



CITY OF SANTA BARBARA

FINANCE COMMITTEE AGENDA REPORT

AGENDA DATE: June 12, 2012
TO: Finance Committee
FROM: Administration Division, Finance Department
SUBJECT: Proposed Revisions To Reserve Policies

RECOMMENDATION:

That the Finance Committee provide staff final direction on the newly proposed policies governing General Fund reserves.

DISCUSSION:

Background

On April 10, and again on May 22, 2012, the Finance Committee and City staff met to evaluate and propose changes to existing policies for the establishment and maintenance of General Fund reserves. The newly proposed reserve policies were developed based on feedback received from the City Council and the Finance Committee, as well as recommendations from City staff.

At this meeting of June 12, staff will be seeking final direction from the Committee on the draft proposed policies. Based on the final direction received from the Committee, the proposed policies will be presented to the City Council at a later date for consideration.

Concurrently, staff will be evaluating reserve policies applicable to Enterprise Funds, incorporating suggestions from Enterprise Fund departments, as well as both the Harbor Commission and Water Commission. Once this process is completed, staff will return to the Finance Committee for discussion and possible changes as appropriate.

ATTACHMENT: Proposed General Fund Reserve Policies

PREPARED BY: Robert Samario, Finance Director

APPROVED BY: City Administrator's Office

**CITY OF SANTA BARBARA
Proposed Reserves Policies
GENERAL FUND**

GENERAL POLICY REQUIREMENTS

The reserves established pursuant to this policy are designed to provide the City with a degree of funds to address unexpected, unplanned and unbudgeted events that have a detrimental impact on the City's financial condition. The use of reserves should be considered in the context of other sources of funds that may be available, such as property and business interruption insurance reimbursements and disaster relief funds in the case of federal and/or state declared emergencies.

Calculation of the final reserve balances will be calculated at the end of each year after the final closing of the accounting records and will be accounted for in each fund, as applicable, as a designation of fund balance for each type of reserve established by this policy.

As soon as practical after the close of a fiscal year, staff will provide City Council a report showing the status of reserves as of June 30. In addition, at any time the use of reserves is proposed in excess of reserves established pursuant to this policy, staff will provide a similar report on reserves and projected fiscal impact from the proposed use of reserves.

DISASTER RESERVE

The Disaster Reserve will be calculated as 15% of the adopted operating budget of the immediately following fiscal year.

The Disaster Reserve is restricted to use in addressing the financial impacts of natural disasters, such as floods, fires, tsunamis, earthquakes and any other event that results in significant damage to City facilities and infrastructure.

The use of Disaster Reserves should generally be limited to disasters that are associated with a federal and/or state declared disaster. However, the use of Disaster Reserves is allowable in cases where the natural disaster is less severe, such as a major fire to a City building that requires temporary facilities to be leased. Disaster reserves may be used only after other available funds are exhausted, including the Economic Contingency Reserve.

Examples of financial impacts that would justify the use of Disaster Reserves include:

- Extraordinary costs incurred in connection with the immediate emergency response to address public safety matters.
- Revenue losses resulting from a significant decline or temporary halt in visitors to the City due to major damage to facilities, infrastructure and local businesses.
- Additional costs necessary to maintain City operations.
- Long term costs incurred to rebuild City facilities and infrastructure.

A simple majority approval of City Council is required for any use of Disaster Reserves.

CONTINGENCY RESERVE

The Contingency Reserve is calculated based on 10% of the adopted operating budget of the immediately following fiscal year.

The main purpose of the Contingency Reserve is to allow for the orderly implementation of a balancing strategy to address the fiscal impacts of unexpected events in a manner that minimizes the impacts to the organization and community, balanced against the goal of preserving reserves.

The Contingency Reserve is restricted to addressing the impacts of unplanned and unexpected events negatively affecting General Fund revenues or expenses. Because the primary revenues in the General Fund can be volatile and fluctuate with economic cycles, an economic recession is the more typical unexpected event that negatively affects local revenues. However, unexpected events that have a financial impact on the General Fund, and the City as a whole, can also include the following:

- Natural disasters, as described above for Disaster Reserves
- Revenue impacts resulting from State of California action and unfunded State mandates
- Unexpected loss of external funding (grants, entitlements, etc.)
- An unplanned loss of, or damage to, a City facility (e.g., loss of a building due to fire)
- Mitigation of an emergency that poses a threat to public health and safety
- Adverse judicial action that requires large cash payments to third parties

The general intent of the Contingency Reserve is not to fund known and/or anticipated financial impacts, such as negotiated salary and benefit increases or increases to health insurance premiums or retirement costs.

The following provides specific requirements applicable to the use of Contingency Reserves.

Council Approval

Any use of Contingency Reserves, except in cases of natural disasters, requires a supermajority approval (at least 5 votes) of City Council

Assessing the Fiscal Condition and Outlook of the General Fund:

The use of Contingency Reserves should be accompanied by an objective evaluation of the General Fund's fiscal condition and an evaluation of the fiscal impacts of the event that triggered the use of reserves. The purpose of this evaluation is to measure and define the scope and duration of the problem to assist in developing an appropriate balancing strategy.

The assessment of fiscal condition should include the use of available and relevant financial and non-financial data, including but not limited to: economic and demographic indexes and trends; historical revenue and expenditures results; and local economic forecasts developed by recognized academic and financial institutions and paid consultants.

Developing a Balancing Strategy

Whenever Contingency Reserves are proposed to be used, the City Council should also approve a balancing strategy. The balancing strategy should include, as appropriate and feasible, other measures that minimize the use of Contingency Reserves, such as:

- Expenditure reductions achieved through efficiency measures, cuts to programs, services and staffing
- Revenue enhancement measures that generate new or increased revenues
- Use of existing one-time funds
- Use of available reserves in other funds, as allowable and appropriate

The balancing strategy should also be consistent with the nature of the fiscal impact. For example, a one-time impact may be resolved fully with the use of reserves, depending on its severity. However, an event that has an ongoing financial impact, such as decline in revenues due to a major recession, will require a balancing strategy that includes ongoing budget adjustments to minimize the use of reserves.

Plan of Replenishment

The use of Contingency Reserves should be accompanied by a plan for their restoration.

- A one-time (one-year) use of reserves should be accompanied by a specific plan for how and when the reserves will be restored.
- An extended use of reserves for more than one year should be accompanied by a long-term strategy that includes a more long-term plan for how the reserves will be restored.