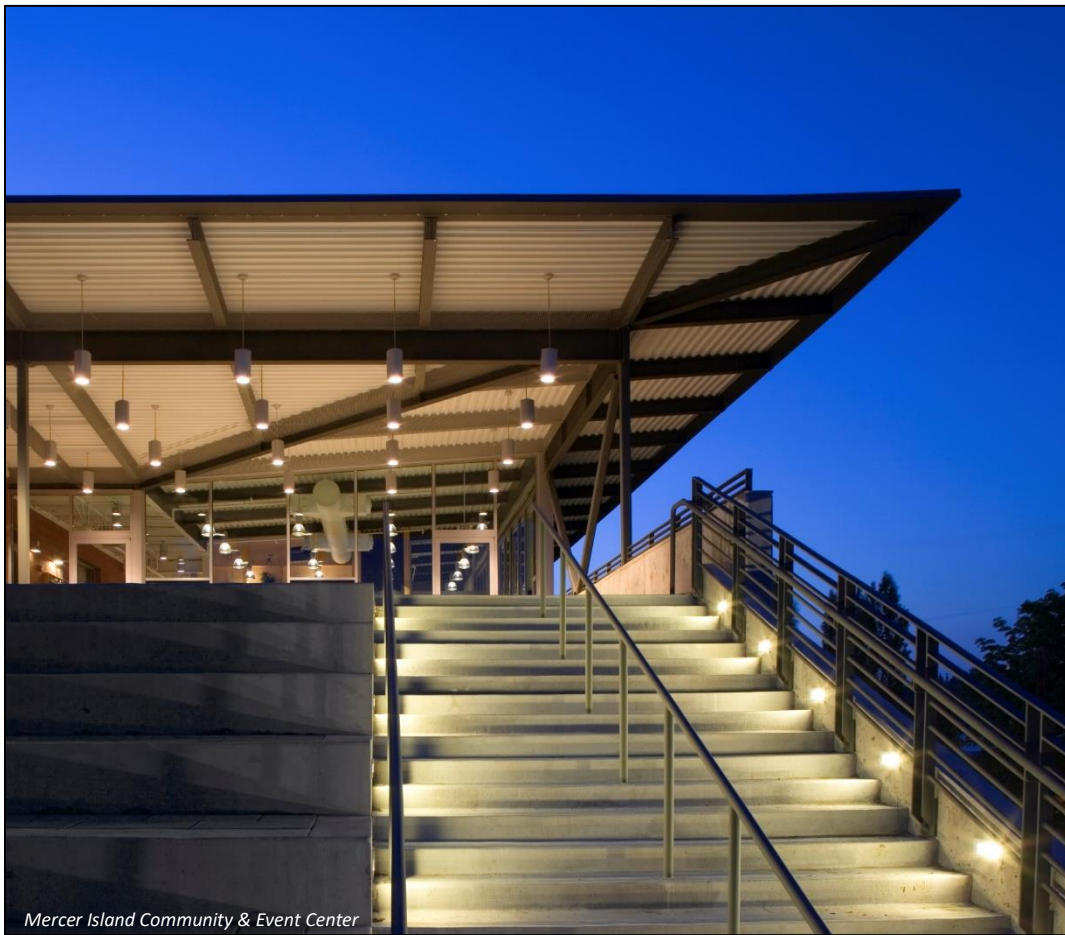


# CITY OF MERCER ISLAND FINANCIAL MANAGEMENT POLICIES



**Adopted**  
09/21/2021

**Amended**

## CITY COUNCIL

*Benson Wong*  
*Mayor*

*Wendy Weiker*  
*Deputy Mayor*

*Lisa Anderl*  
*Jake Jacobson*  
*Salim Nice*  
*Craig Reynolds*  
*David Rosenbaum*

## FINANCE AD HOC COMMITTEE

*Wendy Weiker* *Deputy Mayor*  
*Salim Nice* *Councilmember*  
*Craig Reynolds* *Councilmember*  
*Matthew Mornick* *Finance Director*

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## 1. *Background and Purpose*

The Financial Management Policies (Policies) of the City of Mercer Island (City) serves as a blueprint for City staff to draft the biennial budget, achieve goals set forth in budget work plans, the Comprehensive Plan, and other City planning documents by maintaining sound financial practices in accordance with all Federal, State, and local laws. The Policies are set by City Council and strategically direct financial resources towards meeting the City's long-term goals.

Should any requirement in these Policies conflict with powers, authority, or discretion granted to the City Manager by law, such requirement should be considered guidance or a recommendation from the City Council to the City Manager. If the Policies conflict with state, federal law, or with regulations promulgated thereunder, then the Policies will be interpreted to the maximum extent possible without being in conflict. Once adopted by the City Council, the City's Financial Management Policies will be amended as needed and reviewed every five to seven years with modifications submitted to the City Council for approval.

## 2. *Fiscal Sustainability Philosophy*

Mercer Island is committed to fiscal sustainability. Fiscal sustainability means maintaining a long-term view of financial planning for current and future generations that anticipates risks and preserves and enhances services and quality of life as prioritized by the City Council. The City strives for:

- 2.1. **Informed decision-making.** City administration will provide the City Council in depth analysis of both the short-term and long-term financial impacts of issues brought before the Council for consideration.
- 2.2. **Transparency.** The City will conduct public business with transparency and seek opportunities for citizen education, public participation, and public problem solving. The City will make financial information publicly available pursuant to applicable local and State laws as well as pursue new ways to make the City's finances more accessible and easier to understand.
- 2.3. **Aligned investments.** The City will seek opportunities to invest in ways that do not conflict with community values and priorities as reflected in the City's Comprehensive Plan.
- 2.4. **Diversified revenue sources.** The City will pursue diversified revenue sources and cost-containment measures to protect the delivery of public goods and services and safeguard against changing economic conditions.
- 2.5. **Managing long-term liabilities.** The City will proactively identify and monitor long-term financial liabilities and seek to mitigate these impacts, when possible, while accruing assets to fund these liabilities in a fiscally responsible and intergenerationally equitable manner.



- 2.6. **Shared Responsibility.** The City recognizes a shared responsibility between the employee and employer to appropriately fund employee compensation to attract and retain employees while maintaining a long-term sustainable and balanced budget.
- 2.7. **Equity, efficiency, and effectiveness.** The City will continuously explore new ways to improve day-to-day operations and provide more equitable, efficient, and effective delivery of public goods and services.

### 3. *Operating Budget*

The operating budget is the central financial planning document that embodies all operating revenue and expenditure decisions. It establishes what programs, projects, and operations will be funded in each department within the confines of anticipated municipal revenues. The policies below guide how the City organization develops and implements the operating budget.

- 3.1. The Biennial Budget will be balanced with resources in that biennium, and the City will adopt the Biennial Budget before January 1<sup>st</sup> of its initial fiscal year of the biennium budget-cycle.
- 3.2. The City Council will adopt a Biennial Budget that reflects estimated revenues and expenditures for the ensuing two years. A mid-biennium review and update will take place as prescribed by State law during the first year of the biennium.
- 3.3. The Biennial Budget will establish municipal service levels and priorities for the ensuing two years.
- 3.4. **Expenditure control budgeting** is a budgeting approach that promotes sound fiscal management and offers flexibility and resources to respond to emerging or changing needs. When implemented, at the end of each fiscal year, the City will return one-third of each department's non-salary operating budget savings back to the respective department. Upon City Manager approval, such General Fund savings may be used at the department director's discretion to fulfill the mission of the department. The remaining two-thirds of such savings will return to the General Fund Balance to replenish City reserves and support the Emerging Innovations Reserve, consistent with adopted policies.
- 3.5. The Biennial Budget will establish measurable work plan goals and allow reasonable time to accomplish those goals within the biennium. The City Manager will report back to the City Council on work plan progress during the biennium and report any potential issues in a timely manner.
- 3.6. Prior to budget adoption, the City Council will review and provide the City Manager feedback on the preliminary Biennial Budget.
- 3.7. The City will work proactively with the State, County, and local government agencies, and bodies, such as Association of Washington Cities and Sound Cities Association, to monitor and, when appropriate, act on legislation that may impact the City financially.



#### 4. Revenues and Expenditures

Annual revenues are estimated using established best practices as a basis for preparation of the Biennial Budget. Expenditures approved by the City Council in the Biennial Budget define the City's spending limits for the upcoming biennium. Beyond legal requirements, the City will maintain an operating philosophy of controlling the City's costs and maintaining diverse revenues. The following policies apply to the City's management of revenues and expenditures.

- 4.1 The City will maintain revenue and expenditure categories according to State statute and administrative regulation.
- 4.2 The City will endeavor to maintain a diversified and stable revenue system to minimize the impact of short-term fluctuations in any one revenue source.
- 4.3 Current revenues will be sufficient to support current expenditures.
- 4.4 One-time revenues will be used only for one-time expenditures.
- 4.5 The City will investigate potential new revenue sources and partnerships, particularly those that will not add to the tax burden of residents and local businesses.
- 4.6 Fees for service may be reviewed and adjusted annually to ensure cost recovery goals are being met. At minimum, fees for service shall be re-evaluated (where needed) every three years.
- 4.7 All revenue forecasts will be performed using established local government best practices.
- 4.8 The City will review and update, as needed, its cost allocation methodology plan (Appendix B) every five to seven years, which outlines the policy objectives and underlying process of accounting and recording the fully allocated costs of an internal public service by including indirect costs or "overhead" in addition to direct service costs of service. The cost allocation plan shall be used as an information tool to inform a variety of budgetary decision-making situations including the allocation of resources, establishment of fees designed to recover costs, recovery of indirect costs to administer grant programs, and cost reimbursements associated with providing support services to enterprise and other special revenue funds.
- 4.9 Credit card fee surcharges, cash discounts, and online payment methods shall be reviewed and evaluated at least every five years to ensure that the cost of service is being covered and the City is taking advantage of improving technology and market developments.
- 4.10 Grants to fund new service programs will be reviewed by the City, as they become available, with due consideration given to whether they are cost effective, meet City goals, and are sustainable in the long-term.
- 4.11 The City will establish and maintain Special Revenue Funds to account for proceeds received from a substantial restricted or committed revenue source used to finance designated activities that are required by statute, ordinance, resolution, or executive order.



- 4.12 Investment earnings are distributed based on the percent each Fund makes up of the City's total investments (e.g., if General Fund dollars make up 20% of the City's total investments, then 20% of investment earnings are returned to the General Fund).
- 4.13 Excess investment earnings above Fund and Reserve balance thresholds may be used to finance one-time capital investments or time-limited services at the City Council's discretion.
- 4.14 If decisions are needed to balance a proposed Biennial Budget, the City Council will provide policy direction to the City Manager as to the priority order and combination for raising revenues, reducing expenditures, and/or using reserves.
- 4.15 The use of reserve balances will only be authorized to address temporary revenue shortfalls and/or temporary expenditure increases, or in response to evidence-based revised reserve targets.
- 4.16 The Biennial Budget will be formally amended by the City Council as needed to reflect unforeseen expenditures or revenues. Funding requests will be analyzed by the Finance Department and approved by the City Manager. The City Council will be provided with a review of the legality and/or policy basis for the expenditure, the recommended funding source and fiscal impact, and previously approved amendments since budget adoption.
- 4.17 The City Council will be presented with timely financial status updates and year-end budget reviews including budget amendments, as necessary, to ensure that expenditures are within budget authority.

## **5. Capital Budget**

Every two years, the City develops a Capital Improvement Program (CIP) for City Council review and approval as part of the Biennial Budget process. The City is responsible for considerable investments related to the acquisition, expansion, or rehabilitation of land, technology, buildings, and other major public infrastructure. The preservation, qualified maintenance, and future improvement of these facilities is the focus of the CIP and resulting capital budget.

Planning and implementing sound capital improvement practices and programs will help the City avoid unforeseen costs in the future. The following policies apply:

- 5.1. The City will establish and implement a comprehensive multi-year CIP.
- 5.2. Per State law, the City will develop and annually adopt a six-year Transportation Improvement Program (TIP), which becomes a component of the CIP (RCW 35.77.010).
- 5.3. The CIP will be prepared biennially concurrent with the development of the Biennial Budget. A mid-biennium review and update will take place during the first year of the biennium to reflect any changes in the updated Capital Improvement Program.



- 5.4. The City Council will designate annual ongoing funding levels for each of the major project categories within the Capital Improvement Program. Financial analysis of funding sources will be conducted for all proposed capital improvement projects.
- 5.5. A CIP outlines specific resources to maintain and enhance public infrastructure, including but not limited to prior money in reserves, State and Federal grants, long-term leases, low-interest loans, and debt financing.
- 5.6. The CIP will incorporate City Council priorities and community objectives for the acquisition, expansion, and/or rehabilitation of land, technology, buildings, and other major public infrastructure. The Capital Improvement Program will be consistent with the Capital Facilities Element of the Comprehensive Plan.
- 5.7. The City will maintain an inventory of physical assets, their condition, and remaining useful life.
- 5.8. Consistent with best practices, budgets for capital projects will include appropriate contingency budget between 10 – 20% of the total estimated project budget. Staff will provide additional analysis and context to the City Council for capital projects with contingency estimates greater than 20% of the total estimated budget.
- 5.9. The City will strive to maintain all assets at a sufficient level to protect the City's capital investment and to limit future maintenance and replacement costs.
- 5.10. When evaluating capital investments, the City will elect options with due consideration of long-term cost of ownership and expected useful life or regulatory constraints.
- 5.11. The City Manager may authorize the reallocation of CIP project funds between CIP projects within a CIP category. Funding may only be reallocated within a CIP project category (e.g., within Parks, Recreation, and Open Space Projects, or Sewer Projects, or Water Projects, etc.) when one project is over budget and, in the same period, a second project within the same CIP category has been completed under budget. The City Council will be informed when funds are reallocated between projects as part of the Quarterly reporting process.

## **6. Reserves and Fund Balance**

Adequate fund balance and reserves are a core element of the City's fiscal management strategy and a vital measurement of the City's financial position (outlined in [Appendix A – Fund Balances and Reserves](#)). City and State regulations allow the City to create and maintain specific reserves. Reserves and Fund Balances provide the City with options to respond to unexpected issues, natural disasters, ensure adequate resources for cash flow purposes, afford a buffer against economic duress and other forms of risk, and fund long-term liabilities over time. Reserve and Fund Balances should not, however, grow beyond established policy levels.





The following policies outline reasonable measures that protect the City's financial position and the continued provision of public goods and services from calculated risks.

- 6.0.1. The City will not hold a surplus of public funds to the detriment of providing public goods and services the community has come to expect.
- 6.0.2. The City will establish minimum fund balance targets for each Fund based on the Fund's cash flow requirements, with all fund balances included in the Biennial Budget. The minimum fund balance will be attained and maintained through expenditure management, revenue management, and/or contributions from the General Fund.
- 6.0.3. The City will fully fund reserves for the planned replacement of vehicles, heavy equipment, and radios as well as computer-related hardware and equipment (e.g., servers, networks, PCs, laptops, printers, and phones). Contributions will be made through assessments to each respective department.
- 6.0.4. Additional reserves may be created to fund future known expenditures, special projects, or other specific purposes.
- 6.0.5. All Reserves and Fund Balances and guiding policies will be presented in the Biennial Budget.

### 6.1. Terminology of Fund Balance

- 6.1.1. **Fund Balance** is an accounting term defined as the excess of assets over liabilities in a Fund.
- 6.1.2. A **Reserve** is typically a portion of total fund balance with a use specified by the Administration, City Council, or by the restricted nature of the funds.
- 6.1.3. **Non-spendable Fund Balance** cannot be spent, such as the long-term portion of loans receivable, the principle of an endowment, and inventories.
- 6.1.4. **Restricted Fund Balance** has externally enforceable limitations on the use of fund balance, imposed by parties such as creditors, grantors, laws, or regulations of other governments.
- 6.1.5. **Committed Fund Balance** encompasses long-term limitations imposed by the City Council. For example, the City Council has committed a portion of the General Fund Balance to offset the long-term liability from the Washington Law Enforcement Officers' and Firefighters' System (the LEOFF Retirement Plan).
- 6.1.6. **Assigned Fund Balance** includes the portion of fund balance that is earmarked for an intended use that may be temporary or short-term in nature. The intent is established by the City Council.
- 6.1.7. **Unassigned Fund Balance** comprises all fund balances that are left after considering the other four categories. Use is least constrained in this category of fund balance.



## 6.2. Replenishment Guidance

Reserve replenishments occur in three ways during periods of economic recovery:

- 6.2.1 A **planned replenishment** is a specific one-time contribution included in the adopted Biennial Budget.
- 6.2.2 A **scheduled replenishment** establishes a schedule to repay the use of Reserves or Fund Balances over a specific time.
- 6.2.3 A **surplus replenishment** occurs when ending prior year fund balances are higher than budgeted, either due to greater than budgeted revenues, expenditure savings, or both.

All expenditures drawn from Fund Balances and Reserves shall require prior City Council approval unless previously authorized by the City Council for expenditure in a Biennial Budget or otherwise provided for by City policies. In terms of priority for replenishing the individual reserves, the following guidelines shall be collectively considered:

- 6.2.4 If the Contingency Fund is below target, replenish to target at the start of each biennium.
- 6.2.5 If committed funds are available because planned reserve uses did not occur, those funds should be maintained in the source reserve.
- 6.2.6 The degree to which an individual reserve is below target (for example, the reserve that is furthest from its target level on a percentage basis might receive a larger share of the funds).
- 6.2.7 Decisions on how replenishments are allocated to specific reserves will be based on where available funds came from and on each reserve's status at the time the decision is made.
- 6.2.8 City Council may take action to suspend replenishment policies if it is found that special conditions exist warranting such action.

Once reserves reach target levels, remaining funds shall be available for one or more of the following needs, depending on the nature of the funds available (one-time or ongoing) and in the following suggested order of priority:

- 6.2.9 Reduce liabilities related to sinking funds.
- 6.2.10 Fund one-time investments, projects, or studies.
- 6.2.11 Make a one-time contribution to the Emerging Innovations Investments Reserve.
- 6.2.12 Increase funding for capital purposes.
- 6.2.13 Restore previous program service reductions.
- 6.2.14 Create program and service enhancements.



## 7. Long-term Financial Planning

The City develops and maintains a six-year Financial Forecast that estimates resource and expenditure behavior for the two biennia beyond the current budget period. **Financial forecasting** is the process of projecting revenues and expenditures over a long-term period, using assumptions about economic conditions, future spending scenarios, and other salient factors. The Financial Forecast will provide City leadership with an indication of the long-term fiscal impact of current policies and budget decisions.

- 7.1. **Time Horizon.** The Financial Forecast looks six-years into the future.
- 7.2. **Scope.** The Financial Forecast includes all appropriated Funds.
- 7.3. **Frequency.** The Financial Forecast is updated at least once a year to inform budget development, though it may be updated more often as circumstances warrant.
- 7.4. **Content.** A Financial Forecast includes an analysis of the financial environment, revenue forecasts, personnel, other significant operating costs and when appropriate, strategies for achieving and maintaining a balanced budget in future years.
- 7.5. **Visibility.** The Financial Forecast will be presented at a City Council meeting to ensure that the community is informed of the long-term financial prospects of the government.

## 8. Accounting, Financial Reporting, and Auditing

The City of Mercer Island will establish and maintain a high standard of accounting practices. At all times, the City's accounting and budgetary systems will conform to Generally Accepted Accounting Principles, the State of Washington Budgeting Accounting Reporting System (BARS), and local regulations.

- 8.1. The City will employ cash basis reporting, as prescribed in the Washington State *Budgeting, Accounting, and Reporting System* (BARS), for external and audit purposes.
- 8.2. The City will maintain an accounting system that provides comprehensive financial information to effectively operate the City and provide accountability, oversight, and internal controls over financial transactions.
- 8.3. The City will meet the financial reporting standards set by the Washington State Auditor's Office for Cash-Basis Financial Statements.
- 8.4. The City will be transparent and accurate in all City financial reports and bond representations based on the State Auditor's Office established best practices.
- 8.5. An annual audit will be performed by the State Auditor's Office and will include the issuance of an audit opinion for financial and accountability reports.



- 8.6. The City will strive to provide timely and quarterly and year-end financial reporting with a long-term goal to provide monthly reporting.

## 9. Investments

Per Washington State law, all municipal corporations are empowered to invest in certain types of securities. Within the confines of State law, the City will invest public funds in a manner that will provide a competitive rate of return after prioritizing investment instruments safety and liquidity needed to meet the daily cash flow demands of the City. Key principles that guide investment of public funds are listed below.

- 9.1. The City's cash will be invested in accordance with the City Council's [Adopted Investment Policies](#). Absent investment policies or staff trained to actively invest public funds; cash will be invested in the Local Government Investment Pool of the Washington State Treasurer.
- 9.2. Sufficient cash or other readily liquid instruments shall be maintained to provide for a minimum of 45-days of General Fund expenditures.
- 9.3. The City will manage the risk-reward tradeoff in financial decision making and will exercise good judgment, discretion, and intelligence, not for speculation but for investment, prioritizing safety of the City's investments while targeting an attractive risk-adjusted rate of return derived from investment decisions.
- 9.4. **Net investment income** is the amount of annual investment proceeds after first providing for all costs and expenses incurred in the administration of the City's investments. Net investment income will be allocated quarterly based on each funds relative cash balance as a percentage of the total invested assets. For example, if the Contingency Fund balance is only 10% of the City's total cash investments for a quarter, it would only receive 10% of the investment earnings for that quarter.

## 10. Debt Management Policy

This debt management policy sets forth guidelines to issue and repay debt. It is designed to ensure all debt is issued prudently and cost effectively to provide flexibility, preserve financial stability, and maintain the City's bond credit rating. All debt issued will follow this policy and all other relevant State and Federal regulations.

The City maintains conservative financial policies to assure strong financial health both in the short and long-term. From a policy perspective, the City uses debt as a mechanism:



- 10.0.1. To allocate the costs of needed improvements appropriately between present and future beneficiaries and users.
- 10.0.2. To reduce the immediate cash strain from substantial public improvements. This may include financing large capital investments such as construction of public infrastructure or significant property acquisitions.

### 10.1. Conditions of Debt Issuance

- 10.1.1. In the event there are any recommended deviations or exceptions from the Debt Management Policy when a certain bond issue is structured, those exceptions will be discussed in the agenda bills when the bond issue is presented for City Council’s consideration.
- 10.1.2. Long-term debt will be used for capital investments. It will not be used to support operations such as non-capital furnishings, supplies, maintenance, or personnel.
- 10.1.3. When issuing debt, the City shall strive to use the most favorable debt-funding mechanism given market conditions, costs of debt issuance, and whether it be general obligation bonds or special assessment, revenue, or other self-supporting bonds.
- 10.1.4. The decision on whether to assume new debt shall be based on costs and benefits, current conditions of the municipal bond market, and the City’s ability to afford new debt and service it as determined by an objective analytical approach. This process shall compare generally accepted measures of affordability to the current values for the City. These measures shall include:
  - 10.1.4.1. **Debt per capita** is a measure that describes the distribution of debt per capita of the community’s population.
  - 10.1.4.2. **Debt as a percent of assessed valuation** is outstanding principal as a percentage of the Community’s total assessed valuation.

### 10.2. Debt Limit

- 10.2.1. The City’s indebtedness is limited by Washington State law, which states the City’s bonded indebtedness may not exceed the sum of 7.5% percent of the total assessed valuation of taxable property within the City (outlined in the table below, reference RCW 39.36.020).

Type of Debt	Statutory Limitations
General Obligation:	2.5%
Non-Voted	1.5%



Voted	1.0%
Open Space & Parks	2.5%
Utilities	2.5%
Revenue	No limit
Local Improvement District	No limit

- 10.2.2. Debt issuance will be based on a comprehensive multi-year Capital Improvement Program (CIP) and financial analysis to align appropriate funding sources with proposed capital improvements.
- 10.2.3. Where borrowing is recommended, the source of funds to cover debt service requirements must be identified for the length of the debt instrument, and the effects of that financing projected through six years of the CIP.
- 10.2.4. The City Council may consider using long term debt toward public improvements associated with economic development. To the extent new revenues from the project can be identified and agreed upon, a portion of said revenues could go to support the debt service.
- 10.2.5. The City will plan and direct the use of debt so that service payments will be sustainable.

### 10.3. Debt Structuring

- 10.3.1. Debt will be structured consistent with a fair allocation of costs to current and future beneficiaries or users.
- 10.3.2. Borrowings by the City should be of a term to maturity that does not exceed the useful life of the improvement that it finances and where feasible, should be shorter than the projected economic life. **Useful life** is how long the improvement will do what it is intended to do, life measured in time or in number of uses. **Economic life** is how long the improvement will do what it is intended to do at a cost that is comparable to alternatives.
- 10.3.3. The standard term of long-term borrowing is typically 15-30 years. Maturity of all assessed bonds shall not exceed statutory limitations (RCW 36.83.050).
- 10.3.4. The City shall pay all interest and repay all debt in accordance with the terms of the bond ordinance and bond covenants. To the extent possible, the City will seek level or declining debt service repayment schedules.
- 10.3.5. A **debt refunding** is a refinance of debt typically done to take advantage of lower interest rates. The City will use refunding bonds, where appropriate, when restructuring its current outstanding debt. Unless otherwise justified, such as a desire to remove or change a bond



covenant, a debt refunding will not be pursued without a positive net present value benefit after expenses.

- 10.3.6. Bond amortization schedules will be structured to minimize interest expense with the constraints of revenues available for debt service. The bonds may include call features to maximize the City's ability to advance refund or retire the debt early. However, call features should be balanced with market conditions to ensure that the total cost of the financing is not inappropriately affected.

#### **10.4. Debt Issuance**

- 10.4.1. City Council approval is required prior to the issuance of debt.
- 10.4.2. The City Manager, with in coordination with the Finance Director and the City's financial advisor and/ or bond counsel, shall determine the method of sale best suited for each issue of debt.
- 10.4.3. The City will generally issue its debt through a competitive process but may use a negotiated process under the following conditions:
  - 10.4.3.1. The bond issue is, or contains, a refinancing that is dependent on market/interest rate timing.
  - 10.4.3.2. At the time of issuance, the interest rate environment or economic factors that affect the bond issue are volatile.
  - 10.4.3.3. The nature of the debt is unique and requires specific skills from the underwriter(s) involved.
  - 10.4.3.4. The debt issued is bound by a compressed timeline due to extenuating circumstances such that time is of the essence and a competitive process cannot be accomplished, or a competitive process might result in selection of an underwriter or other situations inconsistent with City policies.
- 10.4.4. When determined appropriate by the City Manager and Finance Director, the City will negotiate financing terms with banks and financial institutions for specific borrowings on a private offering basis. Typically, private placements are carried out when extraneous circumstances preclude public offerings, such as an interim financing, or to avoid the costs of a public offering for smaller issuances. The Finance Director will consult with the City's Financial Advisor and/ or Bond Counsel on a case-by-case basis to determine an appropriate method of sale.
- 10.4.5. With City Council approval, financing for capital projects may be secured from the debt financing marketplace, public works trust funds, or other means including an interfund loan, as appropriate given the circumstances.



- 10.4.6. A thorough financial analysis shall be conducted prior to the issuance of debt including, but not limited to, monitoring of market opportunities, and structuring and pricing of the debt.
- 10.4.7. All debt issued by the City will include a written opinion by the City's financial advisor and/or bond counsel affirming that the City is authorized to issue the proposed debt. The opinion shall include confirmation that the City has met all City and State constitutional and statutory requirements necessary for issuance, a determination of the proposed debt's Federal income tax status and is compliant with legal and regulatory requirements by the State of Washington and the Federal Government's laws, rules, and regulations.
- 10.4.8. The Finance Director will confirm any debt issuance is conducted in compliance with the City's Financial Management Policies.

### **10.5. Credit Ratings**

The City will maintain good communication with bond rating agencies about its financial condition.

- 10.5.1. The City will provide periodic updates to the City Council on the City's general financial condition, coordinating meetings, and presentations in conjunction with a new issuance.
- 10.5.2. The City will continually strive to maintain a Aaa bond rating by maintaining strong financial policies, budgets, forecasts, and improving the financial health of the City.
- 10.5.3. Credit enhancements may be used to improve or establish a credit rating on a City debt obligation. Credit enhancements should only be used if the enhancement will result in a net decrease in borrowing costs or otherwise provide significant benefits (e.g., making the bonds easier to sell).
- 10.5.4. The City will generally issue its debt through a competitive process. For any competitive sale of debt, the City will award the issue to the underwriter offering to buy the bonds at a price and interest rates that provides the lowest True Interest Cost (TIC).

### **10.6. Ongoing Debt Management Practices**

The City shall comply with all applicable Federal, State, and contractual restrictions regarding the investment of bond proceeds, including City of Mercer Island's Investment Policy.

- 10.6.1. Annual disclosure information will be provided to established national information repositories and compliant with State and national regulatory bodies. Disclosure shall take the form of the City's Annual Financial Statements unless information is required by a particular bond issue that is not necessarily contained within the Annual Financial Statements.





- 10.6.2. The City will, unless otherwise permissible and justified, use bond proceeds within the established timeframe pursuant to the bond ordinance, contract, or other documents to avoid arbitrage.
- 10.6.3. **Arbitrage** is the interest earned on the investment of the bond proceeds above the interest paid on the debt. If arbitrage occurs, the City will follow a policy of full compliance with all arbitrage rebate requirements of the Federal tax code and Internal Revenue Service regulations and will perform (internally or by contract consultants) arbitrage rebate calculations for each issue subject to rebate.
- 10.6.4. The City will take all necessary steps to preserve the tax-exempt status of its outstanding debt including, but not limited to, filing, and paying all necessary rebates when due. The City will communicate through its published Biennial Budget, Capital Improvement Program, and Annual Financial Statements the City's indebtedness.



## Appendix A – Fund Balances and Reserves

FUND	NAME	DESCRIPTION
<i>General Fund</i>		
001	Fund Balance	The Fund Balance represents the working capital (e.g., current assets less current liabilities) in the General Fund established for cash flow purposes. It consists of non-spendable, assigned, committed, restricted, and unassigned amounts.
001	LEOFF-1 Long-term Care Reserve	<p>The Reserve is dedicated to pay for the aggregate annual long-term care expenditures for police officers and firefighters who retired under the LEOFF-1 state retirement system.</p> <p>The Reserve is funded by a committed \$83,000 annual contribution from property tax revenues plus a proportionate share of annual interest earnings each year until the Reserve balance is sufficient to fund all future LEOFF-1 long-term care obligations.</p> <p>All annual costs for long-term care (which include LEOFF-1 long-term care costs and the retirement excess compensation paid for by Fund 606 – Firefighter’s Pension Fund) that are above \$500,000 per year are covered by the LEOFF-1 Reserve and the Fund 606 Balance. All costs below this amount are covered by the General Fund.</p>
001	Compensated Absences Reserve	<p>The Reserve represents the City's actual liability for accumulated employee vacation and compensated time hours. The compensated absences liability will be measured using the pay or salary rates in effect at the balance sheet date.</p> <p>When the reserve is used, replenishment to the target of 50% of the total liability will be a priority, consistent with adopted policies.</p>
001	Emerging Innovations Investments Reserve	The Reserve is funded in part by the City’s Expenditure Control Budgeting program to fund projects with a tangible return on investment within a reasonable period, or projects that reduce ongoing expenditures while maintaining or enhancing service levels. When the reserve is used, replenishment will be tied to Expenditure Control savings, and one-time contributions, consistent with adopted policies.
<i>Street Fund</i>		
104	Operating Fund Balance	The Fund Balance is based on a 45-day operating reserve for cash flow purposes.
104	Transportation Impact Fee Reserve	The Reserve includes fees collected from development projects to increase capacity in the City's transportation network.



FUND	NAME	DESCRIPTION
104	Town Center Street (N) Reserve	The Reserve consists of fees collected from private developers for roadway repairs in specific locations in the Town Center.
<b><i>Contingency Fund</i></b>		
130	Contingency Fund	The City's Contingency Fund is maintained in accordance with State law (RCW 35A.33.145) to meet any municipal expense, the necessity or extent of which could not have been reasonably foreseen at the time of adopting the biennial budget. The target balance is set to 12.5% of General Fund budgeted expenditures for a given fiscal year.
<b><i>Youth and Family Services Fund</i></b>		
160	Operating Fund Balance	Fund Balance to address temporary revenue losses due to economic-cycles or other time-limited causes. The Fund Balance will be maintained with YFS revenues at a target threshold of six-months of average monthly YFS expenditures, evaluated each biennium. The Fund Balance provides adequate reserves to address the asynchronous nature between the City's biennial budget and the Mercer Island School District's academic year. The balance may be used in its entirety; however, replenishment will be a priority, consistent with adopted policies.
<b><i>Self-Insurance Claim Reserve</i></b>		
037	Self-Insurance Claim Reserve	The Reserve Pays for insurance claims not covered under the City's property insurance policy through WCIA as well as the \$5,000 deductible per claim. Set a new target funding level at \$60,000 (MICC 4.40.130).
<b><i>Capital Improvement Fund</i></b>		
343	Operating Fund Balance	The Fund Balance is based on a 45-day operating reserve for cash flow purposes.
343	Field Replacement Reserve	The Reserve is a sinking fund for synthetic turf replacement at South Mercer Playfields and Island Crest Park. Funded by a portion of field use fees.
343	Park Impact Fees Reserve	The Reserve consists of fees collected from development projects for increasing capacity of publicly owned parks, open space, and recreation facilities (RCW 82.02.050(4) and RCW 82.02.090(7)).
343	KC Parks Expansion Levy Reserve	The Reserve is for protecting and preserving open space and developing regional trails. Funded by the King County Parks levy.



FUND	NAME	DESCRIPTION
343	Freeman Landing Reserve	The Reserve includes proceeds for the vacation of a portion of Freeman Avenue SE sold to adjacent landowner. Sale proceeds must be used for acquiring additional beach or water access, acquiring additional public view sites to a body of water, or acquiring additional moorage or launching sites (RCW 35.79.040).
343	Reserve - RCO Property	The Reserve includes proceeds from the vacation of a portion of Clarke Beach Park at 7700 East Mercer Way sold to adjacent property owners. Sale proceeds must be used for acquiring additional beach or water access, acquiring additional public view sites to a body of water, or acquiring additional moorage or launching sites.
<b>Technology &amp; Equipment Fund</b>		
345	MICEC Equipment Replacement Reserve	The Reserve is a sinking fund to replace MICEC equipment and furnishings. Funded by \$40,000 in annual MICEC room rental revenue and \$18,000 in annual property tax revenue (based on long-term assessment).
345	State Seizure Funds Reserve	The Reserve consists of funds restricted to law enforcement activities related to controlled substance enforcement or education and cannot supplant existing funding. Funded by Eastside Narcotics Task Force drug seizures.
<b>Water Fund</b>		
402	Operating Fund Balance	The Fund Balance is based on a 90-day operating reserve for cash flow purposes, revisited each biennium.
402	Water Fund Capital Reserve	The Reserve serves as contingency for unplanned major repairs or capital projects costs. The target is 1% of total asset value, revisited each biennium.
<b>Sewer Fund</b>		
426	Operating Fund Balance	The Fund Balance is based on a 60-day operating reserve for cash flow purposes, revisited each biennium.
426	Sewer Fund Capital Reserve	The Reserve serves as contingency for unplanned major repairs or capital projects costs. The target is 2% of total capital assets, revisited each biennium.
426	Lake Line Reserve	The Reserve offsets the future cost to replace a portion of the Lake Line known as Reach-4. Reserve has been funded thru intentional rate increases as directed by the Utility Board.
<b>Stormwater Fund</b>		
432	Operating Fund Balance	The Fund Balance is based on a 45-day operating reserve for cash flow purposes, revisited each biennium.



FUND	NAME	DESCRIPTION
432	Storm Water Capital Reserve	The Reserve serves as contingency for unplanned major repairs or capital projects costs. The target is 2% of total capital assets, revisited each biennium.
432	Basin Improvement Reserve	The Reserve is for watercourse improvements on the Island that is funded by storm water in-lieu fees paid by developers.
<b><i>Equipment Rental Fund</i></b>		
503	Vehicle Replacement Reserve	The Reserve is a sinking fund to replace fleet vehicles and equipment. Funded by internal service charges to each department.
503	Fire Apparatus Replacement Reserve	The Reserve is a sinking fund in an Internal Service Fund to replace fire apparatus. Funded by 1.65% dedicated property tax levy and the excess annual levy proceeds from the Fire State & Fire Rescue Truck levy lid lift from 2014-2021.
503	800 MHz Radio Replacement Reserve	The Reserve is a sinking fund to replace 800 MHz radios used by Police, Fire, and Public Works staff. Funded by internal service charges to each department. Money earmarked for costs associated with transitioning to PSERN.
<b><i>Computer Equipment Fund</i></b>		
520	Computer Replacement Reserve	The Reserve is a sinking fund to replace computer, phone, and network hardware. Funded by internal service rates charged to each user department.



## **Appendix B – Cost Allocation Plan**

### **1. Introduction**

To execute the City Council priority of “focusing efforts and actions to be an environmentally and fiscally sustainable, connected, and diverse community,” the City of Mercer Island (hereinafter referred to as “the City”) reviews and updates the process of accounting and recording the full costs of public services on behalf of the Mercer Island community, as outlined in the cost allocation plan. The principles outlined below guide efforts related to the plan’s MAY 2024 update.

- 1.1. **Accurately calculate the full cost** of providing public goods and services.
- 1.2. **Establish an equitable methodology** for identifying and allocating indirect costs.
- 1.3. **Ensure appropriateness of cost-based user fees outlined in the Fee Schedule**, such as utilities, development review, parks and recreation, or any other service where the recipient of said service pays a fee.
- 1.4. **Generate data on the different internal services** provided to departments, informing City leadership on how best to distribute or allocate overhead resources.
- 1.5. **Ensure accurate pricing for services provided externally** so the City achieves full cost recovery with outside contracts.
- 1.6. **Develop a cost allocation methodology that is reasonably implementable** and does not require excessive staff resources to maintain and update.
- 1.7. **Comply with state law and minimize audit issues.** RCW 43.09.210 requires that all services rendered by one department to another shall be paid for at its true and full value by the receiving department, and that no department shall benefit in any financial manner by an appropriation made for the support of another department.

### **2. Definition of Terms**

- 2.1. **Fund Accounting:** All City activities are organized by funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures.
- 2.2. **Internal Services:** Internal services include operations provided by an internal service department to the City’s operating departments. Examples include City functions such as human resources, legal, finance, information technology, and geographical information systems.
- 2.3. **Overhead Grouping:** The individual department or internal service function whose costs are allocated.

For the basis of allocating costs, the following terms are defined. Each Overhead Grouping is collected by the Finance Department for the two prior fiscal years when updating the cost allocation plan.



- 2.4. Percent Hours Worked: To the best of their ability, staff track which City program, external service, operating department, and/ or allocable fund they spend time supporting.
- 2.5. Percent Prior Year Budget: Applicable costs of the overhead grouping are allocated based on the percentage of the City budget of each City program, external service, operating department, and/ or allocable fund relative to the total City budget.
- 2.6. Records Requests: Record requests are managed in the NextRequest software, which assigns each public record request made by a member of the public to the affiliated department.
- 2.7. Customer Service Log: The number of individual customer service calls, counter visits, and emails sorted by department/fund as collected throughout the year by the customer service team.
- 2.8. Recruitments/Onboardings: The number of recruitments processed through the NEOGOV system. Human Resources (HR) generates a report on each recruitment for each affiliated department. Only recruitments that have a status of "filled" or "open" are included. Each recruitment is followed by an employee onboarding, so this statistic represents both metrics.
- 2.9. Number of Paychecks: The ADP system generates a report of the number of paychecks per employee over a specified period.
- 2.10. Full-time Equivalent Position (FTE): Full-time equivalent, or FTE, measures the total number of full-time employees working within the organization. An FTE is equivalent to a full-time employee, working typically 2,088 hours per fiscal year.

### **3. Overview**

Cost allocation refers to a process of accounting for the full costs of a government service by including its indirect costs or "overhead" in addition to its direct costs.

- 3.1. **Direct costs** clearly and directly tie to a specific fund or operating program, such as supplies, materials, employee compensation, or consultant fees that support a single department or project. For example, use of the City's information technology (IT) equipment results in a direct cost to departments who use the equipment via the City's IT equipment replacement program.
- 3.2. **Indirect costs**, commonly referred to as "overhead costs" or internal services, are not readily identifiable with a particular fund or operating program but are incurred for a joint purpose which benefits more than one cost objective. Examples include accounting, payroll, administration, or human resource support; information technology (IT); or operation and maintenance costs for public facilities shared by City departments.



Although indirect costs are not easily identifiable with direct operating programs, they are nevertheless incurred by the organization in providing a public good or service. The cost allocation plan outlines the methods to assess and distribute these indirect costs to funds and operating programs accurately given the services they receive.

Updates to the cost allocation plan ensure indirect costs are included in service-based fee updates, such as the City's annual water, sewer, and storm water utility rate modeling efforts and the Master Fee Schedule.

#### **4. Process & Application**

The steps involved in preparing the cost allocation plan include the following:

- 4.1. Identify the departments that provide support. These departments are referred to as internal service or allocating departments and provide indirect services as described above.
- 4.2. Identify the departments that receive support. These departments are referred to as operating or receiving departments and they provide direct services.
- 4.3. Accumulate the allowable actual expenditures of the internal service departments that provide support to the operating programs, departments, and/or funds.
- 4.4. Allocate the allowable expenditures of the internal service departments that provide support to the operating programs, departments, and/or funds based on available, meaningful, measurable, and auditable allocations that match the service provided to the service received.

By identifying total direct and indirect program costs, the cost allocation plan serves as an information tool for financial and budgetary decision-making, including when:

- 4.5. Identifying and recapturing all costs – direct and indirect – associated with fee-for-service activity.
- 4.6. Identifying the indirect costs incurred when administering and providing support services to enterprise funds and internal service funds.
- 4.7. Determining indirect cost rates associated with administering federal and state grant programs (2 CFR Part 200).

Generally, the Finance Department will oversee the organization-wide effort to gather data required to calculate and allocate direct and indirect costs. This process will take place during the biennial budget process in the second year of a biennium.

Some allocation methods may require record keeping by individual departments throughout the biennium. The Finance Department will communicate with the required departments in the second year of the biennium to update data sets. Data for the basis of the cost allocation plan update shall be collected from the previous two fiscal years.





City staff analyzed and compared several city and county cost allocation methodologies to establish best practices for allocating costs. The City also consulted resources at MRSC, the State Auditor's Office, ICMA, and GFOA in developing this cost allocation plan.

## **5. Overhead Groupings and Allocation Basis**

### **5.1. Legal**

The City Attorney advises the City Manager, City Council, City departments, and, as needed, Council-appointed boards and commissions. The City Attorney also drafts ordinances and resolutions, reviews contracts and leases, and represents the City in legal proceedings. This overhead grouping includes general municipal legal services provided in-house and on a contractual basis to the City, along with public record requests governed by the Public Records Act (RCW Chapter 42.56).

City Attorney costs are allocated based on the *percent of prior year budget* for each allocable City program, external service, operating department, and/ or fund.

Outside legal services provide ancillary support when there are capacity constraints with in-house Counsel. Costs captured include all contracted outside legal costs, invoiced via *percentage of billable hours* by each allocable City program, external service, City department and/or fund. Daily time tracking is common in the legal profession and is the most accurate cost allocation possible.

Costs associated with a portion of the Paralegal/Public Records Officer and the City Clerk positions tie to assisting with records requests as submitted by members of the public. Records management costs are based on the *number of public records requests* tied to each allocable City program, external service, operating department, and/ or fund.

### **5.2. Administration and Leadership**

The Administration and Leadership overhead grouping includes oversight of major City-initiated projects, implementation of the biennial budget workplan and City Council policy objectives, and the administration of City services and programs, ensuring accountability and customer service excellence. It also includes customer service support along with coordination of public records requests.

The City Manager (including executive assistant support) provides leadership to operating departments, oversight of federal, state, and regional advocacy of City legislative priorities, guidance on the biennial budget process, and is responsible for the overall effective administration of City operations. Costs are allocated based on the *percent of prior year budget* for each allocable City program, external service, operating department, and/ or fund.



The Chief of Administration acts as a strategic partner to operating departments to oversee some internal services, collective bargaining, and major City-initiated projects. Costs are allocated based on the number of budgeted FTE positions for each allocable City program, external service, operating department, and/or fund.

Public Works Administration oversees the City's largest operating department. Support includes managing the Department's operating budget, completing the City's Capital Improvement Program, monitoring responses to constituent inquiries, and staff oversight across most of the City's enterprise funds. It is also responsible for inter-departmental and interagency coordination. Costs are allocated based on the number of budgeted FTE positions for each allocable City program, external service, operating department, and/or fund.

The Customer Service Team provides customer service via phone, email, and in-person for the City organization. Costs captured include the full cost of the Customer Service Team based on the call, email, and in-person counter service for each allocable City program, external service, operating department, and/or fund. The customer service team log is submitted annually to the Finance Department.

The City Clerk fulfills all state requirements of the City Clerk position, supports the City Council and City Manager, and manages essential public records. The portion of the City Clerk position that is not related to public record requests is allocated based on the percentage of prior year budget for each allocable City program, external service, operating department, and/or fund.

### **5.3. Human Resources**

Human Resources (HR) plans, organizes, and administers uniform human resource policies, programs, and procedures. Costs captured include the full cost of the Human Resources Division. Cost allocation is based on the number of budgeted FTE positions and the number of recruitments/onboardings by each allocable City program, external service, operating department, and/or fund.

HR currently tracks the number and status of each recruitment and onboarding by department and submits an annual report to the Finance Department. The Finance Department generates the percentage of FTEs by each allocable City program, external service, operating department, and/or fund.

### **5.4. Payroll**

This overhead grouping includes the full cost of payroll services. Costs are allocated based on the number of paychecks tied to each allocable City program, external service, operating department, and/or fund.



The payroll software system tracks this data. Human Resources submits an annual report with this information to the Finance Department.

### **5.5. Finance and Accounts Payable**

This overhead grouping includes the costs of the Finance Team responsible for financial strategic planning, overseeing annual audits, processing financial statements, managing the City's budget, long-range financial projections, debt issuance, purchasing and accounts payable activities, along with the management and maintenance of the City's enterprise-wide financial management software systems. Costs are allocated based on the percent of prior year budget for each allocable City program, external service, operating department, and/ or fund.

This metric closely tracks the level of effort of the Finance Department in managing the City's budget and finances. However, after implementation of the new Enterprise ERP financial management software is complete, staff will evaluate the possibility of using the new software to track the number of financial transactions by each allocable City program, external service, operating department, and/ or fund. This will be considered as a separate overhead basis during a future cost allocation policy update.

### **5.6. Communications**

This overhead grouping includes the cost of strategic Citywide communications, social media and web content, media relations, public outreach and surveying, neighborhood organization support, and public information assistance. Cost allocation is split between the number of budgeted FTE positions and the percent of prior year budget for each allocable City program, external service, operating department, and/or fund. This data is generated by the Finance Department.

### **5.7. General Liability Insurance**

This overhead grouping includes the cost of general liability insurance. Costs are allocated based on a methodology maintained by the Finance Department that considers both the risk profile and paid hours for each City program, external service, operating department, and/or allocable fund. This closely tracks the actual costs and is adjusted biannually based on actual claims and risk profiles of each City program, external service, or operating department.

### **5.8. Facilities**

This overhead grouping includes the costs to maintain and operate public facilities. This includes the cost for the upkeep and maintenance of City buildings, custodial services, and facility staff management and oversight. Costs are allocated based on a methodology maintained by the Facilities Division and Finance



Department based on the total square footage by FTE for each City program, external service, operating department, and/or allocable fund.