



## ADMINISTRATIVE POLICY

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Jurisdiction: City Council

### FINANCIAL MANAGEMENT POLICIES

#### POLICY

The following financial policies (herein, the "Policies") assist the City with the management of its operating and capital budgeting processes and to standardize and rationalize the issuance of debt by the City. Updated policies insure the prudent use of the City's resources to meet its commitments, to provide needed services to the citizens of Capitola, and to maintain sound financial management practices. These Policies are guidelines for general use, and allow for exceptions in extraordinary conditions. The Policies serve their intended purpose if they stimulate an open debate about the City's operating and capital budget processes, existing and/ or proposed debt position, and they lead to informed decision-making by the City Council. In order to use the Policies properly, they should be applied in the context of the community's overall objectives and goals.

The Policies are divided into three sections: Capital Budgeting and Reserves, Operating Budgeting and Reserves, and Other Policies.

#### A. CAPITAL BUDGETING AND RESERVES; ISSUANCE OF DEBT

##### 1. CAPITAL PLANNING -IN GENERAL:

To enhance creditworthiness and prudent financial management, the City of Capitola is committed to systematic capital planning, intergovernmental cooperation and coordination, and long-term financial planning, and implementation over a two-year period. Evidence of this commitment to systematic capital planning will be demonstrated through adoption of an annual review of the City's five-year capital improvement budget.

##### 2. USE OF LONG-TERM FINANCING METHODS:

Major capital improvements or acquisitions valued over \$250,000 may be made using long-term financing, methods, rather than out of operating revenue. The prioritization of capital projects eligible for debt financing is accomplished through a "needs assessments" undertaken in the formulation and development of the City's five-year capital improvement budget.

##### 3. FISCAL ANALYSIS:

The City will require each capital appropriation request to include a fiscal analysis that identifies the amount of funds requested, the source of funds requested and the impact of the request on existing revenues and operations.

##### 4. ASSET LIFE:

The City will consider long-term financing for the acquisition, maintenance, replacement, or expansion of physical assets (including land) only if they have a useful life of at least five years. City debt will not be issued for periods exceeding the useful life or average useful lives of the project or projects to be financed.

5. CAPITAL FINANCING -IN GENERAL:

The City will rely first on internally generated funds and/or grants and contributions from other government sources to finance its capital improvement needs. Capital improvements will be financed through user fees, service charges, assessments, special taxes or developer exactions so long as the benefits the City will derive from such improvements can be attributed to the users of the improvements. Moreover, the City will specifically consider the costs associated with any borrowing in order to determine that the above funding sources are adequate to service the proposed debt. Accordingly, the Policies assume that development fees will be set at a level that is sufficient at all times to insure that new development pays its fair share of the cost of constructing new facilities in the community.

Debt will be issued for a capital improvement project only in the case of emergency or when it is an appropriate means to achieve an equitable allocation of costs between current and future beneficiaries as determined by the City Council. Debt shall not, in general, be used for projects solely because insufficient funds are budgeted at the time of acquisition or construction. Debt will only be undertaken when the City believes that project revenues or specific resources will be available and sufficient to service the debt over its life. Debt financing will not be considered appropriate for any recurring purpose such as operating or maintenance costs.

The City will evaluate the use of debt in-Lieu of "pay-as-you-go" financing based on the following criteria:

*Factors Favoring "Pay-as-you-Go" Financing:*

1. current fund balances or project revenues are Reliable adequate to fund the project;
2. existing or proposed debt levels would have a deleterious effect on the City's credit rating;
3. credit market conditions are unstable or present extraordinary difficulty in marketing the proposed debt.

*Factors Favoring Use of Debt:*

1. revenues are deemed to be stable & enough to support the proposed debt at investment grade ratings;
2. the nature of the financed project will support investment grade ratings;
3. credit market conditions present favorable interest rates and demand for financing such as the City's
4. the project being financed is mandated by the state or federal government and resources are insufficient or unavailable;
5. the project being financed is immediately required to meet or relieve capacity needs and current resources are insufficient or unavailable;
6. the estimated useful life of the asset to be financed is greater than 5 years.

6. GENERAL OBLIGATION DEBT:

General obligation bonds provide the lowest borrowing costs for major public assets. The source of repayment of a general obligation bond is from proceeds of specific taxes, the City's operating funds and its operating position are not impacted by the issuance of general obligation bonds. Though the use of the term "general obligation bond" implies that the City's "full faith and credit" would be pledged to the repayment of the bond, the bond is actually repaid from an ad valorem tax on real property.

Because of the absence of a limitation on the rate and amount of the tax that might be levied to pay a general obligation bond, state law requires the proposed debt to be approved by the electorate, by a two-thirds vote.

Cities in California may issue general obligation bonds only for the purpose of acquiring, improving or constructing real property.

7. USE OF OTHER DEBT, INCLUDING REVENUE BONDS, CERTIFICATES OF PARTICIPATION OR FINANCING LEASES:

Before issuing revenue debt or financing leases, the City will determine that the proposed facility is both necessary and desirable, and that no other financing method is practical to finance it. The City shall only use revenue debt or financing leases: if the project to be financed will generate positive net revenues after debt service; or, if the project will significantly reduce City operating costs; or, if an equal or greater amount of non-City matching funds will be lost if City's revenue or financing lease funds are not applied in a timely manner; or, in the case of a financing lease, if the project to be financed is less than \$250,000; or, if the project to be financed provides essential City services or would so advance core City policy objectives that its value overrides the value of obtaining voter approval.

B. OPERATING BUDGETING AND RESERVES

1. TWO YEAR OPERATING BUDGET:

The City will maintain a long-range fiscal perspective through the use of a two-year operating budget and a five-year capital improvement budget.

2. BALANCED OPERATING BUDGET:

The City will maintain a balanced operating budget for all governmental funds with on-going revenues equal to or greater than on-going expenditures and debt service. This policy requires that in any given fiscal year we do not budget proposed expenditures in excess of the revenue we expect to receive in the same time frame.

3. "ONE-TIME" REVENUE:

The City will use "one-time" revenues, including fund balance carry-forwards, to fund nonrecurring expenditures. "One time" revenues cannot be relied on in future budget periods and should be used to stabilize existing revenues, retire early debt or for capital purchases.

4. NORMAL REVENUE INFLATION WILL GO TO PAY NORMAL INFLATION EXPENSES:

The City will assume that normal revenue inflation will go to pay normal inflation expenses. Any new or expanded programs will be required to identify funding sources. If normal revenue inflation does not keep up with expense inflation, expenses will be decreased or a new revenue source will be found. If revenues grow at a rate faster than expense inflation, expanded service levels may be considered.

5. CONTINGENCY RESERVE APPROPRIATION:

For each fiscal year, the final adopted General Fund budget shall contain a funded Contingency Appropriation equal to 15% of normal General Fund Expenditures. The Contingency Appropriation "will provide a prudent level of financial resources to protect against temporary revenue shortfalls or unanticipated operating costs, and/or to meet short-term cash flow requirements."

6. EMERGENCY RESERVES:

To protect against significant one-time costs, which might arise from major unpredictable emergency events, in addition to the Contingency Appropriation, the City shall maintain a funded emergency reserve equal to 10% of normal General Fund budgeted expenditures.

7. PERS CONTINGENCY FUND:

The City will maintain a PERS Contingency Fund to stabilize future pension contribution increases. The City will invest the funds in an irrevocable trust fund. The target funding level for this fund is one full year of PERS Contributions with additional money allocated to the fund when the City has available surplus funds.

8. REVENUE DIVERSIFICATION:

The City will endeavor to maintain a diversified and stable revenue base to minimize the effects of economic fluctuations on revenue generation and to protect it from short-term fluctuations in any revenue source.

9. REVENUE PROJECTIONS:

The City will prepare multi-year projections of revenues and other resources in order to understand the level of funding available for services and capital acquisition. The revenue projections will assist the City in understanding of revenue sensitivity to changes in assumptions and to controllable factors such as changes to tax rates or fees. The revenue projection will be for a period of at least two years into the future to evaluate how revenues may change over time, to isolate non-reoccurring revenues and to understand the impact of revenue growth. The major assumptions used in the revenue projection will be documented and identified and different scenarios may be developed to enable City Council to choose a preferred scenario.

10. EXPENDITURE PROJECTIONS:

The City will prepare multi-year projections of expenditures for each fund and for existing and proposed new programs. The expenditure projections will assist the City in determining whether projected expenditure levels can be sustained, whether new programs are affordable, and whether a program's current and future costs are

acceptable compared to program benefits and projected revenue availability. The expenditure projections will be for a period of at least two years into the future to evaluate how expenditures may change over time. All expenditure projections should identify service level assumptions and key issues that may affect actual expenditures.

11. COMMUNITY DEVELOPMENT FEES:

The City's development process costs and related administrative expenses should be offset by fees to the greatest extent possible. Fees will be reviewed and updated on a yearly basis to ensure that they keep pace with changes in the actual costs of service delivery as well as changes in the methods or levels of service delivery.

C. OTHER POLICIES

1. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES:

The City will comply with all the requirements of Generally Accepted Accounting Principles. The City will always conduct its financial affairs and maintain its records in accordance with GAAP as established by the Government Accounting Standards Board, so as to maintain accuracy and public confidence in its financial reporting systems.

2. COUNCIL ACTION TO BE A SCHEDULED BUSINESS ITEM, NOT CONSENT CALENDAR:

For all debt sales, the City will require that the action taken by the City Council to incur the debt will be taken as a scheduled business item, and at a regular or special City Council meeting, consistent with state law.

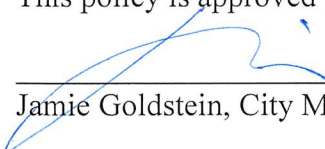
3. INTERNAL BORROWINGS:

Provided sufficient resources are available, liquidity will not be impaired, and a defined source of repayment is available, the City will favor internal over external borrowings to achieve short-term liquidity. In accordance with the City Council Resolution #2683, the Finance Director will initiate and the City Manager will approve inter-fund borrowings, except for year-end accounting entries that create temporary inter-fund loans for the financial statement presentation purposes, and the City Manager will report such borrowings to the Council at its next regular meeting. Interest on inter-fund loans will be recorded only when necessitated by state or federal program requirements, or other contractual or legal obligations.

4. EMPLOYEE COMPENSATION:

The City will continue to pay competitive market level compensation to our employees to ensure that the City has the ability to attract and retain well-qualified personnel while ensuring that the City's compensation practices are competitive and consistent with those of comparable employers.

This policy is approved and authorized by:

  
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Jamie Goldstein, City Manager