

CITY OF FAIR OAKS RANCH
FUND BALANCE AND RESERVE POLICY

I. POLICY

The City maintains appropriate funds to ensure financial stability and availability of resources to meet financial commitments. Adequate fund balance and reserves position an organization to effectively respond to cash flow fluctuations caused by significant economic downturns, outside agency actions, unexpected emergencies, excessive liabilities, or legal judgments against the organization. Use of any City reserve requires City Council approval.

II. GOVERNMENTAL FUNDS – FUND BALANCE

- A. **Fund Balance** - Fund balance shall mean the gross difference between governmental fund assets and liabilities reflected on the balance sheet and is intended to serve as a measure of the financial resources available in a governmental fund. The City Council shall report governmental fund balances per the Governmental Accounting Standards Board (GASB) issued Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (GASB-54). The City recognizes that healthy fund balances are crucial to the City's long-term planning.

Fund Balance Classifications – According to the GASB-54, fund balance must be allocated into one of five categories. The City complies with the following categories and statements.

- a. *Non-spendable* - Portion of total fund balance that is not in spendable form or is legally or contractually required to be maintained intact. Cash outlay for these types of items has already been made and therefore the resources represented by this fund balance category cannot be spent again. (Example: Prepaids or Inventory)
- b. *Restricted* - Portion of total fund balance constrained for specific purposes stipulated by external resource providers, such as grantors, bondholders, or higher level of government or by law or through enabling legislation. (Example: Court Technology Fund or Grants)
- c. *Committed* - Portion of total fund balance constrained to specific purposes and amounts which are internally imposed by City Council. City Council may commit fund balance for any reason that is consistent with the definition contained in GASB-54. The commitment must be in the form of formal Council action taken prior to fiscal year-end; however, the actual dollar amount may be determined in the subsequent period. Only Council can decommit funds previously committed by a separate motion and approval. (Example: One-time Contracts extending beyond the approving fiscal year)

- d. *Assigned* - Portion of total fund balance the City designates for specific purposes as expressed by the City Manager but not meeting the criteria to be reported as committed or restricted fund balance. In accordance with GASB-54, these funds are intended to be used for a specific purpose but have not received the formal approval of the City Council. Redeploying assigned resources to an alternative use does not require formal action by the governing body. (Example: Capital Expenditure for equipment)
- e. *Unassigned* – Residual portion of total fund balance not identified in one of the above-mentioned categories.

B. **Order of Spending Resources** – When an expenditure qualifies for use of both Restricted and Unrestricted Fund Balance, Restricted resources will be spent first. For Unrestricted resources, expenditures will generally be applied in the following order: Committed, then Assigned, and finally Unassigned.

III. GOVERNMENTAL FUNDS – RESERVES

A. **General Fund Reserve Policies** - The General Fund carries a high level of risk because it relies on revenue sources that can decline during economic downturns or be reduced by outside agency decisions. It is also the City's primary source of funding for unexpected events or emergencies. To protect against these risks, the City will carefully manage its General Fund reserves, which include the Emergency Reserve and the Budget Stabilization Reserve, at a combined desired level of 6 months of operating expenditures, excluding debt payments, one-time costs, and transfers for pay-as-you-go (PAYGO) capital projects.

- i. **Emergency Reserve** - This reserve shall maintain the desired level of 4 months of regular ongoing operating expenditures. For the purposes of this policy, current fiscal year's actual expenditures will exclude significant non-recurring items. This reserve shall be used to address emergencies, including but not limited to unanticipated expenditures, natural disasters, cyber events, state/federal emergencies, or acts of terror, or other lawful uses determined by City Council.
- ii. **Budget Stabilization Reserve** - This reserve shall maintain the desired level of 2 months of operating expenditures. This reserve fund, consisting of surplus revenues and unspent appropriations, shall provide for future financial stability with the intent to minimize future tax rate impact, protect against increases for services and fees, and provide flexible funding when needed to maintain the same levels of service. This reserve serves as a source of financial support for the City's budget, a safeguard to fund priorities included in the strategic plan, and as protection against service reductions during periods of declining revenue growth or economic downturns. This reserve provides the City time to reduce expenditures and/or find other ongoing revenue opportunities.

B. **Funding/Replenishment of Reserves – General Fund**

- i. Funding of reserve targets generally come from excess revenues over expenditures or one-time revenues.
- ii. In the event reserve levels fall below the minimum targets, a plan will be formulated to restore the reserves within two years. If projections indicate the reserve balance will be replenished within 12 months through normal operating activity, no corrective action shall be required. However, if the reserve balance is not expected to be restored within that period, the City, with Council approval, shall implement appropriate measures to replenish the balance, which may include the following:
 - Reduction of expenditures
 - Delay of capital purchases
 - Increase in fees and/or taxes
 - Use of year-end surplus

C. Other Governmental Reserve Policies

- i. **Strategic & Capital Projects Reserve** – The Strategic and Capital Project Fund shall be funded primarily through appropriations for identified projects during the annual budget process. Project budgets will be adopted as part of the City’s overall budget. Appropriations for multi-year projects shall roll forward annually until project completion. At the conclusion of each project, any surplus funds resulting from project underruns shall remain in the Fund. These balances may be applied toward future strategic or capital projects or serve as a contingency buffer for projects that exceed their original appropriations.

At the discretion of the City Council, General Fund surpluses may also be transferred into the Strategic and Capital Project Fund to provide additional capacity for future projects.

- ii. **Capital Assets and Infrastructure Replacement Reserve** - The City will maintain a reserve for capital assets and infrastructure replacement for Governmental Funds. The reserve will support funding needed for replacement of the City’s fleet vehicles, large equipment, technology assets, certain minor equipment, and building infrastructure such as HVAC systems, generators, and similar facilities-related assets. The City will target a reserve level of 110% of each asset’s cost, saved incrementally over the useful life of the asset.

IV. ENTERPRISE FUNDS – FUND BALANCE

The fund balance categories discussed above for Governmental Funds do not apply to proprietary funds according to GASB 54. While not required by GASB, the City recognizes the need to apply a fund balance and reserve policy to the proprietary funds maintained by the City as follows:

- A. **Utility Fund Emergency Reserve** - The Utility Fund relies on fees and service charges

to City water and wastewater customers for revenue. The Utility Emergency Reserve fund shall maintain a desired level of at least 6 months of operating expenses. For the purposes of this policy, significant non-recurring items and depreciation expense will be excluded from this calculation. This reserve shall be used to address emergencies, including but not limited to unanticipated expenditures, natural disasters, cyber events, state/federal emergencies, or acts of terror, or other lawful uses determined by City Council.

Funding of this reserve target will generally come from excess revenues over expenditures or one-time revenues.

In the event this reserve level falls below the minimum targets, a plan will be formulated to restore the reserve within two years. If projections indicate the reserve balance will be replenished within 12 months through normal operating activity, no corrective action shall be required. However, if the reserve balance is not expected to be restored within that period, the City, with Council approval, shall implement appropriate measures to replenish the balance, which may include the following:

- Reduction of expenditures
- Delay of capital purchases
- Increase in fees and/or taxes
- Use of year-end surplus

B. Debt Service Reserve - In addition to the reserve for operating expenses, the City shall maintain a minimum fund balance in the Utility Fund equal to or exceeding the requirements dictated by utility debt bond ordinances.

C. Water and Wastewater Capital Projects Reserves - These reserves are funded by the Capital Reserve Fee, which is calculated annually in accordance with City ordinance. The reserves will be utilized for major capital outlay, unforeseen projects, and compliance with government mandates related to water and wastewater capital projects.

D. Infrastructure Improvements Reserves - The City maintains two separate reserves, one for water and one for wastewater. These reserves are funded by the respective water and wastewater impact fees and are designated for capacity-related improvements to the City's utility systems in accordance with state law.

E. Capital Assets and Infrastructure Replacement Reserve - The City will maintain a reserve for capital assets and infrastructure replacement for Enterprise Funds. The reserve will support funding needed for replacement of the City's fleet vehicles, large equipment, technology assets, certain minor equipment, and building infrastructure such as HVAC systems, generators, and similar facilities-related assets. The City will target a reserve level of 110% of each asset's cost, saved incrementally over the useful life of the asset.

V. EXCESS OF RESERVES

In the event fund balance exceeds the desired minimum reserve targets, any excess balance may be appropriated by City Council once it has been determined that use of the excess will not endanger reserve requirements in future years. The City shall not use proceeds or reserves from an Enterprise fund except for expenditures within the purpose of the fund, unless those expenditures have been approved for other purposes as part of the adopted budget. Excess balance may be used in the following ways:

- A. Fund balance excess may add to the Budget Stabilization Reserve to prepare for future cost increases and/or revenue reduction expectations highlighted in the long-term financial forecast.
- B. Fund long-term accrued liabilities, including but not limited to debt service, pension, and other post-employment benefits.
- C. Appropriated to lower the amount of bonds or debt service payments (all forms of debt).
- D. Increase appropriations to fund capital projects in the Capital Improvement Plan.
- E. One-time expenditures, which do not increase recurring operating costs and cannot be funded through current revenues.
- F. Start-up expenditures for new programs approved by the City Council.
- G. In the event a balanced budget is not attainable, excess balance may be used for recurring expenditures and to achieve budget balance under the following conditions:
 - i. The budget imbalance is expected to last for no more than one year and can be corrected with use of excess fund balance; or
 - ii. The budget imbalance is expected to continue beyond one year, provided that the use of excess fund balance will achieve balance as part of a corresponding plan to close the gap.
- H. Other lawful uses determined by City Council.

VI. POLICY REVIEW

This Policy will be reviewed periodically by the Finance Director. All modifications require Council approval.