



Office of the City Manager

## ACTION CALENDAR

November 29, 2016

To: Honorable Mayor and Members of the City Council

From: *DWR* Dee Williams-Ridley, City Manager

Submitted by: Jovan Grogan, Deputy City Manager  
Teresa Berkeley-Simmons, Budget Manager

Subject: General Fund Reserve Policy

### RECOMMENDATION

Adopt a Resolution to amend the General Fund Reserve Policy. The purpose of the policy is to establish a minimal general fund reserve level, designate specific portions of the reserve for stabilization and catastrophic purposes, and define the use, funding and replenishment guidelines of the funds.

### SUMMARY

A general fund reserve, or “rainy day fund,” ensures a government’s ability to maintain vital services to the community during times of economic uncertainty, which can avoid the need to increase taxes and fees for temporary economic shortfalls. For local governments across the nation, the need to maintain a healthy general fund reserve gained greater immediacy in the aftermath of the Great Recession and the municipal bankruptcies that followed.

The City of Berkeley is committed to achieving long-term fiscal stability as well as mitigating the negative impacts of extraordinary risk such as earthquakes, fires, floods, and economic volatility. Establishing an adequate reserve policy will allow the City to mitigate current and future financial risks resulting from economic instability or catastrophic loss.

This report responds to the City Auditor’s recommendations that appeared in the February 2016 audit report entitled “General Fund Reserve Policy Fails to Convey that Maintaining the Reserve is a Priority.” Staff recommends amendments to the reserve policy that: (1) create a minimum General Fund reserve level of 16.7 percent of baseline expenditures, with a goal of reaching 30 percent over time; (2) criteria for how reserve funds are to be allocated and replenished; and (3) a plan for gradually building the reserve level to 30 percent of baseline expenditures so that the City maintains both a Stability reserve (to buttress the effect of routine downturns in the economy) and a Catastrophic reserve (for major emergencies).

## CURRENT SITUATION

One of the key attributes of a financially stable organization is appropriate reserves. Adequate reserves position an organization to weather significant economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, and other catastrophic events. In concert with the City's other financial policies, the City's General Fund Reserve Policy serves as an important tool to guide the use of City resources in meeting the City's financial commitments and provides a framework for addressing unexpected future events in a fiscally responsible manner.

Currently, the City of Berkeley has a General Fund Reserve Policy that is set at 8 percent of General Fund revenues. Although an 8 percent reserve would fund City operations for about 30 days, it is less than half the minimum 16.7 percent reserve level that is recommended by the Government Finance Officers Association (GFOA).

On February 23, 2016, the City Auditor conducted an audit of the City's General Fund reserve policy and issued a report titled "[General Fund Reserve Policy Fails to Convey that Maintaining the Reserve is a Priority](#)"<sup>1</sup> The purpose of the audit was to answer the question: Is the City's General Fund Reserve Policy in line with best practices and what is needed to ensure the General Fund Reserve will allow the City to mitigate current and future financial risks? The City Auditor determined that Berkeley's General Fund Reserve Policy lacks all of the core elements recommended by the GFOA. Included in the City Auditor's report were the following recommendations:

- Amend the General Fund Reserve Policy to align it with best practices. This includes increasing the level to *at least a minimum* of 16.7 percent, designating specific portions of the reserve for contingency and stabilization purposes, and defining the use and replenishment of the funds.
- Perform a risk assessment to determine the appropriate General Fund Reserve balance.

Staff agrees with the Auditor's assessment and through this report, staff presents a revised General Fund Reserve Policy that aligns with the Auditor's recommendations.

In order to determine the appropriate target General Fund Reserve level for the City of Berkeley, staff conducted a risk assessment. Based on the outcome of risk assessment, it was determined that the appropriate reserve level for the City is 30 percent of the Adopted General Fund revenues. The risk assessment is summarized below.

---

<sup>1</sup> [http://www.cityofberkeley.info/uploadedFiles/Auditor/Level\\_3\\_-\\_General/A.2\\_RPT\\_General%20Fund%20Reserves\\_Fiscal%20Year%202016\(1\).pdf](http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_General%20Fund%20Reserves_Fiscal%20Year%202016(1).pdf)

**Risk Assessment**

In addition to recommending a *minimum* of 16.7 percent General Fund Reserve level, the Government Finance Officers Association (GFOA) also states that “a government’s particular situation often may require a level of unrestricted fund balance in the General Fund significantly in excess of this recommended minimum level.” Risk factors that may necessitate a higher reserve level may be vulnerability to natural disasters, dependency on volatile revenue sources, or being subject to cuts in state aid and/or federal grants, as well as other factors.

As recommended by the City Auditor, to determine the appropriate level for the City of Berkeley’s General Fund Reserve, staff used GFOA’s step-by-step guide to analyze the following risk factors:

- Vulnerability to Extreme Events and Public Safety Concerns
- Revenue Source Stability
- Expenditure Volatility
- Leverage
- Liquidity
- Dependency of Other Funds on the General Fund
- Growth
- Capital Projects

The findings for each risk factor is provided below. Each risk factor is given a rating of 1 through 5:

- 5 – Very Important (significant financial risk)
- 4 – Important
- 3 – Neutral (negligible financial risk)
- 2 – Unimportant
- 1 – Very unimportant (little/no financial risk)

The risk assessment was led by the City’s budget staff and included participation from various City departments, including Public Works, Police, Fire, and Finance.

The GFOA Risk Assessment resulted in a score of **27** for the City. According to GFOA, this rating means that the City faces a moderate to high level of risk to retain through reserves. The following table presents a summary of the City’s risk assessment ratings.

## Summary of Berkeley's GFOA Risk Assessment Ratings

Risk Factor	Finding	Rating
Vulnerability to Extreme Events and Public Safety Concerns	Very Important	5
Revenue Source Stability	Neutral	3
Expenditure Volatility	Important	4
Leverage	Neutral	3
Liquidity	Neutral	3
Dependency of Other Funds on the General Fund	Important	4
Growth	Important	4
Capital Projects	Important	4
<b>Sub-total</b>		<b>30</b>
<i>Adjustment for borrowing capacity*</i>		<i>(3)</i>
<b>Final Total**</b>		<b>27</b>
<i>*The City has excellent external and internal borrowing capacity, including a good rating, little existing debt, and political will to use it.</i>		
<i>**A score between 25-31 indicates that an agency faces 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%).</i>		

Additional detail on the Risk Assessment can be found in Attachment 1.

With a GFOA Risk Assessment score of 27, the City is facing a moderate to high level of risk to retain through reserves. It is recommended that the City adopt a target amount of reserves significantly higher than the GFOA recommended minimum of 16.7 percent. Staff recommends a General Fund Reserve policy that states that the City will maintain a minimum General Fund reserve level of 16.7 percent of adopted General Fund Revenues, with a goal of reaching 30 percent over time. This reflects the City of Berkeley's unique profile –both financial and environmental. Further, achieving a 30 percent reserve level will allow the City to maintain both a Stability reserve (to buttress the effect of routine downturns in the economy) and a Catastrophic reserve (for major emergencies). The Risk Assessment will be updated every five years to determine if the reserve level should be increased or lowered (to no less than the minimum level).

Having a stronger reserve balance will allow the City to continue to maintain operations and provide programs and services in the event of a financial crisis or a significant economic downturn.

### Types of Reserves: Stability and Catastrophic

In addition to determining the appropriate reserve levels, GFOA recommends defining the specific purposes for the reserve fund, describing the circumstances under which funds could be used, and assigning a portion of the reserve balance to those respective

purposes. At a minimum, this should include a stabilization reserve and a catastrophic reserve. The proposed Reserve Policy (Attachment 2 Exhibit A) includes specific set asides for stabilization and catastrophic events, as defined below.

A *Stability Reserve* will be maintained to mitigate loss of service delivery and financial risks associated with unexpected revenue shortfalls during a single fiscal year or a prolonged recessionary period. The purpose of this reserve is to provide fiscal stability and not serve as a funding source for new programs or projects. Recommendations to appropriate from this reserve will require approval by a **two-thirds** vote of the City Council.

A *Catastrophic Reserve* will be maintained for the purpose of sustaining General Fund operations in the case of a public emergency such as a natural disaster or other unforeseen catastrophic event. The reserve will be used to respond to extreme, one-time events, such as earthquakes, fires, floods, civil unrest, and terrorist attacks. The Catastrophic Reserve will not be accessed to meet operation shortfalls or to fund new programs or personnel. This reserve will be restricted and only expended in the event such expenditures are necessary to ensure the safety of the City's residents and their property. Funds in this reserve may only be expended by a **two-thirds** vote of the City Council.

Staff is proposing that the 30 percent reserve level be allocated as follows:

- 16.7 percent to the Stability Reserve, and
- 13.3 percent to the Catastrophic Reserve

### **General Fund Monies Not Included in the Reserve**

In the February 23, 2016 report<sup>2</sup>, the City Auditor stated that there was a lack of transparency in the way the General Fund Reserve was presented. The City Auditor recommended that the City “clarify that the general fund reserve is distinctly separate from the general fund balance.”

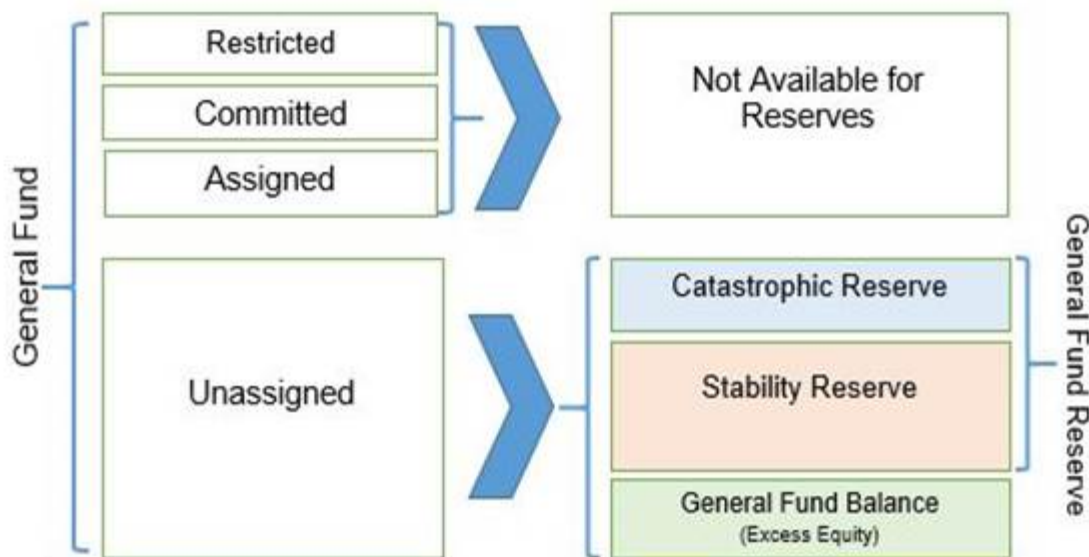
As such, the recommended Reserve Policy states that excess equity (which is also called the “General Fund Balance”) is spendable, along with unrestricted General Fund Balance that is not otherwise assigned, committed, or part of the General Fund Reserves. Excess equity is most commonly a non-recurring source of revenue. Excess equity will be appropriated primarily for unanticipated circumstances, such as a General Fund revenue shortfall affecting programs included in the current year budget or for one-time priority expenditures. Excess equity should be reported separately from the General Fund Reserves; however, excess equity could be used to support funding the Reserves and assist the City in meeting its 30 percent General Fund Reserves target level.

---

<sup>2</sup> [http://www.cityofberkeley.info/uploadedFiles/Auditor/Level\\_3\\_-\\_General/A.2\\_RPT\\_General%20Fund%20Reserves\\_Fiscal%20Year%202016\(1\).pdf](http://www.cityofberkeley.info/uploadedFiles/Auditor/Level_3_-_General/A.2_RPT_General%20Fund%20Reserves_Fiscal%20Year%202016(1).pdf)

This is not intended to supersede other fiscal policies that the Council adopts with the biennial budgets; therefore, not included in the General Fund Reserve are restricted, committed, or assigned funds, which are funds set aside for a specific purpose. For example, money set aside for planned projects, such as unfunded liabilities, infrastructure and technological investments should be distinctly separate from the General Fund Reserves. In addition, the General Fund Reserves should not be used for ongoing or new programs or services.

Total General Fund Reserves will be based on, and reconciled to, the General Fund balance. The following graphic shows the relation between these funds as well as other restricted, committed, and assigned General Fund monies.



- The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- The committed fund balance classification includes amounts that can be used only for the specific purposes determined by the City Council.
- Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed.
- Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications.

At the close of the last fiscal year (FY 2016), the total balance of both the General Fund Reserve and the Fund Balance in the General Fund was \$22.6 million. This combined balance reflects 13.8 percent of adopted General Fund revenues.<sup>3</sup> Staff recommends that the current balance of \$22.6 million be allocated to the Stability and Catastrophic Reserve funds as shown in the following table. This allocation is based on a weighed percentage of the \$22.6 million, relative to the targeted percentage goals of 16.7 percent for the Stability Reserve and 13.3 percent for the Catastrophic Reserve. No money is allocated to Excess Equity, because Council is being asked to allocate Excess Equity from FY 2016 through the First Amendment to the FY 2017 Annual Appropriations Ordinance on tonight's agenda. As such, those funds are not included in the \$22.6 million of available funds.

Category	Recommended Target <i>(% of GF Revenues)</i>	June 30, 2016 Balance	
		Amount	Percentage <i>(% of GF Revenues)</i>
General Fund Reserve			
Stability Reserve	16.7%	\$12.6 M	6.1%
Catastrophic Reserve	13.3%	\$10.0 M	7.7%
	30.0%	\$22.6 M	13.8%
General Fund Balance (Excess Equity)			
GF Fund Balance	n/a	\$0 M	0%

### Methodology to Reach the Recommended Reserve Level

Attaining the recommended 30 percent reserve level is important to the long-term financial health and stability of the City. In addition, it must also be recognized that reaching a 30 percent reserve level will not occur overnight, and it may be necessary to fund unexpected or increased operating and capital cost, while simultaneously building the General Fund Reserve. As such, the recommended Reserve Policy calls for 50 percent of annual Excess Equity (revenue above expenditures), after the carryover process has concluded, to be transferred annually to the reserve until the target of 30 percent is reached. The 50% allocation to the Reserves (Stability and Catastrophic) will be based on the weighted average. The remaining 50 percent of annual Excess Equity should be appropriated by the City Council as described below.

<sup>3</sup> Based on the FY 2017 Adopted General Fund Revenues of \$163,656,214.

**Use of General Fund Reserve and Excess Equity Funds**

In accordance with the City Auditor's recommendations, the proposed Reserve Policy outlines the process by which reserve funds can be approved and clearly articulates allowable uses for such funds.

**Use of the General Fund Reserve**

The proposed Reserve Policy requires a simple majority of the Council (five of the nine members) to authorize an appropriation from General Fund Reserve accounts (Stability Reserve or Catastrophic Reserve). Further, the Policy states that money from the General Fund Reserve can be used for the following activities:

**Stability Reserve**

Funds in this reserve are to be used to mitigate loss of service delivery and financial risks associated with unexpected revenue shortfalls during a single fiscal year or a prolonged recessionary period. The purpose of this reserve is to allow the City to continue operating in its normal course of business –not serve as a funding source for new programs or projects.

**Catastrophic Reserve**

Funds in this reserve may be used for non-recurring, one-time expenses related to a public emergency such as a natural disaster or other unforeseen catastrophic event; such as earthquakes, fires, floods, civil unrest, and terrorist attacks.

**Use of Excess Equity Funds**

The proposed Reserve Policy requires a **two-thirds** vote of the Council (six of the nine members) to authorize an appropriation from excess equity funds. Further, the Policy states that excess equity funds may be used for non-recurring, one-time expenses that do not create an on-going expenditure requirement. Examples of such uses include:

- Addressing the City's infrastructure maintenance backlog
- Contributions to reduce unfunded liabilities
- Contributions to build or maintain the General Fund reserve
- Capital projects that do not create new, ongoing expenditure requirements unless it can be demonstrated that adequate alternative resources exist to support the new, ongoing expenditure requirements
- One-time expenditures that advance a goal of the City Council's Strategic Plan
- Special or one-time, nonrecurring expenditure needs of the City

**Replenishment of the General Fund Reserves**

In accordance with the City Auditor's recommendations, the proposed Reserve Policy provides a process for replenishment of the General Fund Reserve. It states that the City Manager shall recommend a replenishment schedule for all monies proposed for appropriation from the General Fund Reserve. The replenishment schedule shall be adopted with the appropriation to withdraw reserve funds. Repayment shall begin no



more than 5 years from the date of withdrawal and be completed within 10 years from the date of withdrawal. While staff envisions that, in most cases, repayment will start as soon as possible, the repayment guidelines are meant to reflect a commitment to maintain sufficient reserves, while also recognizing that a use of reserves may occur during an economic downturn and it may be necessary to postpone repayment while the economy improves.

#### RATIONAL FOR RECOMMENDATION

The key attribute of a financially stable organization is appropriate reserves strong enough to position an organization to weather significant economic downturns, manage consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies such as natural disasters or catastrophic events caused by human activity. The City's reserve policy serves as the policy framework to deploy needed resources to meet the City's financial obligations and address any unexpected future events in a fiscally prudent manner.

The General Fund, however, is less than half of the City's total budget. Special Funds such as the Permit Service Center Fund, Zero Waste Fund, Marina Fund, Sanitary Sewer Fund, and Equipment Replacement Fund, which also support services to the community and support the health of the organization will be reviewed to determine appropriate funded levels that should be maintained as reserves. Adequate reserve levels in the special funds will help alleviate the pressure on the General Fund reserves. Staff will return to Council in the fall of 2017 with a proposed reserve policy for the City's Special Funds.

#### ENVIRONMENTAL SUSTAINABILITY

Actions included in the budget will be developed and implemented in a manner that is consistent with the City's environmental sustainability goals and requirements.

#### CONTACT PERSON

Jovan Grogan, Deputy City Manager, City Manager's Office, 981-7000  
Teresa Berkeley-Simmons, Budget Manager, City Manager's Office, 981-7000  
Diane Hayes, Senior Management Analyst, City Manager's Office, 981-7000

#### Attachments

1: Risk Assessment Summary

2: Resolution

Exhibit A: General Fund Reserve Policy

## City of Berkeley

### Risk Assessment Summary

#### Risk Assessment

To determine the appropriate level for the City of Berkeley's General Fund Reserve, staff used GFOA's step-by-step guide to analyze the following risk factors.

- Vulnerability to Extreme Events and Public Safety Concerns
- Revenue Source Stability
- Expenditure Volatility
- Leverage
- Liquidity
- Dependency of Other Funds on the General Fund
- Growth
- Capital Projects

The findings for each risk factor is provided below. Each risk factor is given a rating of 1 through 5:

- 5 – Very Important (significant financial risk)
- 4 – Important
- 3 – Neutral (negligible financial risk)
- 2 – Unimportant
- 1 – Very unimportant (little/no financial risk)

The risk assessment was led by the City's budget staff and included participation from various City departments, including Public Works, Police, Fire, and Finance.

Below is a summary of each risk factor.

- **Vulnerability to Extreme Events and Public Safety Concerns**  
The City of Berkeley is at extreme risk of natural disasters. The 2014 Local Hazard Mitigation Plan<sup>1</sup> describes the risk factors associated with extreme events. Risks include vulnerability due to major earthquakes, fires, landslides, floods, hazardous materials release and terrorism. The 2013 American Community Survey reported the City of Berkeley population at 116,774. The estimated ratio of public safety staff (Fire and Police) available to Berkeley citizens is approximately 385:1. In an extreme event such as an earthquake, risks to Public Safety would be high due to the number of citizens per available public safety staff ratio. Response time would drastically increase and the

---

<sup>1</sup>The 2014 Local Hazard Mitigation Plan [http://www.ci.berkeley.ca.us/uploadedFiles/Fire/Level\\_3\\_-\\_General/2014%20LHMP.pdf](http://www.ci.berkeley.ca.us/uploadedFiles/Fire/Level_3_-_General/2014%20LHMP.pdf)

support from public safety mutual aid professionals could diminish if the disaster's impact was county or statewide.

*Risk Factor Score: 5 Very Important. We are subject to extreme events of severe potential magnitude which would require a quick and decisive government response. There are few alternative risk management approaches.*

- **Revenue Source Stability**

The major sources of General Fund revenue stem from Property Tax, Property Transfer Tax, Sales Tax, Utility Users Tax and Business Licenses fees.

Risk factors that affect the revenue generated by property taxes are: (1) changes in assessed values, which are caused by inflation adjustments; (2) construction activity and sales of properties, and economic growth in the Bay Area; as well as (3) the rate of revenue collection. Because Property Transfer Tax is tied directly to all real property sales, it is a volatile revenue source and difficult to predict more than one year at a time.

Factors that affect the revenue generated by Transfer Taxes include the sale price of property and the frequency with which property is sold. These immediate factors are driven by the availability of mortgage loans, the level of long-term interest rates, the supply and demand for real estate in Berkeley, and general economic growth in the Bay Area –all of which are highly sensitive to national and state economic conditions.

Factors that affect the revenue generated by Sales Tax include: (1) overall economic growth in the Bay Area and competition from neighboring cities; (2) growth rate of specific dominant commercial/industrial sectors in Berkeley; (3) Berkeley's business attraction and retention efforts, especially on retail establishments; and (4) catalog and internet sales.

Some factors that affect the revenue generated by Utility Users Tax are: (1) consumption of gas, electricity, telecommunication services, cable, and cellular; (2) regulatory actions, including deregulation and re-regulation; (3) PUC rate changes; (4) market forces (supply and demand); (5) evolution of technology; and (6) legislative actions at State and Federal levels.

Factors that affect the Business License Tax (BLT) revenue are: (1) the number of business renewals; (2) commercial and industrial growth rates; (3) attraction/loss of businesses; (4) economic growth in the Bay Area; (5) results of Finance BLT collection activity; and (6) the City Auditor's and Finance Department's revenue audit activities.

*Risk Factor Score: 3 Neutral. A wide variety of factors influence the City's General Fund revenues. This, combined with the diversity of the revenues means*

*that the City does not face an unusually high or low level of risk from revenue instability.*

- **Expenditure Volatility**

Increases in expenditures are at risk due to changes in personnel cost beyond the City's control (i.e. CalPERS required pension funding) as well as unfunded liabilities tied to critical infrastructure needs including unfunded capital and major maintenance needs. Spikes in expenditures can also be attributed to one-time costs and ongoing maintenance such as the City's 25 year old Enterprise Resource Planning (ERP) software (referred to internally as FUND\$). Slight declines in expenditures can be attributed to staffing vacancies. Establishing reserves in special funds is a way to mitigate spikes in expenditures due to one-time costs.

*Risk Factor Score: 4 Important. We are subject to key potential expenditure spikes, such the City needs significant reserve levels; however, there are other available approaches to mitigate risks.*

- **Leverage**

The City's assets are used as leverage to borrow funds for general obligations such as the Tax and Revenue Anticipation Note (TRAN) and special funding such as bonds. The City is not highly leveraged. The statutory requirement of the GAAN determines the size of the borrowing the City can incur, which mitigates excessive leveraging.<sup>2</sup> The City's FY 2017 GANN Appropriation Limit is \$240 million while the City's current indebtedness is \$174 million.

*Risk Factor Score: 3 Neutral. We do not face an unusually high or low level of risk from leverage.*

- **Liquidity**

Liquidity is the measure of ease in which the City can meet its financial obligations with available liquid assets. The primary sources of an intra-period cash imbalance (recognizing expenditures and revenue in the appropriate period) occur with seasonal revenues that include Property Tax, Business Licenses fees, Sales Tax, and Utility Users Tax. The risk that the City faces is that the amount received in a given period may differ from the projection. However, the magnitude to this risk will not interfere with operations. The city utilizes the TRAN on an annual basis. A rigorous cash analyses is performed to determine the cash need vs. the cash projections. Short term investments mitigate any imbalances.

---

<sup>2</sup> Appropriations Limit for FY 2017

[http://records.cityofberkeley.info/Agenda/Documents/ViewDocument/6\\_28\\_2016%3B%20CLK%20-%20Report%20\(Public\)%3B%20FINANCE%3B%20%3B%20REGULAR%3B%20APPROPRIATIONS%20LIM.pdf?meetingId=190&documentType=Agenda&itemId=2425&publishId=7792&isSection=false](http://records.cityofberkeley.info/Agenda/Documents/ViewDocument/6_28_2016%3B%20CLK%20-%20Report%20(Public)%3B%20FINANCE%3B%20%3B%20REGULAR%3B%20APPROPRIATIONS%20LIM.pdf?meetingId=190&documentType=Agenda&itemId=2425&publishId=7792&isSection=false)

Our Finance Investment Policy is safety, liquidity and yield. In addition to the General Fund, the City has several sources of liquidity that boost the total available cash that can be used for note repayment.

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

- **Other Funds Dependency**

The Capital Improvement Fund, Street Light Assessment, Clean Storm, Paramedic, and Public Liability Funds rely on the General Fund for an important part of their funding. Extreme events could create emergency work requiring General Fund support above the current support received.

*Risk Factor Score: 4 Important. We have at least some funds that rely on the General Fund and this includes reliance for backstopping.*

- **Growth**

Density and population within the City of Berkeley is a major risk factor. Stress on the infrastructure due to the impact of sewer capacity, as well as increase in transportation is causing stress on city streets. Mitigation approaches to avoid, reduce, or transfer the risk of growth would include rate adjustments to customers, increase in taxes and increase in fees. Stress on the City's public safety staff can be a key factor in providing services in the event of a significant increase in population. As such, current staffing is insufficient to address population increase and at risk of increase in staffing costs due to overtime.

*Risk Factor Score: 4 Important. We have some growth that may cause imbalance in the timing of revenues and expenditures.*

- **Capital Projects**

The City's infrastructure has many deficiencies due to deferred maintenance over many years. The results are higher capital and maintenance costs. As noted in a recent report to the City Council<sup>3</sup>, while the City has recently completed more than \$40 million in capital and major maintenance projects and has an estimated \$215 million worth of projects in various stages of planning, design or construction, the unfunded capital needs in streets, storm drain/watershed, transportation and buildings/facilities exceeds \$393 million. And, the amount of recurring funding to address these needs is \$7.4 million. While these unmet infrastructure needs represent both General Fund and non-General Fund assets, if deficiencies continue to be deferred and if preventative maintenance is not performed, operating and maintenance costs will continue to rise and

---

<sup>3</sup> Update on Capital Improvements: Recent and Planned Projects and Ongoing Need.  
[http://www.cityofberkeley.info/Clerk/City\\_Council/2016/10\\_Oct/Documents/2016-10-18\\_WS\\_Item\\_01\\_Update\\_on\\_Capital\\_Improvements.aspx](http://www.cityofberkeley.info/Clerk/City_Council/2016/10_Oct/Documents/2016-10-18_WS_Item_01_Update_on_Capital_Improvements.aspx)

rehabilitation and replacement costs will increase exponentially –some of this will undoubtedly be borne by the General Fund.

Performing preventative maintenance would reduce costs and significantly extend the life of the public's assets. The good news is that there are several major revenue sources that mitigate a significant portion of the funding of projects for street and roads, sidewalks, sewer and storm drain improvement and maintenance.

*Risk Factor Score: 4 Important. We face a risk that deferred and unmet infrastructure needs may require General Fund support beyond what is currently budgeted for operational and maintenance costs.*

The aforementioned risk factors provide a total score of 30. This is then adjusted by three additional criteria: Government Size, Budget practices, and borrowing capacity.

- **Government Size**  
Score: 0 – Government Size is between 50,000 and 300,000 in population.
- **Budget Practices**  
Score: 0 – The budget is lean and has no contingencies in it.
- **Borrowing Capacity**  
Score: (-3) – We have excellent external and internal borrowing capacity, including a good rating, little existing debt, and political will to use it.

**GFOA Risk Assessment Results:** The GFOA Risk Assessment resulted in a score of **27** for the City. The following summarizes the above ratings.

#### Summary of Berkeley's GFOA Risk Assessment Ratings

Risk Factor	Finding	Rating
Vulnerability to Extreme Events and Public Safety Concerns	Very Important	5
Revenue Source Stability	Neutral	3
Expenditure Volatility	Important	4
Leverage	Neutral	3
Liquidity	Neutral	3
Dependency of Other Funds on the General Fund	Important	4
Growth	Important	4
Capital Projects	Important	4
<b>Sub-total</b>		<b>30</b>
<i>Adjustment for borrowing capacity</i>		<i>(3)</i>
<b>Final Total</b>		<b>27</b>

The following table provides GFOA's score guidelines.

GFOA Risk Assessment Score Guidelines

Score	GFOA Analytical Guidance
<b>8 - 16</b>	Agency faces minimal risk to retain through reserves. Consider a target equal to the GFOA minimum recommended reserve of 16.6% of revenues/expenditures.
<b>17-24</b>	Agency faces 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.
<b>25-31</b>	Agency faces 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.
<b>32 - 40</b>	Agency faces 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.

With a GFOA Risk Assessment score of 27, the City is facing a moderate to high level of risk to retain through reserves. It is recommended that the City adopt a target amount of reserves significantly higher than the GFOA recommended minimum of 16.7 percent. Staff recommends a General Fund Reserve policy that states that the City will maintain a minimum General Fund reserve level of 16.7 percent of adopted General Fund Revenues, with a goal of reaching 30 percent over time. This reflects the City of Berkeley's unique profile –both financial and environmental. Further, achieving a 30 percent reserve level will allow the City to maintain both a Stability reserve (to buttress the effect of routine downturns in the economy) and a Catastrophic reserve (for major emergencies).

RESOLUTION NO. ~~##,###~~-N.S.

ESTABLISHING THE CITY COUNCIL'S POLICIES FOR THE GENERAL FUND  
RESERVES

WHEREAS, the General Fund Reserves ensure the City's ability to maintain vital services to the community during times of economic uncertainty; and

WHEREAS, the City is committed to achieving long-term fiscal stability as well as mitigating the negative impacts of extraordinary risk such as earthquakes, fires, and floods; and

WHEREAS, the prior General Fund Reserve level of 8% is not consistent with GFOA's best practice recommended minimum General Fund Reserve level of 16.7%; and

WHEREAS, specific portions of the reserve should be designated for contingency and stabilization purposes and should be reported separately from the General Fund Balance; and

WHEREAS, the use and replenishment of the General Fund Reserves should be defined

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that the attached exhibit titled General Fund Reserves Policies are hereby adopted.

Exhibits

A: General Fund Reserve Policy



## City of Berkeley

### General Fund Reserve Policy

#### Policy

The General Fund is the City's primary operating fund. It is not connected to any one revenue source and may be used at the City's discretion. The General Fund is the operation fund that pays for general services provided by the City as well as public safety and capital improvements. The General Fund accounts for all general revenues and expenditures of the City related to the delivery of the City's general services not specifically collected or levied for other City funds.

The City of Berkeley is committed to achieving long-term fiscal stability as well as mitigating the negative impacts of extraordinary risk such as earthquakes, fires, floods, and economic volatility. A key attribute of a financially stable organization is appropriate reserves. Strong reserves position an organization to weather significant economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, catastrophic events. Establishing an adequate General Fund reserve policy allows the City to mitigate current and future financial risks resulting from economic instability or catastrophic loss.

The City's General Fund Reserves Policy documents the City's approach to establishing and maintain strong reserves and is designed to identify City operations and functions for which reserves should be established and maintained; establish target reserve levels and the methodology for calculating reserve levels; provide a methodology for meeting reserve targets; and establish criteria for the use of reserves and the process to replenish reserves.

#### Functions of Reserves: Stability and Catastrophic

The City of Berkeley will establish and maintain adequate financial reserves in order to prepare for the impact economic cycles and physical disasters have upon essential services to the public and assure annual fluctuation in revenue do not impede the City's ability to meet expenditure obligations. When revenue fail to meet the normal operating requirements of essential public services, or the need for disbursements temporarily exceeds receipts, reserves, upon a two-thirds vote of the City Council, may be used in accordance with the standards set forth herein, as determined by a Risk Assessment (best practices) that will be updated every five years to assess if the reserve level should be increased or lowered (to no less than the minimum level).

A Stability Reserve will be maintained to mitigate loss of service delivery and financial risks associated with unexpected revenue shortfalls during a single fiscal year or a

prolonged recessionary period. The purpose of this reserve is to provide fiscal stability and not serve as a funding source for new programs or projects.

In times of economic downturn, if revenues are insufficient to meet the normal operating requirements of essential services, funds contained in the Reserve may be used if authorized by a two-thirds vote of the City Council, based on the following principles:

1. Staffing levels in essential services shall be temporarily maintained, in order to avoid or reduce the necessity for immediate lay-offs: only in extreme conditions will reserves be used to support operational positions for longer than two years;
2. A hiring freeze must be implemented for designated positions as appropriate to maintain essential services to the public;
3. All other reasonable and available expenditure reduction measures have been taken by the City Manager and the City Council before using one-time funding to support operational positions;
4. User fees and services charges will be fully utilized for those services for which they were collected;
5. The level of the Reserve shall be restored in a timely manner as economic recovery occurs, consistent with the maintenance of essential services;
6. "Essential services", "appropriate levels" of such services, and "extreme conditions" shall be recognized from time to time by the City Council upon the recommendation of the City Manager.

A Catastrophic Reserve will be maintained for the purpose of sustaining General Fund operations in the case of a public emergency such as a natural disaster or other unforeseen catastrophic event. The reserve will be used to respond to extreme, one-time events, such as earthquakes, fires, floods, civil unrest, and terrorist attacks. The Catastrophic Reserve will not be accessed to meet operation shortfalls or to fund new programs or personnel. This reserve will be restricted and only expended in the event such expenditures are necessary to ensure the safety of the City's residents and their property.

### **Funding and Functions that are NOT Part of the General Fund Reserves**

Not included in the General Fund Reserves are funds that are set aside for a specific purpose. This would include restricted, committed, and assigned funds.

- The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action by the City Council.

- Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed.

In addition, the General Fund Reserves will not be used for ongoing or new programs or services.

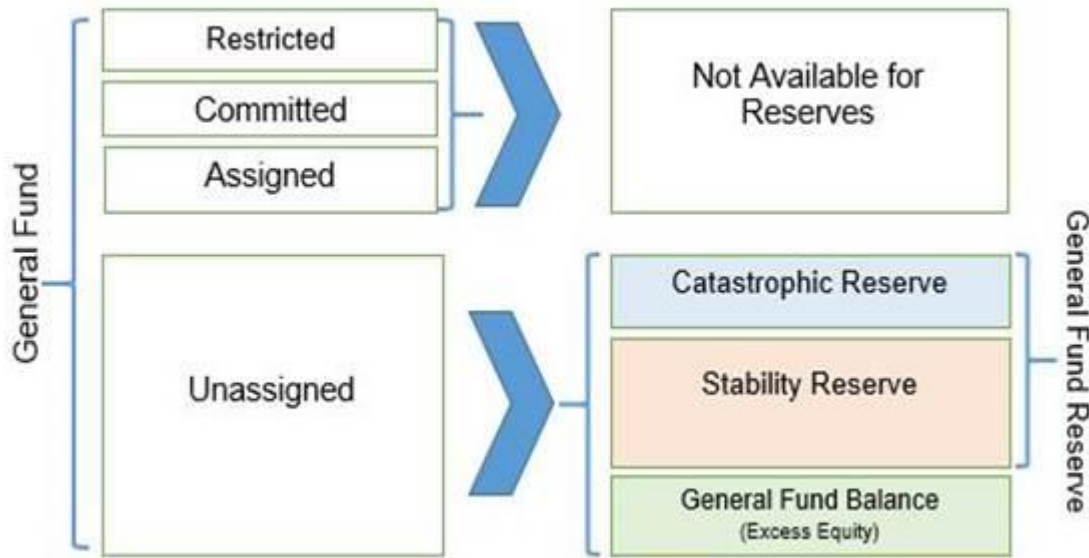
### **Target Reserve Levels**

General Fund Reserves consist of the total of the Stability Reserve and the Catastrophic Reserve. The target level for total General Fund Reserves shall be a minimum level of 16.7% of adopted revenues, with a goal of reaching 30% over time. The 30 percent reserve level will be allocated as follows:

- 16.7% to the Stability Reserve, and
- 13.3% to the Catastrophic Reserve

### **Methodology to Meet Reserve Levels**

The General Fund Reserves are distinctly separate from the General Fund Balance. The sum of the Stability Reserve and the Catastrophic Reserve and the amount determined to be Excess Equity is deemed to be General Fund Unassigned Fund Balance. Unassigned fund balance is the residual classification for the City's general fund and includes all spendable amounts not contained in the other classifications. The following graphic shows the relation between these funds as well as other restricted, committed, and assigned general fund monies.



Excess Equity is most commonly a non-recurring source of revenue. Excess Equity should be reported separately from the General Fund Reserves; however, Excess Equity could be used to support funding the General Fund Reserves and assist the City in meeting its 30% target level.

Attaining the recommended 30% reserve level is important to the long-term financial health and stability of the City. However, it must be recognized that reaching a 30% reserve level will not occur overnight and it may be necessary to fund unexpected or increased operating and capital cost, while simultaneously building the General Fund Reserves. This is not intended to supersede other fiscal policies that the Council adopts with the biennial budgets. As such, the Reserve Policy calls for 50% of annual Excess Equity (revenue above expenditures), after the carryover process has concluded, to be transferred annually to the Reserves. The 50% allocation to the Reserves (Stability and Catastrophic) will be based on the weighted average. The remaining 50% of annual Excess Equity can be appropriated by a two-thirds vote of the City Council as described below.

- Addressing the City's infrastructure maintenance backlog
- Contributions to reduce unfunded liabilities
- Contributions to build or maintain the General Fund reserve
- Capital projects that do not create new, ongoing expenditure requirements unless it can be demonstrated that adequate alternative resources exist to support the new, ongoing expenditure requirements

- One-time expenditures that advance a goal of the City Council's Strategic Plan
- Special or one-time, nonrecurring expenditure needs of the City

### **Replenishment of the General Fund Reserves**

The City Manager shall recommend a replenishment schedule for all monies proposed for appropriation from the General Fund Reserves. The replenishment schedule shall be adopted with the appropriation to withdrawal reserve funds. Repayment shall begin no more than 5 years from the date of withdrawal and be completed within 10 years from the date of withdrawal. While staff envisions that, in most cases, repayment will start as soon as possible, the repayment guidelines are meant to reflect a commitment to maintain sufficient reserves, while also recognizing that a use of reserves may occur during an economic downturn and it may be necessary to postpone repayment while the economy improves.

