is whether the general fund should be "back stopping" these other funds in the first place. For example, an under-performing enterprise fund may be receiving operating transfers not because it is good public policy, but because the political will has not been mobilized to make the enterprise self-sufficient or to divest of it.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to other funds.

Growth

Identify Risks. This factor is only relevant if significant growth is a realistic possibility in the next three to five years. Start by identifying major potential sources of growth.

Assess Risks. Estimate the potential marginal costs associated with serving new growth and compare it to marginal revenues (this information should be available from long-term financial plans and forecasts). If there is a gap due to significant timing differences between when revenue is received from growth and when expenditures are made on services for that growth, then reserve targets could be adjusted to account for that gap.

Identify Other Risk Mitigation Approaches. Special growth or impact fees could be assessed at the time of construction to avoid this risk. For example, if a new development is expected to generate $10M annually in new taxes starting three years in the future (but nothing before then), but costs $7M to service starting in two years, then a reserve (or impact fees) may be needed. If the gap between revenue growth and service expenditures is due to a structural mismatch between costs and revenues (i.e., the growth does not pay for itself), then the government should re-examine its tax-fee structures, service provision methods, and/or land use plans to correct this imbalance.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to growth.

Capital Projects

Identify Risks. Use a capital improvement plan to determine if there are high priority projects without a funding source.

Assess Risks. Assess whether decision-makers might consider pay-as-you-go financing, using general fund reserves as at least part of the source.

Identify Other Risk Mitigation Approaches. If pay-as-you-go financing is something decision-makers might consider, then the finance officer may wish to broach the possibility of a commitment or assignment for the project so that pay-as-you-go financing does not detract from the general reserve's ability to manage other risks.

Assess Necessity of Risk Retention. Assign a score for the importance of risk retention through the use of reserves, when it comes to capital projects.

Your Target

Step 1. Determine Your TotalSscore from the Risk Factors
Step 1 on this sheet totals your scores from the foregoing sheets.

Step 2. Preliminary Analysis
In Step 2, find your score in the ranges presented and consult the analytical guidance. This is preliminary, as the analytical guidance will be refined in the next steps.

Step 3. Consider the Impact of Government Size, Budget Practices, and Borrowing Capacity
In Step 3, you consider additional drivers of fund balance: government size, budget practices, and borrowing capacity. In each blue box, enter the indicated number of positive or negative points for each driver (totaling them for each driver, as might be needed).

Size of Government. GFOA's analysis of the thousands of governments that participate in GFOA's comprehensive annual financial report presentation award program shows a very weak direct relationship between population size and size of fund balance. In fact, a statistical analysis of the data shows that although there is an inverse relationship between population size and size of fund balance, only about between 10% and 20% of the variation in fund balance size between governments can be explained by population.[i] Hence, the sheet only provides points for the very largest and smallest governments.

Budget Practices. The presence of formal or informal contingencies already built into the budget may relieve the need to carry some additional reserves. The finance officer can search directly for the presence of informal contingencies by searching prior years' budget-versus-actual reports for areas with consistent positive variances – this may indicate areas that are consistently over-budgeted. The finance officer can also look indirectly for contingencies by examining the budgeting system for practices that unintentionally encourage informal contingencies. For example, systems that provide little flexibility for managers to transfer budgets between different accounts will encourage managers to build additional slack into their budget since they do not have the ability to move surpluses in one account to counteract a deficit in another.

Borrowing Capacity. You can evaluate your borrowing capacity by comparing your current level of debt against your financial policy for debt. If no policy standards are in place, consider the rating agency guidelines below.

Standard and Poor's Debt Ratios and Ranges[ii]

	Overall Net Debt per Capita	Overall Net Debt as a % of Market Value	Debt Service as a % of Expenditures
Low	Below $1,000	Below 3%	Below 8%
Moderate	$1,000 - $3,000	3% - 6%	8% - 15%
Moderately High	$3,000 - $5,000	6% - 10%	15% - 20%
High	Above $5,000	Above 10%	Above 25%

The finance officer should also consider internal borrowing capacity. Inventory reserves in other funds and assess the extent to which these reserves are necessary to deal with the risks with which these funds are faced. If other funds have sizable reserves compared to the risks they are retaining, they could serve as an alternative to larger general fund reserve targets. However, internal borrowing should not be considered an alternative without a strong internal borrowing policy in place.

Step 4. Consider the Impact of Commitments/Assignments, Outsider Perceptions, and Political Support

In Step 4, you consider the drivers of Commitments/Assignments, Outsider Perceptions, and Political Support. Put an "X" in the blue cell next to all the statements that apply to you.

Commitments or Assignments. Think about all assignments and commitments that impact fund balance. Then assess how constraining those assignment and commitments are and how available that portion of the fund balance might be to retain risk. For instance, a board might "commit" a certain amount to a "rainy day" reserve. This sort of commitment would be very consistent with the purpose of retaining the types of risk defined in this analysis, and so could be considered part of the total amount of general fund balances available for a reserve. Conversely, an assignment or commitment for asset maintenance or a special project is intended to be spent on a particular use, and therefore is not really available for risk retention. These sorts of uses should be subtracted from the definition of fund balance available for a reserve.

Outsider Perceptions. Take stock of relevant outsider perceptions. What have rating agencies said in the past about your level of reserves? Could failure to carry a certain level of reserves contribute to a ratings downgrade? Also consider citizen perspectives – ould having too high of a reserve provoke a backlash? Take these perceptions into account when settling on a final reserve target.

Political Support. A reserve target must be formally adopted by the board in order to do much good. Therefore, consider what might lead to a politically acceptable target level. For instance, governing boards often place great weight on benchmarking studies with similar organizations – a proposed target might garner more support if it is seen as consistent with the practices of comparable governments.

Step 5: Putting It All Together

The green cell contains a revised risk score, which takes account of your point totals from Step 3. Using this revised score, revisit the ranges and analytical guidance in Step 2.

Also, consider the boxes you checked in Step 4. Add the advice from these statements to your final analytical guidance from Step 2. Using this advice, you can finalize a reserve target and present it to the board.

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[i] The range comes from using different permutations of the data set, such as removing or including certain outliers.

[ii] The ratios are taken from David G Hitchcock, Karl Jacob, and James Wiemken, "Key General Obligation Ratio Credit Ranges – Analysis vs. Reality," Standard & Poor's: 2008. However, the ranges have been modified slightly by the authors to provide a more streamlined presentation. Specifically, in the original document, the overall net debt per capita "low" range is $1,000 to $2,000 and the "moderate" range is $2,000 to $5,000.

Vulnerability to Extreme Events

1. Identify Risks

What extreme events are you at risk for?

A	Fire
B	Flood
C	Drought
D	Earthquake
E	Shoreline trail/bluff stabilization

2. Assess Risks

What is your vulnerability to each extreme event, given past experience?

A	Moderate
B	Moderate
C	High (but City not responsible for water service)
D	Low probability; depending on epicenter, losses could be significant
E	Moderate

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk (i.e., manage it without reserves)

A	FEMA reimbursement
B	FEMA reimbursement
C	State drought relief, possible FEMA reimbursement
D	FEMA reimbursement
E	FEMA reimbursement

Note: While significant reimbursements from FEMA are likely, it is also likely that there will be significant lags between when recovery costs are incurred and when payments will be received. Lastly, based on experiences in other cities, even under the best of circumstances, it is unlikely that the City will be reimbursed for all recovery costs. And even where costs are largely recovered, there is no reimbursement for lost revenues - like sales tax and TOT - during the disaster and recovery period.

4. Considering the above, how important for you is it to retain the risks of extreme events through reserves ?

3 < Enter your score here

5 **Very important.** We are subject to extreme events of severe potential magnitude which would require a quick and decisive response from our government. There are few alternative risk management approaches.

4 **Important.** We are subject to extreme events of severe potential magnitude, but our government does not have an important disaster response role and/or we have other risk management alternatives.

3 **Neutral.** We do not face an unusually high or low level of risk from extreme events.

2 **Unimportant.** We are subject to one or two types of significant extreme events and we have other risk management options.

1 **Very unimportant.** We are subject to very few, if any, potential extreme events of significant potential damage

Revenue Source Stability

1. Identify Risks

What are your major revenue sources?

A	Property Tax (30%)
B	Sales Tax (23%)
C	TOT (16%)
D	Utility Users Tax (8%)
E	Franchise Fees (5%)
F	State Takeaways (Always a Threat)

Note: Top 3 revenues account for about 70% of total; Top 5 account for about 85%

2. Assess Risks

How stable are your revenue sources?

A	Historically stable but downturn in "Great Recession"
B	Subject to significant swings with economy
C	Subject to significant swings with economy
D	Stable
E	Stable
F	Historically significant

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk (i.e., manage it without reserves)

Limited in all cases

4. Considering the above, how important for you is it to retain the risks of revenue instability through reserves ?

4 < Enter your score here

5 **Very important.** We rely on just one or two sources of revenue, and they are unstable

4 **Important.** We rely on unstable sources for a significant portion of our revenue and/or have particular unstable payers as part of our tax base (e.g., sales tax from an industry with volatile sales)

3 **Neutral.** We do not face an unusually high or low level of risk from revenue instability

2 **Unimportant.** While some portion of our revenue base has instability, the majority of revenues are pretty stable.

1 **Very unimportant.** Our revenues are very stable and diverse.

Expenditure Volatility

1. Identify Risks

What are sources of potential expenditure spikes?

A	Increased pension costs
B	Health Insurance Costs
C	Unexpected infrastructure repairs
D	State/federal mandates

2. Assess Risks

What is the potential cost of these spikes?

A	Based on CalPERS investment losses and approved funding methodology changes, very high
B	Significant
C	Unknown
D	Moderate

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of these potential spikes? (i.e., manage it without reserves)

A	Need to address on ongoing basis
B	Need to address on ongoing basis
C	Unknown
D	Limited (legislative advocacy)

4. Considering the above, how important for you is it to retain the risks of expenditure spikes through reserves ?

5 < Enter your score here

5 **Very important.** There are expenditure spikes with very high potential to open a significant hole in our budget.

4 **Important.** We are subject to important potential expenditure spikes, such that we need reserves but we also have other risk mitigation approaches available.

3 **Neutral.** We do not face an unusually high or low level of risk from expenditure spikes

2 **Unimportant.** There are one or a few potential spikes but the risk of them occurring is low, the impact not great and/or we have other risk management options.

1 **Very unimportant.** We have no important risk from expenditure spikes.

Leverage

1. Identify Risks

What are major sources of leverage you are subject to?

A	Pension liabilities
B	OPEB liabilities
C	
D	

2. Assess Risks

What are the implications of leverage for the organization's financial flexibility?

A	Higher future costs
B	
C	
D	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of leverage? (i.e., manage it without reserves)

A	Need to address these higher cost on an ongoing basis: reserves not an appropriate source of funding
B	
C	
D	

4. Considering the above, how important for you is it to retain the risks of leverage through reserves ?

5	< Enter your score here
5	**Very important.** We are subject to significant leverage and have no other risk management approach
4	**Important.** We are subject to significant leverage and do not have equally significant offsetting risk management approaches.
3	**Neutral.** We do not face an unusually high or low level of risk from leverage
2	**Unimportant.** We have one or two sources of leverage, but these are largely addressed with other risk management strategies.
1	**Very unimportant.** We have no important sources of leverage that aren't already managed with out reserves.

Liquidity

1. Identify Risks

What are your major sources of potential intra-period cash imbalances?

A	Property tax collections in December and June (30% of revenues): see cash flow worksheet
B	Gas and electric franchise payments in April
C	Pension obligation bond payments in July
D	Liability and workers' compensation insurance payments to PARSAC in July

2. Assess Risks

How likely are these risks to occur and what is their potential magnitude?

A	Ongoing
B	Ongoing
C	Ongoing
D	Ongoing

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of liquidity? (i.e., manage it without reserves)

A	Tax/revenue anticipation notes - but results in added interest costs
B	Borrow from other funds - but adds "leverage" to them
C	

4. Considering the above, how important for you is it to retain the risks of liquidity spikes through reserves ?

5 < Enter your score here

5 **Very important.** We have very important potential intra-period imbalances with few risk management alternatives.

4 **Important.** We have important potential intra-period imbalances, but do have some off-setting risk management alternatives.

3 **Neutral.** We do not face an unusually high or low level of risk from intra-period cash imbalances.

2 **Unimportant.** We have some minor potential intra-period cash imbalances.

1 **Very unimportant.** Our cash flows are very stable.

Other Funds Dependency

1. Identify Risks

What other funds rely on the general fund for an important part of their funding?

A	Very limited
B	
C	

2. Assess Risks

How likely is it that these funds will need the general fund to "backstop" them in an emergency?

A	
B	
C	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of other funds' dependency? (i.e., manage it without reserves)

A	
B	
C	

4. Considering the above, how important for you is it to retain the risks of other fund dependency through reserves ?

2	< Enter your score here
5	**Very important.** A number of funds rely on the general fund for backstopping, with few, if any, risk management alternatives.
4	**Important.** We have at least some funds that rely on the general fund and this includes reliance for backstopping.
3	**Neutral.** We do not face an unusually high or low level of risk from other fund dependency.
2	**Unimportant.** There are a small number of funds that rely on the general fund, and the potential for the general fund to need to backstop them is small.
1	**Very unimportant.** No other funds rely on the general fund for backstopping.

Growth

1. Identify Risks

What are potential major sources of growth in the next three to five years?

A Very limited new development opportunities

2. Assess Risks

What is the potential for these sources of growth to cause imbalances in the revenue received from the growth and the expenditures needed to serve it?

A Limited

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of growth? (i.e., manage it without reserves)

A Limited, if significant growth does occur

4. Considering the above, how important for you is it to retain the risks of growth through reserves ?

2 < Enter your score here

5 **Very important.** We expect significant growth with imbalances in the timing of revenues and expenditures

4 **Important.** We have some growth that will cause imbalances in the timing of revenues and expenditures.

3 **Neutral.** We do not face an unusually high or low level of risk from growth

2 **Unimportant.** We have a small potential for future growth and/or only minor potential imbalances in the timing between revenues and expenditures.

1 **Very unimportant.** We expect no growth or growth will fully pay for itself as expenditures are incurred.

Population as of January 1: Last Ten Years

2017	15,498
2016	15,388
2015	15,364
2014	15,298
2013	15,245
2012	15,195
2011	15,122
2010	15,053
2009	14,935
2008	14,874
2007	14,879

Source: State of California, Department of Finance, Demographic Research Unit
http://www.dof.ca.gov/Forecasting/Demographics/Estimates/

Capital Projects

1. Identify Risks

What high priority capital projects don't have a funding source?

A	The City has a significantly underfunded CIP
B	
C	

2. Assess Risks

What is the likelihood that reserves will be looked to as a funding source for the project?

A	Likely
B	
C	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of capital projects using reserves as a funding source? (i.e., manage it without reserves)

A	Not applicable
B	
C	

4. Considering the above, how important for you is it to retain the risks of unfunded capital projects through reserves ?

5	< Enter your score here
5	**Very important.** There are very high profile projects with out a funding source and reserves are likely to be considered as a funding source.
4	**Important.** There are at least some high profile projects where reserves may be called upon to provide at least some of the funding.
3	**Neutral.** We do not face an unusually high or low level of risk from unfunded high-priority projects
2	**Unimportant.** High priority capital projects will probably have funding sources, if they don't already.
1	**Very unimportant.** All high priority capital projects have funding sources.

Guiding Your Selection of a Fund Balance Target

Step 1. Determine your total score from the risk factors

31	Your total score from the risk factors (calculated if you entered a score in other sheets)

Step 2. Preliminary Analysis
Compare your score from Step 1 to the guidelines below.

Your Score	*Analytical Guidance*
8 - 16	You face minimal risk to retain through reserves. Consider a target equal to the GFOA minimum recommended reserve of 16.6% of revenues/expenditures.
17-24	You face a low to moderate level of risk to retain through reserves. Consider adopting a reserve target somewhat higher than the GFOA minimum (e.g. 17-25% of revenues/expenditures). Since risk is low, do not invest excessive analytical effort in determining an exact target amount. Consider a short, informal benchmarking study with peer agencies to provide guidance.
25-31	You face a moderate to high level of risk to retain through reserves. Consider adopting a target amount of reserves significantly higher than the GFOA recommended minimum (e.g., 26 - 35%). Consider a short, informal benchmarking survey as a starting point, but then analyze your most significant risk factors to make sure they are adequately covered by what the survey suggests is reasonable.
32 - 40	You face a high level of risk to retain through reserves. Consider adopting a much higher target than the GFOA minimum (e.g., greater than 35%). Consider performing a more in-depth analysis of the risks you face to arrive at target level of reserved that provides sufficient coverage.

Step 3. Consider Impact of Government Size, Budget Practices, & Borrowing Capacity
For each driver pick which description best fits you and enter the appropriate number of points.

2	**Government Size**
+2	We are under 50,000 in population
0	We are between 50,000 and 300,000 in population
-4	We are over 300,000 in population

0	**Budget Practices**
-3	The budget has a formal contingency beyond what is being considered for this reserve.
-2	The budget has informal contingencies beyond what is being considered for the reserve.
0	The budget is lean and has no contingencies in it.

-2	**Borrowing Capacity**
-3	We have excellent external and internal borrowing capacity, including a good rating, little existing debt, and political will to use it.
-2	We have some external and/or internal borrowing capacity and political will could be mobilized to use it.
0	We have little or no borrowing capacity.

Step 4. Consider Impact of Commitments/Assignments, Outsider Perceptions & Political Support

Place an "X" next to each statement that applies to you.

Commitments and Assignments

x	We have commitments or assignments that designate fund balance for uses other than retaining the types of risk described in this analysis. If so, these commitments/assignments should not be included in the total reserve used to reach your target.

Outsider Perceptions

	Rating agencies have given us a target level of reserve for getting a good rating. If so, use that target in place of or in addition to a benchmarking survey to provide guidance on starting point for your target.
	The public is likely to question reserve levels as too high. If so, be sure to document your analysis findings in the other sheets.

Political Support

	The governing board places great weight on the policies of comparable jurisdictions. If so, conduct a benchmarking survey that includes governments the board perceives as relevant.
	The board places great weight on rating agency recommendations. If so, tie the reserve target recommendation to rating agency recommendations or standards.
	The board places great weight on GFOA recommendations. If so, use this analysis and GFOA's Best Practices to support your recommendation.

Step 5. Putting it All Together

A. Consider your adjusted risk score and re-consult the analytical guidance.

31 < Your adjusted risk score (risk score modified with results from Step 3)

B. Review results of Step 4.

Review each item you checked from Step 4 and add the advice to your analytical guidance.

C. Proceed with finalizing target

Proceed with setting a final reserve target based on analytical guidance.

Appendix D: Cash Flow Analysis, 2017-18 Budget

	Total	% Total	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
REVENUES														
Taxes														
Property Tax	6,573,000	30%						3,746,600						2,826,400
TOT	5,173,000	23%	776,000	776,000	465,600	465,600	284,500	284,500	284,500	284,500	284,500	284,500	284,500	698,300
Sales Tax	3,460,000	16%	288,300	288,300	288,300	288,300	288,300	288,300	288,300	288,300	288,300	288,300	288,300	288,700
Utility Users Tax	1,675,000	8%	139,600	139,600	139,600	139,600	139,600	139,600	139,600	139,600	139,600	139,600	139,600	139,400
Franchise Fees	1,015,000	5%					101,500			101,500	253,800	304,400	101,500	152,300
Business License Tax	332,000	2%	49,800	49,800	49,800	7,100	7,100	7,100	7,100	33,200	99,600	7,100	7,100	7,200
Other Taxes	156,000	1%	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000
Total Taxes	18,384,000	83%	1,266,700	1,266,700	956,300	913,600	834,000	4,479,100	732,500	860,100	1,078,800	1,036,900	834,000	4,125,300
Intergovernmetal	244,000	1%	20,300	20,300	20,300	20,300	20,300	20,300	20,300	20,300	20,300	20,300	20,300	20,700
Licenses & Permits	511,000	2%	42,600	42,600	42,600	42,600	42,600	42,600	42,600	42,600	42,600	42,600	42,600	42,400
Service Charges	1,451,000	7%	120,900	120,900	120,900	120,900	120,900	120,900	120,900	120,900	120,900	120,900	120,900	121,100
Other Revenues	1,461,000	7%	121,800	121,800	121,800	121,800	121,800	121,800	121,800	121,800	121,800	121,800	121,800	121,200
Total Revenues	22,051,000	100%	1,572,300	1,572,300	1,261,900	1,219,200	1,139,600	4,784,700	1,038,100	1,165,700	1,384,400	1,342,500	1,139,600	4,430,700
ANNUALCOSTS														
Pension Obigation Bonds	2,000,000	8%	2,000,000											
PARSAC Premiums	1,298,000	5%			1,298,000									
Other Costs	20,620,700	87%	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,300
Total Costs	23,918,700	100%	3,718,400	1,718,400	3,016,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,400	1,718,300
NET REVENUES	(1,867,700)	-	(2,146,100)	(146,100)	(1,754,500)	(499,200)	(578,800)	3,066,300	(680,300)	(552,700)	(334,000)	(375,900)	(578,800)	2,712,400
Cummulative Net	(1,867,700)		(2,146,100)	(2,292,200)	(4,046,700)	(4,545,900)	(5,124,700)	(2,058,400)	(2,738,700)	(3,291,400)	(3,625,400)	(4,001,300)	(4,580,100)	(1,867,700)
% OF ANNUAL COSTS			**-9%**	**-10%**	**-17%**	**-19%**	**-21%**	**-9%**	**-11%**	**-14%**	**-15%**	**-17%**	**-19%**	**-8%**

Basis of Budgeting

The basis of budgeting is the same as the basis of accounting.

Treasury and Cash Management

The City shall manage the treasury in compliance with California Government Code Section 53600 and City Council Policy 400-5, which requires quarterly Treasurer's Reports to the City Council, reconsideration of Policy 400-5 by the Council at least once every two years, and selection of investments based on considerations of safety, liquidity, and yield, in order of decreasing priority.

In circumstances where short-term borrowing (i.e., fewer than 12 months) is required to mitigate the effects of uneven revenue disbursements from the state and ensure expenditure cash-flow demands may be met, the following options shall be considered, with the ultimate course of action dependent on the least cost, greatest security for the City, and administrative efficiency:

- Tax and Revenue Anticipation Notes (TRAN)
- Treasury Loan from Monterey County
- Inter-fund loans
- Commercial line of credit.

Should inter-fund loans be selected as a cash-flow strategy, the following conditions shall apply:

- City Council approval required for all loans;
- Duration of less than 12 months with the loan and repayment occurring within the same fiscal year;
- Fixed loan term (i.e., specific number of months with repayment date);
- Borrowing fund must pay interest at level to result in no loss of interest revenue to the lending fund;
- Specific revenue pledged to repay the loan based on realistic expectations for receipt;
- Funds in the lending fund must not be needed for operations during the period of the loan; and
- Loans must not be made from grant funds or other funds enabled by State or Federal legislation.

The City Council shall receive real-time reports of warrants drawn on the City Treasury.

Reserves

Reserves are established to ensure that sufficient resources shall be maintained in specified funds in amounts sufficient to manage reasonable risks, meet unanticipated needs, capitalize on opportunities, and provide for reasonable contingencies. Further, reserve balances shall be categorized and prioritized in accordance with GASB Statement #54 (GASB 54).

- In the City of Pacific Grove, "operating reserve" is equivalent to portions of the accumulated fund balance that are classified as either committed, assigned, or unassigned, per GASB 54.

- The order in which spendable reserves may be used is prioritized as follows: restricted, committed, assigned, and then unassigned, per GASB 54. Council action is required to increase, decrease, eliminate or reclassify amounts reported in each category.

- Use of reserves must be authorized in advance by the City Council.

- If reserves are expended for their intended use, the City Council shall prioritize restoration of reserves to levels established by policy before allocating resources to fund new or improved services.

- *General Fund.* The City establishes a target reserve level of 10% of the General Fund annual operating budget, and shall maintain reserves of at least 10%, unless otherwise approved by the City Council for specific purposes. The 10% reflects the following components:

  - Emergency financial need (e.g., capital repair, natural disaster)
  - Economic contingency (to mitigate sudden service and staffing cuts in response to economic shocks and downturns)
  - Economic opportunity (to leverage public resources for public investment opportunities, e.g., downtown property)

  - One-time opportunities to invest in assets (e.g., an expanded Library), as an alternative to debt financing

- *Golf Fund.* The purpose of the Golf Fund is to enable operation of the golf course as an enterprise without operating subsidies from the General Fund, unless deliberately authorized. The City establishes a target reserve level of 25% of revenues of the Golf Fund, as of June 30th of two fiscal years prior, to be used for capital improvements, cash management, and emergency protection. Given the vulnerability of the golf business to recession, 20% of the 25% would be retained for use in mitigating the effects of unexpected revenue downturns, and 5% would be available retained for emergency repairs or other emergencies.

- *Sewer Fund.* The Sewer Fund shall maintain a reserve of at least $500,000.

- *Workers Compensation Fund:* The Workers Compensation Fund shall maintain a balance of current assets equal to 67% of total liabilities, or higher, should actuarial analysis conclude an imminent risk to the City for unanticipated losses.

- *Liability Insurance Reserve*: The Liability Insurance Reserve shall maintain a balance of at least $300,000 in current assets, which is equivalent to the maximum amount the City would be required to pay in the event of two catastrophic losses in a single year (City's Self-Insured Retention Limit is currently $150,000 per claim).

Debt Management

- Long-term borrowing shall be restricted to the purpose of funding capital improvement projects and equipment. The use of long-term borrowing for ongoing operations shall be avoided.

Appendix F: Consultant Background

Bill Statler has extensive experience in organizational review, strategic planning and policy analysis, as well as in a broad range of financial management practices that have received state and national recognition for excellence in financial planning and reporting.

His work ranges from San Luis Obispo (the city that Oprah Winfrey calls the "Happiest City in America") to volunteer service helping the troubled City of Bell reform their government.

SENIOR FINANCIAL MANAGEMENT EXPERIENCE

Bill Statler has over 30 years of years of senior financial management experience, which included serving as the Director of Finance & Information Technology/City Treasurer for the City of San Luis Obispo for 22 years and as the Finance Officer for the City of Simi Valley for 10 years before that.

Under his leadership, the City of San Luis Obispo received national recognition for its financial planning and reporting systems, including:

- Award for Distinguished Budget Presentation from the Government Finance Officers Association of the United States and Canada (GFOA), with special recognition as an outstanding policy document, financial plan and communications device. ***San Luis Obispo is one of only a handful of cities in the nation to receive this special recognition***.

- Awards for excellence in budgeting from the California Society of Municipal Finance Officers (CSMFO) in all four of its award budget categories: innovation, public communications, operating budgeting and capital budgeting. ***Again, San Luis Obispo is among a handful of cities in the State to earn recognition in all four of these categories***.

- Awards for excellence in financial reporting from both the GFOA and CSMFO for the City's comprehensive annual financial reports.

- Recognition of the City's financial management policies as "best practices" by the National Advisory Council on State and Local Budgeting.

The financial strategies, policies and programs he developed and implemented resulted in strengthened community services and an aggressive program of infrastructure and facility improvements, while at the same time preserving the City's long-term fiscal health.

CONSULTING AND INTERIM ASSIGNMENTS

Long-Term Financial Plans

- City of Salinas
- City of Camarillo
- City of Carpinteria
- City of Pismo Beach
- City of Grover Beach

- City of Twentynine Palms
- City of Bell
- Bear Valley Community Services District

Strategic Planning and Council Goal-Setting
In collaboration with the HSM Team

- City of Monrovia
- City of Sanger
- City of Pismo Beach
- City of Bell (Pro Bono)
- City of Willits

Organizational Analysis and Policy Advice

- Organizational Review (Plans/Public Works and Community Services): City of Monterey
- Finance Organizational Review: Ventura Regional Sanitation District
- Benchmark Analysis: City of Capitola
- Financial Management Improvements: City of Capitola
- Organizational Review: City of Willits (in collaboration with the HSM Team)
- Finance Division Organizational Review: Sacramento Metropolitan Fire District
- Finance Department Organizational Review: City of Ceres (in collaboration with national consulting firm)
- Financial Management Transition Team and Policy Advice: City of Bell (Pro Bono)
- Preparation for Possible Revenue Ballot Measure: City of Monterey
- Fund Accounting Review: State Bar of California
- Construction Project Contracting Review: Central Contra Costa Sanitary District
- Focused Financial Review: City of Watsonville
- Financial Assessment: City of Guadalupe
- Financial Condition Assessment: City of Grover Beach
- General Fund Reserve Policy: City of Lompoc
- General Fund Reserve Policy: City of Willits
- Reserve Policy: State Bar of California
- Budget and Fiscal Policies: City of Santa Fe Springs

Interim Finance Director

- City of Monterey
- San Diego County Water Authority
- City of Capitola

Other Financial Management Services

- Revenue Options Study: Santa Clara Valley Water District
- Revenue Options Study: City of Greenfield
- Revenue Options Study: City of Pismo Beach

- Cost Allocation Plan: City of Greenfield
- Cost Allocation Plan: City of Guadalupe
- Cost Allocation Plan: City of Port Hueneme
- Cost Allocation Plan: City of Grover Beach
- Cost Allocation Plan Review: State Bar of California
- Cost Allocation Plan Review: City of Ukiah
- Disciplinary Proceedings Cost Recovery Review: State Bar of California
- Water and Sewer Rate Reviews: Avila Beach Community Services District
- Water and Sewer Rate Reviews: City of Grover Beach
- Solid Waste Rate Review: County of San Luis Obispo, Los Osos and North County Areas
- Joint Solid Waste Rate Review: Cities of Arroyo Grande, Grover Beach, Pismo Beach and Oceano Community Services District

PROFESSIONAL LEADERSHIP

- Member, Board of Directors, League of California Cities (League): 2008 to 2010
- Member, California Committee on Municipal Accounting: 2007 to 2010
- Member, GFOA Budget and Fiscal Policy Committee: 2005 to 2009
- President, League Fiscal Officers Department: 2002 and 2003
- President, CSMFO: 2001
- Member, Board of Directors, CSMFO: 1997 to 2001
- Chair, CSMFO Task Force on "GASB 34" Implementation
- Fiscal Officers Representative on League Policy Committees: Community Services, Administrative Services and Environmental Quality: 1992 to 1998
- Chair, Vice-Chair and Senior Advisor for CSMFO Committees: Technology, Debt, Career Development, Professional and Technical Standards and Annual Seminar Committees: 1995 to 2010
- Member, League Proposition 218 Implementation Guide Task Force
- Chair, CSMFO Central Coast Chapter: 1994 to 1996

TRAINER

- League of California Cities
- Institute for Local Government
- California Debt and Investment Advisory Commission
- Government Finance Officers Association of the United States and Canada
- California Society of Municipal Finance Officers
- Municipal Management Assistants of Southern California and Northern California
- National Federation of Municipal Analysts
- Probation Business Manager's Association
- Humboldt County
- California Association of Local Agency Formation Commissions
- American Planning Association

Appendix F: Consultant Background

Topics included:

- Long-Term Financial Planning
- The Power of Fiscal Policies
- Financial Analysis and Reporting
- Fiscal Health Contingency Planning
- Effective Project Management
- Providing Great Customer Service in Internal Service Organizations: The Strategic Edge
- Strategies for Downsizing Finance Departments in Tough Fiscal Times
- Top-Ten Skills for Finance Officers
- Telling Your Fiscal Story: Tips on Making Effective Presentations
- What Happened in the City of Bell and What We Can Learn from It
- Multi-Year Budgeting
- Top Challenges Facing Local Government Finance Officers
- Fiscalization of Land Use
- Debt Management
- Transparency in Financial Management: Meaningfully Community Involvement in the Budget Process
- Financial Management for Non-Financial Managers
- Preparing for Successful Revenue Ballot Measures
- Integrating Goal-Setting and the Budget Process
- Financial Management for Elected Officials
- 12-Step Program for Recovery from Fiscal Distress
- Strategies for Strengthening Organizational Effectiveness
- Budgeting for Success Among Uncertainty: Preparing for the Next Downturn

PUBLICATIONS

- *Guide to Local Government Finance in California*, Solano Press, Second Edition, 2017 (Co-Author)
- *Setting Reserve Policies – and Living Within Them*, CSMFO Magazine, May 2017
- *Presenting the Budget to Your Constituents*, CSMFO Magazine, July 2016
- *Planning for Fiscal Recovery*, Government Finance Review, February 2014
- *Managing Debt Capacity: Taking a Policy-Based Approach to Protecting Long-Term Fiscal Health*, Government Finance Review, August 2011
- *Fees in a Post-Proposition 218 World*, League of California Cites, District Attorney's Department Spring Conference, May 2010
- *Municipal Fiscal Health Contingency Planning*, Western City Magazine, November 2009

- *Understanding the Basics of County and City Revenue*, Institute for Local Government, 2008 (Contributor)
- *Financial Management for Elected Officials*, Institute for Local Government, 2010 (Contributor)
- *Getting the Most Out of Your City's Current Revenues: Sound Fiscal Policies Ensure Higher Cost Recovery for Cities*, Western City Magazine, November 2003
- *Local Government Revenue Diversification, Fiscal Balance/Fiscal Share and Sustainability*, Institute for Local Government, November 2002 (Co-Author)
- *Why Is GASB 34 Such a Big Deal?*, Western City Magazine, November 2000
- *Understanding Sales Tax Issues*, Western Cities Magazine, June 1997
- *Proposition 218 Implementation Guide*, League of California Cities, 1997 (Contributor)

HONORS AND AWARDS

- Cal-ICMA Ethical Hero Award (for service to the City of Bell)
- CSMFO Distinguished Service Award for Dedicated Service and Outstanding Contribution to the Municipal Finance Profession
- National Advisory Council on State and Local Government Budgeting: Recommended Best Practice (Fiscal Polices: User Fee Cost Recovery)
- GFOA Award for Distinguished Budget Presentation: Special Recognition as an Outstanding Policy Document, Financial Plan and Communications Device
- CSMFO Awards for Excellence in Operating Budget, Capital Improvement Plan, Budget Communication and Innovation in Budgeting
- GFOA Award of Achievement for Excellence in Financial Reporting
- CSMFO Certificate of Award for Outstanding Financial Reporting
- National Management Association Silver Knight Award for Excellence in Leadership and Management
- American Institute of Planners Award for Innovation in Planning
- Graduated with Honors, University of California, Santa Barbara

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Visit my web site for additional information at www.bstatler.com

Government Finance Officers Association

BEST PRACTICE

Fund Balance Guidelines for the General Fund

BACKGROUND:

In the context of financial reporting, the term *fund balance* is used to describe the net position of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net position of governmental funds calculated on a government's budgetary basis.[1] While in both cases *fund balance* is intended to serve as a measure of the financial resources available in a governmental fund; it is essential that differences between GAAP *fund balance* and budgetary *fund balance* be fully appreciated.

1. GAAP financial statements report up to five separate categories of fund balance based on the type and source of constraints placed on how resources can be spent (presented in descending order from most constraining to least constraining): *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.[2] The total of the amounts in these last three categories (where the only constraint on spending, if any, is imposed by the government itself) is termed *unrestricted fund balance*. In contrast, budgetary fund balance, while it is subject to the same constraints on spending as GAAP fund balance, typically represents simply the total amount accumulated from prior years at a point in time.
2. The calculation of GAAP fund balance and budgetary fund balance sometimes is complicated by the use of sub-funds within the general fund. In such cases, GAAP fund balance includes amounts from all of the subfunds, whereas budgetary fund balance typically does not.
3. Often the timing of the recognition of revenues and expenditures is different for purposes of GAAP financial reporting and budgeting. For example, encumbrances arising from purchase orders often are recognized as expenditures for budgetary purposes, but never for the preparation of GAAP financial statements.

The effect of these and other differences on the amounts reported as *GAAP fund balance* and *budgetary fund balance* in the general fund should be clarified, understood, and documented.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance in the general fund.

RECOMMENDATION:

GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund for GAAP and budgetary purposes.[3] Such a

guideline should be set by the appropriate policy body and articulate a framework and process for how the government would increase or decrease the level of unrestricted fund balance over a specific time period.[4] In particular, governments should provide broad guidance in the policy for how resources will be directed to replenish fund balance should the balance fall below the level prescribed.

Appropriate Level. The adequacy of unrestricted fund balance in the general fund should take into account each government's own unique circumstances. For example, governments that may be vulnerable to natural disasters, more dependent on a volatile revenue source, or potentially subject to cuts in state aid and/or federal grants may need to maintain a higher level in the unrestricted fund balance. Articulating these risks in a fund balance policy makes it easier to explain to stakeholders the rationale for a seemingly higher than normal level of fund balance that protects taxpayers and employees from unexpected changes in financial condition. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.[5] The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.[6] Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, 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 unrestricted fund balance in the general fund at any one time. In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

1. The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
2. Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
3. The potential drain upon general fund resources from other funds, as well as, the availability of resources in other funds;
4. The potential impact on the entity's bond ratings and the corresponding increased cost of borrowed funds;
5. Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose). Governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance, rather than on unrestricted fund balance.

Use and Replenishment.

The fund balance policy should define conditions warranting its use, and if a fund balance falls below the government's policy level, a solid plan to replenish it. In that context, the fund balance policy should:

1. Define the time period within which and contingencies for which fund balances will be used;
2. Describe how the government's expenditure and/or revenue levels will be adjusted to match any new economic realities that are behind the use of fund balance as a financing bridge;
3. Describe the time period over which the components of fund balance will be replenished and the means by which they will be replenished.

Generally, governments should seek to replenish their fund balances within one to three years of use. Specifically, factors influencing the replenishment time horizon include:

1. The budgetary reasons behind the fund balance targets;
2. Recovering from an extreme event;
3. Political continuity;
4. Financial planning time horizons;
5. Long-term forecasts and economic conditions;
6. External financing expectations.

Revenue sources that would typically be looked to for replenishment of a fund balance include nonrecurring revenues, budget surpluses, and excess resources in other funds (if legally permissible and there is a defensible rationale). Year-end surpluses are an appropriate source for replenishing fund balance.

Unrestricted Fund Balance Above Formal Policy Requirement. In some cases, governments can find themselves in a position with an amount of unrestricted fund balance in the general fund over their formal policy reserve requirement even after taking into account potential financial risks in the foreseeable future. Amounts over the formal policy may reflect a structural trend, in which case governments should consider a policy as to how this would be addressed. Additionally, an education or communication strategy, or at a minimum, explanation of large changes in fund balance is encouraged. In all cases, use of those funds should be prohibited as a funding source for ongoing recurring expenditures.

Notes:

1. For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.
2. These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.
3. Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.
4. See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).
5. In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.
6. In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues and/or expenditures, that decision should be followed consistently from period to period.

This best practice was previously titled Appropriate Level of Unrestricted Fund Balance in the General Fund.

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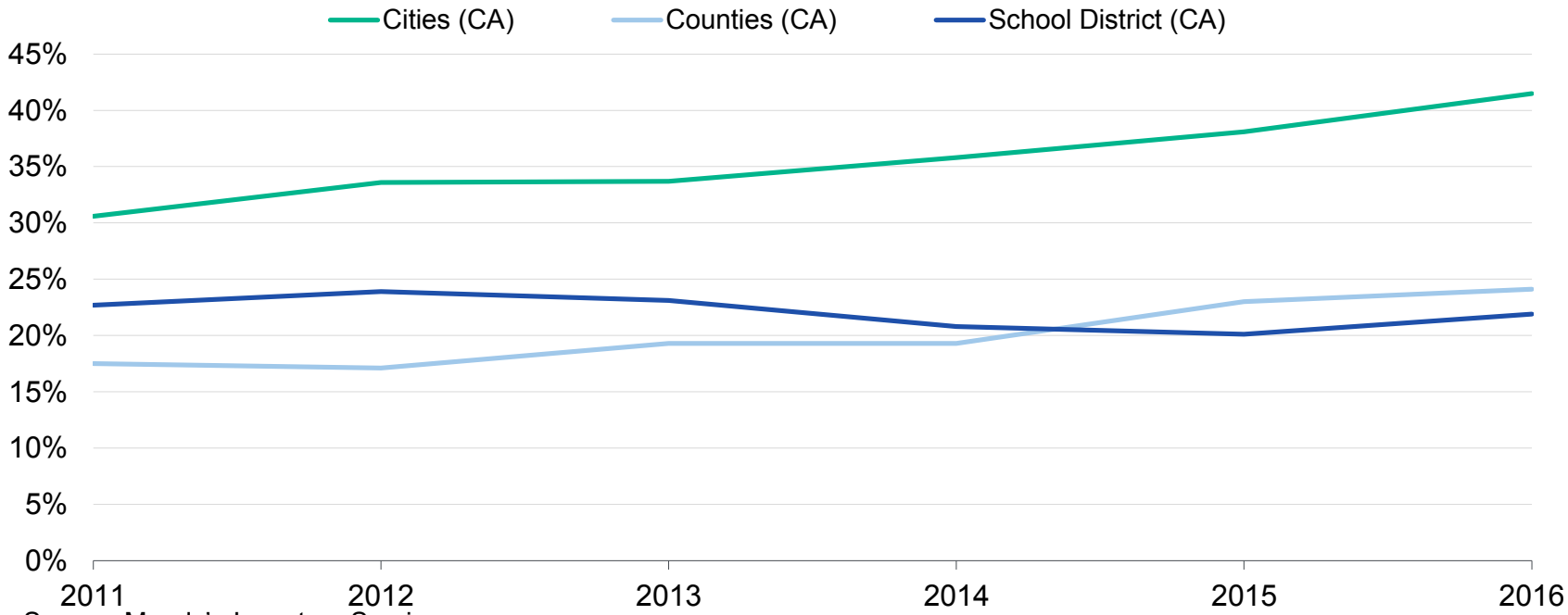
Average Operating Fund Balances Increasing for California Cities and Counties

- School districts lagged general increasing trend, but increased in 2016
- CA city operating fund balance average exceeds national average
- CA counties lag national averages though reserves are still at healthy levels



Source: Moody's Investors Service

City of Pacific Grove
Council Policy

Subject	Policy Number	Effective Date	Page
Budget and Financial Management	**400-6**	**October 1, 2014**	**Page 1 of 7**

Purpose
This Budget and Financial Management policy is established to help ensure that the City's financial resources are managed in a manner that fosters administrative transparency and confidence among the City Council, citizenry, and staff that the City's resources shall be available to fund ongoing City services, consistent with local economic conditions and the City Council's service priorities.

Budget Process
Budget management occurs year-round, with ongoing City Council direction and public input. In addition to formal updates on the budget and fiscal forecast, staff provides periodic updates on revenues and expenditures.

The City uses a five-year fiscal planning horizon, in which the annual budget is the first year of the forecast. The forecast is a tool that helps decision-makers identify important trends and understand long-term consequences of budget decisions. Importantly, the forecast is not a budget and does not represent a plan. It is a model based on cost and revenue assumptions that is updated continuously. Since the degree of revenue uncertainty increases with each successive year of the forecast (i.e., we can place much more confidence in projections for the first year of the forecast period than for the last, the forecast is a more viable framework for decision-making in the near-term, and only suggests relative financial health based on stated economic assumptions in the later years.

The annual budget process begins in January or February with City Council discussion of goals for the following year. At this meeting, staff presents an update of the current year budget and five-year fiscal forecast, as well as estimates of revenues for the following year and baseline expenditure assumptions. Baseline expenditures include existing staffing levels and other costs required to continue current service levels. At this meeting, the City Council provides direction to staff on the goals for the following budget year and five-year forecast, which include both goals for services and capital projects as well as the amount of additional funding or expenditure reduction required to achieve the goals.

Based on this direction, the City Manager distributes budget instructions and baseline staffing cost information to department managers for developing the budget. Subsequently, the City Manager and Finance Director work with program managers to develop the budget consistent with Council goals.

In February and March, the City Council reviews evolving revenue information and expenditure assumptions and determines the process for City Council consideration of the budget.

The City Manager finalizes the recommended budget and presents it to the City Council in May. After public input and discussion at this meeting, the City Council either directs modifications to the budget or introduces an ordinance adopting the budget. At the second reading of the ordinance at a subsequent regular City Council meeting, the budget is adopted and effective July 1st of the fiscal year.

Fiscal Forecast

- Staff shall maintain a five-year General Fund fiscal forecast to include revenues, expenditures, as well as the net results of operations and the beginning and ending fund balances for each year of the forecast.

Operating Budget

- The City Council shall adopt an annual operating budget, pursuant to Article 29 of the City Charter, prior to the start of the fiscal year.
- Revenue projections for a given year shall include a contingency reserve of 1%, either positive or negative, depending on the general direction of the economy. The need for such a contingency can be re-evaluated after January 1 of the budget year.
- Subject to exception for specific circumstances, the City Manager's recommended budget shall include an expenditure contingency in the General Fund equal to 1%, which may only be spent on projects required to advance City Council goals, expressed either explicitly or through the City Council's work plan.
- The operating budget shall include ongoing operating revenues sufficient to fund ongoing operating expenditures. Reserves may be used as a resource to fund operations, with City Council acknowledgement of such use and a plan for re-establishing operations within annual anticipated revenues.
- The budget shall provide for adequate maintenance and the orderly replacement of fixed assets and equipment.
- Each October, staff shall present a report to the City Council estimating the year-end results for the preceding fiscal year. This report shall compare unaudited actual figures with budgeted and the most recently estimated actual figures.
- Appropriations are approved at the fund level, and in the case of the General Fund, at the department or program level. All amendments to the budget at these levels may be approved only by the City Council.
- For budget purposes, programs and departments are defined as follows:
    - City Council
    - Legal Services
    - City Manager/Human Resources/City Clerk
    - Finance
    - Information Systems
    - Community and Economic Development
    - Police and Disaster Preparedness
    - Fire and Emergency Medical Services
    - Library
    - Museum
    - Recreation
    - Public Works

The City Manager shall have authority to transfer funds within a given fund and between department appropriations to ensure that programmatic budgets may adapt throughout the year to evolving circumstances. Departmental appropriations in the 5100 series of the chart of accounts (salary and benefits) that reflect salary and benefit savings, may not be used to offset expenditures in the 5200 series of account codes (services and supplies) or the 6000 series of account codes (capital expense) without the express, written approval of the City Manager. These changes shall have no negative effect on the given fund or the General Fund.

Capital Projects

The City shall adopt a five-year capital improvement and maintenance plan, with the first year of the plan to be appropriated as part of the operating budget. The purpose of the plan is to identify and prioritize capital project needs.

The budget shall also include capital expenditures; where possible, such capital expenditures will be funded with non-recurring revenues or grants.

At least the first two years of the plan shall be fully funded, with funding shortfalls and challenges clearly identified in remaining years.

A Capital Improvement is defined as property, plant, or improvements having a useful life of two or more years and a total amortized acquisition and maintenance cost of $2,500 or more. All estimated construction, maintenance, and operating costs and potential funding sources for each proposed capital improvement shall be identified.

The City shall finance only those capital improvements consistent with the adopted capital improvement plan and City priorities. All capital improvement operating and maintenance costs shall be included in the fiscal forecast.

Basis of Accounting

Financial statements are prepared in accordance with General Accepted Accounting Principles and all relevant Pronouncements promulgated by the Governmental Accounting Standards Board (GASB). All governmental fund types are accounted for using the modified accrual basis of accounting. Their revenues are recognized when they become measurable and available as net current assets.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred. An exception to this general rule is principal and interest on general long-term debt, which is recognized when due. Financial resources usually are appropriated in other funds for transfer to a debt service fund in the period in which maturing debt principal and interest must be paid. Such amounts are not current liabilities of the debt service fund, as their settlement shall not require expenditure of existing fund assets.

All proprietary fund types and nonexpendable trust funds are accounted for using the accrual basis of accounting. Their revenues are recognized when they are earned, and their expenses are recognized when they are incurred.

Basis of Budgeting
The basis of budgeting is the same as the basis of accounting.

Treasury and Cash Management
The City shall manage the treasury in compliance with California Government Code Section 53600 and City Council Policy 400-5, which requires quarterly Treasurer's Reports to the City Council, reconsideration of Policy 400-5 by the Council at least once every two years, and selection of investments based on considerations of safety, liquidity, and yield, in order of decreasing priority.

In circumstances where short-term borrowing (i.e., fewer than 12 months) is required to mitigate the effects of uneven revenue disbursements from the state and ensure expenditure cash-flow demands may be met, the following options shall be considered, with the ultimate course of action dependent on the least cost, greatest security for the City, and administrative efficiency:

- Tax and Revenue Anticipation Notes (TRAN)
- Treasury Loan from Monterey County
- Inter-fund loans
- Commercial line of credit.

Should inter-fund loans be selected as a cash-flow strategy, the following conditions shall apply:

- City Council approval required for all loans;
- Duration of less than 12 months with the loan and repayment occurring within the same fiscal year;
- Fixed loan term (i.e., specific number of months with repayment date);
- Borrowing fund must pay interest at level to result in no loss of interest revenue to the lending fund;
- Specific revenue pledged to repay the loan based on realistic expectations for receipt;
- Funds in the lending fund must not be needed for operations during the period of the loan; and
- Loans must not be made from grant funds or other funds enabled by State or Federal legislation.

The City Council shall receive real-time reports of warrants drawn on the City Treasury.

Reserves
Reserves are established to ensure that sufficient resources shall be maintained in specified funds in amounts sufficient to manage reasonable risks, meet unanticipated needs, capitalize on opportunities, and provide for reasonable contingencies. Further, reserve balances shall be categorized and prioritized in accordance with GASB Statement #54 (GASB 54).

- In the City of Pacific Grove, "operating reserve" is equivalent to portions of the accumulated fund balance that are classified as either committed, assigned, or unassigned, per GASB 54.

- The order in which spendable reserves may be used is prioritized as follows: restricted, committed, assigned, and then unassigned, per GASB 54. Council action is required to increase, decrease, eliminate or reclassify amounts reported in each category.

- Use of reserves must be authorized in advance by the City Council.

- If ~~reserves are expended for their intended use,~~ reserve balances fall below the stated target amount, the City will strive to restore reserves to the stated level within five years. As revenues versus expenditures improve, the City will allocate at least half of the funds to reserve restoration, with the balance available to fund asset replacements, unfunded liabilities, capital improvement projects, service level restorations or other Council priorities.

- The actual City reserve balances shall be reported each year, along with ~~their~~ City reserve policy levels. This information should appear in the Transmittal Letter which accompanies the audited financial statements.

- ~~the City Council shall prioritize restoration of reserves to levels established by policy before allocating resources to fund new or improved services.~~

General Fund~~.~~
The City will strive to maintain a minimum unassigned fund balance of at least 35% of operating and debt service expenditures in the General Fund for fiscal stability, cash flow and contingencies/strategic opportunities. This balance is based on the risk assessment methodology for setting reserve levels developed by the Government Finance Officers Association of the United States and Canada (GFOA) in adequately addressing:

- Revenue source stability, local disasters and other financial hardships or downturns in the local or national economy.
- Contingencies for unseen operating or capital needs, including strategic investment opportunities.
- Unfunded liabilities such as self-insurance, pensions and retiree health obligations.
- Dependency of other funds on the General Fund.
- Institutional changes, such as State budget takeaways and unfunded mandates.
- Cash flow requirements.

The unassigned fund balance of 35% is allocated into three separate categories to reflect the following intended uses:

- Cash Flow: 20%
  - Provides assistance in meeting cash flow needs during the fiscal year
  - Closes a projected *short-term* revenue-expenditure gap

- Fiscal Stability: 10%
  - Responds to unexpected expenditure requirements or revenue shortfalls
  - Offers a resource to reduce unfunded liabilities

- Provides strategic bridge funds, when a forecast shows an ongoing structural gap

- Contingencies/Strategic Opportunities: 5%
  - Supports expenses associated with emergencies, natural disasters, and unplanned capital repairs
  - Provides a resource for economic development and revenue base improvements, productivity improvements, and other strategic opportunities that will strengthen City revenues, reduce future costs, or achieve high-priority City goals.

Reserves should not be used to fund ongoing costs or projected systemic "gaps." They should be restricted to one-time or short-term uses.

Future Capital Project or Other Long-Term Goal Assignments or Commitments
The Council may also commit or assign specific General Fund balance levels above the reserve target for future development of capital projects, unfunded liabilities or other long-term goals that it determines to be in the best interests of the City.

Other Commitments and Assignments
In addition to the 35% target noted above, unrestricted fund balance levels will be sufficient to meet funding requirements for approved programs or projects which are carried forward from the prior year; debt service reserve requirements; commitments for encumbrances; and other restrictions, commitments or assignments required by contractual obligations, state law or generally accepted accounting principles.

- ~~The City establishes a target reserve level of 10% of the General Fund annual operating budget, and shall maintain reserves of at least 10%, unless otherwise approved by the City Council for specific purposes. The 10% reflects the following components:~~
  - ~~Emergency financial need (e.g., capital repair, natural disaster)~~
  - ~~Economic contingency (to mitigate sudden service and staffing cuts in response to economic shocks and downturns)~~
  - ~~Economic opportunity (to leverage public resources for public investment opportunities, e.g., downtown property)~~
  - ~~One-time opportunities to invest in assets (e.g., an expanded Library), as an alternative to debt financing~~

Golf Fund
The purpose of the Golf Fund is to enable operation of the golf course as an enterprise without operating subsidies from the General Fund, unless deliberately authorized. The City establishes a target reserve level of 25% of revenues of the Golf Fund, as of June 30th of two fiscal years prior, to be used for capital improvements, cash management, and emergency protection. Given the vulnerability of the golf business to recession, 20% of

the 25% would be retained for use in mitigating the effects of unexpected revenue downturns, and 5% would be available retained for emergency repairs or other emergencies.

Sewer Fund
The Sewer Fund shall maintain a reserve of at least $500,000.

Workers Compensation Fund
The Workers Compensation Fund shall maintain a balance of current assets equal to 67% of total liabilities, or higher, should actuarial analysis conclude an imminent risk to the City for unanticipated losses.

Liability Insurance Reserve
The Liability Insurance Reserve shall maintain a balance of at least $300,000 in current assets, which is equivalent to the maximum amount the City would be required to pay in the event of two catastrophic losses in a single year (City's Self-Insured Retention Limit is currently $150,000 per claim).

Debt Management

- Long-term borrowing shall be restricted to the purpose of funding capital improvement projects and equipment. The use of long-term borrowing for ongoing operations shall be avoided.

- The term of the debt shall not exceed the expected useful life of the object of the financing.

- Debt obligations shall be prioritized in the budget process and payments shall be made in a timely and efficient manner.

- Refunding techniques shall be employed where appropriate, and with all due City Council approval, to allow for restructuring of outstanding debt to remove or change restrictive covenants, and/or to reduce annual debt service in an amount sufficient to justify the costs related to restructuring the debt.

- Total debt in any fund shall not exceed prudent levels.

Property Acquisition and Disposition

- Acquisition of real property shall be tied to a specific objective, with the source of adequate funds identified and considerations given for the long-term fiscal and policy impacts.

- Disposition of real property shall be considered for those properties without specific deed restrictions and that are unused, under-utilized, economically not viable, or that were acquired for an outdated plan or purpose.

Annual Audit

The City of Pacific Grove shall undertake an annual independent audit.

- The City's Comprehensive Annual Financial Report (CAFR) including accompanying schedules and notes shall be completed no later than December 31 of each contract year.

- All funds of the City shall be audited in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller of the United States.

- The form of the CAFR shall be compliant with the requirements of the Government Finance Officers Association (GFOA) Certificate Program and will include the independent auditor's opinion on the Government-Wide Financial Statements and Fund Financial Statements.

- A separate "management letter" shall be published that includes recommendations for improvements in internal control, accounting procedures and other significant observations.

Capital Policy

All assets, including land, buildings, machinery and equipment, with an original cost in excess of $5,000 and a useful life of three years or more will be subject to capitalization.

- The capitalization threshold is applied to individual units of fixed assets. For example, ten chairs purchased via a single order, each costing $600 will not qualify for capitalization although the total cost of $6,000 exceeds the threshold of $5,000.
- Repair costs for fixed assets will be subject to capitalization when the repair extends the useful life of the related fixed asset.
- Useful Life Schedule

Description	Useful Life In Years
Buildings	100 Years
Machinery and equipment	5 Years
Furniture and fixtures	5 Years
Improvements other than buildings	3 Years
Sidewalks, curb, gutters, and streets	20-50 Years
Traffic signals	15 Years
Street signs	15 Years
Storm drains	20-50 Years
Park equipment	10-50 Years

- For construction in progress, no depreciation is recorded until the asset is placed in service. When construction is completed, the asset shall be reclassified as building, building improvement, land improvement, or equipment and should be capitalized and depreciated.
- The City shall use the straight-line method for depreciating all fixed assets (the basis of the asset is written off evenly over the useful life of the asset). Depreciation shall begin in the month the asset is placed in service.
- All computer and computer related equipment will be recorded and controlled as inventory and not depreciated. Constant changes in technology, software demands, and system configurations cause this asset class to be obsolete before it reaches its useful life.

Donated Assets

Fixed assets acquired by gift, donation or payment of a nominal sum not reflective of the asset's market value shall be assigned cost equal to the fair market value at the time of receipt.

Adopted: Resolution 11-086 (Adopted November 2, 2011)
Amended: Resolution 14-063 (Amended October 1, 2014)
Amended: Resolution 15-055 (Amended October 21, 2015)
Amended: Resolution 16-048 (Amended September 7, 2016)

RESOLUTION NO. 16-xxx

AMENDING COUNCIL POLICY NO. 400-6 BUDGET AND FINANCIAL MANAGEMENT

FINDINGS

1. The City Council's current Budget and Financial Management Policy 400-6 establishes a General Fund Reserve target level of at least 10% of the annual operating budget, unless otherwise approved by City Council for specific purposes.

2. An evaluation of the City's cash flow needs and exposure to risk; best practices, and a comparison with benchmark cities indicates an increase in reserve policy levels is needed to assist with fiscal sustainability and managing financial risks.

3. Council Policy 400-6, *Budget and Financial Management Policies,* should be amended to increase the City's General Fund reserve levels to a minimum of 35%.

4. This action does not constitute a "Project" as that term is defined under the California Environmental Quality Act (CEQA) Guideline Section 15378, as it is an organizational or administrative activity that will not result in direct or indirect physical changes in the environment.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF PACIFIC GROVE:

1. The Council determines that each of the Findings set forth above is true and correct, and by this reference incorporates those Findings as an integral part of this Resolution.

2. Amendments to Budget and Financial Management Policy No 400-6 are hereby approved as indicated in the draft amended policy attached hereto, which by this reference are incorporated as set forth in its entirety.

3. This Resolution shall take effect immediately following passage and adoption thereof.

PASSED AND ADOPTED BY THE COUNCIL OF THE CITY OF PACIFIC GROVE
this 7th day of March, 2018, by the following vote:

AYES:
NOES:
ABSENT:

APPROVED:

_____
BILL KAMPE, Mayor

ATTEST:

_____
SANDRA KANDELL, CITY CLERK

APPROVED AS TO FORM:

_____
DAVID C. LAREDO, City Attorney