

M E M O R A N D U M

To: Town Commission
From: Tom Harmer, Town Manager
Sue Smith, Finance Director
Report date: January 25, 2021
Meeting date: February 16, 2021
Subject: Fund Balance Reserve Policy

Recommended Action

Provide direction to Manager.

Background

At the November 4, 2013 Regular Meeting, the Commission passed Resolution 2013-35 formally adopting a Fund Balance Policy for the General Fund, in accordance with Government Finance Officers Association (GFOA) recommended best practices and formalized the Town's compliance with Governmental Accounting Standards Board (GASB) Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*.

The Policy provided the purpose, definitions and policies related to Non-spendable, Restricted, Committed, Assigned and Unassigned classifications of Fund Balance and the spending order for GASB Statement No. 54 reporting purposes.

The Commission requested a review of the policy given the current size of our Fund Balance, the different assignments of reserves that have been previously authorized by the Commission, and the unfunded capital initiatives being considered.

Town staff completed thorough research using GFOA's framework of risk assessment and presented a peer review of other Fund Balance policies. The research also included an analysis of the Town's debt compared to similar municipalities and a review of S&P Global Credit Rating Agency comments as guidance. A thorough examination of the risk factors not only helps lead to a customized reserve target size, but also improves the Town's understanding of the risks it faces and its overall financial risk profile.

Current Policy

The Town's current policy follows GFOA's Best Practice on General Fund reserves and sets a minimum level of *Unassigned Fund Balance* as stated below:

“The desired unassigned general fund balance shall be not less than two months or 16% of general fund operating expenditures.”

Unassigned Fund Balance are those funds that have not been restricted, committed or assigned to specific purposes.

The current policy also sets a minimum level of total *Unrestricted Fund Balance*. *Unrestricted Fund Balance* is the combination of committed, assigned and unassigned reserve balances.

“The desired combined unrestricted available fund balances should not be less than three months or 25%. The three-month minimum is based on the caveat that there is sufficient cash available for borrowing in other funds in case of a natural disaster. For purposes of this calculation, total operating expenditures shall include transfers out and contingency line items but shall exclude capital outlay.”

Risk Assessment Process

The analysis looked at eight general areas of risk, identified and assessed the specific relevant risks to the Town of Longboat Key and looked at ways the Town mitigates those risks. Through this process, staff has identified three prime risk factors having the largest impact on Town Reserves:

- Vulnerability to extreme events and public safety concerns
- Vulnerability to revenue volatility
- Degree of leverage

The remaining areas of risk were considered secondary or of lesser importance:

- Expenditure volatility
- Liquidity
- Other Funds reliance on the General Fund
- Growth
- Capital Projects

Based on the specific risk analysis that was performed for Longboat Key, the final scoring was a 25 as explained in the attached report. Based on this score, the GFOA recommends adopting a target amount of reserves significantly higher (e.g. 26-35%) rather than the GFOA minimum (16%).

During our Peer Review, we researched fifteen communities in Florida that have similar characteristics to Longboat Key. There was some variation in each communities' approach to setting their Fund Balance levels. Overall almost all the communities exceed 25%.

Staff Analysis

As mentioned, our current reserve policy requires the Town to maintain at least 60 days (16%) of unassigned General Fund Balance and at least 90 days (25%) of overall unrestricted Fund Balance.

Our current General Fund reserve levels are:

| | | |
|-----|-------------|----------------------------------------------------|
| 43% | \$7,124,728 | Unassigned (157 days) |
| 7% | \$1,150,000 | assigned to economic uncertainty reserve (25 days) |
| 8% | \$1,310,075 | assigned to pension (29 days) |
| 0% | \$ 59,005 | assigned for encumbrances (1 day) |
| 0% | \$ 14,205 | nonspendable (Prepays and inventory) |
| 15% | \$2,533,285 | Total Assigned and Nonspendable |
| 58% | \$9,658,013 | Total (212 days) |

Proposed Reserve(s) Policy:

While our current policy doesn't call out the assignments specifically, having a reserve for emergencies and a reserve for economic uncertainty would make their purpose clearer than one all-encompassing reserve and this is a change being proposed.

We are proposing a two month (60 days or 16%) Unassigned Fund Balance in addition to two specific assignments using a minimum and maximum range, to allow for flexibility and changes in financial conditions or special circumstances as shown below.

- Unassigned Fund Balance 16% (approx. 60 days)
- Economic Uncertainty/Revenue Stabilization Reserves 8%-16% (30-60 days)
- Emergency Reserves/Natural Disasters 8%-16% (30-60 days)

The new recommended combined target range is 32% - 48% of total budgeted expenditures (excluding capital outlay), which is in line with the range of reserves maintained by other municipalities that are comparable to the Town of Longboat Key. It is also greater than the 16% the GFOA considers a minimum and addresses the results of the Risk Analysis. This change is an increase in the unrestricted minimum of 7% (26 days) from our current policy.

While not required in the proposed new policy, the Town Manager proposes an additional assignment of \$750,000 (5% of the budget) to cover future fiscal capital expenses. The \$750,000 may be used to help offset capital expenses during the budget process and can be restored if the result of the audit exceeds anticipated revenue projections and/or any annual underspending within the Fund.

The current size of the Town's Fund Balance allows us to fill our reserves at the maximum of the ranges. The Town's current assignment for Pension falls under the Economic Uncertainty/Revenue Stabilization Category, because it is the recession and economic impacts on the stock market that will generate a spike in the annual contribution requirements.

Based on past history, the Town experienced three consecutive budget years of \$1 million revenue losses. We are proposing to fill the maximum of the range 16% between the two at \$1,360,000 each. The average peer reserve of emergencies and natural disasters is 15% with the lowest being 5% and the largest being at 32%. The Town reserve will be filled at 16%, the maximum of the range.

Assignment of Fund Balance may be made, from time-to time, by intent of the Town Commission, or a body or official to which the Town Commissioners have delegated that authority, which is the Town Manager. Based on the review of our Fund Balance policy and recommendations discussed above, the proposed assignments recommended for FY21 are shown below:

| | | |
|-----|-------------|----------------------------------------------------------|
| 16% | \$2,720,000 | Unassigned (60 days) |
| 8% | \$1,360,000 | assigned to economic uncertainty reserve (30 days) |
| 8% | \$1,360,000 | assigned to pension (30 days) |
| 16% | \$2,720,000 | assigned to Natural Disasters/Extreme Events (60 days) |
| 5% | \$ 750,000 | assigned to future fiscal budget capital costs (16 days) |
| 0% | \$ 59,005 | assigned for encumbrances (1 day) |
| 0% | \$ 14,205 | nonspendable (Prepays and inventory) |
| 37% | \$6,263,210 | Total Assigned and Nonspendable (137 days) |
| 53% | \$8,983,210 | Total (197 days) |

Once the proposed reserve and assignments are fully funded that leaves an additional Fund Balance available above the established levels. For FY21 the remaining unassigned reserves is \$674,803 (4% and 15 days).

Unassigned reserves in excess of established levels may be used as follows:

- to offset operating expenditures or revenue losses in the subsequent fiscal year budget
- unanticipated budgetary shortfalls
- one-time expenditures or other capital initiatives
- transfer funds to the Misc. Capital Project Fund for vehicles, equipment, facility and major I.T. infrastructure improvements having no other funding sources.

General Fund Contingencies

In addition to the funding of reserve levels within the General Fund, the Town also budgets contingencies within the operating budget. These contingencies were not part of this review and the staff recommends that we continue to fund these on an annual basis. The current contingencies are listed below and would be factoring into the FY22 budget planning process.

- \$250,000 General Fund Contingency (this fiscal year (FY21) reduced by \$25,000 in the budget process to fund the Town’s portion of the St. Armand’s Pedestrian Monitors Program).
- \$ 50,000 Red Tide Event Contingency

The Town Manager and Finance Director will present the analysis and recommendations at the February 16, 2021 Regular Workshop Meeting. Based on direction received, a revised Fund Balance policy will be brought to the Commission at a future Regular Meeting for formal action.

Staff Recommendation

Provide direction to Manager.

Attachments

- A. Risk Assessment Report (Available in the Town Clerk's office)
- B. Exhibit A-GFOA Risk Assessment Model (Available in the Town Clerk's office)
- C. Exhibit B-Peer Review Comparison Matrix (Available in the Town Clerk's office)
- D. PowerPoint (Available in the Town Clerk's office)

End of Agenda Item