

CITY OF DANA POINT
AGENDA REPORT

Reviewed By:	
DH	_____
CM	_____
CA	_____

DATE: AUGUST 23, 2006

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: INVESTMENT REVIEW COMMITTEE

SUBJECT: RESERVE AND CAPITAL INFRASTRUCTURE POLICIES

RECOMMENDED ACTION:

- A. Approve the recommendation of the Investment Review Committee (IRC) to adopt the General Fund Reserve Policy and the Capital Infrastructure Funding Policy, and to implement said policies in FY 2006-07.
- B. Modify the existing \$1,500,000 Cash Flow Reserve by establishing the level at 10% of General Fund revenues (\$2.8 million); modify the existing \$2,000,000 Emergency Reserve by establishing the level at 20% of General Fund revenues (\$5,500,000); eliminate the existing \$1,000,000 Uninsured Claims Reserve; eliminate the existing \$66,685 Vehicle & Equipment Replacement Reserve; create a new designated General Fund reserve entitled Capital Projects Sinking Fund Reserve and establish the initial funding level at \$2,500,000.

ISSUE:

Shall the City Council adopt A) a General Fund Reserve Policy to ensure that the City has sufficient funds on hand at all times to meet its fiscal obligations and unanticipated contingencies; and B) a Capital Infrastructure Funding Policy to ensure sufficient funding for the on-going maintenance or replacement of existing capital infrastructure and the construction of new capital infrastructure?

BACKGROUND:

On October 12, 2005 the City Council adopted Resolution No. 05-10-12-01 which expanded the scope of responsibility of the IRC to advise, review, comment and work with staff to draft specific financial management policies and provide

recommendations for the City Council's consideration relating to the development and implementation of general fiscal policies.

DISCUSSION:

The IRC has met several times over the past year to diligently review the City's existing financial policies in relation to operating budgets and General Fund reserve levels with the intent of drafting a General Fund Reserve Policy and a Capital Improvement Project funding policy. To assist the IRC in this analysis, staff prepared a 5-year summary analysis which provides prior year and future projected fiscal information from FY2006 through FY2010 (**SUPPORTING DOCUMENT C**). The purpose of this analysis was to provide insight into the levels of operating surpluses being generated by the City's General Fund, which is the principle funding source for capital improvement projects. The analysis, which is predicated on the City's historical experience, projects that total revenues and total expenditures will increase each fiscal year on average by 5%. Please note that the analysis also takes into account the early payoff this month of the \$2.9 million Certificate of Participation debt which has resulted in a projected negative operating surplus this fiscal year. However based on future projected revenue streams exceeding total expenditures, the net operating surplus is projected to be a positive variance in FY2008 and future years. Also importantly, the impact of the Headlands development has not been factored into this analysis due to uncertainty with respect to the actual timing of the construction of improvements that will fiscally impact the City.

This analysis was used as a tool by the IRC to determine appropriate adjustments to reserve funds, while at the same time ensuring sufficient funding is available to meet fiscal obligations, unanticipated contingencies, and to fund the on-going maintenance of existing capital infrastructure. The recommendations of the IRC have been developed into the two proposed financial policies as described in more detail below.

General Fund Reserve Policy

The existing and proposed General Fund Reserve designations and funding levels are as listed below. The IRC is recommending the current policy and funding levels be revised as set forth in the proposed General Fund Reserve Policy (**ACTION DOCUMENT A**) and described below:

	FY2006-07 CURRENT LEVELS	FY2006-07 PROPOSED LEVELS
Cash Flow	\$1,500,000	\$2,800,000 (10%)
Uninsured claims	1,000,000	0
Vehicle/equipment replacement	66,685	0

Emergencies	2,000,000	5,500,000 (20%)
Art in Public Places	105,796	105,796
Capital Projects Sinking Fund	0	2,500,000
Undesignated	<u>7,373,190</u>	<u>2,363,358</u>
TOTAL	\$12,300,560	\$13,524,043

Cash Flow: This fund is to ensure adequate cash resources are on hand at all times to compensate for normal fluctuations in monthly cash receipts and disbursements. Current policy is to maintain the Cash Flow Reserve at \$1,500,000. It is recommended this reserve level be increased and maintained at a minimum of 10% of total annual General Fund Revenues.

Uninsured Claims: This fund is intended for major claims against the City not covered through insurance policies. Current practice is to maintain this fund at a level of \$1,000,000. It is recommended this fund be eliminated and combined with the Emergency Fund.

Emergencies: This fund is intended to ensure adequate funds are available for unanticipated emergencies as a result of natural disasters or major economic calamities such as earthquakes or major loss of transient occupancy tax income. Past practice has been to maintain this fund at a funding level of \$2 million annually. It is recommended this funding level be increased and maintained at a minimum of 20% of total annual General Fund Revenues.

The proposed combined cash flow and emergency reserve level equal 30% of total annual General Fund revenues. Currently, this combined reserve level is budgeted at a fixed dollar amount of \$2,500,000. It is important to note that most bond rating agencies prefer a minimum level of 10% for emergency expenditures. Therefore based on the City's fairly level and reliable revenue streams, 30% is a reasonable and prudent reserve level.

Vehicle/Equipment Replacement: This fund is to ensure adequate funds are available for routine replacement of major office equipment and vehicles. It is recommended this fund be eliminated as it has been the City's practice to incorporate the replacement of these assets into the operating budget.

Art in Public Places: No change – based on fees collected from developers and the funds are restricted for use in the development of art in public places.

Capital Projects Sinking Fund Reserve: It is recommended this new reserve fund be established to accumulate funds for the future repair and/or replacements of existing capital infrastructure. It is recommended that the fund be maintained at a minimum level of \$2.5 million, and that \$2.5 million be shifted from the Undesignated General Fund Reserve to provide the initial funding for this new reserve. Concurrent with each budget cycle, the City Manager and the Director of

Public Works shall provide the City Council with a report recommending a sufficient sinking fund reserve amount, and listing the City's progress towards accumulating the required funding for future infrastructure repair or replacement projects.

Undesignated: No change: This fund is a general designation for accumulated funds for economic uncertainties in future City revenues and expenditures.

Capital Infrastructure Funding Policy

This proposed policy (**ACTION DOCUMENT B**) memorializes current practice and implements new requirements relative to identifying and prioritizing new capital projects, and preparing the CIP Budget.

Currently, the annual estimated costs to maintain existing capital infrastructure is deducted from General Fund operating surplus and transferred into the CIP Budget.

The IRC is recommending that this policy be revised so that the estimated annual cost to fund mandates, repairs or the replacement of *existing* infrastructure be presented as a component of the General Fund operating budget, not in the CIP Budget. For illustration purposes, the 5-year budget analysis reflects this policy change in the Public Works expenditure budget. Further, and as noted above, a Capital Projects Sinking Reserve Fund would be established at a minimum level of \$2.5 million to ensure funding for the on-going maintenance of and future replacement of existing capital infrastructure.

The policy recommends that *new* projects and potential future projects remain identified and budgeted for in the CIP Budget as is currently the practice. The proposed Capital Infrastructure Funding Policy requires that each fiscal year an amount equal to the projected General Fund operating surplus, if any, will be transferred to the CIP Fund to ensure that new capital infrastructure projects are continually funded.

The policy also maintains the current practice whereby in connection with each bi-annual budget process, the City Manager and the Public Works Director shall prepare a prioritized list of new capital projects and their estimated costs for the Council's consideration. Subject to Council approval, a new project would be categorized as Priority 1 if funding is available. The policy also provides that if sufficient funds are not available to fully fund a Priority 1 project, then a multi-year funding plan will be presented by staff and a portion of the total required funding will be allocated in each fiscal year so that the project can be constructed as scheduled. Priority 2 projects are potential future capital projects which are listed for future consideration and will not receive any funding until classified as a Priority 1 project by the City Council.

The policy also memorializes current policy that funding priorities will be based upon the level of available General Funds, combined with any outside funding sources, i.e. grant funds. It was the consensus of the IRC that all costs and funding sources associated with a new capital project must be identified and presented to the City Council at the time new projects are agendized for approval. This will ensure that future annual operation and maintenance costs, the estimated useful life of the project, and replacement costs are considered and accounted for in the annual CIP and Operating Budgets. This policy change is also included in the proposed policy.

Staff recommends the City Council approve and adopt the proposed General Fund Reserve Policy and the Capital Infrastructure Funding Policy.

NOTIFICATION AND FOLLOW-UP:

Investment Review Committee
Appropriate Staff Members

STRATEGIC PLAN INITIATIVE:

Achieve total excellence in municipal services and City administration/planning with excellent customer service and cost-effectiveness.

FISCAL IMPACT:

Modifying the reserves as recommended in the proposed General Fund Reserve Policy will result in the transfer of monies from the existing Undesignated General Fund Reserve into the new/revised reserves by modifying the existing \$1,500,000 Cash Flow Reserve by establishing the level at 10% of General Fund revenues (\$2.8 million); modify the existing \$2,000,000 Emergency Reserve by establishing the level at 20% of General Fund revenues (\$5,500,000); eliminate the existing \$1,000,000 Uninsured Claims Reserve; eliminate the existing \$66,685 Vehicle & Equipment Replacement Reserve; create a new designated General Fund reserve entitled Capital Projects Sinking Fund Reserve and establish the initial funding level at \$2,500,000.

Other annual fiscal impacts will be dictated upon economic uncertainties and the amount of available General Fund surplus.

ALTERNATIVE ACTIONS:

Other actions as deemed appropriate by the City Council.

ACTION DOCUMENTS:

PAGE NO.

- A. [General Fund Reserve Policy.....7](#)
- B. [Capital Infrastructure Funding Policy.....9](#)

SUPPORTING DOCUMENTS: PAGE NO.

- C. Actual and Projected General Fund Reserve Analysis (FY06-FY10), including revised Reserves and Designations.....11

(Hard copy to be provided)

ACTION DOCUMENT A**City of Dana Point****General Fund Reserve Policy****I. Purpose**

General Fund reserves are created to:

- a) Ensure that the City has sufficient funds on hand at all times to meet its fiscal obligations as embodied in the adopted budget;
- b) Maintain a high level of credit worthiness for the City;
- c) Provide a source of funding for unanticipated contingencies that could result from major uninsured claims against the City, natural disasters, major economic downturns and other situations of this nature;
- d) Ensure sufficient funds are available for the future repair or replacement of major existing capital infrastructure.

II. Definition of Designated Reserves

Designated reserves represent discretionary funds set aside by the City Council for specific purposes. Although there is no *legally binding* restriction on such reserves the City Council has administratively placed budgetary restrictions on the amounts of such reserves and when these funds may be used. Designated reserves are distinct from those reserves which are mandated either legally or under specific governmental accounting requirements, such as encumbrances or restricted assets. The City has established the following designated reserves:

- a) Cash Flow Reserve – this reserve is established to provide a cushion for normal fluctuations in monthly revenue inflows and expenditure outflows, such that a sufficient amount of monies are always on-hand to meet the City’s fiscal obligations. Such a reserve also helps to ensure that the City maintains a strong rating among credit rating agencies.
- b) Emergency Reserve – this reserve is established to provide a source of fiscal resources that can be tapped immediately to deal with the types of situations described in I.c). In order to tap this reserve, a minimum 4/5 vote of the City Council is required.
- c) Capital Projects Sinking Fund Reserve – this reserve is established to accumulate funds for the future repair and/or replacement of existing capital infrastructure.

III. Amounts of Designated Reserves

Based upon the recommendation of the Investment Review Committee, as ratified by the City Council, the following amounts have been established for the designated reserves described in section II.)

- a) Cash Flow Reserve – an amount equal to 10% of total General Fund revenues.
- b) Emergency Reserve – an amount equal to 20% of total General Fund revenues.
- c) Capital Projects Sinking Fund Reserve – an amount not less than \$2.5 million. (Concurrent with each budget cycle, the City Manager and the Director of Public Works shall provide the City Council with a report recommending a sufficient sinking fund reserve amount, and listing the City's progress towards accumulating the required funding for future infrastructure repair or replacement projects).

Approved by the City Council on _____.
DATE

ACTION DOCUMENT B**City of Dana Point****Capital Infrastructure Funding Policy****II. Annual Funding to be Transferred into the Capital Improvements Projects (“CIP”) Fund**

Each fiscal year an amount will be transferred from the General Fund to the CIP Fund equal to the projected General Fund operating surplus, if any, for that fiscal year plus the excess (if any) of any General Fund operating surplus from the preceding year.

The operating surplus is defined as the excess of General Fund revenues and operating transfers-in over expenditures and operating transfers-out, as increased or decreased by any amounts necessary to fully fund or replenish all General Fund reserves and designations.

IV. Annual Listing of Proposed Capital Infrastructure Projects

For each fiscal year the City Manager and Public Works Director shall prepare and provide the City Council with a prioritized list of capital infrastructure projects and their estimated costs.

New capital infrastructure projects for Council consideration shall be prioritized for budgeting in the CIP Fund as follows:

- a) Priority 1 – recommended new capital infrastructure projects (if funding levels allow within budget)
- b) Priority 2 – potential future capital infrastructure projects (unfunded)

Note: Projects classified as “repairs, replacements and mandates” to *existing* infrastructure shall be included in the General Fund operating budget.

In connection with the bi-annual budget process the City Council will consider the City Manager and Public Works Director’s recommendations for the purpose of reaching consensus on the proposed new capital infrastructure projects, their funding level and their prioritization (1 or 2), with consideration given to associated future costs as identified in section III of this policy.

V. Funding Priorities for Capital Infrastructure Projects

Funding priorities shall be based upon the level of available General Funds (as determined in section I.), combined with any outside funding available from other sources such as the Federal government, State government, County government, the private sector, etc.:

- a) All new capital infrastructure projects identified as Priority 1 shall receive the first allocation of available funding equal to 100% of the estimated capital infrastructure project cost.
- b) Each fiscal year a CIP budget reserve equal to 10% of the required funding for Priority 1 new capital infrastructure projects shall be created. Unless otherwise directed by the City Council this reserve may only be used to fund changes in cost estimates, quantities or project scope of Priority 1 capital infrastructure projects.
- c) When sufficient funds are not available to fully fund a designated Priority 1 capital infrastructure project, then a multi-year funding plan will be presented and a portion of the total required funding shall be allocated in each fiscal year so that adequate funds will be accumulated over time to construct the capital infrastructure project as scheduled.

Priority 2 capital infrastructure projects are new capital infrastructure projects which are listed for the purpose of consideration of future construction funding and are incorporated into the backlog of unfunded capital infrastructure projects. They shall not receive any funding allocations until such time as they are classified as Priority 1 capital infrastructure projects.

VI. Supplemental Information to be Provided on Agenda Reports

When capital infrastructure projects are presented to the City Council for approval the fiscal impact section shall include the following information:

- a) The full program cost to develop and build the project
- b) The future annual ongoing operation and maintenance costs (if applicable)
- c) The estimated useful life of the project
- d) The estimated annual funding required to accumulate monies for the future replacement of the project (if applicable)

Approved by the City Council on _____.

DATE