

Memo

To: Roseville Finance Commission
From: Chris Miller, Finance Director
Date: April 9, 2019
Re: Item #6: Review Recent Council Directives and Joint Meeting with the City Council

Background

On March 25, 2019 the Finance Commission held a joint meeting with the City Council for the purposes of presenting the Commission's recommendation to establish new measures associated with the Capital Improvement Plan (CIP) review process. After receiving the recommendation, the Council suggested some minor changes and directed the Commission to make final modifications to the proposed Capital Investment Policy.

The Council further recommended that the changes be brought back for approval on a future 'Consent Agenda'. In other words, the Council is not expecting the Commission to formally present the final recommendation. The Council's final guidance included:

- The possible removal of the word 'maintenance' from line 4 of the Policy.
- A desire to retaining (in some fashion) the proposed deletion of lines 13-16 of the Policy.
- The possible combination of priority guidelines #1 and #2 as depicted on lines 103-105 of the Policy and/or the inclusion of the words 'replace or' following the word 'that' on line 104 of the Policy.
- Expanding the Fiscal Note (lines 161-231) and Fiscal Review (lines 233-244) sample templates to include more examples of possible metrics that might be considered.

A copy of the most recently-revised Capital Investment Policy is included in *Attachment A*. It includes highlighted sections that pertain to the final Council guidance noted above.

At a prior meeting on March 18, 2019, the City Council held a discussion on 2018 year-end cash reserve levels and the establishment of a Cash Reserve Fund. The Council did choose to transfer excess cash reserves in selected funds to a separate Cash Reserve Fund as recommended by the Commission. Following that action, the Council directed the Finance Commission to review the following:

- The Operating Fund Cash Reserve Policy target reserve levels for the Parks & Recreation Fund
- Establishing a formal Cash Reserve (carry-forward) Policy

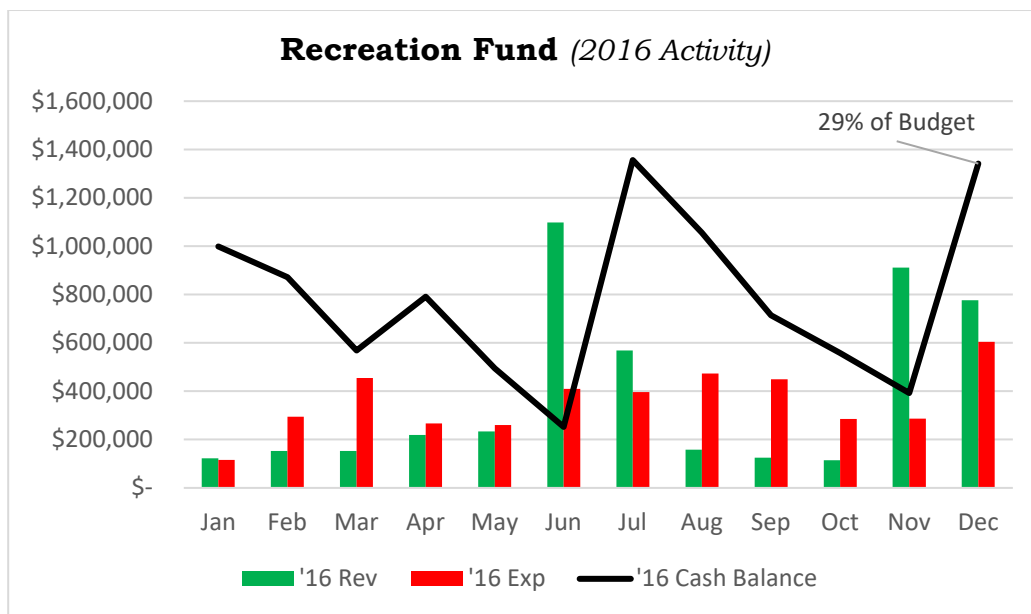
To assist the Commission in initiating these two new directives and to highlight potential next steps, Staff has compiled some additional background information. This is presented below in separate sections.

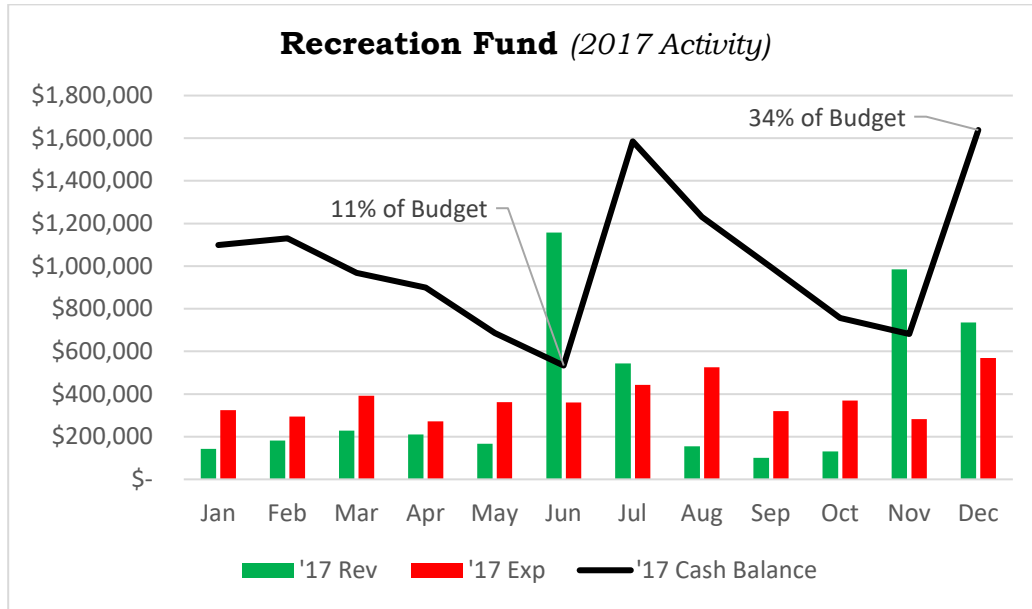
Review Operating Fund Cash Reserve Policy target reserve levels for the Parks & Recreation Fund

At the March 18, 2019 City Council meeting, the Council directed both the Finance and Parks & Recreation Commissions to review the cash reserve target levels identified in the City’s Operating Fund Cash Reserve Policy.

Under the current Policy (*Attachment B: highlighted section*), the targeted cash reserve level for the Parks & Recreation Fund is at a fixed 25%. This is in contrast to some other funds that have a range of targets. This Policy was last reviewed by the Finance Commission On February 12, 2019. However, it was also reviewed on multiple occasions in 2018 in conjunction with the Commission’s discussions on creating a Cash Reserve (Carry-Forward) Fund.

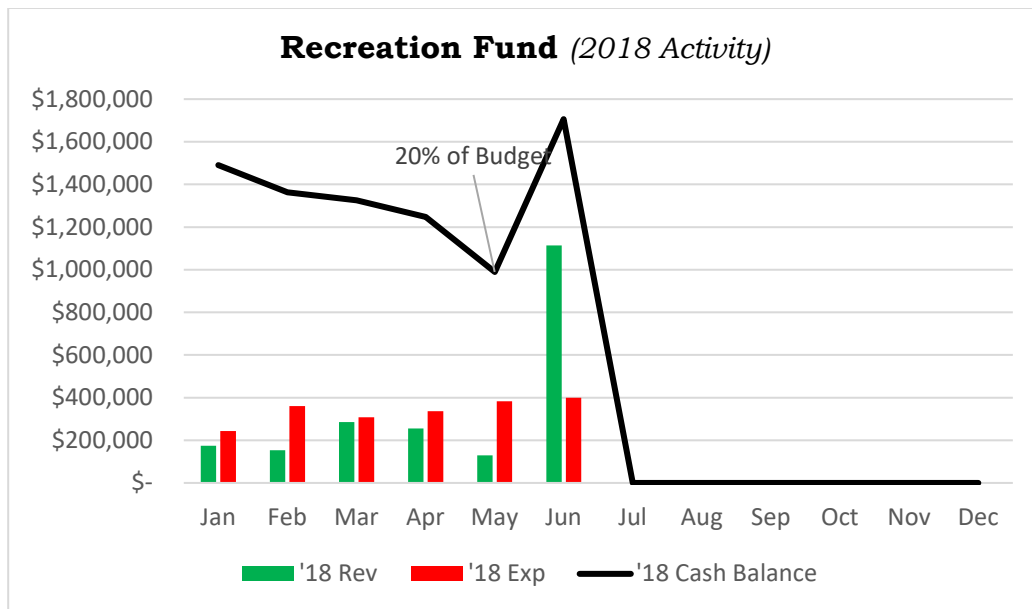
The Commission will recall that during the 2018 Cash Reserve Fund discussions, it spent a considerable amount of time determining what the appropriate cash reserve target level ought to be. This included a *month-by-month* analysis of actual cash flows in 2016 and 2017. The charts below were used in the analysis for the Parks & Recreation Fund. They originally appeared in your August 16, 2018 discussion.





One of the key takeaways from these two charts was that after starting 2017 with a cash reserve level of 29%, it fell to 11% at its lowest point in June. This represented a decline of 18%.

The Commission then looked at the cash flow analysis for 2018 (through June) which is depicted in the next chart.



In 2018, the cash reserve level dropped from 34% at the beginning of the year to 20% by the end of May before rebounding. This represented a decline of 14%.

After its analysis and discussion surrounding the cash flows from the previous two years, the Commission affirmed that it was appropriate to preserve a range of cash reserve targets for some operating funds. In support of the conclusion, it subsequently recommended changes to target ranges for the Communications, Information Technology, and License Center funds at the joint City Council-Finance Commission meeting on September 17, 2018. However, it did not recommended any changes to the Parks & Recreation fund leaving it at a fixed target of 25%.

Staff will note that the Fund’s cash balance (excluding donations) at the end of 2018 is at approximately \$1,235,000 or 25% of the annual operating budget – hitting the fixed target reserve level. This exact outcome was the result of a one-time transfer of approximately \$635,000 in excess cash reserves to the separate Cash Reserve Fund. Absent the transfer, the Fund would have had a balance of 38%. This is depicted in the table below.

	12/31/2018	Less	12/31/2018	12/31/2018	12/31/2018	12/31/2018
	Cash	From	<i>Available</i>	Reserve	Amount	Amount
<u>Operating Fund</u>	<u>Reserves</u>	<u>Donations</u>	<u>Reserves</u>	<u>Level</u>	Above High	Below Low
					<u>Target %</u>	<u>Target %</u>
General (unrestricted portion)	\$ 5,103,081	\$ (62,803)	\$ 5,040,278	32%	\$ -	\$ 456,689
Parks & Recreation	2,171,463	(300,612)	1,870,851	38%	634,968	-
Communications	101,056	-	101,056	19%	-	-
Information Technology	616,458	-	616,458	21%	169,644	-
License Center	356,665	-	356,665	19%	80,990	-
					<hr style="border-top: 1px solid black;"/>	<hr style="border-top: 1px solid black;"/>
					\$ 885,602	\$ 456,689

Establishing a formal Cash Reserve Fund Policy

In addition to directing the Commission to review cash reserve target levels for the Parks & Recreation Fund, the Council also directed the Finance Commission to consider drafting a formal Cash Reserve (carry-forward) Fund Policy.

As a starting point to the discussion, it is suggested that the Commission review the existing language in the Operating Fund Cash Reserve Policy to determine whether further modifications are desired in order for the Policy to be consistent with the Commission’s recommendation on the use of excess cash reserves. The Policy is included in *Attachment A (highlighted section)*.

Staff Recommendation

Not applicable.

Requested Commission Action

Review and discuss the associated topics and determine next steps in developing recommendations for the City Council.

Prepared by: Chris Miller, Finance Director
 Attachments: A: Capital Investment Policy (with proposed revisions)
 B: Operating Fund Cash Reserve Policy

Capital Investment Policy

(March 25, 2019 2nd Proposed Revision)

The purpose of the City's Capital Investment Policy is to ensure future capital improvements, **maintenance**, and replacements are made when needed in a manner which is both fiscally and operationally prudent. The Policy also outlines the general process for considering higher-cost capital asset additions or replacement of existing assets that feature substantial changes from their original size, functionality, or purpose.

The goal of this policy is to provide a stable funding mechanism for the City's infrastructure by setting aside specific resources on a periodic basis. This will ease the burden on present and future taxpayers, without significant fluctuations in annual property tax levies.

~~It is not the intent of the City Council to fund major new facilities, which have not had the original funding established either through tax increment, general taxes, bonding or other such sources. The replacement funds and corresponding fund interest earnings are expected to be only for replacement purposes.~~

Scope

~~All City departments are included in this Policy and City funds are included in the 20-Year Capital Improvement Plan (CIP). The CIP identifies the timing and financing of all capital items.~~

Policy

- The City will develop a 20-year Plan for capital investments and update it at least every 2 years.
- All capital investments shall be made in accordance with an adopted Capital Improvement Plan or in conjunction with a strategic or other long-term planning process.
- The City will coordinate development of the capital improvement budget with development of the operating budget. Future operational costs associated with new capital improvements will be projected and included in operating budget forecasts.
- The City will provide ongoing preventative maintenance and upkeep on all its assets at a level adequate to protect the City's capital investment and to minimize future maintenance and replacement costs. The City should periodically review and follow industry-recommended replacement schedules for all City capital assets.
- The City will identify the estimated costs and potential funding sources for each capital project proposal before it is submitted to Council for approval.
- The City will determine the least costly financing and acquisition method for all new projects.

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- For future development or redevelopment proposals that require public infrastructure and/or public financing assistance and/or City support services, a fiscal analysis shall be prepared identifying the project sources and uses. The analysis should also demonstrate the costs and benefits of the project. The cost of this analysis shall be borne by the developer.
- The City will establish departmental Vehicle and Equipment Replacement Funds. The City will appropriate monies to them annually to provide for timely replacement of vehicles and equipment. The amount will be maintained at an amount equal to the proportion of useful life expired multiplied by estimated replacement cost.
- The City will establish a Building Capital Maintenance Fund, and will appropriate funds to it annually to provide for timely maintenance of all buildings supported by general governmental funding. Only maintenance which meets the capitalization threshold shall be paid for out of this fund. Maintenance includes major items such as roof repair and HVAC replacement.
- The City shall establish a Street Infrastructure Replacement Fund to provide for the general replacement of streets and related infrastructure throughout the community. The annual MSA capital allocation, will be included as a part of the source of funds for computing the adequacy of this fund. This fund has been formally categorized by the Council as a permanent fund, whereby the interest proceeds are only used for the stated purpose. The cash reserve amount should remain between \$8-12 million.
- The City shall establish a Park Capital Maintenance Fund to provide for the general replacement of parks and related infrastructure throughout the community. The funding should equal the proportion of useful life expired multiplied by estimated replacement cost for all park system assets.
- Within each enterprise fund, the City shall establish a funding mechanism to provide for the general replacement of related infrastructure throughout the community. The funding should equal the proportion of useful life expired multiplied by estimated replacement cost for all enterprise fund system assets.
- From time to time the City Council shall establish additional replacement funds as the need becomes apparent.
- The Finance Commission will annually oversee and report to the City Council a review and analysis of planned capital investments and related reserve balances. The purpose of such analysis will be to gauge the health and sustainability of City reserves related to capital

84 investments for the short (1-3 year), medium (4-9 years), and long term (10+ years). It will
 85 also take into account related borrowing and repayment costs.

86
 87 ~~▪ Capital Replacements should be considered using the following priority guidelines~~
 88 ~~rankings (in order):~~

- 89 ~~1. Projects necessary for public health and safety, or to meet legal mandates.~~
 90 ~~2. Projects that responsibly maintain existing assets to either extend remaining~~
 91 ~~service life or to create efficiency.~~
 92 ~~3. Projects that expand existing assets or services in order to benefit the Public~~
 93 ~~Good.~~
 94 ~~4. Projects that purchase new assets or services in order to benefit the Public Good.~~

95 ~~▪ For purposes of added transparency associated with capital spending decisions, the~~
 96 ~~Capital Improvement Plan (CIP) should include the following designations and review:~~

	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>
Definition	Items that are incorporated into a <u>replacement policy</u> , and have a fairly consistent useful life	Items that are incorporated into a <u>strategic plan</u> or similar <u>long-term planning initiative</u>	Items that are considered <u>non-routine</u> or purchased on a <u>highly infrequent basis</u> and have a significant financial impact
Policy/Plan Review	City Manager & City Council	City Council or Advisory Commissions	City Council
Purchasing Approval (see comments below)	City Manager up to \$20,000; City Council \$20,000 or greater	City Manager up to \$20,000; City Council \$20,000 or greater	City Manager up to \$20,000; City Council \$20,000 or greater
City Council Responsibility	Review replacement policies annually or as needed	Review Plans or initiatives annually or delegate to Advisory Commissions	Review as needed in conjunction with a standard form providing justification, funding source, and supporting narrative

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<u>Purchasing Approval Comments:</u>	
(a) MN Statute 412.691 limits the City Manager purchasing authority to \$20,000 or less	
(b) MN Statute 471.345 establishes the following rules for entering into contracts:	
<u>Amount</u>	<u>Requirement</u>
\$25,000 or less	Purchase on open market or obtain at least two quotes
\$25,000 - \$175,000	Direct negotiation (two quotes if possible) or competitive bidding process
\$175,000 or more	Competitive bidding proces required

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- 101 ▪ Capital Replacements should be considered using the following priority guidelines
102 rankings (in order):

103

1) Projects necessary for public health and safety, or to meet legal mandates.

104

2) Projects that responsibly maintain existing assets to either extend remaining
105 service life or to create efficiency.

106

3) Projects that expand existing assets or services in order to benefit the Public
107 Good.

108

4) Projects that purchase new assets or services in order to benefit the Public Good.

109

- 110 ▪ Higher-cost capital asset additions or replacement of existing assets that feature substantial
111 changes from their original size, functionality, or purpose should be considered using the
112 guidelines included in Exhibit A. For these same assets, a fiscal look-back exercise should
113 also be utilized using the guidelines included in Exhibit B.

113

114 Definitions

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116 Capital assets – Assets which cost \$5,000 or more and have a useful life of two or more years.

117

118 Capital Improvement Plan – A comprehensive 20 year outlook itemizing all capital assets and
119 their replacement funding requirements. The plan will take into account useful asset lives and
120 salvage values.

121

122 Replacement Cost– In today’s dollars, the cost to replace the asset. If it is expected the retired
123 asset will have a salvage value, the estimated salvage value should be deducted from the
124 expected replacement cost.

125

126 Asset Life – The number of years which is the asset is in use, also known as the useful life of
127 a capital asset.

128

129 Bonding – The amount of debt incurred to obtain capital assets.

130
131 Capital Asset Maintenance – Expenditures which protect the City’s investment in capital assets
132 and provide for ongoing upkeep.

133
134 Equipment – A tangible capital asset which does not qualify as a vehicle, building, street, or
135 park asset. Examples are mowers, tools, etc.

136
137 MSA Capital Allocation – Municipal State Aid is money the City receives from the State to
138 help pay for maintenance of MSA-designated streets. MSA streets are collector or arterial
139 streets that interconnect to other cities or major thoroughfares.

140
141 Enterprise Fund – A separate accounting and financial reporting mechanism for municipal
142 services for which is 100% fee supported. Examples are Water, Sewer, and Golf Course.

143
144 General Governmental Fund – A separate accounting and financial reporting mechanism for
145 spending in which a property tax is generally levied. Examples are police, fire, streets, parks
146 and recreation.

147
148 Enterprise Fund System Asset – Assets which support enterprise services such as water, sewer,
149 and golf course.

150
151 Park System Asset – All assets within city parks excluding buildings. Examples would be
152 trails, equipment, and courts.

153
154 Implementation

155 The City shall use replacement funds to assist in the replacement of equipment, vehicles, and
156 capital building maintenance. New equipment or buildings are to be funded from new dollars,
157 unless they are designated to replace currently owned assets. Funds may be used up to the
158 amount of the replacement funds set aside for that particular asset. Any additional funding shall
159 be from new sources.

160

City of Roseville Capital Investment Policy*Proposed March 25, 2019***Exhibit A: Fiscal Note**

161 Introduction

162 The City recognizes that higher-cost capital asset additions or replacement of existing assets that
163 feature substantial changes from their original size, functionality, or purpose can have a significant
164 impact on the financial sustainability of the City. As a result, the decision to acquire these types of
165 assets should feature added measures to ensure a transparent and public decision-making process
166 is followed. In recognition of these distinct impacts, the following guidelines have been prepared.

168 General Guidelines

169 Each asset addition or asset replacement that features a substantial change as described above in
170 excess of \$500,000, should be accompanied by supporting documentation that includes the
171 following:

- 172 ▪ Description of the purchase/project/initiative
- 173 ▪ Narrative that describes the nexus to a strategic or other long-term planning process
- 174 ▪ Purchase cost
- 175 ▪ Funding source(s)
- 176 ▪ *Where applicable*, a multi-year financial pro forma^(a) or business plan

177
178
179 These supplementary guidelines do not apply towards asset replacements that are included into the
180 Capital Improvement Plan (CIP) and which feature similar functionality or purpose as the original
181 asset. This reflects the fact that these assets are already integrated in the delivery of programs and
182 services.

183
184 In contrast, higher-cost (\$500,000 or greater) capital asset additions or substantially-changed asset
185 replacements have greater potential to disrupt asset replacement strategies and have significant
186 impacts on the operating budget moving forward. Therefore, it is recommended that these asset
187 acquisitions be accompanied by a multi-year financial pro forma or business plan that includes
188 supporting documentation that identifies unmet needs, objectives, and action plans.

189
190 ^(a) *The financial pro forma would include a list of estimated operating revenues and expenditures*
191 *(including staffing changes) as well as the assumptions used to calculate those estimates.*

192
193 An example of the supporting documentation is included below.

194

City of Roseville Capital Investment Policy

Proposed March 25, 2019

Exhibit A: Fiscal Note

SAMPLE SUPPORTING DOCUMENTATION

195
196

197 Project/Initiative Title: **Document Archival & Retrieval System**
 198 Department/Division: Central Services
 199 Estimated Up-Front Cost: \$150,000
 200 Estimated On-Going Cost: \$38,000 - \$42,700 (*see below*)
 201 Funding Source: Central Services Fund (*Tax Levy Supported*)
 202

Description:

204 The City utilizes a variety of systems and procedures for archiving and retrieving stored documents.
 205 These documents are housed in a variety of locations including; on-site and off-site electronic file
 206 servers, third-party applications, departmental file cabinets, and others. In addition, documents are
 207 stored in a variety of formats include .pdf, TIFF, JPEG, and others.
 208

209 As a result, the process of archiving and retrieving documents is not only inefficient, but also
 210 potentially unreliable especially with documents that are required to be retained for a defined period
 211 of time. A centralized, standardized document system based on statutory storage requirements is
 212 necessary to address these issues.
 213

214 The importance of a successfully-designed archival and retrieval capability is referenced in *Section*
 215 *7 of the City of Roseville Business Continuity Plan*. The proposed purchase will fulfill this objective.
 216

5-Year Financial Pro Forma:

218 The proposed System features a combination of on-site and off-site backup physical storage area
 219 networks (SAN) and software licensing; and will include an up-front commitment of \$150,000. The
 220 following table identifies the on-going *operational* costs which will require additional tax levy or
 221 other sources.
 222

Revenues	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
Property Tax	\$ -	\$ -	\$ -	\$ -	\$ -
Intergovernmental	-	-	-	-	-
Licenses & Permits	-	-	-	-	-
Other: Tower Rentals	38,000	39,100	40,300	41,500	42,700
Total	\$ 38,000	\$ 39,100	\$ 40,300	\$ 41,500	\$ 42,700
Expenditures	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>
Personnel	\$ -	\$ -	\$ -	\$ -	\$ -
Operating & Maintenance	-	-	-	-	-
Depreciation (Cost-Recovery)	28,000	28,800	29,700	30,600	31,500
Other: Software Licensing	\$ 10,000	\$ 10,300	\$ 10,600	\$ 10,900	\$ 11,200
Land/Property Acquisition	-	-	-	-	-
Vehicles & Equipment	-	-	-	-	-
Total	\$ 38,000	\$ 39,100	\$ 40,300	\$ 41,500	\$ 42,700

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City of Roseville Capital Investment Policy

Proposed March 25, 2019

Exhibit A: Fiscal Note

226 The estimates provided in the table above include the following assumptions:

- 227
- 228 ▪ 3% annual increase in software licensing costs to accommodate additional licenses and
- 229 inflationary impacts.
- 230 ▪ SAN replacement costs based on a 5-year amortization schedule, original purchase price
- 231 plus 3% annual inflation.
- 232

City of Roseville Capital Investment Policy*Proposed March 25, 2019***Exhibit B: Fiscal Review**

SAMPLE SUPPORTING DOCUMENTATION

Project/Initiative Title: **Neighborhood Park Buildings**Description

[Enter brief description of the project/initiative here]

	Original	Initial Bid	Actual
Construction Cost	<u>Estimate</u>	<u>Award</u>	<u>Amount</u>
Estimate	\$ 6,000,000	\$ 6,500,000	\$ 6,600,000
\$ Change: Estimate v. Bid		500,000	
% Change: Estimate v. Bid		8%	
\$ Change: Estimate v. Actual			600,000
% Change: Estimate s. Actual			10%
Program Revenue	<u>2015</u>	<u>2016</u>	<u>2017</u>
Estimate	\$ 15,000	\$ 35,000	\$ 50,000
Actual	43,000	66,000	95,000
% Over (Under) Estimate	187%	89%	90%
Operating Cost	<u>2015</u>	<u>2016</u>	<u>2017</u>
Estimate	\$ 100,000	\$ 130,000	\$ 135,000
Actual	92,000	122,000	128,000
% Under (Over) Estimate	8%	6%	5%
Net Cost	<u>2015</u>	<u>2016</u>	<u>2017</u>
Estimate	\$ 85,000	\$ 95,000	\$ 85,000
Actual	49,000	56,000	33,000
Facility Usage	<u>2015</u>	<u>2016</u>	<u>2017</u>
Community Engagement	20	25	30
City Functions	175	185	190
Rentals	110	130	155
Total	305	340	375

Supporting Narrative

[Enter supporting narrative/comments on the metrics presented above here]

Operating Fund Reserve Policy *(revised 4/10/2017)*

Purpose

- To provide a cushion against unexpected revenue and income interruptions
- To provide working capital by ensuring sufficient cash flow to meet the City's needs throughout the year

Policy

- The City will maintain a general fund reserve of 35-45% of the general fund's total annual operating budget. This ensures that the City has adequate funds on hand to provide for operations between bi-annual property tax collection periods. Any surplus beyond the required general fund reserve may be transferred to another reserve fund with a funding shortfall
- The City will strive to create a reserve in the Recreation Fund to equal 25% of the annual recreation budget. This reserve will provide a cash flow cushion and reduce the inter-fund borrowing expense to the Recreation Fund. Because of more frequent cash inflows, a 25% reserve will be adequate to support the daily cash needs of the fund
- The Community Development Fund is supported solely by building permit fees and charges. Because the economic environment has a major effect on this Fund, a fund balance of 25-50 % of the annual budget is a reasonable target. It is expected that as economic downturns take place, this reserve will provide for a transition period during which the Council will be able to assess and to better match operations with the economic need
- City enterprise funds shall have operating cash reserves sufficient to provide for monthly cash flow, and for a reasonable level of equipment and infrastructure replacement. Major reconstruction or system upgrades, may need to be funded from enterprise revenue bonds. Annual utility rate reviews will be made in regard to projected operating expenses and capital improvements. The Council will, on an annual basis, establish rates in accordance to operating cost recovery and the projected capital improvements
- The Communications Fund has greater cash flow variability than in prior years and therefore warrants a higher reserve level than previously established. It is expected to operate with balances of 10-30% of the annual operating budget
- The License Center and Information Technology funds have consistently demonstrated strong cash flows which allows for a lower overall reserve level and are expected to operate with balances of 10-15% of the annual operating budget

- All other operational funds are expected to operate with positive reserve balances of 10-25% of the annual operating budget. Each operational fund shall be reviewed on an annual basis to assure the fund balance is in line with the fund's objectives
- For the EDA, its General Operating Fund should maintain a reserve level of 35% of the annual budget to ensure that it has sufficient funds to provide for operations in-between property tax collection periods
- In the event the minimum fund balance drops below prescribed levels, the City shall dedicate new incoming property tax or program revenues (where applicable) in an amount sufficient to bring fund balance levels back into compliance within three fiscal years
- Unless otherwise directed by the City Council, monies held in individual Funds shall be expended first from restricted fund balances, second from committed fund balances, then from assigned fund balances, before using unassigned fund balance

Implementation

All fund reserves shall be reviewed each year at the time of the annual budget preparation for the purpose of complying with this policy. Budgets shall be prepared on an "All Resources" basis, so that the City Council and Community can readily discern the current and projected management of all reserves.

If aggregate unrestricted reserves in the tax-supported operating funds are outside of targeted goals, the Council is advised to create a plan to get reserves into targeted goal ranges by committing reserve funds, using aggregate excess reserves to reduce the levy, or making appropriate budget or tax levy adjustments.