COUNTY OF SAN MATEO
Inter-Departmental Correspondence
County Manager's Office

DATE: February 4, 2010
BOARD MEETING DATE: February 9, 2010
SPECIAL NOTICE/HEARING: None
VOTE REQUIRED: Majority

TO: Honorable Board of Supervisors

FROM: David S. Boesch, County Manager

SUBJECT: Update of County Reserves Policy

RECOMMENDATION:
Adopt updates to the County Reserves Policy.

BACKGROUND:
The Board of Supervisors approved the original County Reserves Policy in April 1999. The policy has remained unchanged since that time. In light of the current economic crisis and the County's recent reliance on one-time Reserves to balance the budget, the Board directed staff during the June 2008 budget hearings to review reserves policies of other jurisdictions for updated best practices and to revise the policy to outline consequences for departments that fall below the two percent reserves requirement.

DISCUSSION:
The County's Fund Balance and Reserves policies help reduce the negative impact on the County during times of economic uncertainty and potential losses of funding from other governmental agencies. Fund Balance and Reserves are viewed as one-time sources of funding which are only used for one-time purposes or as part of a multi-year financial plan to balance the budget. The County avoids operating deficits that are created through dependency on one-time funding for ongoing expenditures. The revised County Reserves Policy includes minimum requirements for Non-Departmental and departmental reserves, General Fund appropriation for contingencies, reserves for countywide capital improvements and automation projects, and provides guidelines for the use of these funds. At its January 20, 2010 meeting, the Board's Finance & Operations Committee reviewed the updated Policy and recommended that it be forwarded to the full Board for adoption.

Review of State/Local Reserves Policies
Staff selected eighteen counties and five cities within the State of California for comparison purposes. The agencies were primarily selected based on one or more of the following characteristics: their close geographic proximity to the County, their comparable population to the County, or their reputation as a high achieving

organization, including nine recipients of the Government Finance Officers Association's (GFOA) Distinguished Budget Presentation Award. In comparing our policy with these jurisdictions, the following areas were reviewed: (1) minimum reserves percentage required by the policy, (2) basis for calculating reserves requirement (Revenues, Expenditures, or Fund Balance), (3) whether General Fund operating departments appropriate reserves, and (4) minimum reserves requirement for operating departments.

The findings can be found in the attached table and are summarized as follows: nineteen jurisdictions have a formal policy while four do not and only two jurisdictions (Orange and San Diego counties) allow General Fund operating departments to appropriate reserves; however, neither has a minimum reserves requirement. Perhaps the most interesting finding was the different methods used by counties and cities for determining the minimum reserves requirement. Similar to San Mateo County, seven jurisdictions base their minimum reserves requirement exclusively on expenditure appropriations (including five GFOA Award recipients), eight base their calculation exclusively on general purpose discretionary revenues, one bases its calculation exclusively on fund balance, and three use some combination of fund balance, revenue and/or expenditure appropriations. The counties with the highest reserves requirement percentages generally used revenues or fund balance as their basis. For example, Contra Costa County's reserves requirement is 15% of general purpose revenues. Translating San Mateo County's three percent contingency and two percent departmental reserve requirements from Net Appropriations to general purpose revenues equals 15.8%. The average reserves/contingencies requirement for all surveyed jurisdictions is 5% of Net Appropriations when applying the various methodologies to the County's budget. The most stringent policy of those surveyed is that of Ventura County which calls for a minimum general reserve of 1% of total appropriations, a contingency of $2 million, and a minimum reserves requirement of 10% of total General Fund revenues, with a General Fund reserve goal of 15%. Ventura County currently falls short of its 10% minimum reserves requirement with 8.7% of General Fund revenues.

Workgroup Conclusions

Although a case could be made for any of the methodologies used as the basis for calculating the reserves requirement, the use of Net Appropriations takes into consideration the entire budget, including State and federally funded programs, as well as programs funded by local sources, such as fees and charges for services. The exclusive use of general purpose discretionary revenues takes changes in all other revenue sources out of the equation and fund balance is much too volatile during economic downturns. For these reasons the Workgroup believes the continued use of Net Appropriations as the basis is the preferred method; however, we do recognize that departments may have material one-time grants and contract expenditures appropriated for non-core services that may inflate the reserves requirement beyond what is reasonably attainable for those departments to achieve.

Given the current budget situation, it can be assumed with some degree of certainty that over the next three years departments will draw down significantly on their reserve balances. With that in mind, the Workgroup recommends that the two percent departmental reserves requirement remain in place, as well as the Non-Departmental three percent contingency requirement, but that a Non-Departmental General Fund reserve of five percent be established to ensure that the County's General Fund reserve balances do not drop below ten percent. The Workgroup also finds it prudent to increase the amount set aside for Countywide Capital Improvements and Automation Projects, and recommends that these amounts be increased from $1 million each to $2 million each, for a total set aside of $4 million.

Recommended Updates to the County Reserves Policy

The major recommended changes to the updated County Reserves Policy are as follows:

- Non-Departmental General Fund Reserve Requirement – Policy establishes a new reserve requirement in Non-Departmental Services of five percent of Net Appropriations. This new requirement is in addition to the three percent General Fund contingency, two percent departmental reserve requirement, and set asides for countywide capital improvement and automation projects.
- Reserve for Countywide Capital Improvements and Automation Projects – The minimum reserve requirement to be set aside in Non-Departmental Services will be increased from $1 million to $2 million for both countywide capital improvement and automation projects, resulting in a total reserve requirement of $4 million.
- Reserves Replenishment Plan – Should departments fall below the two percent minimum requirement, they must develop a multi-year financial plan that details how they intend to replenish their reserves to the two percent minimum within three-year years or a mutually agreed upon timeframe. Departments that are unable to demonstrate progress towards achieving the minimum requirement shall be subject to enhanced fiscal oversight, including quarterly budget updates to the County Manager's Office.
- Calculation of Two Percent Reserves Requirement – Net Appropriations will continue to be the basis for calculating the minimum Reserve Requirement. However, material/one-time grant funds and revenue derived from service contracts that do not represent core departmental services will also receive consideration for exclusion, with final approval resting with the County Manager's Office.
- Excess ERAF (Educational Revenue Augmentation Fund) – Excess ERAF is recognized as a separate component of Non-Departmental Services' Fund Balance and Reserves and its uses are limited to one-time and short-term purposes.

Adoption of the updated County Reserves Policy contributes to the Shared Vision 2025 outcome of a Collaborative Community by ensuring fiscal accountability, healthy reserve balances and the responsible use of reserves.

FISCAL IMPACT:

Based on the County's FY 2009-10 Adopted Budget, the revised policy would require a minimum General Fund reserve requirement of $104.7 million (or 10.3% of Net Appropriations). The County's General Fund reserves balance is currently $217.6 million (21.4% of Net Appropriations).

Attachments:

Reserves Policy Comparison with other Jurisdictions
Updated County Reserves Policy

Organization County	Policy	Total	Appropriation Basis	Can Dept. Appropriate Reserves?	Dept Minimum Req
Alameda	General reserve of 1% of discretionary revenue	1%	Revenue	No	No
Contra Costa	Minimum unreserved GF balance of 5% of GF revenues and minimum GF balance of 10% of GF revenues	15%	Revenue	No	No
Los Angeles	"Rainy Day" fund of 3% of total annual fund balance and 10% reserve cap of on-going locally generated revenue	13%	Revenue and Fund Balance	No	No
Marin	A minimum of 5% of its GF operating budget	5%	Expenditures	No	No
Monterey	Annual contingency funding of 1% of adopted revenues to serve as "rainy day funds"; General Fund strategic reserve of 10% of adopted revenues	11%	Revenue	No	No
Napa	A minimum of 3% of GF appropriation into an operating contingency and reserves of 10% of GF appropriations	13%	Expenditures	No	No
Orange	Reserves of 10% of ongoing general purpose revenues	10%	Revenue	Yes, for specific programs and uses	No
Riverside	Budget policy target of 15% of discretionary revenue for the size of one designation (economic uncertainty) and 4% of discretionary revenue for contingency	19%	Revenue	No	No
Sacramento*	No policy	N/A	N/A	N/A	N/A
San Diego*	General reserve at 5% of budgeted general purpose revenues; general fund contingency at 2% of general purpose revenues; general fund unappropriated, unreserved, undesignated fund balance at 10% of budgeted general purpose revenues; no target for management reserves	17%	Revenue and Fund Balance	Yes, management reserves	No
Santa Barbara*	Allows for certain GF departmental designations, but the general policy is for all savings and unanticipated revenue to fund balance then strategic reserves	N/A	Fund Balance	No	No
Santa Clara	Contingency reserve of 5%	5%	Revenue	No	No
Santa Cruz	No policy	N/A	N/A	N/A	N/A
San Mateo*	**GF net appropriations of 3% and departmental reserves of 2%**	**5%**	**Expenditures**	**Yes**	**2%**
Shasta	General reserve target balance of 5% of unrestricted General Fund resources	5%	Revenue	No	No
Sonoma*	Total GF discretionary reserves of 5%-15% of GF operating revenues	15%	Revenue	No	No
Stanislaus*	Not less than 5% of GF appropriations for the preceding three fiscal years	5%	Expenditures	No	No

Organization County	Policy	Total	Appropriation Basis	Can Dept. Appropriate Reserves?	Dept Minimum Req
Ventura	Minimum general reserve for GF is 1% of total appropriations; GF contingencies of $2 million; GF designations of 10% of total revenues with long term goal of 15% of total appropriations	11%	Revenue and Expenditures	No	No
City					
Fresno*	Adopted GF appropriations of 5%	5%	Expenditures	No	No
Los Angeles*	Contingency reserve of 3% of GF adopted budget and emergency reserve account of 2% of GF adopted budget	5%	Expenditures	No	No
Oakland*	GF appropriations of 7.5%	7.5%	Expenditures	No	No
Sacramento	No policy	N/A	N/A	N/A	N/A
San Jose*	Central fund reserve amount of a minimum of 3% of the operating budget	3%	Expenditures	No	No
City/County					
San Francisco	No policy	N/A	N/A	N/A	N/A

*Government Finance Officer's Association Distinguished Budget Presentation Award Recipient

LONG-TERM FINANCIAL POLICIES

The primary fiscal agents for the County—the Board of Supervisors, County Manager, Controller, Assessor and Treasurer—have made public access to financial information a priority. The County's budget, budget information, Comprehensive Annual Financial Report (CAFR) and Popular Annual Financial Report (PAFR) are available on the County website, www.co.sanmateo.ca.us. Residents can look up the assessed value of their property or pay their property taxes online. Board meetings (including budget hearings) air on Peninsula TV, a local access cable channel operated by a consortium of public agencies.

COUNTY RESERVES POLICY

The Board of Supervisors approved the County's original Reserves Policy in April 1999. The creation of the policy was initiated by the County's Fiscal Officers to help reduce the negative impact on the County during times of economic uncertainty and potential losses of funding from other governmental agencies. The Board of Supervisors approved the revised policy on DATE REVISED POLICY IS APPROVED BY THE BOARD OF SUPERVISORS to align the policy with the current fiscal environment. Fund Balance and Reserves are viewed as one-time sources of funding which are only used for one-time purposes or as part of a multi-year financial plan to balance the budget. The County avoids operating deficits that are created through dependency on one-time funding for ongoing expenditures. The revised policy includes minimum requirements for Departmental Reserves, General Fund Appropriation for Contingencies, Reserves for Countywide Capital Improvements and Reserves for Countywide Automation Projects, and provides guidelines for the use of these funds.

Departmental Reserve Requirements

1. Use of One-Time Funds - One-time funds will not be used to fund ongoing operations, unless in the context of a multi-year financial plan to balance expenditures and Reserves.

2. Minimum Departmental Reserve Requirements - The minimum Departmental Reserves requirement is two (2) percent of Net Appropriations. Departmental Reserves will only be used for the following:

   a. one-time emergencies;

   b. unanticipated mid-year losses of funding;

   c. short-term coverage of costs associated with unanticipated caseload increases; and

   d. short-term coverage of costs to minimize employee lay-offs provided there is a long-term financial plan.

3. Reserves Replenishment Plan - Departments must obtain approval from the County Manager's Office prior to using Reserves which puts them in the position of falling below the two (2) percent Reserves requirement. Approval of funding Reserves below the two (2) percent requirement would be contingent upon review and approval of a multi-year financial plan that details how the department intends to replenish their Reserves to the two (2) percent level within three years or a mutually agreed upon timeframe by the department and County Manager's Office. Department plans must address the use of excess Fund Balance with the first priority being the replenishment of Reserves. This plan will be reviewed annually at the budget meeting with the County Manager's Office to determine if progress is being made to achieve the two (2) percent level. Departments that are unable to demonstrate progress towards achieving the two (2) percent requirement shall be subject to enhanced fiscal oversight, including quarterly budget updates to the County Manager's Office.

4. Calculation of Two (2) Percent Reserves Requirement - Net Appropriations will be the base for calculating the minimum Reserve requirement. Any exceptions will be made on the basis of materiality of adjustment and impact on direct ongoing operations. Material/onetime grant funds that must be appropriated should be excluded from the two (2) percent Reserves calculation. Revenue derived from service contracts that do not represent core departmental services will also receive consideration for

exclusion, with final approval resting with the County Manager's Office. With the exception of required grant matching funds, grants and service contacts will not be backfilled by the County's General Fund should funding be eliminated or reduced. The two (2) percent requirement for each department will be determined at the time that the final budget is formally adopted by the Board of Supervisors.

5. Guidelines for Fund Balance in Excess of Minimum Reserve Amount - Fund Balance generated in excess of the two (2) percent minimum departmental Reserves requirement can only be allocated to the following:

    a. Appropriate in Departmental Reserves for future one-time purposes;

    b. Purchase of fixed assets;

    c. Sinking fund for future replacement of assets;

    d. Deferred maintenance;

    e. One-time departmental projects;

    f. Reserve for audit disallowances;

    g. Local match for grants;

    h. Seed money for new departmental programs provided there is a plan that includes identification of future ongoing funding sources and outcome measures; and

    i. Short-term coverage of operational costs in order to maintain program integrity and prevent employee lay-offs in conjunction with sections 1 and 2 above.

6. Deferred or Incomplete Projects - Unexpended one-time funds from deferred or incomplete projects, including grant funds, can be carried over to the next fiscal year at 100% of the amount not spent. These will be exempt from the Fund Balance Policy's 75/25 split.

7. Service Departments and Non-General Fund Departments - Fund balance generated by service departments shall be evaluated by the Service Charges Committee, including representatives from the County Fiscal Operating Committee, following the end of each fiscal year to recommend how they should be applied. Application of funds will be done in a way that maximizes cost reimbursement through claiming and fairly allocates any impacts on the A-87 cost plan.

    Internal Service Funds can maintain Reserve balances for future purposes including, but not limited to, vehicle and equipment replacement costs and risk management claims.

    As a goal, County Enterprise Funds, Special Revenue Funds and Special Districts should generate revenue sufficient to support the full direct and indirect costs of these funds above and beyond General Fund subsidy or contribution levels approved by the Board.

<u>General Fund Non-Departmental Reserve Requirements</u>

1. General Fund Reserves – Shall be maintained at a minimum of five (5) percent of total General Fund Net Appropriations for one-time purposes or as part of a multi-year financial plan to balance the County's budget. The five (5) percent requirement may include Excess ERAF (Educational Revenue Augmentation Fund) reserves. After Contingencies, the second priority for excess Fund Balance at the end of each fiscal year is to replenish this amount so that it is at or above the five (5) percent level.

2. Appropriation for Contingencies – Shall be maintained at three (3) percent of total General Fund Net Appropriations for one-time emergencies and economic uncertainties. In order to maintain the highest possible credit rating, the first priority for excess Fund Balance at the end of each fiscal year is to replenish this amount so that it is maintained at the three (3) percent level.

3. Reserve for Capital Improvements – In order to preserve the County's capital assets, a minimum reserve of $2 million, which will include half of the Capital Facilities Surcharge, shall be maintained and appropriated annually for countywide capital improvements as specified in the County's Capital Improvement plan. The five-year plan will be updated annually during the budget process.

4. Reserve for Countywide Automation Projects – A minimum reserve of $2 million shall be maintained and appropriated annually for countywide automation projects that will generate long-term ongoing savings and reductions to Net County Cost. Projects will be determined during the budget process.

5. Amounts in Excess of above Requirements - Fund Balance generated in excess of the above requirements, including <u>all</u> Excess ERAF, can only be allocated or maintained as Reserves for the following one-time or short-term purposes:

    a. Capital and technology improvements

    b. Reduction of unfunded liabilities, including Retirement and Retiree Health obligations;

    c. Debt retirement;

    d. Productivity enhancements;

    e. Cost avoidance projects;

    f. Litigation;

    g. Local match for grants involving multiple departments;

    h. Innovation and Entrepreneurial Fund – creates one-time and short term incentives for team efforts that generate ongoing savings or revenues in new and creative ways; including one-time investments in infrastructure and other areas, with established parameters regarding payback periods and returns on investment.

    i. Seed money for new programs involving multiple departments provided there is a plan that includes identification of future ongoing funding sources and outcome measures; and

    j. Other purposes deemed to be fiscally prudent for the County as identified and recommended by the County Manager's Office to the Board of Supervisors.