

FINANCIAL ADVISORY BOARD AGENDA ITEM – July 30, 2018 Meeting

ACTION REQUESTED:

Receive a Report on City Reserve Level Policies

DEPARTMENT: Finance Department

SUBMITTED BY: Franco Bottalico, Budget Analyst

BOARD/COMMISSION REVIEW:

N/A

BACKGROUND:

The City of Naperville's current Emergency Reserve Policy was adopted by the City Council on December 20, 2011. The policy stipulates that the City maintain a minimum of a 20% reserve. The purpose of the reserve is to ensure the city's ability to fund the provision of critical services to the public during, or immediately after, an emergency event. The intention is to mitigate current and future risks from events which result in either:

- sudden and significant decreases in locally collected revenue or intergovernmental aid;
- or unanticipated expenditures related to relief efforts in response to an extreme event;
- or the immediate cash requirement for unexpected major capital maintenance expenditures.

In addition to the Emergency Reserve Policy and Ends Policy for the General Fund, the City also has a resolution regarding the reserves for both Utility Enterprise Funds (Electric and Water/Wastewater). The reserve policy for the Utility Enterprise Funds was adopted on April 15, 2003, instructing the City to maintain a 30-day working capital reserve for each fund.

In 2015, the Naperville City Council and City staff developed four ends policies to help guide the City's priorities in the coming years. One of these policies is that Naperville will be financially stable and maintain a AAA bond rating. One of the performance management goals to meet this ends policy is to provide services that ensure a high quality of life for our residents through fiscal management and financial stability, the City will actively seek to increase its reserves to 25% and reduce its debt by 25% in the next eight years.

The City has successfully maintained the 20% reserve for the General Fund and has pursued a 30-day reserve for each of the Utility Enterprise Funds.

DISCUSSION:

Staff has begun preliminary research on the advisability of these policies going forward.

Staff's initial research looked at guidance from the Government Finance Officers Association (GFOA) for the appropriate fund balance levels for the General Fund and the enterprise funds. GFOA recommends that the City maintain their reserves at no less than two (2) months of reserves. This equates to 17%. However, GFOA cautions that the City should review other variables that affect the reserves, including the risks of cuts in state and/or federal funding. Additionally, for the City's enterprise funds, the GFOA Best Practices publication addresses working capital and recommends forty-five days (45) worth of annual operating expense.

Staff, also reviewed the comments from the rating agencies that accompanied the City's most recent bond issuance. The S & P Global review of the City noted that the City has a "very strong budgetary flexibility" based on the commitment to raise the fund balance to 25% of the general fund expenditures. Moody's Investor Services issued more cautious comments. Moody's notes the City's credit challenge, "Cash (reserves) relative to operating revenues is modest compared to similarly rated entities". Moody's, also, noted the one factor that could result in a rating downgrade would be the decline in liquidity and/or fund balances.

The City's General Fund balance at the end of 2017 was \$28,413,080. This was 23.7% of 2017 actual expenditures of \$119,659,236.

The Electric Utility Fund's 2017 adopted operating expenses were \$157,622,289. Based on the City's current 30-day reserve policy, the reserve should be \$13,135,191. The Fund Balance at the end of 2017 is \$16,898,469.

The Water Utilities Fund 2017 adopted operating expenses were \$62,285,280. Based on the City's current 30-day reserve policy, the reserve should be \$5,190,440. The fund balance at the end of 2017 was \$2,655,879. Based on the City Council direction at the December 5, 2017 Council Meeting, the Water Utilities Fund will reprice its rates to increase reserves.

The following is a comparison of each fund by its respective reserve level goal and actual amount based upon the 2017 Comprehensive Annual Financial Report (CAFR):

Fund	Reserve Level Goal	Actual Reserve Amount	Over / (Under)
General (25%Goal)	\$29,914,809	\$28,413,080	(\$1,501,729)
Electric Utility (30-Day)	\$13,135,191	\$16,898,469	\$3,763,278
Water Utilities (30-Day)	\$5,190,440	\$2,655,879	(\$2,534,561)

The City has Reserve Fund Policies in place that provide for funding during or immediately following an unexpected significant event. Within the last seven (7) years City Council has instructed staff to review the General Fund reserves. The first time was in 2011 when the Council passed the ordinance to articulate the usage of reserve funds and the appropriate fund levels. The second time was in 2015, when Council adopted the Ends Policy that the fund reserves should increase to 25% by 2022. As the City has recently adopted the Financial Advisory Board's (FAB) cash investment policy recommendations, and as stewards of the City's financial health, staff is soliciting the FAB for guidance on

the City's Reserve Fund Policies and is seeking input for potential modifications to these policies.

The following is a summary table of comparable communities' reserve policies:

	General Fund	Electric Fund	Water/Wastewater Fund
Naperville	20% of the subsequent year's annual budgeted expenditures less inter-fund transfers	30-day operating reserve	30-day operating reserve
Aurora	Either (1) 10% of expenditures and other financing sources as originally budgeted; or (2) \$1M plus 25% of the current FY's property tax levy	-	Based on certain bond covenants, required to establish and maintain prescribed amounts of resources that can be used for specified purposes.
Batavia	No less than 2 months and no more than 6 months of operating expenditures	-	Unrestricted net asset targets should represent no less than 3 months of operating expenses (excluding debt service and capitalized asset expenses).
Geneva	90 days of current budget year operating expenditures	90 days of current budget year expenditures	90 days of current budget year expenditures
Hoffman Estates	25% or preceding year's operating budget	-	-
Oswego	Minimum assigned fund balance of 30% of the subsequent year's operating expenditures; and minimum cash reserve balance equal to 25%	-	Unrestricted net assets balance equal to 30% of the subsequent year's operating expenditures; additional reserve sufficient to meet all payments for the following FY based on the bond ordinance requirements for pledged revenues and bond coverage requirements
Plainfield	At least equal to 25% of the total General Fund annual operational expenditures	-	At least equal to 25% of the total Water and Sewer Fund annual operational expenditures
Schaumburg	40% of the subsequent year's budget for expenditures	-	10% of subsequent year's budget for operating and nonoperating expenses, plus a prorated amount of the next interest and principal payments on outstanding debt

St. Charles	Minimum of 25% of annual expenditures and transfers out	Minimum of 25% of annual expenditures and transfers out	Minimum of 25% of annual expenditures and transfers out
Warrenville	Minimum of 25% of the current fiscal year's operating expenditures budget	-	A sufficient amount of working capital (Current Assets minus Current Liabilities) to provide for operations, fixed assets acquisition and capital projects
Winnetka	6 months of operating expenditures	4 months of operating expenditures	4 months of operating expenditures

Staff can provide each of these policies upon request. In addition to the reserve policies for the three major operating funds, staff has also begun reviewing reserve policies related to the Self-Insurance Fund. According to our benefits consultant, many other self-insured organizations have a fund reserve of approximately 40% of annual medical claims, one-month of prescription drug claims, and 25% of dental claims to have enough money in reserves to meet expenses for the volatile nature of future claims without borrowing money from their General Fund.

Another major component in the holistic review of reserve policies is the development of a City capital and debt policy. Currently, the City has a debt management policy but no guidelines on standards, limits, or guidelines of borrowing. Staff has included as part of this agenda item a sample policy from the City of Highland Park.

SUMMARY:

The information above is meant for informational purposes and consideration in review and potential modification to the City's current reserve policies.