

AGENDA REPORT FROM
DECEMBER 11, 2013 MEETING

RESERVES



CHARTER COMMITTEE AGENDA REPORT

MEETING DATE: DECEMBER 11, 2013

ITEM NUMBER: 8B-1

SUBJECT: RESERVE REQUIREMENTS

DATE: DECEMBER 5, 2013

FROM: SPECIAL COUNSEL'S OFFICE

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INTRODUCTION

At the November 13, 2013 meeting, the Charter Committee discussed whether the proposed charter should include a reserve requirement. Subsequent to that meeting, staff received the following proposals for a reserve requirement from Charter Committee members:

General Fund Reserve Proposals

- 1) Reserves will be listed as a separate line item in the budget. (5% of total expenditures).
- 2) The City shall maintain cash reserves for unexpected events of risk and opportunity of 50% of General Fund gross revenues (property taxes, sales taxes, fees, etc.). This level should be achieved by June 30, 2020.

The following is a discussion of these two options.

DISCUSSION

Emergency Reserves

In 1991, the City Council adopted Ordinance No. 91-20 codified in Title 2, Chapter 5, Article 6 of the Costa Mesa Municipal Code requiring the General Fund Operating Reserve. The use of General Fund Operating Reserve is restricted to emergencies and unanticipated urgent events. The amount of the General Fund Operating Reserve is not codified in the ordinance but rather is set by the City Council via resolution. Currently, the City Council has established the General Fund Operating Reserve at \$14.125 million. This amount is identified as "Committed Fund Balance" in the City's Comprehensive Annual Financial Report. Staff is conducting a study of reserves to determine an appropriate level of reserves for various scenarios including another economic downturn, a major natural disaster or a catastrophic infrastructure failure.

Non-Emergency Reserves

In addition to the General Fund Operating Reserve, the City sets aside unallocated portion of the tax revenue as reserves. Prior to the economic downturn, the City's cash reserve was in the range of \$70 million. The vast majority of those reserves are based on sales tax revenue. During the three (3) years following the recession, the reduction in sales tax revenue resulted in various cuts within the City including a reduction in the workforce by approximately 1/3rd. However, approximately \$32 million of those reserves were used to cover budget gaps. The City's revenue is on the upswing beginning in the 2011-12 fiscal year. Over the past three years, the City has experienced an \$14 million increase to the general fund.

With the improvements in the economy, the City is in a position to begin rebuilding its reserves. At the Study Session of the City Council held on November 12th, 2013, the CEO announced an administrative budget policy that would allocate a minimum of 1% of the general fund revenues to increase reserves until reserve goals are met. What that exact amount will be, is up to the City Council to decide.

Preemptive Measures

Additionally, the City acts preemptively by allocating funds to capital improvements, general liability claims, workers' compensation, and equipment replacement fund, among others. By allocating these funds to specific areas, as opposed to reserves, there is less likelihood of an emergency that the General Fund Operating Reserve is intended to protect against. The CEO's administrative budget policy allocates a minimum of 5% (with a goal of 7.5%) of general fund revenues to capital projects. Also, in an emergency, these capital projects could be cancelled or suspended and the funds directed to deal with an emergency.

Charter Provision

There is concern with addressing a reserve requirement via the proposed Charter. As the last eight (8) years demonstrate, the cyclical nature of sales tax revenue makes it difficult in bad times to meet a fixed percentage reserve requirement by way of the proposed Charter. In a charter, any modifications require voter-approval, thus, making it extremely difficult to City to respond to immediate concerns that may be inconsistent with a charter provision. That is not to say that additional reserve requirements cannot be put in place. With respect to emergencies, the Charter Committee can propose to the City Council that the amount in the General Fund Operating Reserve be increased. Alternatively, as with the General Fund Operating Reserve, the City Council could adopt an ordinance for non-emergency reserves. A reserve amount, consistent with the economy at that given time, can be set via resolution.

If the Charter Committee wishes to propose a charter provision, Staff recommends instead the language previously provided which states, "[t]he City Council shall maintain sufficient cash reserves for the purpose of placing the payment of operating expenses of the City on a cash basis." Moreover, if the Charter Committee decides to include a reserve requirement in the draft Charter, there should be sufficient mechanisms in place that allow the City to use those funds when appropriate.

CONCLUSION

Staff recommends that the Charter Committee not address reserve requirements by way of a charter provision for a number of reasons. First, the City is currently required by ordinance to maintain emergency reserves. Moreover, the City maintains non-emergency reserves out of sales tax revenue. Because of the cyclical nature of sales tax revenue, a fixed percentage in savings is difficult to maintain in times of economic difficulty. In lieu of a charter provision, the City Council can increase the emergency reserves set forth in the General Fund Operative Reserve or adopt a policy or ordinance governing non-emergency reserves.