



## MEMORANDUM

**TO:** City Council

**FROM:** Nicole Valentine, Administrative Services Director

**SUBJECT:** Consider Adoption of a Resolution Updating the Fund Balance and Reserve Policy

**DATE:** April 9, 2024

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### **SUMMARY OF ACTION:**

Updating the Fund Balance and Reserve Policy will be used as a guide for future City Council and staff actions regarding the financial health of the City.

### **IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:**

There is no fiscal impact resulting from updating the Fund Balance and Reserve Policy. The total fund balance amounts reported in any given fund will not be altered. Only the consideration of reporting of the individual components that make up the total fund balance are being discussed.

### **RECOMMENDATION:**

Adopt a Resolution updating the Fund Balance and Reserve Policy.

### **BACKGROUND:**

The City Council first adopted the Fiscal Policy on September 5, 1995, and has revised the policy on November 12, 1996; February 10, 1998; May 29, 2003; May 24, 2005; and most recently June 28, 2011. Many of these updates were included with a review of the budget adoption. The current reserve policy states the following:

- Establish and maintain a Fund Balance reserve goal of 20% of expenditures with a minimum of 15% in the General Fund.
- Maintain a minimum of 5% of the General Fund budget as a Contingency Reserve.
- Contribute 10% of annual appropriations to the improvement of Infrastructure.

Over many years, the City has established a comprehensive and extensive budget and financial policy framework. This framework is reviewed with each Biennial Budget and periodically amended based on the need of the organization as well as changes in mandates and best practices.

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In 2009, the Governmental Accounting Standard Board (GASB) introduced GASB Statement No. 54 – Fund Balance Reporting and Governmental Fund Type Definitions. The statement’s objective is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be applied consistently. The classifications comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in its governmental funds.

In order to apply GASB 54, staff amended the established policies and combined them into a stand-alone comprehensive policy document for easy access and reference. The City’s Biennial Budget will continue to incorporate this information in the financial policy section and reference the adopting resolution. Additionally, the Fund Balance and Reserve Policy will be posted on the City website. The City’s independent auditor will use the definitions of fund balance when providing the City’s annual audit and annual financial statements.

On [June 27, 2023](#), the City Council adopted FY 2023-25 Biennial Budget which included an overview of the Consolidated General Fund to provide the City Council and the community the full picture of the City revenues, expenditures, ending fund balances, and the updated Consolidated General Fund is shown in Table 1:

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**Table 1 – FY 2023-25 Consolidated General Fund Budget & Available Fund Balance in Thousands**

	FY 2023-24			FY 2024-25		
	General Fund	Local Sales	Consolidated Total	General Fund	Local Sales	Consolidated Total
<b>Beginning Fund Balance</b>	\$8,993	\$3,093	\$12,086	\$8,462	\$2,904	\$11,366
<b>Revenues:</b>						
Revenues	18,544	2,962	21,506	19,000	3,033	22,033
Transfers In	3,114	-	3,114	3,185	-	3,185
<b>Total Revenues</b>	<b>21,658</b>	<b>2,962</b>	<b>24,620</b>	<b>22,185</b>	<b>3,033</b>	<b>25,218</b>
<b>Expenditures:</b>						
Salaries and Benefits	12,089	-	12,089	12,437	-	12,437
Services and Supplies	9,435	1,042	10,477	9,775	1,087	10,862
Debt Service	310	-	310	294	-	294
Capital Outlay	240	-	240	150	-	150
Transfers Out	115	2,109	2,224	2,475	3,858	6,333
<b>Total Expenditures</b>	<b>22,189</b>	<b>3,151</b>	<b>25,340</b>	<b>25,131</b>	<b>4,945</b>	<b>30,076</b>
<b>Total Operating Incr/(Dec)</b>	<b>(531)</b>	<b>(189)</b>	<b>(720)</b>	<b>(2,946)</b>	<b>(1,912)</b>	<b>(4,858)</b>
<b>Available Fund Balance</b>	<b>\$8,462</b>	<b>\$2,904</b>	<b>\$11,366</b>	<b>\$5,516</b>	<b>\$992</b>	<b>\$6,508</b>
<b>Reserve %</b>	38.1%	92.2%	44.9%	22.0%	20.1%	21.6%
<b>\$ Above Reserve Policy</b>	4,025	2,274	6,299	491	3	494
<b>Funds Available to Allocate</b>	3,500	1,695	5,195	400	-	400

The City’s Annual Comprehensive Financial Report (ACFR) was presented on [January 23, 2024](#), and a request to review the reserve policy was discussed. The Beginning Fund Balances for the funds have been updated upon completion of the ACFR and are shown in Table 2:

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**Table 2 – Updated Fund Balances FY 2023-25 Consolidated General Fund Budget & Available Fund Balance in Thousands**

	FY 2023-24			FY 2024-25		
	General Fund	Local Sales	Consolidated Total	General Fund	Local Sales	Consolidated Total
Beginning Fund Balance	\$11,862	\$7,625	\$19,487	\$11,331	\$7,436	\$18,767
Revenues:						
Revenues	18,544	2,962	21,506	19,000	3,033	22,033
Transfers In	3,114	-	3,114	3,185	-	3,185
<b>Total Revenues</b>	<b>21,658</b>	<b>2,962</b>	<b>24,620</b>	<b>22,185</b>	<b>3,033</b>	<b>25,218</b>
Expenditures:						
Salaries and Benefits	12,089	-	12,089	12,437	-	12,437
Services and Supplies	9,435	1,042	10,477	9,775	1,087	10,862
Debt Service	310	-	310	294	-	294
Capital Outlay	240	-	240	150	-	150
Transfers Out	115	2,109	2,224	2,475	3,858	6,333
<b>Total Expenditures</b>	<b>22,189</b>	<b>3,151</b>	<b>25,340</b>	<b>25,131</b>	<b>4,945</b>	<b>30,076</b>
Total Operating Incr/(Decr)	(531)	(189)	(720)	(2,946)	(1,912)	(4,858)
Available Fund Balance	\$11,331	\$7,436	\$18,767	\$8,385	\$5,524	\$13,909
<b>Reserve %</b>	51.1%	236.0%	74.1%	33.4%	111.7%	46.3%
<b>\$ Above Reserve Policy</b>	6,895	6,806	13,701	3,360	4,536	7,896
<b>Funds Available to Allocate</b>	3,300	4,520	7,820	2,800	3,780	6,580

The estimated Consolidated General Fund available fund balance at the end of FY 2024-25 is \$13,909,000.

**ANALYSIS OF ISSUES:**

Healthy reserves are a mark of fiscal stability and a cornerstone of financial flexibility. The Government Finance Officers Association (GFOA) best practice recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their General Fund of no less than two months (16.67%) of regular general fund operating revenues or operating expenditures.

The updated Fund Balance and Reserve Policy included in Attachment 1, as Exhibit A, does not change the current Operating Reserve policy that is equal to 15%, with a goal of 20% of the City’s annual operating expenditures.

The updated Fund Balance and Reserve Policy establishes a Budget Stabilization Reserve that will maintain a \$1,000,000 balance of annual Consolidated General Fund operating expenditures. The Budget Stabilization Reserve is meant to be used to address financial impacts resulting from changes in the economic environment. If revenues are insufficient to meet the normal operating requirements of essential services in times of

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economic downturn, funds contained in the Budget Stabilization Reserve may be used if approved by City Council action.

The updated Fund Balance and Reserve Policy also establishes a Pension and Other Post-Employment Benefits Reserve. Funds set aside under this reserve shall be used to further mitigate costs associated with pensions and other post-employment benefits. These funds will be used as a funding source for potential additional discretionary payments to pay down unfunded liability, held in the reserve account, or placed in a City Council approved trust instrument. Funds may be used for such purposes as a supplemental funding source for unanticipated increases to the annual pension and/or other post-employment benefit costs resulting from future actuarial assumptions and investment market volatility, or to make the City's annual payments during times of economic uncertainty as brought on by such circumstances as a recession resulting in funding gaps.

Additionally, the updated Fund Balance and Reserve Policy establishes three replacement/repairs reserves:

- Information Technology Reserve – Funds set aside under this reserve shall be used for information system and technology projects including communications systems, hardware, and software, which are capital in nature. Technology can change rapidly within the information systems sphere and often comes at a large cost. This reserve helps the City keep pace with changes in information technology and take advantage of improvement/efficiency opportunities in this area. While this will not eliminate the need to utilize the General Fund to support technology, it will help defray costs associated with unforeseen impacts to the City's Information Technology system.
- Fleet Replacement Reserve – Funds set aside under this reserve shall be used to maintain a Fleet Replacement Reserve in the Consolidated General Fund to provide for the timely replacement of existing vehicles should they come to the end of their useful life or become inoperable. The intent of this fund is to help self-finance the City's fleet needs into the future.
- Facility Repairs Reserve – Funds set aside under this reserve shall be to address any unforeseen maintenance and repairs or planned replacements within City owned facilities. This fund is not intended to support planned facility maintenance and repairs.

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There is no set required balances for the Pensions, Information Technology, Fleet Replacement, and Facility Repairs reserves but it is recommended that these reserves be funded at levels adequate to fund the City's schedules for equipment replacement, facility repairs, and future pension obligations. The City's future budgets will incorporate a line item to increase these fund balances each year.

The updated Fund Balance and Reserve Policy incorporates the Reserves for Enterprise Funds that have been approved and incorporated in the City Rate setting but not adopted with the formal policy. Funds contained in the Reserves for Enterprise Funds are restricted revenues and may only be used for authorized purposes related to the water and wastewater systems.

The City will incorporate this update Fund Balance and Reserve Policy in the FY 2024-25 Mid-Cycle Budget Update and provided balances with that report.

**ALTERNATIVES:**

The following alternatives are provided for the Council's consideration:

1. Adopt a Resolution updating the Fund Balance and Reserve Policy;
2. Modify as appropriate the Fund Balance and Reserve Policy; or
3. Provide other direction to staff.

**ADVANTAGES:**

The last update to the Fund Balance and Reserve Policy was more than thirteen years ago. The proposed changes align the GFOA best practices and continue to improve the City's ongoing commitment to responsible stewardship and transparency of public funds.

**DISADVANTAGES:**

There are no disadvantages in relation to the recommended action.

**ENVIRONMENTAL REVIEW:**

Adopting a resolution updating the Fund Balance and Reserve Policy is not subject to the California Environmental Quality Act ("CEQA") because it has no potential to result in either a direct, or reasonably foreseeable indirect, physical change in the environment. (State CEQA Guidelines, Cal. Code Regs., tit. 14, §§ 15060, subd. (c)(2)- (3), 15378.)

**PUBLIC NOTIFICATION AND COMMENTS:**

The Agenda was posted at City Hall and on the City's website in accordance with Government Code Section 54954.2.

**ATTACHMENTS:**

1. Proposed Resolution