STAFF REPORT

CITY OF WASCO

TO: Honorable Mayor and Council Members

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DATE: April 27, 2021

SUBJECT: Budget and Fiscal Policies

RECOMMENDATION

Staff recommends that the City Council conceptually approve the proposed *Budget and Fiscal Policies* in guiding preparation of the Preliminary Budget, with final adoption in June 2020 in conjunction with approval of the 2020-21 Budget, except for the *Capital Financing and Debt Management Policy*: in meeting State Water Resource Control Board (SWRCB) loan requirements, this policy will be presented for formal Council approval at the May 4, 2021 meeting.

DISCUSSION

When clearly articulated (and followed), budget and fiscal policies provide an essential foundation for effective financial decision-making and in protecting the City's fiscal health, in both the short and long-term.

The City's fiscal health is a lot like personal health: it isn't what you live for; but it is hard to enjoy your life without it. Cities don't exist to be fiscally healthy: they exist to make communities better places to live, work and play. However, this requires the fiscal capacity to link community goals with the resources needed to achieve them. In short, fiscal health is not an end in itself; but it is an important part of the tool kit in achieving "ends."

And like personal health, fiscal health is rarely luck. The strength of the local economy is obviously an important fiscal health factor – just as genes are in personal health. However, regardless of the strength of its local economy, no city is immune from economic downturns or unexpected expenditure needs.

Formal statements key budget and fiscal policies provide the foundation for assuring long-term fiscal health by establishing a clear framework for effective and prudent financial decision-making.

For this reason, clearly articulated policies are a city's "north star" in guiding the preparation and implementation of budgets and financial plans. They help make tough decisions easier by stating an organization's values before they are placed under stress by adverse circumstances. The organization might still choose to do something different – effective policies are guides, not straightjackets – but they are a powerful starting point: but for "this," the organization should do what?

Stated simply, articulating and then following prudent fiscal policies is the most effective and proven way for cities to ensure their long-term fiscal health.

They are both preventative and curative: clearly articulated policies help prevent problems from arising in the good times; and help respond to bad times when they do occur. They also help provide continuity as elected officials and staff change. Lastly, they are most powerful when it is put in place before the need for them arrives.

In summary, adopting key fiscal policies is an essential factor for effective stewardship of the City's resources, both in the short and long-term.

Proposed Budget and Fiscal Policies

"One size does not fit all" in setting fiscal policies Careful consideration needs to be given in developing policies that are appropriate given the unique circumstances of each city.

Based on "best practices" recommended by professional organizations like the Governments Finance Officers Association of the United States and Canada (GFOA) and the California Society of Municipal Finance Officers (CSMFO) as well as the major credit rating agencies, fiscal policy areas that the City will want to address are presented in the sidebar.

Within the next six months, we recommend addressing each of these policy areas. However, for guidance in preparing the 2020-21 Budget, we recommend focusing on the following four policies as set forth in Attachment 1 at this time:

- Budget purpose and organization
- Revenue management
- Minimum fund balance and reserves
- Financial reporting and budget administration

Each of these will provide an important foundation and guidance for staff preparation of the Preliminary Budget for 2020-21 as well for the Council's review of it at the workshops and hearings that will follow its issuance by June 1, 2020.

Fiscal Policy "Best Practices"

"One size does not fit all" in setting fiscal policies. Careful consideration needs to be given in developing policies that are appropriate given the unique circumstances of each city. Fully addressing all of these areas is planned within the next six months:

- Budget purpose and organization (including a balanced budget policy and what this means)
- Revenue management
- User fee cost recovery: when should user fees fund services versus general purpose revenues?
- Minimum fund balance and reserves
- Financial reporting
- Budget administration
- Capital improvement plan (CIP) management
- Capital financing and debt management
- Purchasing
- Human resources management

Capital Financing and Debt Management Policy

While not essential for the preparation of the 2021-22 Budget, we also recommend considering the *Capital Financing and Debt Management* policy at this time. As noted above, adopted debt policies are required by the SWRCB in considering the City's $25.8 million loan application for water system improvements. Moreover, the City's current policies (Attachment 2) call for the preparation of a comprehensive debt management policy:

"In recognition of its responsibility for the management of debt obligation for itself and its component units, the City of Wasco will develop a comprehensive set of formal debt policies."

Accordingly, we recommend formal adoption of the proposed *Capital Financing and Debt Management Policy* by the Council approval at the May 4, 2021.

Preparing the Proposed Policy. It draws on "best practices" and policies used in other highly-regarded cities. Moreover, it reflects the elements recommended by the State of California Debt and Investment Advisory Commission (CDIAC). As such, In several cases, it addresses debt issues that are not currently on the City's radar, such as land-based and conduit financings. However, in assuring that it meets SWRCB loan requirements, it is intended to be comprehensive in meeting current and future needs.

Current Budget and Fiscal Policies

As presented in Attachment 2, the City currently has adopted budget and fiscal policies covering the following areas:

- Balanced budget
- Investments
- Debt management
- Reserves
- Budgetary procedures and authority
- Revenues
- Five-Year CIP
- Competitive compensation

With two exceptions, the proposed policies cover all current areas (in most cases using the same language) but remove redundancy in several cases, organize them differently to group similar policies together and provide supplemental information in some cases for greater clarity. Since they do not directly relate to budget development or administration, the two exceptions are investments and City Manager contract amendment authority. These will be carried forward as currently written.

These policies were last presented in the 2019-20 Budget. For 2021-22 and future years, these policies will be again be presented as an integral part of the budget document.

Minimum Fund Balance and Reserves

While each of the attached policy areas speak for themselves, minimum fund balance ("reserves") is an especially important policy in determining the City's ability to respond to unexpected fiscal hardships such as local disasters, public health crises, downturns in the economy, external revenue hits like (State budget takeaways) and unforeseen operating or capital needs. Stated simply, it is the City's first line of defense in responding to adverse, unforeseen circumstances.

As noted above, the City is fortunate to already have in place a reserve policy (as well several others: Attachment 2). However, there are several proposed changes and clarifications that will be useful for 2021-22 and beyond in implementing this policy, most notably:

- ***Purpose of reserves.*** Reserves exist for a reason. The proposed policy sets forth those purposes in accordance with the risk assessment methodology developed by the GFOA.

- ***Guidance on when it is appropriate to go below the minimum target.*** The proposed policy clarifies the one-time circumstances where taking reserves below the target minimum balances would be appropriate.

- ***Restoring the reserve if it falls below the target minimum.*** The proposed policy provides for restoring reserves to policy levels within five years; and as revenues versus expenditures improve, allocating at least 50% to restoring the reserve.

- ***Using reserves above the minimum.*** The proposed policy provides a framework for the potential use of reserves above the minimum. The Short Story: Since reserves can only be used once, uses above the minimum should be for one-time purposes.

- ***Defining the reserve.*** Under generally accepted accounting principles, General Fund balance is organized into five categories: non-spendable; restricted; committed; assigned and unassigned. The proposed policy clarifies that the minimum target applies to the "unassigned" balance (after commitments and assignments for other purposes).

- ***Setting the minimum General Fund reserve.*** The current policy calls for setting the minimum General Fund reserve at 30% of operating expenditures. Using the GFOA's structured approach to setting reserve levels, we recommend setting the target at 35%. (A description of the methodology and the assessment results are provided in Attachment 3). Two factors largely account for this recommended increase: recent experience with the pandemic; and the results of a high-level cash flow analysis that shows two peak cash flow shortfalls of 15% in November and 20% in May prior to the recent of property tax revenues (Attachment 4). Setting the reserve at 35% provides greater flexibility in meeting cash flow needs and other contingencies.

Next Steps

If conceptually approved by the Council at this time, staff will use these policies as the foundation in guiding preparation of the 2020-21 Preliminary Budget. Final adoption of the policies will occur in June 2020 in conjunction with the Council's approval of the 2021-22 Budget. (The only exception to this is the proposed Capital Financing and Debt Management policy, which is recommended for formal adoption on at the May 4 Council meeting.)

As noted above, for future reference, the City's *Budget and Fiscal Policies* will be included the Budget document (as will any future additions or revisions).

In considering the proposed *Budget and Fiscal Policies*, it is important to not only clearly articulate the policy, but to assure compliance with it. Stated simply, clearly stating where the City wants to be (versus where it may be today) will significantly enhance the City's ability to achieve it.

For this reason, each policy area is followed by a brief summary of "compliance status." Where the City has not yet achieved the goal, a status summary on the City's progress in doing should be provided. In short, including the policies in the Budget document and indicating its compliance status will keep the policies in front of the Council, community and organization; and help make the relationship between policy and "actual" transparent for these stakeholders.

FISCAL IMPACT

There are no direct fiscal impacts as a result of conceptually approving the proposed Budget and Fiscal policies. However, this will provide an important policy framework and foundation for preparing the Budget.

ALTERNATIVES

1. Approve different budget and fiscal policies than those proposed.

2. Do not approve budget and fiscal policies in establishing a policy framework for financial management and decision-making.

ATTACHMENTS

1. Proposed Budget and Fiscal Policies
2. Current Budget and Fiscal Policies
3. GFOA Fund Balance Assessment Methodology and Results
4. General Fund Cash Flow Analysis

BUDGET PURPOSE AND ORGANIZATION

A. **Balanced Budget.** The City will maintain a balanced budget. This means that:

   1. Operating revenues should fully cover operating expenditures, including debt service.

   2. Ending fund balance/working capital must meet minimum policy levels or other target levels established by the Council for the fiscal year.

   Under this policy, it is allowable for total expenditures to exceed revenues in a given year; however, in this situation, beginning fund balance should only be used to fund capital improvement plan projects or other "one-time," non-recurring expenditures. (See *Fund Balance and Reserves* policy for other circumstances when it would be appropriate to use beginning fund balance.)

B. **Budget Objectives.** Through its Budget, the City will link resources with goals and results by:

   1. Identifying community needs for essential services.

   2. Organizing the programs required to provide these essential services.

   3. Describing programs and activities performed in delivering services.

   4. Proposing objectives for improving the delivery of program services.

   5. Identifying and appropriating the resources required to perform program activities and accomplish program objectives.

   Budgetary emphasis will focus on providing high quality municipal services, recognizing the fundamental importance to the citizens of public safety and properly maintained infrastructure.

C. **Measurable Objectives.** The Budget will establish measurable program objectives and allow reasonable time to accomplish those objectives.

D. **Goal Status Reports.** The status of major program objectives will be formally reported to the Council on an ongoing, periodic basis.

E. **Adequate Maintenance of Existing Assets.** The budget will provide sufficient funding for adequate maintenance and orderly replacement of capital plant and equipment. Future maintenance needs for all new capital facilities will be fully costed out and added costs will be recognized and included in future year budget projections.

F. **Five-Year Capital Improvement Program.** The City will maintain a long-range fiscal perspective through the use of a five-year Capital Improvement Plan.

G. **Continued Commitment to Customer Service and Productivity Improvements**. Strong customer service and productivity improvements, with a focus on value added services, remain important budgetary goals. Consistent with this goal, the City will strive to pay competitive market level compensation to its employees.

H. **Mid-Year Budget Reviews.** The Council will formally review the City's fiscal condition, and amend appropriations if necessary, six months after the beginning of each fiscal year.

Status: In Compliance. *These practices are either in place or the Council has adopted a budget process and document for 2021-22 that meets these policy objectives. However, linking resources to outcomes and measuring performance will always be a work in progress, with ongoing improvements.*

REVENUE MANAGEMENT

A. Current Revenues for Current Uses; One-Time Revenues for One-Time Purposes. The City will make all current expenditures with current revenues, avoiding procedures that balance current budgets by postponing needed expenditures, accruing future revenues or rolling over short-term debt. The City will avoid using one-time revenues to fund ongoing program costs.

B. Revenue Distribution. The Council recognizes that generally accepted accounting principles for state and local governments discourage the "earmarking" of General Fund revenues, and accordingly, the practice of designating General Fund revenues for specific programs should be minimized in the City's management of its fiscal affairs. In those cases where it does occur, the basis and methodology for earmarking should be clearly articulated in the City's Budget and Fiscal Policies.

C. Grant Management. Intergovernmental assistance in the form of grants and loans will be used to finance only:

1. Capital improvements that are consistent with the Five-Year Capital Improvement Program (CIP) priorities and can be maintained and operated over time.
2. Technological upgrades or enhancements.
3. Capital acquisition items.
4. Operating programs which either can be sustained over time or have a limited horizon.
5. Other areas as determined by the Council to be in the best interest of the City.

D. Enterprise Fund Fees and Rates. All fees and charges for each enterprise fund (such as Water, Wastewater and Sanitation) will be set at a level that fully supports the direct and indirect costs of the enterprise, including operations, maintenance, capital improvements and debt service, as well as meet any debt service coverage requirements set forth in related bond covenants.

E. Internal Service Funds. All internal service funds will have revenues (intra-City user charges, interest earnings and other income) sufficient to meet all operating and capital expenses. Such revenues shall also be sufficient to maintain minimum reserve targets.

Status: In Compliance. *These practices are either in place or the Council has adopted a budget process and document for 2021-22 that meets these policy objectives.*

MINIMUM FUND BALANCE AND RESERVES

Section 1: Policy

A. **Policy Overview.** This policy accomplishes two main goals. First, it sets forth specific levels of minimum unassigned fund balance to be maintained for the City's General Fund and a minimum level of available working capital for the City's Water, Wastewater and Sanitation enterprise funds. Secondly, this policy establishes a framework and process for the City to follow if these reserve levels fall below the established minimum.

This Policy provides guidelines for fiscal sustainability through maintaining adequate operational liquidity and should be used in preparing the City's Annual Operating Budget, Capital Improvement Program, and general financial management of the City. It recognizes the need for exceptions in extraordinary conditions and unforeseeable events while maintaining a goal and path to regain fiscal sustainability when necessary.

This policy is also intended to follow best practices and industry standards, including those issued by the Governmental Finance Officers Association of the United States and Canada (GFOA) in setting reserve levels that adequately address risks such as:

1. Economic uncertainties, local disasters, public heath crises and other financial hardships or downturns in the local or national economy.
2. Contingencies for unseen operating or capital needs.
3. Unfunded liabilities such as pensions.
4. Institutional changes, such as State budget takeaways and unfunded mandates.
5. Cash flow requirements.

B. **Objectives.** The purpose of this policy is to assist the City in the pursuit of the following equally important objectives:

1. Maintain long-term fiscal sustainability of the General, Water, Wastewater and Sanitation Funds.
2. Meet the short-term liquidity needs of the General, Water, Wastewater and Sanitation Funds.
3. Cultivate a fiscally responsible internal control environment.
4. Help achieve the highest possible credit ratings and lowest possible financing costs when borrowing funds.

C. **Budget Integration and Financial Management**. The City's Annual Operating Budget and Capital Improvement Plan should be developed to comply and implement the various aspects of this policy. This includes but is not limited to both the budgeted use of excess unassigned fund balance or available working capital and the rebuilding of the same as needed to maintain compliance with the minimum reserve levels established herein.

Any areas of shortfall or otherwise non-compliance with the minimum reserve levels contained within this policy should be disclosed in the City Annual Operating Budget document and Comprehensive Annual Financial Report, including a response from management on what actions are being taken to bring the City back into compliance with the policy.

Section 2: Minimum Balances

The following amounts are established as the minimum unassigned fund balance for the City's General Fund and minimum available working capital for the City's major utility enterprise funds.

A. **General Fund.** At the end of each fiscal year, the General Fund should have a minimum unassigned fund balance of at least 35% of operating and debt service expenditures. This represents about 120 days of General Fund operating cash flow and is conservatively based on the risk assessment methodology for setting reserve levels developed by the GFOA.

B. **Water, Wastewater and Sanitation Funds.** The City operates three major utility enterprise funds: water, wastewater and sanitation, which provide essential public services that are paid for by users of these services. Maintaining adequate liquidity in these funds is an essential factor in the City's ability to provide these services without interruption. Accordingly, at the end of each fiscal year the City should have a minimum available working capital balance (current assets less current liabilities, minus amounts designated for funding capital projects or other purposes) in each of these enterprise funds at equal or more than 25% of operating and debt service expenditures for that fund. This minimum available working capital balance should be factored into all future user rate studies used to establish utility user rates for these three funds.

C. **Internal Service Funds.** The City's internal service funds shall maintain working capital of at least 60 days of operating expenditures.

D. **Taking Reserves Below Minimum Policy Levels**. There are circumstances where intentionally taking reserves below the established policy levels would be appropriate in responding to the risks that reserves are intended to mitigate and are not considered a violation of this policy. These include <u>one-time uses</u> such as:

   1. Making investments in human resources, technology, economic development, productivity improvements and other strategies that will reduce future costs or increase future revenue sources.

   2. Reducing ongoing expenditures through the partial or full refinancing of unfunded long-term liabilities.

   3. Closing short-term revenue/expenditure gaps.

   4. Responding to unexpected expenditure requirements or revenue shortfalls.

   5. Meeting one-time cash flow needs as well as normal cash flow needs during the year.

   6. Where a forecast shows an ongoing structural gap, providing a strategic bridge to the future.

   Any intentional use of reserves that reduces reserve levels below the minimum policy levels shall be specifically approved by the City Council.

Section 3: Other Assignments/Commitments

A. **Future Capital Project or Other Long-Term Goal Assignments or Commitments.** The Council may also commit or assign specific General Fund balance levels above the reserve target for future development of capital projects, unfunded liabilities or other long-term goals that it determines to be in the best interests of the City.

B. **Other Commitments and Assignments.** In addition to the 35% target noted above, unrestricted fund balance levels will be sufficient to meet funding requirements for programs or projects approved in prior years which are carried forward into the new year; debt service reserve requirements; commitments for encumbrances; and other restrictions, commitments or assignments required by contractual obligations, state law or generally accepted accounting principles.

Section 4: Correcting Balances Below the Minimum Balance

Whenever the City's Funds with established minimum balances per this policy fall below these minimal levels, the City will strive to restore these balances to the minimum level within five-years. Some actions that may be considered to rectify this situation include the following:

A. **General Fund**

1. Strategically reducing general fund operating budgets.

2. Updating and improving the City's economic development strategy.

3. Assessing workload and staffing levels to ensure appropriate staffing of General Fund operations, redeploy staffing if necessary.

4. Conduct a revenue study to update General Fund revenue sources that may have fallen behind.

5. Conduct an analysis of General Fund cost allocation to plan to ensure other City funds are paying the appropriate fees for the General Fund services they receive.

6. Identify special revenues or other funds that can help support the General Fund.

B. **Water, Wastewater and Sanitation Funds**

1. Strategically reduce operations budgets.

2. Initiate a user rate analysis and implement rate changes as needed.

3. Analyze existing debt and possible refinancing options to reduce existing debt service cost.

4. Defer non-essential capital improvement projects until adequate funding can be secured through rate increases, grants or debt issuance.

As revenues versus expenditures improve, the City will allocate at least half to reserve restoration, with the balance available to fund asset replacements, unfunded liabilities, capital improvement projects, service level restorations or new operating programs.

Section 5: Use of Balances Exceeding the Minimum Balance

At times, the City may find itself with unassigned General Fund balances and/or available working capital in the Water, Wastewater and Sanitation funds that exceed the minimums established by this policy. This policy does not require or recommend that those additional reserve funds be spent down but it does establish the following guidelines regarding the potential use of those funds.

A. Excess reserve funds are not to be used for new or existing recurring expenses except on a short-term basis.

B. Investment of these funds on a longer-term basis, in compliance with the City's Investment Policy, should be considered to provide an ongoing source of recurring investment income for the City.

C. Assignment or use of these funds should be considered for early partial or full retirement of existing debt or other unfunded long-term liabilities.

D. A review of the one-time capital improvements needed within the City should be considered to identify and prioritize potential capital projects. Once potential projects have been identified, assignment or use of these funds should be considered for these one-time capital improvement projects.

Status: In Progress. *After assigning $9.3 million for potential labor housing complex demolition and site clean-up costs, the projected unassigned General Fund balance at June 30, 2021 is 18% of operating expenditures. Consistent with the City's policy, the goal is to restore reserves to policy levels with the next five years.*

FINANCIAL REPORTING AND BUDGET ADMINISTRATION

A. **Annual Reporting.** The City will prepare annual financial statements as follows:

   1. In accordance with best practices and industry standards, the City will contract for an annual audit by a qualified independent certified public accountant. The City will strive for an unqualified auditors' opinion.

   2. The City will use generally accepted accounting principles in preparing its annual financial statements and will strive to meet the requirements of the GFOA's Award for Excellence in Financial Reporting program.

   3. The City will issue audited financial statements within 180 days after year-end.

B. **Interim Reporting.** The City will prepare and issue timely interim reports on the City's fiscal status to the Council and staff. This includes on-line access to the City's financial management system; monthly reports to program managers; more formal quarterly reports to the Council and Department Heads; mid-year budget reviews; and interim annual reports.

C. **Budget Administration.** The Council may amend or supplement the budget at any time after its adoption by majority vote of the Council members. Council approval is required for all new appropriations from fund balance/working capital. The City Manager has the authority to make administrative adjustments to the budget as long as those changes will not have a significant policy impact nor affect budgeted year-end fund balances.

D. **Agenda Report Review**. A Fiscal Impact Statement will be provided with each staff report submitted to the Council as part of the agenda packet.

Status: In Compliance. *These practices are in place.*

CAPITAL FINANCING AND DEBT MANAGEMENT

A. **Capital Financing**

1. The City will consider the use of debt financing only for one-time capital improvement projects and only under the following circumstances:

    a. When the project's useful life will exceed the term of the financing.
    b. When project revenues or specific resources will be sufficient to service the long-term debt.

2. Debt financing will not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The issuance of short-term instruments such as revenue, tax or bond anticipation notes is excluded from this limitation.

3. Capital improvements will be financed primarily through user fees, service charges, assessments, special taxes or developer agreements when benefits can be specifically attributed to users of the facility. Accordingly, development impact fees should be created and implemented at levels sufficient to ensure that new development pays its fair share of the cost of constructing necessary community facilities.

4. While development impact fees can be a major funding source in financing capital project improvements, revenues from these fees are subject to significant fluctuation based on the rate of new development. Accordingly, the following guidelines will be followed in designing and building projects funded with development impact fees:

    a. The availability of impact fees in funding a specific project will be analyzed on a case-by-case basis as bid specifications or contract awards are submitted for approval.

    b. If adequate funds are not available at that time, the Council will make one of two determinations:

        - Defer the project until funds are available.
        - Based on the high-priority of the project, advance funds from the General Fund or appropriate enterprise fund, which will be reimbursed as soon as funds become available. Repayment of advances should be the first use of development impact fee funds when they become available.

5. The City will use the following criteria to evaluate pay-as-you-go versus long-term financing in funding capital improvements:

    Factors Favoring Pay-As-You-Go Financing

a. Current revenues and adequate fund balances are available or project phasing can be accomplished.

b. Existing debt levels adversely affect the City's credit rating.

c. Market conditions are unstable or present difficulties in marketing.

Factors Favoring Long Term Financing

d. Revenues available for debt service are deemed sufficient and reliable so that long-term financings can be marketed with investment grade credit ratings.

e. The project securing the financing is of the type that will support an investment grade credit rating.

f. Market conditions present favorable interest rates and demand for City financings.

g. A project is mandated by state or federal requirements, and resources are insufficient or unavailable.

h. It is a high-priority that is immediately required to meet or relieve service or capacity needs and current resources are insufficient or unavailable.

B. Budget Integration and Policy Links

The decision to incur new indebtedness should be integrated with the adopted Operating Budget and Capital Improvement Plan (CIP). While CIP projects may surface independently from the budget process, they will typically be an integral of the adopted CIP. Moreover, projects in the CIP typically have strong policy links to the General Plan, Special Plans, adopted facility or infrastructure plans and other policy documents. Annual debt service requirements will be included in the Operating Budget.

C. Sources of Capital Financing

1. ***Cash Funding.*** The City funds a significant portion of its CIP on a “pay-as-you-go” basis. As part of a “pay as you go” strategy, the City will first look for grant funding for capital projects.

2. ***Interfund Borrowing***. The City may borrow internally from other funds with surplus cash instead of issuing bonded debt. The purpose of interfund borrowing is to finance high priority needs and reduce costs of interest, debt issuance and/or administration. Purposes warranting the use of this type of borrowing could include short-term cash flow imbalances due to grant terms, interim financing pending the issuance of bonds or long-term financing in lieu of bonds. The City funds from which the money is borrowed shall be repaid with interest based upon the earning rate of the City’s investment pool. The Finance Director shall also exercise due diligence to ensure that it is financially prudent for the Fund making the loan. Interfund loans will be evaluated on a case-by-case basis. Any borrowing between two City funds which exceeds 24 months requires a repayment schedule approved by the Council.

3. ***Bank Loans, Lines of Credit and Direct Placements***. While not a common method of financing capital projects, financial institution credit or other direct placements may be evaluated on a case-by-case basis where the advantages over other methods are compelling.

4. ***State and Federal Loans.*** The City will evaluate State and Federal loan programs, including but not limited to loans such as the State Water Resources Control Board's revolving fund loans for the construction of water and wastewater infrastructure projects.

5. ***Other Loan Programs***. The City may consider other loan programs on a case-by-case basis where the advantages over other methods are compelling.

6. ***Equipment Lease Purchase Agreements.*** The City may consider lease-purchase agreements for long-lived assets such as backhoes and trash trucks.

7. ***Bond Financing.*** The City may issue any bonds that are allowed under federal and state law, including but not limited to general obligation bonds, certificates of participation, revenue bonds, lease-revenue bonds, assessment district bonds and special tax bonds.

   While conduit financings do not constitute a general obligation of the issuer, the same level of due diligence prior to bond issuance is required as outlined Section F below. The City will consider requests for assessment or special tax district formation on a case-by-case basis as outlined in Section G below.

D. ***Joint Powers Authority (JPA).*** In addition to the long and short-term financing instruments described above, the City may also consider joint arrangements with other governmental agencies when a project serves the public interest beyond City boundaries.

E. **Debt Management**

1. The City will not obligate the General Fund to secure long-term financings except when marketability can be significantly enhanced.

2. An internal feasibility analysis will be prepared for each long-term financing which analyzes the impact on current and future budgets for debt service and operations. This analysis will also address the reliability of revenues to support debt service.

3. The City will generally conduct financings on a competitive basis. However, negotiated financings may be used due to market volatility or the use of an unusual or complex financing or security structure.

4. The City's financing team (such as financial advisor, bond counsel and trustee) will typically be selected through a competitive request for proposal (RFP) process for a multi-year, program-based term in providing ongoing advice and understanding of City needs.

5. The City will seek an investment grade rating (Baa/BBB or greater) on any direct debt and will seek credit enhancements such as letters of credit or insurance when necessary for marketing purposes, availability and cost-effectiveness.

6. The City will monitor all forms of debt annually coincident with the City's Budget preparation and review process and report concerns and remedies, if needed, to the Council.

7. The City will diligently monitor its compliance with bond covenants and ensure its adherence to federal arbitrage regulations.

8. The City will maintain good, ongoing communications with bond rating agencies about its financial condition. The City will follow a policy of full disclosure on every financial report and bond prospectus (Official Statement).

9. In accordance with generally accepted accounting principles and the City internal control procedures, the Finance Director is responsible for ensuring bond proceeds are spent for the intended purposes identified in the bond documents and that the proceeds are spent in the time frames identified in the tax certificate prepared by the City's bond counsel.

10. For any applicable debt issued after January 2017, the City will file annual debt transparency reports with the California Debt and Investments Advisory Commission in accordance State Government Code Section 8855.

F. **Debt Capacity**

1. ***General Purpose Debt Capacity.*** The City will carefully monitor its levels of general-purpose debt. Because the City's general purpose debt capacity is limited, it is important that general purpose debt financing is only used for high-priority projects where the City cannot reasonably use other financing methods for two key reasons:

   a. Funds borrowed for a project today are not available to fund other projects tomorrow.
   b. Funds committed for debt repayment today are not available to fund operations in the future.

   In evaluating debt capacity, general-purpose annual debt service payments should not exceed 10% of General Fund revenues.

2. ***Enterprise Fund Debt Capacity.*** The City will set enterprise fund rates at levels needed to fully cover debt service requirements (including any coverage requirements) as well as operations, maintenance, administration and capital improvement costs. The ability to afford new debt for enterprise operations will be evaluated as an integral part of the City's rate review and setting process.

G. **Land-Based Financings**

1. ***Public Purpose.*** The City will consider formation of land-based financing districts in accordance with the State's assessment law or the Mello-Roos Community Facilities Act. There will be a clearly articulated public purpose in forming an assessment or special tax district in financing public improvements. This should include a finding by the Council as to why this form of financing is preferred over other funding options such as impact fees, reimbursement agreements or direct developer responsibility for the improvements.

2. ***Eligible Improvements.*** Except as otherwise determined by the Council when proceedings for district formation are commenced, preference in financing public improvements through an assessment or special tax district shall be given for those public improvements that help achieve clearly identified community facility and infrastructure goals in accordance with adopted facility

and infrastructure plans as set forth in key policy documents such as the General Plan, Specific Plan, Facility or Infrastructure Master Plans, or Capital Improvement Plan.

Such improvements include study, design, construction and/or acquisition of:

a. Public safety facilities.
b. Water supply, distribution and treatment systems.
c. Waste collection and treatment systems.
d. Major transportation system improvements, such as freeway interchanges; bridges; intersection improvements; construction of new or widened arterial or collector streets (including related landscaping and lighting); sidewalks and other pedestrian paths; transit facilities; and bike paths.
e. Storm drainage, creek protection and flood protection improvements.
f. Parks, trails, community centers and other recreational facilities.
g. Open space.
h. Cultural and social service facilities.
i. Other governmental facilities and improvements such as offices, information technology systems and telecommunication systems.

School facilities will not be financed except under appropriate joint community facilities agreements or joint exercise of powers agreements between the City and school districts.

3. ***Active Role.*** Even though land-based financings may be a limited obligation of the City, the City will play an active role in managing the district. This means that the City will select and retain the financing team, including the financial advisor, bond counsel, trustee, appraiser, disclosure counsel, assessment engineer and underwriter. Any costs incurred by the City in retaining these services will generally be the responsibility of the property owners or developer; will be advanced via a deposit when an application is filed; or will be paid on a contingency fee basis from the proceeds from the bonds.

4. ***Credit Quality.*** When a developer requests district formation, the City will carefully evaluate the applicant's financial plan and ability to carry the project, including the payment of assessments and special taxes during build-out. This may include detailed background, credit and lender checks, and the preparation of independent appraisal reports and market absorption studies. For districts where one property owner accounts for more than 25% of the annual debt service obligation, a letter of credit further securing the financing may be required.

5. ***Reserve Fund.*** A reserve fund should be established in the lesser amount of: the maximum annual debt service; 125% of the annual average debt service; or 10% of the bond proceeds.

6. ***Value-to-Debt Ratios.*** The minimum value-to-date ratio should generally be 4:1. This means the value of the property in the district, with the public improvements, should be at least four times the amount of the assessment or special tax debt. In special circumstances, after conferring and receiving the concurrence of the City's financial advisor and bond counsel that a lower value-to-debt ratio is financially prudent under the circumstances, the City may consider allowing a value-to-debt ratio of 3:1. The Council should make special findings in this case.

7. ***Appraisal Methodology***. Determination of value of property in the district shall be based upon the full cash value as shown on the ad valorem assessment roll or upon an appraisal by an independent Member Appraisal Institute (MAI). The definitions, standards and assumptions to be used for appraisals shall be determined by the City on a case-by-case basis, with input from City consultants and district applicants, and by reference to relevant materials and information promulgated by the State of California, including the Appraisal Standards for Land-Secured Financings prepared by the California Debt and Investment Advisory Commission.

8. ***Capitalized Interest During Construction.*** Decisions to capitalize interest will be made on case-by-case basis, with the intent that if allowed, it should improve the credit quality of the bonds and reduce borrowing costs, benefiting both current and future property owners.

9. ***Maximum Burden.*** Annual assessments (or special taxes in the case of Mello-Roos or similar districts) should generally not exceed 1% of the sales price of the property; and total property taxes, special assessments and special taxes payments collected on the tax roll should generally not exceed 2%.

10. ***Benefit Apportionment.*** Assessments and special taxes will be apportioned according to a formula that is clear, understandable, equitable and reasonably related to the benefit received by—or burden attributed to—each parcel with respect to its financed improvement. Any annual escalation factor should generally not exceed 2%.

11. ***Special Tax District Administration.*** In the case of Mello-Roos or similar special tax districts, the total maximum annual tax should not exceed 110% of annual debt service. The rate and method of apportionment should include a back-up tax in the event of significant changes from the initial development plan and should include procedures for prepayments.

12. ***Foreclosure Covenants.*** In managing administrative costs, the City will establish minimum delinquency amounts per owner, and for the district as a whole, on a case-by-case basis before initiating foreclosure proceedings.

13. ***Impact on the City Bonding Capacity.*** The City will consider the effect of assessments or special taxes on the City's ability to issue bonds or other property-based tax measures.

14. ***Adjustment of Development Impact Fees.*** Assessment and special tax districts can fund public facilities or infrastructure improvements otherwise funded with the City's development impact fees or project-specific exactions. In such cases, the area's development impact fee obligations will be adjusted proportionately.

15. ***Special Tax Consultant.*** As part of special tax district formations, the City will retain a special tax consultant to prepare a report that recommends a special tax rate and method for the proposed district and evaluates the special tax proposed to determine its ability to adequately fund identified public facilities, City administrative costs and services (if applicable) and other related expenditures.

16. ***Disclosure to Bondholders.*** In general, each property owner who accounts for more than 10% of the annual debt service or bonded indebtedness must provide ongoing disclosure information annually as described under SEC Rule 15(c)-12.

17. ***Disclosure to Prospective Purchasers.*** Full disclosure about outstanding balances and annual payments should be made by the seller to prospective buyers at the time that the buyer bids on the property. It should not be deferred to after the buyer has made the decision to purchase. When appropriate, applicants or property owners may be required to provide the City with a disclosure plan.

H. **Conduit Financings**

1. The City will consider requests for conduit financing (use of the City's tax-exempt status by other agencies in issuing their own bonds that do not incur any repayment obligation by the City) on a case-by-case basis using the following criteria:

    a. The City's bond counsel will review the terms of the financing and render an opinion that there will be no liability to the City in issuing the bonds on behalf of the applicant.

    b. There is a clearly articulated public purpose in providing the conduit financing.

    c. The applicant is capable of achieving this public purpose.

2. This means that the review of requests for conduit financing will generally be a two-step process:

    a. First asking the Council if they are interested in considering the request and establishing the ground rules for evaluating it.

    b. And then returning with the results of this evaluation and recommending approval of appropriate financing documents if warranted.

    This two-step approach ensures that the issues are clear for both the City and applicant, and that key policy questions are answered.

3. The workscope necessary to address these issues will vary from request to request, and accordingly will have to be determined on a case-by-case basis. Additionally, the City should generally be fully reimbursed for its costs in evaluating the request; however, this should also be determined on a case-by-case basis.

I. Enhanced Infrastructure Financing District (EIFD)

1. EIFD financing should be considered for public facility or infrastructure improvements that confer Citywide and/or regional benefits. This may include the "City share" of infrastructure included in the City's development impact fees.

2. Unless there is a Development Agreement in place that provides otherwise, EIFDs should not be used to fund real estate projects' proportional share of infrastructure costs otherwise included in the City's development impact fees or charged as project-specific exactions (such as subdivision improvements).

3. City should consider EIFDs when more than one local government jurisdiction is participating to produce maximum benefit.

4. At the time of formation of the EIFD (or if changes to the EIFD are contemplated), the City should require a fiscal impact analysis to determine if an EIFD is fiscally prudent and analyze opportunity cost to the City's General Fund.

J. Refinancings

1. ***General Guidelines.*** Periodic reviews of all outstanding debt will be undertaken to determine refinancing opportunities. Refinancings will be considered (within federal tax law constraints) under the following conditions:

   a. There is a net economic benefit.

   b. It is needed to modernize covenants that are adversely affecting the City's financial position or operations.

   c. The City wants to reduce the principal outstanding in order to achieve future debt service savings, and it has available working capital to do so from other sources.

2. ***Standards for Economic Savings*****.** In general, refinancings for economic savings will be undertaken whenever net present value savings of at least five percent (5%) of the refunded debt can be achieved.

   a. Refinancings that produce net present value savings of less than five percent will be considered on a case-by-case basis, provided that the present value savings are at least three percent (3%) of the refunded debt.

   b. Refinancings with savings of less than three percent (3%), or with negative savings, will not be considered unless there is a compelling public policy objective.

Summary

The City's updated Financial Reserve Policy strives to maintain a minimum General Fund balance reserve equal to 30% of its operating budget.

The City will strive to fund all current expenditures from current revenues, avoiding procedures that balance current budgets by postponing needed expenditures, accruing future revenues or rolling over short-term debt.

One-time funds will not be budgeted or used to pay ongoing operating expenses for the City. Exceptions require City Council approval and a financial plan to get back to covering ongoing expenditures using only ongoing revenues.

Recurring revenue growth will be used to pay for recurring expenditures. Recurring expenditure increases should not be approved which exceed recurring revenue growth. Any new or expanded programs will be required to identify new funding sources and/or offsetting reductions in expenditures.

The Water, Wastewater and Sanitation Enterprise Funds will have revenues (customer charges, interest income and all other income) sufficient to meet all cash operating expenses, capital expenses, prescribed cash reserves and debt service coverage requirements set forth in related bond covenants.

All Internal Service Funds will have revenues (intra-City user charges, interest income and other income) sufficient to meet all cash operating expenses and capital expenses. Such revenues shall also be sufficient to maintain cash reserves.

The City will strive to maintain a minimum working capital balance equal to 90 days of operating requirements for the Water, Wastewater and Sanitation Enterprise Funds operating budgets. In addition, a cash capital improvement reserve will be maintained for capital improvement projects.

The City will maintain a long-range fiscal perspective through the use of an Annual Operating Budget and a five-year Capital Improvement Plan.

Major capital improvement projects will be funded using the most financially prudent method available. Such methods include:

- Traditional long-term financing (bond issues).
- "Pay As You Go" financing (using recurring revenues only).
- Combination of debt financing and "Pay As You Go" financing.
- Using cash accumulated in excess of policy requirements.

A Fiscal Impact Statement will be provided with each staff report submitted to the City Council as part of the City Council agenda process.

The City will comply with all the requirements of "Generally Accepted Accounting Principles."

The City will annually review and adopt a formal set of Debt Policies.

The City will strive to pay competitive market level compensation to its employees.

Investment Policy

It is the policy of the City of Wasco to invest public funds in a prudent manner which will provide maximum security while meeting daily cash flow demands and conforming to all statutes governing the investment of public funds. Within these parameters, funds will be invested to optimize investment return.

The purpose of this document is to set forth the City's policies guiding prudent investment of temporarily idle funds and to establish guidelines and objectives for suitable investments including delegation of authority, prudence, monitoring and reporting, policy review, diversification, eligible securities, safekeeping, collateralization, selection of depositories, brokers/dealers and glossary of terms.

Debt Policy

In recognition of its responsibility for the management of debt obligation for itself and its component units, the City of Wasco will develop a comprehensive set of formal debt policies. Such policies are necessary in order to consolidate information of debt obligations and to maintain good credit standing. These policies will be reviewed annually by the City Treasurer and Finance Director and any changes will be presented to the City Council for approval.

The City of Wasco shall issue bonds primarily to finance capital improvement projects in accordance with set procedures included in the document. In a few instances, the City may be permitted to issue bonds to finance other projects or purposes, including operating expenses. However, such uses must receive City Council approval. For the purpose of this document, the term "bond" shall also include a variety of debt instruments including notes, commercial paper, certificates of participation, etc.

Fund Balance Policy

The City Council adopted a Fund Balance Policy in accordance with the requirements of Governmental Accounting Standards Board Statement No 54. This Policy establishes procedures for reporting fund balance classifications, establishes prudent reserve requirements and establishes a hierarchy of fund balance expenditures. The policy also authorizes and directs the Finance Director to prepare financial reports, which accurately categorize fund balance per GASB Statement No. 54. GASB 54 establishes five components of fund balance, each of which identifies the extent to which the City is bound to honor constraints on the specific purposes for which amounts can be spent as follows: Non-Spendable fund balance, Restricted fund balance, Committed fund balance, Assigned fund balance and Unassigned fund balance.

General Policies

Budgetary emphasis will focus on providing high quality municipal services, recognizing the fundamental importance to the citizens of public safety and properly maintained infrastructure.

The City will strive to fund all current expenditures from current revenues, avoiding procedures that balance current budgets by postponing needed expenditures, accruing future revenues or rolling over short-term debt.

The budget will provide sufficient funding for adequate maintenance and orderly replacement of capital plant and equipment.

Future maintenance needs for all new capital facilities will be fully costed out and added costs will be recognized and included in future year budget projections.

Strong customer service and productivity improvements, with a focus on value added services, remain important budgetary goals.

Budgetary Procedures and Authority

The Finance Department notifies all City Departments when monthly reports are ready for review comparing budget vs. year-to-date actual expenditures for their respective department.

The City established a threshold cost of $5,000 for capitalization of fixed assets. This only applies if the estimated useful life of the asset is more than one (1) year.

The City's Budget Document will include selected performance measures to better describe the workload of the different City programs, to gauge our effectiveness in providing services and to ultimately be able to compare the City's overall performance with other like agencies.

All budgetary procedures will conform to State regulations and Generally Accepted Accounting Principles (GAAP).

Specific levels of budgetary authority will be maintained:

1. Department Heads will be responsible for ensuring that expenditures within departmental budget categories of salaries and benefits; services and supplies and capital outlay do not exceed appropriations. Budget appropriations will be made at the line-item level; however, the level of control (level at which expenditures may not exceed appropriations) will be total departmental appropriations for each of these budget categories (excluding capital outlay).

2. The City Manager will have the authority to transfer up to $50,000 in appropriations between capital projects and between funds for capital projects in order to meet the policy intent of the City Council.

3. City Council approval will be required to transfer appropriations between departments.

4. Contract change orders may be administratively approved by the City Manager up to an aggregate amount of $25,000 subject to terms and conditions approved by the City Council. Any amount greater than $25,000 or exceeding the aggregate amount requires City Council approval.

Revenue Policies

A diversified and stable revenue system will be maintained to shelter the City from short-run fluctuations in any single revenue source.

The City will estimate revenues using an objective, analytical process; in the case of assumption uncertainty, conservative projections will be utilized. Revenues will be projected for the current year and reviewed semi-annually.

Intergovernmental assistance in the form of grants and loans will be used to finance only:

1. Capital improvements that are consistent with the Five-Year Capital Plan priorities and can be maintained and operated over time; or

2. Technological upgrades or enhancements; or

3. Capital acquisition items; or

4. Operating programs which either can be sustained over time or have a limited horizon.

5. Other areas as determined by the City Council to be in the best interest of the City.

One-time revenues will be used for operating programs only after an examination determines whether they are subsidizing an imbalance between operating revenues and expenditures and only if a long-term forecast shows that the operating deficit will not continue. In general, one-time revenues will be used only to support capital or other non-recurring expenditures.

All fees and charges for each enterprise fund (i.e., Water, Wastewater and Sanitation) will be set at a level that fully supports the direct and indirect cost of the enterprise.

Reserve Policy

Funding of reserves will come generally from one-time revenues, excess fund balance and projected revenues in excess of projected expenditures. They will generally be reserved based on the City Financial Reserve Policy in the following priority order:

1.Reserve for Economic Contingency or Emergencies.
2.Special Purpose Designated Reserves.

However, flexibility will be retained to allocate available funds among the reserves based on the current circumstances and needs of the City's various operating funds.

Attachment 2

If it becomes necessary to utilize reserve funds for unique one-time costs, emergencies or maintaining City services during periods of reductions, appropriations should, when feasible, be accompanied by a plan for the replenishment within a reasonable period of time.

The City's enterprise funds shall maintain working capital equal to at least 90 days of operating requirements for the Water, Wastewater and Sanitation operating budgets. This will be evaluated as of June 30th of each fiscal year end.

The City's internal service funds shall maintain working capital of at least 60 days of operating requirements. This will be evaluated as of June 30th of each fiscal year end.

The City's general fund shall maintain a fund balance equal to 30% of the total expenditures appropriated for the following fiscal year. This will be evaluated and measured as of June 30th of each fiscal year end.

GFOA Fund Balance Assessment Methodology

OVERVIEW

The recommended policy sets the target minimum unassigned General Fund balance at 35% of operating and debt service expenditures. This is based on the structured assessment methodology for setting reserve levels developed by the Government Finance Officers Association of the United Sate and Canada (GFOA) in considering a city's exposure to the following eight fiscal risk factors:

- Vulnerability to extreme events and public safety concerns
- Revenue source stability
- Expenditure volatility
- Leverage, such as unfunded pensions and asset maintenance
- Liquidity (cash flow)
- Dependence of other funds on the General Fund
- Growth: revenue and expenditure imbalance
- Unfunded high priority capital projects

Depending on the results of this assessment, the GFOA methodology provides recommended targets ranging from a minimum of 16.6% of expenditures (60 days cash flow) to circumstances where more than 35% might be warranted. Based on the City's circumstances, the GFOA's structured methodology recommends a target of 26% to 35%. Based on a "rating" at the end of the of the scale, the assessment supports a target of 35% of operating expenditures.

PRUDENT RESERVES REFLECT ABILITY TO MANAGE RISK
Not Fiscal Strength Per Se

Reserves – whether large or small – do not per se reflect on a city's financial capacity or underlying fiscal strength. There are much better indicators than reserves for this, most notably the ability over time for ongoing revenues to adequately meet day-to-day service needs, capital improvement goals and debt service requirements.

Stated simply, reserves are a risk management tool: how much can things go differently than the organization otherwise thought they would before it must take corrective action? Reserves can also serve as a bridge to the future, providing time to develop and implement thoughtful solutions.

Typical risks that reserves help mitigate include economic uncertainties, such as downturns in the economy and external revenue hits (like State takeaways); responding to local disasters; contingencies for unforeseen operating or capital needs; strategic opportunities; and cash flow.

What's the Right Amount? It depends on each agency's unique fiscal circumstances and capacity for risk. In answering this question, the GFOA has developed structured assessment approach.

GFOA ASSESSMENT METHODOLOGY

The GFOA's methodology for setting reserve levels in considers an agency's exposure to the following eight fiscal risk factors:

1. ***Vulnerability to Extreme Events and Public Safety Concerns.*** Major extreme events the community could reasonably be subject to and the likelihood and potential magnitude of loss for each event.

2. ***Revenue Source Stability.*** Volatility of each major revenue source based on factors such as past experience and trends with that revenue, characteristics of the tax or rate payers, state or federal revenue takeaways and economic factors.

3. ***Expenditure Volatility.*** Spikes in expenditures, usually arising from special, non-recurring circumstances such as lawsuits; critical special projects without a funding source; or new state or federal spending requirements and unfunded mandates.

4. ***Leverage.*** Common examples include unfunded pensions and unfunded asset, as well as outstanding bonded indebtedness and compensated absences. Is the source of leverage very large? Does it have an off-setting funding source or asset?

5. ***Liquidity (Cash Flow).*** Intra-period cash imbalances, such as property taxes that are only received at two major points during the year (December and June).

6. ***Dependence of Other funds.*** Are there other funds that have a significant dependence on the General Fund?

7. ***Growth.*** Is significant growth a realistic possibility in the next three to five years? This includes assessing likely potential marginal costs associated with serving new growth compared with marginal revenues and resulting gaps.

8. ***Capital Projects.*** Are there high priority projects without a funding source, where reserves may be looked to as a funding source?

The methodology uses a scale of 5-1 in assessing how important reserves are in mitigating each risk:

5: Very important
4: Important
3: Neutral
2: Unimportant
1: Very unimportant

Since there are eight mitigation factors, total scores will range from 8 (the least risk) to 40 points (greatest risk). Along with these eight risk factors, the methodology also considers:

GFOA Fund Balance Assessment Methodology

- City size (assumes larger cities have more mitigation strategies than smaller ones)
- Other reserve/contingency funds
- Borrowing capacity

Depending on the results of this assessment, the GFOA methodology provides recommended targets ranging from a minimum of 16.6% of expenditures (60 days cash flow) to circumstances where more than 35% might be warranted.

The following summarizes the GFOA's rating scale.

GFOA Reserve Rating Scale

Rating	Target Minimum General Fund Reserve
8 -16	Minimal risk to retain through reserves. Consider target equal to the GFOA minimum recommended reserve of 16.6% (two months cash flow) of revenues/expenditures.
17-24	Low to moderate level of risk to retain through reserves. Consider reserve target of 17% to 25%.
25-31	Moderate to high level of risk to retain through reserves. Consider reserve target of 26% to 35%.
32-40	High level of risk to retain through reserves. Consider reserve target greater than 35%.

As detailed in Attachment 3.2, the City's rating under this methodology is 30, which indicates that the target minimum should be at the top of this range (35%).

Two factors intuitively support this assessment: recent experience with the pandemic; and the results of a high-level cash flow analysis that shows two peak cash flow shortfalls of 15% in November and 20% in May prior to the recent of property tax revenues (Attachment 4). Setting the reserve at 35% provides greater flexibility in meeting cash flow needs and other contingencies.

GFOA Fund Balance Assessment Methodology

ACCOUNTING FOR THE RESERVE

As noted in side bar, under generally accepted accounting policies, General Fund balances are classified into the following categories:

- Non-spendable
- Restricted
- Unrestricted
  - Committed
  - Assigned
  - Unassigned

The policy sets the reserve target based on the unassigned General Fund balance: net of non-spendable, restricted, committed or assigned balances.

This intuitively makes sense: non-spendable and externally restricted funds are not readily available to meet the risks that the reserve is intended to mitigate. (This is also the recommended approach by the GFOA in its publication *Financial Policies*). It should also be net of other commitments or assignments, so it is available to meet its intended purposes.

Based on the unassigned fund balance, two things can be readily determined from audited financial statements after calculating the policy target based on actual operating expenditures:

- Whether the City has achieved its policy goal.

- And the amount (if any) that reserves (unassigned fund balance) exceed or are less than the policy goal.

General Fund Balance Classifications

Under generally accepted accounting principles set by the Government Accounting Standards Board (GASB) in Statement No. 54, General Fund balance is classified into five components:

- ***Non-Spendable.*** Amounts that are not in spendable form, such prepaid items or inventories.

- ***Restricted.*** Amounts subject to *externally* enforceable restrictions imposed by outside third parties.

- ***Committed.*** Amounts whose use is constrained internally by the agency itself for specific purposes set by the governing body.

- ***Assigned.*** Amounts intended for specific purposes as determined by the governing body or others it has formally designated.

- ***Unassigned.*** Residual classification of spendable amounts available for other purposes.

Vulnerability to Extreme Events

1. Identify Risks

What extreme events are you at risk for?

A	Fire
B	Flood
C	Drought
D	Earthquake
E	Pandemic

2. Assess Risks

What is your vulnerability to each extreme event, given past experience?

A	Moderate
B	Moderate
C	High
D	Low probability; depending on epicenter, losses could be significant
E	Low, but high impact

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk (i.e., manage it without reserves)

A	FEMA reimbursement
B	FEMA reimbursement
C	State drought relief, possible FEMA reimbursement
D	FEMA reimbursement
E	Federal Funds possible, such as CARES, ARPA

Note: While significant reimbursements from FEMA are likely, it is also likely that there will be significant lags between when recovery costs are incurred and when payments will be received. Lastly, based on experiences in other cities, even under the best of circumstances, it is unlikely that the City will be reimbursed for all recovery costs. And even where costs are largely recovered, there is no reimbursement for lost revenues - like sales tax and TOT - during the disaster and recovery period.

4. Considering the above, how important for you is it to retain the risks of extreme events through reserves ?

4 < Enter your score here

5 **Very important.** We are subject to extreme events of severe potential magnitude which would require a quick and decisive response from our government. There are few alternative risk management approaches.

4 **Important.** We are subject to extreme events of severe potential magnitude, but our government does not have an important disaster response role and/or we have other risk management alternatives.

3 **Neutral.** We do not face an unusually high or low level of risk from extreme events.

2 **Unimportant.** We are subject to one or two types of significant extreme events and we have other risk management options.

1 **Very unimportant.** We are subject to very few, if any, potential extreme events of significant potential damage

Revenue Source Stability

1. Identify Risks

What are your major revenue sources?

A	Property Tax (26%)
B	Sales Tax (25%)
C	Internal Service Charges/Transfers (25%)
D	Permits/Service Charges (4%)
E	State Takeaways (Always a Threat)

Note: Top 3 revenues account for about 75% of total

2. Assess Risks

How stable are your revenue sources?

A	Historically stable but downturn in "Great Recession"
B	Subject to significant swings with economy
C	Stable
D	Subject to swings based development activity
E	
F	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk (i.e., manage it without reserves)

Limited in all cases

4. Considering the above, how important for you is it to retain the risks of revenue instability through reserves ?

4 < Enter your score here

5 **Very important.** We rely on just one or two sources of revenue, and they are unstable

4 **Important.** We rely on unstable sources for a significant portion of our revenue and/or have particular unstable payers as part of our tax base (e.g., sales tax from an industry with volatile sales)

3 **Neutral.** We do not face an unusually high or low level of risk from revenue instability

2 **Unimportant.** While some portion of our revenue base has instability, the majority of revenues are pretty stable.

1 **Very unimportant.** Our revenues are very stable and diverse.

Expenditure Volatility

1. Identify Risks

What are sources of potential expenditure spikes?

A	Increased pension costs
B	Unexpected infrastructure repairs
C	State/federal mandates

2. Assess Risks

What is the potential cost of these spikes?

A	Based on CalPERS investment losses and approved funding methodology changes, very high
B	Unknown
C	Moderate

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of these potential spikes? (i.e., manage it without reserves)

A	Need to address on ongoing basis
B	Unknown
C	Limited (legislative advocacy)

4. Considering the above, how important for you is it to retain the risks of expenditure spikes through reserves ?

5 < Enter your score here

5	**Very important.** There are expenditure spikes with very high potential to open a significant hole in our budget.
4	**Important.** We are subject to important potential expenditure spikes, such that we need reserves but we also have other risk mitigation approaches available.
3	**Neutral.** We do not face an unusually high or low level of risk from expenditure spikes
2	**Unimportant.** There are one or a few potential spikes but the risk of them occurring is low, the impact not great and/or we have other risk management options.
1	**Very unimportant.** We have no important risk from expenditure spikes.

Leverage

1. Identify Risks

What are major sources of leverage you are subject to?

A	Pension liabilities
B	
C	
D	

2. Assess Risks

What are the implications of leverage for the organization's financial flexibility?

A	Higher future costs
B	
C	
D	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of leverage? (i.e., manage it without reserves)

A	Need to address these higher cost on an ongoing basis: reserves not an appropriate source of funding
B	
C	
D	

4. Considering the above, how important for you is it to retain the risks of leverage through reserves ?

3	< Enter your score here
5	**Very important.** We are subject to significant leverage and have no other risk management approach
4	**Important.** We are subject to significant leverage and do not have equally significant offsetting risk management approaches.
3	**Neutral.** We do not face an unusually high or low level of risk from leverage
2	**Unimportant.** We have one or two sources of leverage, but these are largely addressed with other risk management strategies.
1	**Very unimportant.** We have no important sources of leverage that aren't already managed with out reserves.

Liquidity

1. Identify Risks

What are your major sources of potential intra-period cash imbalances?

A	Property tax collections in December and June (26% of revenues): see cash flow worksheet
B	Gas and electric franchise payments in April
C	
D	

2. Assess Risks

How likely are these risks to occur and what is their potential magnitude?

A	Ongoing
B	Ongoing
C	
D	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of liquidity? (i.e., manage it without reserves)

A	Tax/revenue anticipation notes - but results in added interest costs
B	Borrow from other funds - but adds "leverage" to them
C	

4. Considering the above, how important for you is it to retain the risks of liquidity spikes through reserves ?

5 < Enter your score here

5 **Very important.** We have very important potential intra-period imbalances with few risk management alternatives.

4 **Important.** We have important potential intra-period imbalances, but do have some off-setting risk management alternatives.

3 **Neutral.** We do not face an unusually high or low level of risk from intra-period cash imbalances.

2 **Unimportant.** We have some minor potential intra-period cash imbalances.

1 **Very unimportant.** Our cash flows are very stable.

Other Funds Dependency

1. Identify Risks

What other funds rely on the general fund for an important part of their funding?

A	Very limited
B	
C	

2. Assess Risks

How likely is it that these funds will need the general fund to "backstop" them in an emergency?

A	
B	
C	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of other funds' dependency? (i.e., manage it without reserves)

A	
B	
C	

4. Considering the above, how important for you is it to retain the risks of other fund dependency through reserves ?

2 < Enter your score here

5 **Very important.** A number of funds rely on the general fund for backstopping, with few, if any, risk management alternatives.

4 **Important.** We have at least some funds that rely on the general fund and this includes reliance for backstopping.

3 **Neutral.** We do not face an unusually high or low level of risk from other fund dependency.

2 **Unimportant.** There are a small number of funds that rely on the general fund, and the potential for the general fund to need to backstop them is small.

1 **Very unimportant.** No other funds rely on the general fund for backstopping.

Growth

1. Identify Risks

What are potential major sources of growth in the next three to five years?

A Limited new development opportunities

2. Assess Risks

What is the potential for these sources of growth to cause imbalances in the revenue received from the growth and the expenditures needed to serve it?

A Limited

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of growth? (i.e., manage it without reserves)

A Limited, if significant growth does occur

4. Considering the above, how important for you is it to retain the risks of growth through reserves ?

2 < Enter your score here

5 **Very important.** We expect significant growth with imbalances in the timing of revenues and expenditures

4 **Important.** We have some growth that will cause imbalances in the timing of revenues and expenditures.

3 **Neutral.** We do not face an unusually high or low level of risk from growth

2 **Unimportant.** We have a small potential for future growth and/or only minor potential imbalances in the timing between revenues and expenditures.

1 **Very unimportant.** We expect no growth or growth will fully pay for itself as expenditures are incurred.

Population as of January 1: Last Ten Years

2017	15,498
2016	15,388
2015	15,364
2014	15,298
2013	15,245
2012	15,195
2011	15,122
2010	15,053
2009	14,935
2008	14,874
2007	14,879

Source: State of California, Department of Finance, Demographic Research Unit
http://www.dof.ca.gov/Forecasting/Demographics/Estimates/

Capital Projects

1. Identify Risks

What high priority capital projects don't have a funding source?

A	The City has a significantly underfunded CIP
B	
C	

2. Assess Risks

What is the likelihood that reserves will be looked to as a funding source for the project?

A	Likely
B	
C	

3. Identify other risk mitigation approaches

What options do you have to avoid, reduce, or transfer the risk of capital projects using reserves as a funding source? (i.e., manage it without reserves)

A	Not applicable
B	
C	

4. Considering the above, how important for you is it to retain the risks of unfunded capital projects through reserves ?

5	< Enter your score here
5	**Very important.** There are very high profile projects with out a funding source and reserves are likely to be considered as a funding source.
4	**Important.** There are at least some high profile projects where reserves may be called upon to provide at least some of the funding.
3	**Neutral.** We do not face an unusually high or low level of risk from unfunded high-priority projects
2	**Unimportant.** High priority capital projects will probably have funding sources, if they don't already.
1	**Very unimportant.** All high priority capital projects have funding sources.

Guiding Your Selection of a Fund Balance Target

Step 1. Determine your total score from the risk factors

30	Your total score from the risk factors (calculated if you entered a score in other sheets)

Step 2. Preliminary Analysis

Compare your score from Step 1 to the guidelines below.

Your Score	*Analytical Guidance*
8 - 16	You face minimal risk to retain through reserves. Consider a target equal to the GFOA minimum recommended reserve of 16.6% of revenues/expenditures.
17-24	You face a low to moderate level of risk to retain through reserves. Consider adopting a reserve target somewhat higher than the GFOA minimum (e.g. 17-25% of revenues/expenditures). Since risk is low, do not invest excessive analytical effort in determining an exact target amount. Consider a short, informal benchmarking study with peer agencies to provide guidance.
25-31	You face a moderate to high level of risk to retain through reserves. Consider adopting a target amount of reserves significantly higher than the GFOA recommended minimum (e.g., 26 - 35%). Consider a short, informal benchmarking survey as a starting point, but then analyze your most significant risk factors to make sure they are adequately covered by what the survey suggests is reasonable.
32 - 40	You face a high level of risk to retain through reserves. Consider adopting a much higher target than the GFOA minimum (e.g., greater than 35%). Consider performing a more in-depth analysis of the risks you face to arrive at target level of reserved that provides sufficient coverage.

Step 3. Consider Impact of Government Size, Budget Practices, & Borrowing Capacity

For each driver pick which description best fits you and enter the appropriate number of points.

2	**Government Size**
+2	We are under 50,000 in population
0	We are between 50,000 and 300,000 in population
-4	We are over 300,000 in population

0	**Budget Practices**
-3	The budget has a formal contingency beyond what is being considered for this reserve.
-2	The budget has informal contingencies beyond what is being considered for the reserve.
0	The budget is lean and has no contingencies in it.

-2	**Borrowing Capacity**
-3	We have excellent external and internal borrowing capacity, including a good rating, little existing debt, and political will to use it.
-2	We have some external and/or internal borrowing capacity and political will could be mobilized to use it.
0	We have little or no borrowing capacity.

Step 4. Consider Impact of Commitments/Assignments, Outsider Perceptions & Political Support

Place an "X" next to each statement that applies to you.

Commitments and Assignments

x	We have commitments or assignments that designate fund balance for uses other than retaining the types of risk described in this analysis. If so, these commitments/assignments should not be included in the total reserve used to reach your target.

Outsider Perceptions

	Rating agencies have given us a target level of reserve for getting a good rating. If so, use that target in place of or in addition to a benchmarking survey to provide guidance on starting point for your target.
	The public is likely to question reserve levels as too high. If so, be sure to document your analysis findings in the other sheets.

Political Support

	The governing board places great weight on the policies of comparable jurisdictions. If so, conduct a benchmarking survey that includes governments the board perceives as relevant.
	The board places great weight on rating agency recommendations. If so, tie the reserve target recommendation to rating agency recommendations or standards.
	The board places great weight on GFOA recommendations. If so, use this analysis and GFOA's Best Practices to support your recommendation.

Step 5. Putting it All Together

A. Consider your adjusted risk score and re-consult the analytical guidance.

30	< Your adjusted risk score (risk score modified with results from Step 3)

B. Review results of Step 4.

Review each item you checked from Step 4 and add the advice to your analytical guidance.

C. Proceed with finalizing target

Proceed with setting a final reserve target based on analytical guidance.

City of Wasco General Fund Cash Flow: 2020-21 Mid-Year Revised

Attachment 4

	Total	% Total	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
REVENUES/SOURCES														
Property Tax: General	975,000	6%						487,500						487,500
Property Tax: VLF	3,151,359	20%						1,575,680						1,575,680
Sales Tax: General	1,588,000	10%	132,333	132,333	132,333	132,333	132,333	132,333	132,333	132,333	132,333	132,333	132,333	132,333
Sales Tax: Measure X	2,360,000	15%	196,667	196,667	196,667	196,667	196,667	196,667	196,667	196,667	196,667	196,667	196,667	196,667
Franchise Fees	350,000	2%										350,000		
TOT	74,451	0%	18,613			18,613			18,613			18,613		
Business License Tax	75,000	0%	6,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250	6,250
Permit/Service Charges	666,500	4%	55,542	55,542	55,542	55,542	55,542	55,542	55,542	55,542	55,542	55,542	55,542	55,542
G&A Allocations	1,514,727	9%	126,227	126,227	126,227	126,227	126,227	126,227	126,227	126,227	126,227	126,227	126,227	126,227
Grants	2,568,600	16%	214,050	214,050	214,050	214,050	214,050	214,050	214,050	214,050	214,050	214,050	214,050	214,050
Other Sources (Uses)	2,518,685	16%	209,890	209,890	209,890	209,890	209,890	209,890	209,890	209,890	209,890	209,890	209,890	209,890
Other Revenues	140,610	1%	11,718	11,718	11,718	11,718	11,718	11,718	11,718	11,718	11,718	11,718	11,718	11,718
Total Revenues/Sources	15,982,932	100%	971,290	952,677	952,677	971,290	952,677	3,015,856	971,290	952,677	952,677	1,321,290	952,677	3,015,856
ANNUALCOSTS														
Operating	10,803,905	59%	900,325	900,325	900,325	900,325	900,325	900,325	900,325	900,325	900,325	900,325	900,325	900,325
Capital	7,405,563	41%	617,130	617,130	617,130	617,130	617,130	617,130	617,130	617,130	617,130	617,130	617,130	617,130
Total Costs	18,209,468	100%	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456	1,517,456
NET SOURCES	(2,226,536)	-	(546,166)	(564,779)	(564,779)	(546,166)	(564,779)	1,498,401	(546,166)	(564,779)	(564,779)	(196,166)	(564,779)	1,498,401
Cummulative Net	(2,226,536)		(546,166)	(1,110,945)	(1,675,724)	(2,221,890)	(2,786,669)	(1,288,268)	(1,834,434)	(2,399,213)	(2,963,992)	(3,160,158)	(3,724,937)	(2,226,536)
% OF ANNUAL COSTS			**-3%**	**-6%**	**-9%**	**-12%**	**-15%**	**-7%**	**-10%**	**-13%**	**-16%**	**-17%**	**-20%**	**-12%**