

# Memo

**To:** Roseville Finance Commission  
**From:** Michelle Pietrick, Finance Director  
**Date:** July 13, 2021  
**Re:** Item #6: Discuss Fund Reserve levels and policy modifications

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## **Background**

Best practices recommend that policies be reviewed periodically to insure they remain relevant. The Finance Commission reviewed the attached operating fund reserve policy in 2019 when the Excess Cash Reserve fund was created. The Finance Commission had recommended that the Park and Recreation Fund reserves target level should be a range of 15%-25% of the next year's budget. The Parks & Recreation Commission had recommended the target level remain at 25%. At the April 13<sup>th</sup> Finance Commission meeting, the different recommendations were discussed, as this had not gone to the City Council for a final decision. At that meeting it was decided to take a broader examination of all funds to make a full recommendation to the City Council.

In establishing a policy governing the level of fund balance for individual funds there are a number of factors that a government should consider, including:

1. The predictability of revenues and the volatility of expenditures (higher fund balance levels may be needed if revenues are subject to unpredictable fluctuations or operating expenditures are highly volatile).
2. If funds do not have adequate reserves, the General Fund is the fall back fund to sustain other operations, therefore, it is appropriate to establish reserve levels for other funds.
3. The perceived exposure to significant on-time outlays (e.g., disasters, immediate capital needs, state budget cuts)

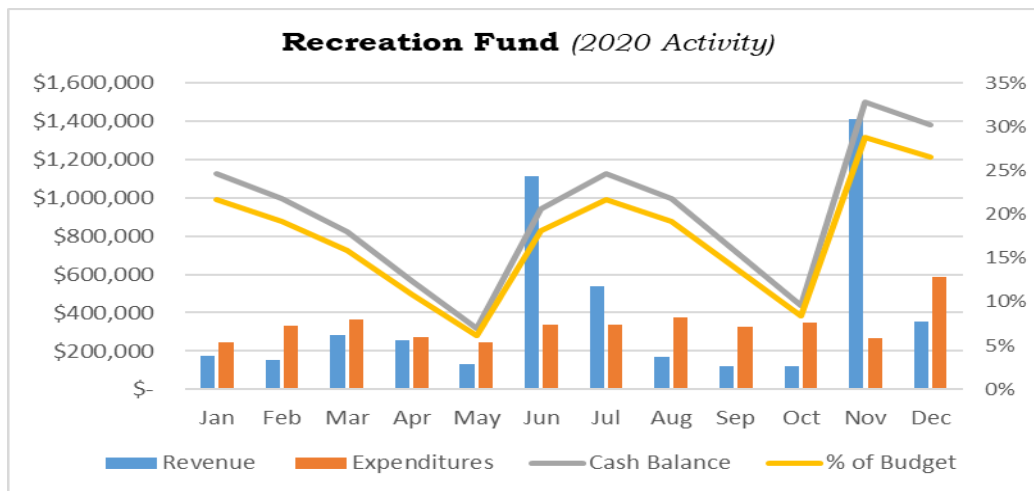
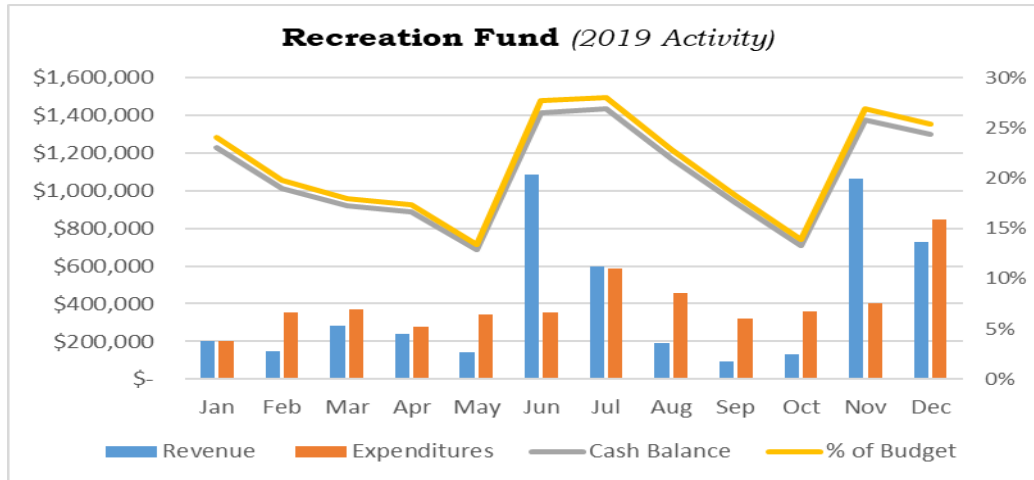
## General Fund

The current reserve level for the General Fund is 35-45% of the following year's expenditure budget, which enable the City to provide for operations between the bi-annual property tax collection periods. Property tax revenue is 45% of the total revenue in the general fund. The current reserve level appears to be appropriate.

## Recreation Fund

The current reserve level for the Recreation fund is 25% of the annual budget. By not stipulating a range for the reserve level, if the fund falls below that level at year end, the City is forced to find resources to achieve this minimum as demonstrated with the most recent year end when the fund was at 20% reserves and a transfer was made from the Excess Cash Reserve Fund. An analysis of the past five years, shows that the Recreation fund never went below 10% and it went as high as 44%, with the exception of 2020 when the fund hit a low of 6% at the end of May.

Property Taxes account for 57% of the total revenues for this fund but there also is a seasonal flow to the operations in this fund. The next two charts show this fluctuation for 2019 and 2020.



The balance at year end should cover activity through May and based on the analysis a range or 15-25% would be appropriate for the Recreation Fund.

License Center

Prior to 2020, the License Center had consistently demonstrated strong cash flows and had contributed dollars to the Excess Cash Reserve Fund in 2018 and 2019. In 2020, the unforeseen pandemic demonstrated why reserves are necessary. The License Center experienced a \$688,500 loss in revenues due to closures and slow recovery of operations. The City Council transferred \$354,958 from the Excess Cash Reserve Fund so the License Center was at the low reserve level of 10% of the budget. The current policy has a reserve range of 10%-15% and staff recommends that the reserve level be changed to 15-25% to provide more stability in this fund as recovery back to pre-pandemic levels will take more time.

Communications Fund

The current policy has a reserve range of 10-30% for the Communications Fund. The primary source of revenue in this fund is cable franchise fees which have been steadily dropping the past few years. In 2021, a property tax levy amount of \$50,000 was introduced to bolster the funds resources. As there will be a need for on-going levy support, the current reserve levels appear to be appropriate.

Information Technology Fund

The current reserve level for the information technology (IT) fund is 10-15%. The IT function has grown over the years and supports approximately 40 entities. The function is migrating over to a stand-alone entity known as Metro-INET. Once the migration is completed, this fund will no longer be necessary as the City will merely be contracting for IT services. Staff believes the current level is sufficient and will help offset increased costs for the next few years.

Capital Project Funds

The city has a number of capital project funds to provide resources for various capital improvements and replacements. These funds are identified in the Capital Investment Policy and are mainly financed through property tax levies along with some grant funding. As such, we do not currently have stipulated reserve levels for these funds. These funds are analyzed during the budget process and any adjustments to the funding are proposed as part of the Budget approval and property tax levy setting process.

Enterprise Funds

Enterprise funds distinguish between current and non-current assets and liabilities. These funds establish working capital (current assets less current liabilities) targets. It is essential that a government maintain adequate levels of working capital in its enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees. In 2020, the City contracted for a Utility Rate Study on the Water and Storm Drainage Enterprise funds. In that Study, Ehlers recommended a minimum working capital target equal to 50% of the operating expenditure budget plus the next year's debt service payments. Ehlers used industry standards to develop the Utility Rate Study. The recommended utility rate increases in the Water fund for 2021-2026 of 5% each year were designed to not only cover operating expenses and capital outlay, but also to rebuild the working capital to achieve this minimum target. The Storm Drainage fund has increases of 4% programmed for 2021-2024 to cover operations, capital improvements and rebuilding of the working capital to achieve the minimum target.

Annual monitoring of the Enterprise Funds occurs through the budget and rate setting processes and through the annual financial audit. Utility Rate Study will be conducted on the Sanitary Sewer fund in 202 along with a review of the current structure set for the Water and Storm Drainage Funds. The Recycling fund and the Golf Course fund are the other two Enterprise Funds that the City maintains and these are also examined during the budget and audit processes.

**Staff Recommendation**

Staff recommends modifying the Operating Fund Reserve Policy with the recommendations noted in this report..

**Requested Commission Action**

Review and approve the revised Operating Fund Reserve Policy which will be forwarded to the City Council.

Prepared by: Michelle Pietrick, Finance Director  
Attachments: A: Operating Fund Reserve Policy with modifications



## Operating Fund Reserve Policy

~~Revised April 27, 2020~~ Revised July 8, 2021

### 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
- To provide funds to address unexpected or unplanned events

### 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 of 15-25%~~ of the annual recreation budget. This reserve will provide a cash flow cushion to cover operations between bi-annual property tax collections and the fluctuation in charges for services revenues during the year and reduce the inter-fund borrowing expense to the Recreation Fund. Because of more frequent cash inflows during the year, a 15-25% 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. As recommended in the Ehlers Utility Rate Study conducted in 2020, the City will strive to attain a minimum working capital target equal to 50% of the operating expenditures plus debt service payments in the next year.
- The Communications Fund ~~has~~ greater cash flow variability ~~than~~ in prior years and now receives a small amount of property tax levy support and therefore warrants a higher reserve level than previously established. It is expected to operate with reserve balances of 10-30% of the annual operating budget.
- The License Center ~~and Information Technology funds~~ has consistently demonstrated strong cash flows which allow eds for a lower overall reserve level. Based on the experiences of 2020, the fund reserves targets are increased to 15-25% and are expected to operate with balances of



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~~10-15%~~ of the annual operating budget.

- ~~▪ The Information Technology fund will operate with positive reserve balances of 10-15% which will eventually be eliminated once Metro Inet is fully established at which time, the IT function will simply be a division of the General Fund. 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.~~
- Capital Project funds are identified in the Capital investment policy. Annual property tax levies supply funding for the various projects and fund balances increase over time to pay for equipment and infrastructure projects, the balances then drop and rebuild over time to cover the next projects.
- 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 and at the annual audit 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. With the creation of the Cash Reserve Fund, certain funds will have their reserve swept if they exceed the high target range, see the next section.

### Cash Reserve Fund

The City has established a Cash Reserve Fund that will take the excess cash reserves from selected funds that are over the maximum reserve levels as defined under this policy, less funds needed for capital expenditures or funds donated to the City. The following funds are subject to the Cash Reserve Fund policy:

- General Fund (unrestricted portion)
- Parks and Recreation Fund

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~~Revised April 27, 2020~~ Revised July 8, 2021

- Communication Fund
- Information Technology Fund
- License Center

~~As part of the annual audit~~ ~~On April 1 of each year~~, the excess funds above the maximum reserve level at December 31 of the previous year (less funds needed for capital expenditures and funds donated to these accounts) shall be transferred to the Cash Reserve Fund ~~before the books are closed for that particular year~~. The funds transferred to the Cash Reserve Fund shall be tracked on an annual basis and reported to the Finance Commission and ~~approved by the City Council by April of the subsequent year~~.

Any expenditures from the Cash Reserve Fund must be authorized by the City Council.