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Councilmember District 5

## REVISED AGENDA MATERIAL

**Meeting Date:** January 24, 2017

**Item Number:** 43

**Item Description:** General Fund Reserve Policy

**Submitted by:** Mayor Jesse Arreguin and Councilmember Sophie Hahn

The General Fund Reserve Policy was brought to the City Council as an item on the December 13, 2016 Agenda, but was automatically carried over to the January 24, 2017 meeting due to lack of time. Mayor Arreguin and Councilmember Hahn submitted revisions to the City Manager's original recommendation in Supplemental Packet #2, distributed on December 13, 2016. This version of the proposed revised General Fund Reserve Policy is included in the agenda packet for the current, January 24, 2017 meeting.

All but two of the additional changes attached herewith were submitted as part of Supplemental Packet #3 for the December 13, 2016 City Council meeting, which were not formally accepted by Council due to the item's postponement. We hereby offer those same changes (attached) plus two additional changes, as revised material for the meeting to take place on January 24, 2017.

Pursuant to conversations with the City Manager, Mayor Arreguin and Councilmember Hahn recommend that the Council adopt the further revised version of the General Fund Reserve policy as provided herewith. This version shows cumulative tracked changes for the previous and current revisions.

As recommended here, the General Fund Reserve policy will:

- Establish a General Fund Reserve (the "Reserve") to be comprised of two elements: a Stability Reserve (55% of the Reserve) and a Catastrophic Reserve (45% of the Reserve). No part of the Reserve shall be used for ongoing or new programs or services.
  - The purpose of the Stability Reserve is to provide fiscal stability in response to unexpected downturns or revenue shortfalls.

- The purpose of the Catastrophic Reserve is to respond to extreme, one-time events, such as earthquakes, fires, floods, civil unrest, and terrorist attacks.
- Establish an immediate minimum Reserve Level of 13.8% of FY17 Adopted General Fund Revenues
- Establish an Intermediate Reserve minimum of 16.7% by the end of FY20
- Establish a Long Term Goal of a Reserve of a minimum of 30% of General Fund Revenues, to be achieved within no more than 15 years
- Establish that, starting in FY18, 50% of Excess Equity above the first \$1M shall be allocated to the Reserves. The City Council may allocate additional Excess Equity to the General Reserve Fund by majority vote.
- Requires that a replenishment schedule be adopted simultaneous with an appropriation to withdraw Reserve funds or, if infeasible due to emergency circumstances, no more than 3 months from the date of the withdrawal appropriation.
- Repayment shall begin no more than 5 years from the date of withdrawal, and be completed within 10 years of the date of withdrawal.

## City of Berkeley General Fund Reserve Policy

### Policy

The General Fund is the City's primary operating fund. It is not connected to any one revenue source and may be used at the City's discretion. The General Fund is the operation fund that pays for general services provided by the City as well as public safety and capital improvements. The General Fund accounts for all general revenues and expenditures of the City related to the delivery of the City's general services not specifically collected or levied for other City funds.

The City of Berkeley is committed to achieving long-term fiscal stability as well as mitigating the negative impacts of extraordinary risk such as earthquakes, fires, floods, and economic volatility. A key attribute of a financially stable organization is appropriate reserves. Strong reserves position an organization to weather significant economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, and other catastrophic events. Establishing an adequate General Fund reserve policy allows the City to mitigate current and future financial risks resulting from economic instability or catastrophic loss.

~~The City's General Fund Reserves Policy documents the City's approach to establishing and maintain strong reserves and is designed to identify City operations and functions for which reserves should be established and maintained; establish target reserve levels and the methodology for calculating reserve levels; provide a methodology for meeting reserve targets; and establish criteria for the use of reserves and the process to replenish reserves.~~

### Functions of Reserves: Stability and Catastrophic

The City of Berkeley will establish and maintain an adequate ~~financial reserves in order~~ General Fund Reserve ("Reserve") to prepare for the impact of economic cycles and ~~physical disasters catastrophic events have upon essential services to the public~~ and assure annual fluctuations in revenue do not impede the City's ability to meet expenditure obligations. When revenues s fail to meet the City's normal operating requirements ~~of essential public services~~, or the need for disbursements temporarily exceeds receipts, General Fund reserves, upon a ~~two-thirds~~ majority vote of the City Council, may be used in accordance with the standards set forth herein, ~~as determined by a Risk Assessment (best practices) that will be updated every five years to assess if the reserve level should be increased or lowered (to no less than the minimum level).~~

The Reserve shall be comprised of two elements: a Stability Reserve and a Catastrophic Reserve. The Reserve shall not be used for ongoing or new programs or services.

A Stability Reserve will be maintained to mitigate loss of service delivery and financial risks associated with unexpected revenue shortfalls during a single fiscal year or during a prolonged recessionary period. The purpose of ~~this reserve~~ the Stability Reserve is to provide fiscal stability in response to unexpected downturns or revenue shortfalls, and not to serve as a funding source for new programs or projects.

~~In times of economic downturn, if revenues are insufficient to meet the normal operating requirements of essential services, funds contained in the Reserve may be used if authorized by a two-thirds vote of the City Council, based on the following principles:~~

- ~~1. Staffing levels in essential services shall be temporarily maintained, in order to avoid or reduce the necessity for immediate lay-offs; only in extreme conditions will reserves be used to support operational positions for longer than two years;~~
- ~~2. A hiring freeze must be implemented for designated positions as appropriate to maintain essential services to the public;~~
- ~~3. All other reasonable and available expenditure reduction measures have been taken by the City Manager and the City Council before using one-time funding to support operational positions;~~
- ~~4. User fees and services charges will be fully utilized for those services for which they were collected;~~
- ~~5. The level of the Reserve shall be restored in a timely manner as economic recovery occurs, consistent with the maintenance of essential services;~~
- ~~6. "Essential services", "appropriate levels" of such services, and "extreme conditions" shall be recognized from time to time by the City Council upon the recommendation of the City Manager.~~

A Catastrophic Reserve will be maintained for the purpose of sustaining General Fund operations in the case of a public emergency such as a natural disaster or other ~~unforeseen~~ catastrophic event. The ~~reserve~~ Catastrophic Reserve will be used to respond to extreme, onetime events, such as earthquakes, fires, floods, civil unrest, and terrorist attacks. The Catastrophic Reserve will not be accessed to meet operational shortfalls or to fund new programs or ~~personnel~~ projects. ~~This reserve will be restricted and only expended in the event such expenditures are necessary to ensure the safety of the City's residents and their property.~~

## Funding and Functions that are NOT Part of the General Fund Reserves

Not included in the General Fund Reserves are funds that are set aside for a specific purpose. This would include restricted, committed, and assigned funds.

- The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action by the City Council.
- Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed.

~~In addition, the General Fund Reserves will not be used for ongoing or new programs or services.~~

## Target Reserve Levels

~~The General Fund Reserves consists of the total of the Stability Reserve and the Catastrophic Reserve. 55% of the Reserve shall be allocated to the Stability Reserve and 45% to the Catastrophic Reserve.~~

~~Effective immediately, the target level for total the General Fund Reserves shall be a minimum level of 16.713.8% of 2017-adopted revenues Adopted General Fund Revenues with an Intermediate Goal of a minimum of 16.7% of 2018-Adopted General Fund Revenues by the end of Fiscal Year 201820, if financially feasible. ;~~

~~The Council hereby adopts a Long Term Goal of a Reserve of a minimum of 2030% of General Fund Revenues, to be achieved within no more than 4015 years. Based on a risk assessment (according to best practices), to be updated at least every five years, the Council may consider increasing or lowering the General Fund Reserve level.~~

~~Starting in Fiscal Year 2018, to achieve the City's Intermediate and Long Term Reserve Goals, 50% of Excess Equity above the first \$1M shall be allocated to Reserves. Additional Excess Equity may be allocated to Reserves by a majority vote of the City Council.~~

~~After achieving the 16.7% Intermediate Goal, achieving the 20% Long Term Goal will require setting aside approximately 0.5% of Adopted General Fund Revenues annually (assuming funding over ten years). Simultaneous with the Biennial Budget process, the City Manager shall determine the recommended percent of each year's Adopted General Fund Revenues to be set aside each budget year to achieve the Long Term Goal of 20% or more Reserves within ten years. The City Council shall adopt a percent~~

~~allocation to fund the Long Term Goal along with adoption of the Biennial Budget. The adopted percent may be amended in the mid-Biennial Budget process.~~

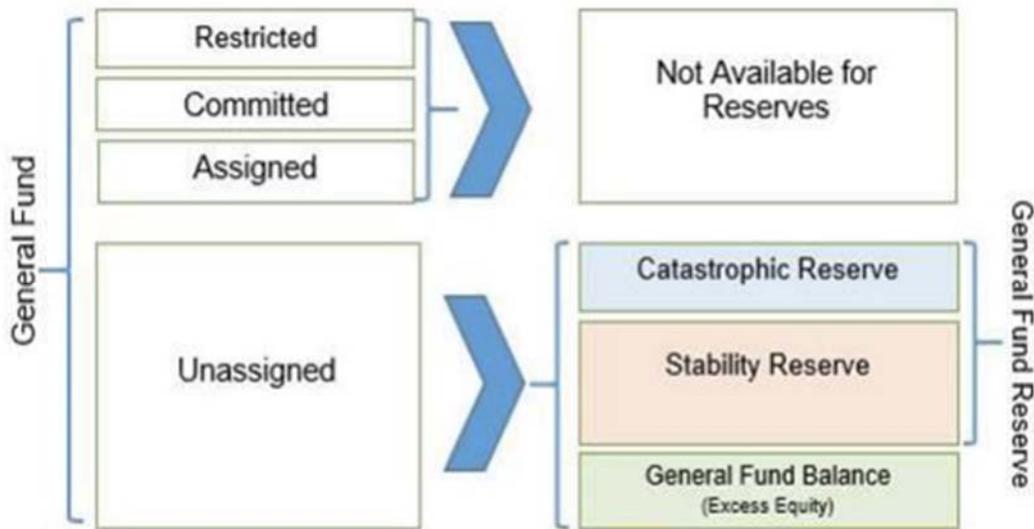
~~All interest accrued on Reserve funds shall be added to the Reserve. The actual percent of Adopted General Fund Revenues necessary to achieve the Long Term Goal will depend on a number of factors, including, but not limited to, actual Adopted General Fund Revenue amounts, expense growth and returns on invested Reserve funds.~~

~~In addition, the City Manager shall explore the feasibility, costs and benefits of meeting a portion of the 20% Long Term Goal through a line of credit which, if feasible and obtained, shall reduce the percent of Adopted General Revenue funds to be set aside annually., with a goal of reaching 30% over time. The 30 percent reserve level will be allocated as follows:~~

- ~~• 16.7% to the Stability Reserve, and~~
- ~~• 13.3% to the Catastrophic Reserve~~

### **Methodology to Meet Reserve Levels**

The General Fund Reserves ~~are is~~ is ~~distinctly~~ separate from the General Fund Balance. The sum of the Stability Reserve and the Catastrophic Reserve and the amount determined to be Excess Equity is deemed to be General Fund Unassigned Fund Balance. Unassigned fund balance is the residual classification for the City's general fund and includes all spendable amounts not contained in the other classifications. The following graphic shows the relation between these funds as well as other restricted, committed, and assigned general fund monies.



Excess Equity is most commonly a non-recurring source of revenue and shall only be used for one-time, nonrecurring expenditure needs of the City. Excess Equity should be reported separately from the General Fund Reserves; ~~however, Excess Equity could be used to support funding the General Fund Reserves and assist the City in meeting its 30% target level.~~

Attaining the recommended Long Term Goal of 30% reserve level ~~Reserves~~ is important to the long-term financial health and stability of the City. ~~However, it must be recognized that reaching a 30% reserve level will not occur overnight and it may be necessary to fund unexpected or increased operating and capital cost, while simultaneously building the General Fund Reserves. This is not intended to supersede other fiscal policies that the Council adopts with the biennial budgets. As such, the Reserve Policy calls for 50% of annual Excess Equity (revenue above expenditures), after the carryover process has concluded, to be transferred annually to the Reserves. The 50% allocation to the Reserves (Stability and Catastrophic) will be based on the weighted average. The remaining 50% of annual Excess Equity can be appropriated by a two-thirds vote of the City Council as described below.~~

- ~~• Addressing the City's infrastructure maintenance backlog~~
- ~~• Contributions to reduce unfunded liabilities~~
- ~~• Contributions to build or maintain the General Fund reserve~~
- ~~• Capital projects that do not create new, ongoing expenditure requirements unless it can be demonstrated that adequate alternative resources exist to support the new, ongoing expenditure requirements~~
- ~~• One-time expenditures that advance a goal of the City Council's Strategic Plan~~

- ~~Special or one-time, nonrecurring expenditure needs of the City~~

## Replenishment of the General Fund Reserves

The City Manager shall recommend a replenishment schedule for all monies proposed for appropriation from the General Fund Reserves. The replenishment schedule shall be adopted simultaneous with the appropriation to withdraw ~~al-reserve Reserve~~ funds or, if infeasible due to emergency circumstances, no more than 3 months from the date of the withdrawal appropriation. Repayment shall begin no more than 5 years from the date of withdrawal and be completed within 10 years from the date of withdrawal.

While staff envisions that, in most cases, repayment will start as soon as possible, the repayment guidelines are meant to reflect a commitment to maintain a sufficient reservesReserve, while also recognizing that a use of ~~reserves-Reserve funds~~ may occur during an economic downturn and it may be necessary to postpone repayment while the economy improves.