



CITY OF SONOMA FINANCIAL RESERVE POLICIES

BACKGROUND

Comprehensive reserves are a vital component of a sound financial plan for both the City and the City's Water Utility Fund. Strong reserves position an organization to weather significant economic downturns more effectively, manage the consequences of outside agencies actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, catastrophic events, or excessive liabilities or legal judgements against the organization.

Fiscal stability is an important factor to any City. It is Council's responsibility to provide for the continuation of services in the event of natural or fiscal emergency. Realizing that city revenues are not stable and are dependent upon national, state and local economic trends, it is prudent for the City of Sonoma to have a "Financial Reserve Policy" in place to address any downturns that would affect the city revenues.

The City of Sonoma endeavors to maintain adequate reserves for its General Fund and Water Utilities Fund, as a matter of fiscal prudence and sound financial management. These policies will guide the City in:

- Planning for economic uncertainties, downturns in the local or national economy, local disasters or catastrophic events;
- Maintaining good standing with credit rating agencies;
- Future debt or capital obligations
- Ensuring cash availability when revenue is unavailable
- Deciding when to use reserves and how to replenish reserves if they have been spent.

Per current Government Accounting Standards Board Statement No. 54, ("GASB" 54), fund balances are divided into five (5) categories in the financial statements:

CATEGORY	DESCRIPTION
Non-Spendable	Cannot be readily converted to cash or is not legally spendable (example: assets required to be maintained intact)
Restricted	Externally imposed restrictions on spending (creditors, granting agencies, or laws)
Committed	City Council formally imposed restrictions on spending (by resolution or other action)
Assigned	Funds reserved by City Council direction of City for designated purposes
Unassigned	Residual balance not classified in any of the above categories and available for expenditure

Cities often create different reserves within these classifications to set aside funds for specific purposes. For purposes of this document, the City’s General Fund reserve will include the sum of the Committed, Assigned, and Unassigned Fund Balances for that fund.

To mitigate these financial challenges, three separate General Fund reserves and three separate Water Utility Fund reserves are established as set forth below.

GENERAL FUND RESERVES

GENERAL FUND			
Reserves	Description	Calculation	GASB Categorization
General Fund Operating Reserve	Provide funding to evaluate alternatives in the event of financial hardships, provide resources in times of economic uncertainties and downturns, and to provide funding due to unexpected expenditures and/or reductions in revenues.	Two (2) months annual operating expenditures (17% of annual operating expenditures)	Committed
General Fund Emergency Reserve	Provide operating and/or repair funds in the event of a local disaster or catastrophic event.	Base amount of \$1,500,000	Committed
General Fund Special Projects Reserve	To segregate surplus fund balance from recurring revenue sources so that such surpluses will be appropriated only for non-recurring expenditures and 2) to create a funding source for one-time projects such as, but not limited to: <ul style="list-style-type: none"> ▪ · Capital improvement projects of any type ▪ · Surveys, studies and analyses of both operating and capital needs ▪ · Updates of adopted plans (e.g., general plan or specific generalplan elements, facility master plans) ▪ · Temporary service programs (for example, a limited-duration code or traffic enforcement effort). 	No dedicated funding; based on Council direction and financial resources	Committed or Assigned
General Fund Unassigned Reserve	Residual balance not classified in any of the above categories and available for expenditure	Residual General Fund balance not classified above and available for expenditure	Unassigned

General Fund Operating Reserve

The purpose of the General Fund Operating Reserve is to provide sufficient cash flow and to provide breathing room for the City to evaluate alternatives in the event of financial hardships, provide resources in times of economic uncertainties and downturns, and to provide funding due to unexpected expenditures and/or reductions in revenues.

The Government Finance Officers Association (GFOA) maintains a best practice for general fund reserves. While the level of reserves should be assessed on a City's unique circumstances or risk levels, the recommended best practice is to keep at least two months of operating expenditures or minimum of 15% reserves.

The General Fund Operating Reserve can cover any significant unanticipated or mandated expenditures which cannot be deferred or efficiently funded by borrowing. This reserve is not intended to provide funding for new programs or for "buys of opportunity" or similar circumstances, usually involving the purchase of property. The General Fund Operating Reserve is distinguished from the General Fund Emergency Disaster/Reserve, from any reserves that may be assigned for specific purposes, and from unassigned fund balance and shall be reported separately on the balance sheet.

Under "GASB 54" the General Fund Operating Reserve will also be categorized in the City's financial statements as *Committed* fund balance.

When adopting the budget each year, the City of Sonoma shall establish a General Fund Operating Reserve of 17% of annual General Fund expenditures, (equal to two month of annual operating expenditures), which is available for appropriation for financial hardships or to provide resources in times of economic uncertainties and downturns, and to provide funding due to unexpected expenditures and/or reductions in revenues.

Process for the Use of the General Fund Operating Reserve in the Event of Financial Adversity:

- In the event of financial adversity, (defined as a prolonged downturn in one or more major revenue sources for the General Fund or imposition of a significant, unanticipated and unavoidable expense that cannot be deferred or efficiently funded by borrowing), staff would request City Council approval to utilize the General Fund Operating Reserve to maintain current service levels until a reduced budget is prepared or other solutions identified.
- Appropriate staff (i.e. City Manager, Assistant City Manager and Department Heads) would evaluate affected revenues and programs and make recommendations regarding any reduced service levels and/or any other solutions.
- The proposed financial plan would be shared with all City staff.
- Recommendations from the City Manager and staff on the proposed financial plan would be presented to the City Council for review, discussion, and adoption at a public meeting.

Use of the General Fund Operating Reserve in the event of financial adversity will be by direction of the City Council only and shall be appropriated by a simple majority vote of the City Council.

Whenever expenditures or transfers are made from the General Fund Operating Reserve, it shall be a high priority for the City to reimburse such expenditures soon, normally by deferring other service or project expenditures.

Should the Council opt not to draw on the Operating Reserve or should the financial hardship exceed the available reserve funds, the City Council may direct that funding be augmented through the following

options:

- Inter-fund Financing Transfer;
- External/Third-Party Financing;
- Immediate spending freeze; and/or
- Other financing options available at the point of need.

The City Council may from time-to-time authorize budget appropriations that would reduce the General Fund Operating Reserve below its policy-mandated 17% level and this shall be by a simple majority vote of the City Council.

If the City Council appropriates funds that, for any purpose authorized in this policy, would drop the General Fund Operating Reserve below 17%, the next budget cycle should include a plan for how the General Fund Operating Reserve will be restored to the required 17% reserve level within a reasonable time.

General Fund Emergency Reserve

The purpose of the City of Sonoma's General Fund Emergency Reserve is to provide operating and/or repair funds in the event of a local disaster or catastrophic event.

When adopting the budget each year, the City of Sonoma shall establish a General Fund Emergency Reserve of \$1.5 million, which is available for appropriation to respond to local disasters or catastrophic events, whether natural or man-made.

The City Council may from time-to-time authorize budget appropriations that would reduce the General Fund Emergency Reserve below its policy-mandated \$1.5 million level and this shall be by a simple majority vote of the City Council. These appropriations should be made only in response to significant events such as, (but not limited to), natural disasters, declared emergencies or catastrophic events.

If the City Council appropriates funds that, for any purpose authorized in this policy, would drop the General Fund Emergency Reserve below \$1.5 million, the next budget cycle should include a plan for how the General Fund Emergency Reserve will be restored to the required \$1.5 million reserve level within a reasonable time.

In case of emergencies falling under the purview of the City of Sonoma Municipal Code Section 2.36, purchases authorized by the Director of Emergency Services under Section 2.36.060 (b) may cause the balance in the General Fund Emergency Reserve to fall below the required \$1.5 million level.

Under "GASB 54" the General Fund Emergency Reserve will be categorized in the City's financial statements as *Committed* fund balance.

General Fund Special Projects Reserve

The City of Sonoma shall establish a General Fund Special Projects Reserve which is made up of unassigned fund balance in the General Fund. The purposes of the General Fund Special Projects Reserve are 1) to segregate surplus fund balance from recurring revenue sources so that such surpluses will be appropriated only for non-recurring expenditures and 2) to create a funding source for one-time projects such as, but not limited to:

- Capital improvement projects of any type

- Surveys, studies and analyses of both operating and capital needs
- Updates of adopted plans (e.g., general plan or specific general plan elements, facility master plans)
- Temporary service programs (for example, a limited- duration code or traffic enforcement effort).

Approval of any appropriation from the General Fund Special Projects Reserve shall be by a simple majority vote of the City Council.

Under “GASB 54”, the General Fund Special Projects Reserve will be categorized in the City’s financial statements as either Assigned, if the funds are reserved by City Council direction or the City Manager for designated purposes; or Committed or Assigned, if the funds are approved in the annual budget process.

General Fund Inter-Fund Financing

The City of Sonoma maintains additional funds outside the General Fund, which may be utilized to provide interim financing to the General Fund in the event of financial adversity. Financing levels of the inter-fund loan shall not exceed 50% of the available fund balance and shall be documented by an established repayment schedule, including interest accrued on the loan using the quarterly Local Agency Investment Fund (“LAIF”) interest rate earned by the City on its idle cash, approved by the City Council based on the recommendation of staff.

The staff recommendation shall include a certification that the fund from which the cash is to be borrowed shall not need these dollars during the repayment period to meet City obligations, based upon fund financial projections and based upon legal requirements. Repayment of these loans shall become the priority in future budgeting cycles.

WATER UTILITY FUND RESERVES

It is the City Council’s responsibility to provide for the continuation of water utility services in the event of a natural or fiscal emergency, therefore fiscal stability is vital for the City’s Water Utility Fund. In 2018, the City updated its water rates and conducted a comprehensive review of the City’s Water Utility financial plan, user classifications, and various rate structures to help ensure the City will continue to provide high quality, dependable water service to the community while maintaining financial stability, affordability, and adequate levels of investment in infrastructure. In keeping with sound financial policies three separate Water Utility Fund reserves were established, as outlined below:

Water Utility Fund Reserves			
Reserves	Description	Calculation	GASB Categorization
Water Utility Fund Operating Reserve	Provide cash flow to support the operation, maintenance and administration of the City’s Water Utility Fund to cover any significant unanticipated or mandated expenditures.	Two (2) months of annual expenditures (17%)	Committed
Water Utility Capital Reserve	To cover any unexpected and unplanned infrastructure repairs and replacements not included in the Capital Improvement Plan (CIP) annual budget.	Annual average of CIP expenditures (averaged over the next five years)	Committed
Water Utility Fund Rate Stabilization Reserve	To be used during periods of short-term revenue shortages due to economic recession, drought, or other causes, to alleviate the need to quickly implement substantial rate increases.	10% of annual Volumetric Charge revenue, increasing by 1% every year until it reaches 15% of annual Volumetric Charge revenue	Committed

Water Utility Fund Operating Reserve

The purpose of the Water Utility Fund Operating Reserve is to provide working capital to support the operation, maintenance and administration of the City’s Utility Fund, ensuring that cash flow needs of normal operations are met.

Beginning with fiscal year 2018/19, the City shall establish and maintain an Operating Reserve target level equal to two months or 17% of operating and maintenance expenditures.

The Water Utility Fund Operating Reserve can cover any significant unanticipated or mandated expenditures which cannot be deferred or efficiently funded by borrowing. This reserve is not intended to provide funding for new programs or for “buys of opportunity” or similar circumstances, usually involving the purchase of property. The Water Utility Fund Operating Reserve is distinguished from any reserves that may be assigned for specific purposes and from unassigned fund balance and shall be reported separately on the balance sheet.

Under "GASB 54" the Water Utility Fund Operating Reserve will be categorized in the City's financial statements as Committed fund balance.

Process for the Use of the Water Utility Fund Operating Reserve in the Event of Financial Adversity:

- In the event of financial adversity, (defined as a prolonged downturn in one or more major revenue sources for the Water Utility Fund or imposition of a significant, unanticipated and unavoidable expense that cannot be deferred or efficiently funded by borrowing), staff would request City Council approval to utilize the Water Utility Fund Operating Reserve to maintain current service levels until a reduced budget is prepared or other solutions identified.
- Appropriate staff (i.e. City Manager, Public Works Director and Department Heads) would evaluate affected revenues and programs and make recommendations regarding solutions.
- The proposed financial plan would be shared with all City staff.
- Recommendations from the City Manager and staff on the proposed financial plan would be presented to the City Council for review, discussion, and adoption at a public meeting.

Use of the Water Utility Fund Operating Reserve in the event of financial adversity will be by direction of the City Council only and shall be appropriated by a simple majority vote of the City Council.

Whenever expenditures or transfers are made from the Water Utility Fund Operating Reserve, it shall be a high priority for the City to reimburse such expenditures soon, normally by deferring other service or project expenditures.

Water Utility Fund Capital Reserve

The purpose of the Water Utility Fund Capital Reserve is to cover any unexpected and unplanned infrastructure repairs and replacements not included in the Capital Improvement Plan (CIP) annual budget.

Beginning with Fiscal Year 2018/19 the City shall establish and maintain a Water Utility Fund Capital Reserve of annual average CIP expenditures (averaged over the next five years). The Capital Reserve target levels do not include the debt funded CIP projects.

Use of the Water Utility Fund Capital Reserve in the event of any unexpected and unplanned infrastructure repairs and replacements not included in the Capital Improvement Plan (CIP) annual budget will be by direction of the City Council only and shall be appropriated by a simple majority vote of the City Council.

Whenever expenditures or transfers are made from the Water Utility Fund Capital Reserve, it shall be a high priority for the City to establish a plan to reimburse the Water Utility fund Capital Reserve as soon as fiscally possible.

Under "GASB 54" the Water Utility Fund Capital Reserve will also be categorized in the City's financial statements as Committed fund balance.

Water Utility Fund Rate Stabilization Reserve

The Water Utility Fund Rate Stabilization Reserve is to be used during periods of short-term revenue shortages due to economic recession, drought, or other causes, to alleviate the need to quickly implement substantial rate increases. Beginning in Fiscal Year 2018/19 the Water Utility Rate Stabilization Reserve target level is 11% of annual Volumetric Charge revenue. The Water Utility Rate Stabilization Reserve will be increase by 1% every year, until it reaches a targeted 15% percent of annual Volumetric Charge

revenue.

Use of the Water Utility Fund Rate Stabilization Reserve during periods of short-term revenue shortages caused by economic recession, drought, or other reasons, will be by direction of the City Council only and shall be appropriated by a simple majority vote of the City Council.

Whenever transfers are made from the Water Utility Fund Rate Stabilization Reserve, it shall be a high priority for the City to reimburse the Reserve as soon as fiscally possible.

Under "GASB 54" the Water Utility Fund Rate Stabilization Reserve will also be categorized in the City's financial statements as Committed fund balance.