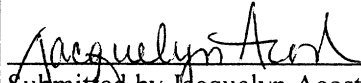


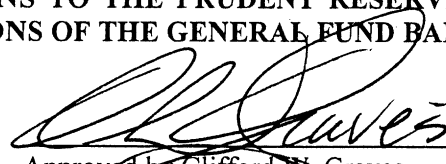


City of Carson Report to Mayor and City Council

March 16, 2011
New Business Discussion

**SUBJECT: CONSIDERATION OF MODIFICATIONS TO THE PRUDENT RESERVE POLICY
AND OTHER RESERVES/DESIGNATIONS OF THE GENERAL FUND BALANCE**


Submitted by Jacquelyn Acosta
Administrative Services General Manager


Approved by Clifford W. Graves
Interim City Manager

I. SUMMARY

On June 2, 1998, the City Council approved the establishment of a “prudent reserve” for economic uncertainties and unforeseen expenditures equivalent to 20% of the budgeted expenditures for each fiscal year. (Exhibit No. 1) Since then, there have been several years in which the city has been faced with financial challenges that have resulted in decreases in the General Fund balance. Staff deems it necessary for the City Council to review the current “prudent reserve” policy and requests that the City Council consider the recommended changes.

II. RECOMMENDATION

Take the following actions:

1. APPROVE a decrease in the General Fund balance “prudent reserve” percentage for economic uncertainties and unforeseen expenditures from 20% to 10% of annual expenditures.
2. APPROVE additions and modifications to the other designations of the General Fund balance as outlined in this report.

III. ALTERNATIVES

1. SET the “prudent reserve” equal to some other amount as determined by the City Council.
2. DO NOT MODIFY the existing “prudent reserve” percentage.

IV. BACKGROUND

As of June 30, 1997, the city’s General Fund balance had reached \$22.8 million while its adopted annual operating budgeted expenditure was only \$32.4 million. Of the total fund balance, \$15.5 million, or 68%, represented the unreserved, undesignated fund balance. As indicated in the staff report to the City Council dated June 2, 1998, (Exhibit No. 2), it may be contended that large amount of unreserved, undesignated funds is an indication of overtaxation. Based on the review of the city’s financial position and other information presented on the report, staff recommended, and Council approved, the establishment of a prudent reserve that would allow the city to set a reservation requirement in order to

respond to unexpected economic circumstances. The approved threshold that became effective in fiscal year 1997/98 was 20% of the subsequent year's annual operating budget.

Since FY 1997/98, the city's General Fund balance has fluctuated between a high of \$42.6 million in FY 2000/01 and a low of \$18.2 million in FY 2009/10. Against that backdrop is the consistent increase in the General Fund's annual operating budget and the corresponding increase in the "prudent reserve," or reserve for economic uncertainties, as shown in Exhibit No. 3.

In 2008, the global economic crisis adversely affected the revenue streams of national, state and local governments. For the city of Carson, its major sources of General Fund revenues are directly tied those components of the economy that were hardest hit by the recession such as consumer spending and the real estate market. While it appears that the economy bottomed out in 2009, forecasts indicate that the financial recovery will be very slow and arduous; therefore, a review of the reserve threshold has become imperative.

For the period covered July 1996 through June 2010, the reserve for economic uncertainties (prudent reserve) comprises an average of 38% of the General Fund balance. That leaves little room for the required reservations of the fund balance as well as the current designations, both necessary for the city to honor constraints on the specific purposes for which those monies can be spent. The funds accumulated in the reserve for economic uncertainties have proven to cushion financial distress; however, certain adjustments need to be effected to place the prudent reserve at a more attainable level.

The Government Finance Officers Association (GFOA) recommends that at a minimum, the general purpose governments, regardless of size, should maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or general fund operating expenditures. The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances. The operating expenditures of the city of Carson are more predictable and for the last three (3) years, it was determined that the average two-month expenditure is \$11 million. Given that goal, it is recommended that beginning with the year that ended on June 30, 2010, the "prudent reserve" be reduced to 10% of annual operating expenditures. With that adjustment, the prudent reserve totaling \$6.2 million, combined with the unreserved, undesignated fund balance of \$5.5 million or a total of \$11.7 million is more than the two-month expenditure reserve requirement of \$11 million. The table on the next page shows the recommended modifications to the city's General Fund balance composition.

City of Carson
General Fund Balance Composition

	Preliminary June 30, 2010	Recommended Changes	Recommended June 30, 2010
Reserved for:			
Encumbrances	162,842		162,842
Inventory	445,594		445,594
Loans Receivable	65,365		65,365
Prepaid Assets	271,035		271,035
Total reserved	944,836		944,836
Unreserved, designated for			
1% PEG Fees	90,563		90,563
Utility Underground	565,360		565,360
Capital Projects-Bond Funded	1,155,409		1,155,409
Raised Median Construction	957,342	(724,228)	233,114
Construction Projects	785,278	(785,278)	-
Self-Insurance	3,014,007	(1,514,007)	1,500,000
Special Projects	3,184,000	(2,184,000)	1,000,000
Alameda Corridor Projects	1,000,000		1,000,000
Economic Uncertainties	12,396,134	(6,198,067)	6,198,067
Total unreserved, designated	23,148,093		11,742,513
Unreserved, undesignated	(5,910,805)		5,494,775
Total General Fund Balance	18,182,124		18,182,124

As shown on the column “Preliminary June 30, 2010”, the unreserved, undesignated fund balance is a negative \$5.9 million due partly to the unadjusted 20% designation for economic uncertainties that eats up 68% of the \$18.2 million fund balance account. Other designations of the fund balance such as bond-funded capital projects, utility undergrounding, 1% PEG fees, and raised median construction have to be assigned to ensure that the funds are available when the projects/activities are implemented. Moreover, adjustments to the designation of fund balance for self-insurance and special projects appears to be in order as the accounts have not been utilized since July 1998. While staff is recommending to reduce the percentage of the “prudent reserve” to 10% at this time, it will, at the soonest opportunity, present a report to the City Council which will discuss recovery strategies aimed at taking the percentage back up and increasing the “prudent reserve” percentage.

If Council approves staff recommendations, the changes to the fund balance will be effectuated as of June 30, 2010.

V. **FISCAL IMPACT**

Approval of staff recommendations will re-align the reserves/designations of the city’s General Fund balance.

VI. EXHIBITS

- 1. Minutes of the June 2, 1998 City Council meeting. (pg. 5)
- 2. Report to Mayor and City Council dated June 2, 1998. (pgs. 6-11)
- 3. Historical General Fund Budget and General Fund Balance. (pg. 12)

Document1

Prepared by: Trini H. Catbagan, Finance Officer

TO:Rev010511

Reviewed by:

City Clerk	<u>City Treasurer</u>
<u>Administrative Services</u>	<u>Development Services</u>
<u>Economic Development Services</u>	<u>Public Services</u>

Action taken by City Council	
Date _____	Action _____

BUDGET WORKSHOP (Items 1 - 2)

ITEM NO. (1) ESTABLISHMENT OF A "PRUDENT RESERVE" (FINANCE)

RECOMMENDATION for Redevelopment Agency / City Council:

TAKE the following actions:

1. **APPROVE** a "prudent reserve" of 20% of annual expenditures for economic uncertainties and unforeseen expenditures.
2. **APPROVE** additional designations of fund balance as listed on page 5.

ACTION: It was moved to approve the policy of twenty percent (20%) for a "prudent reserve" and that such reserve and fund balance designations be applied to the FY 1998/99 on motion of Olaes, seconded by Fajardo and unanimously carried with Calas and O'Neal absent.

ITEM NO. (2) BUDGET WORKSHOP #1 - GENERAL FUND (FINANCE)

RECOMMENDATION for the Redevelopment Agency / City Council:

1. **HOLD** the budget workshop.

ACTION: This item was not discussed.

ORAL COMMUNICATIONS None.

CLOSED SESSION None.

ADJOURNMENT:

The meeting was Adjourned at 5:17 P.M. by Mayor/Chairman Fajardo with Calas and O'Neal absent.

ATTEST:

Heidi S. Kawigora
CITY CLERK/AGENCY SECRETARY

John Fajardo
MAYOR/CHAIRMAN

**APPROVED AND ADOPTED
BY CITY COUNCIL**

6-16-98

App. by submittal

LO/F 3/0/2-C+HO/O

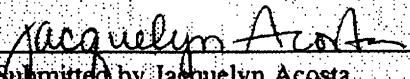
Carson Redevelopment Agency / City Council
June 2, 1998
PAGE 2

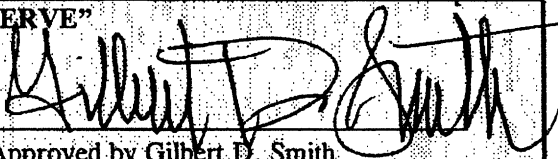


City of Carson Report to Mayor and City Council

June 2, 1998
New Business Discussion
2:00 P.M. Workshop

SUBJECT: ESTABLISHMENT OF A "PRUDENT RESERVE"


Submitted by Jacquelyn Acosta
Director of Finance


Approved by Gilbert D. Smith
Interim City Manager

I. SUMMARY

Over the past few years, the City's General Fund Balance has increased to a very healthy \$22.8 million. A significant amount of that is unreserved, undesignated. Large amounts of unreserved, undesignated funds often send the wrong message to the public. Therefore, staff believes it appropriate to examine the City's fund balance and designate a criteria for the establishment of a "prudent reserve."

II. RECOMMENDATION

Take the following actions:

1. **APPROVE** a "prudent reserve" of 20% of annual expenditures for economic uncertainties and unforeseen expenditures.
2. **APPROVE** additional designations of fund balance as listed on page 5.

III. ALTERNATIVES

1. Create a "prudent reserve" equal to some other amount as determined appropriate by the City Council.
2. Do not create a "prudent reserve."

IV. BACKGROUND

As you know, the City's financial position, and specifically its General Fund balance, declined significantly during the late 1980s. This decline was mostly the result of an economic slowdown that affected most of the State, but greatly impacted the South Bay region with its dependence on the ailing aerospace industry. Beginning with the FY 1991/92 budget, the City Council enacted a variety of measures that, over the years, restored the City's General Fund balance. As of 6/30/97, the total General Fund balance was \$22,795,621, and of that, \$15,477,189 is unreserved and undesignated. When we close out FY 1997/98, the total fund balance will increase by approximately \$2.4 million.

June 2, 1998

While City leadership should be congratulated for restoring the City's financial position, there is also a popular view, which many citizens and taxpayers subscribe to, that governments should not raise money until it is needed. Accordingly, some argue that a high level of unreserved, undesignated fund balance is an indication of overtaxation. The remainder of this staff report will address the importance of a "prudent reserve" that can allow the City to invest some of its fund balance while maintaining a reserve that can see the City through hard times.

First, it is important to establish that Carson truly does have a significant fund balance relative to their budgeted operating expenditures. The table below compares FY 1996/97 fund balance and budgeted expenditures for seven local South Bay cities:

City	Total General Fund Balance	Unreserved, Undesignated Fund Balance	Budgeted Operating Expenditures	Unreserved, Undesignated as a % of Budgeted Expenditures
Carson	22,795,621	15,477,189	33,668,226	45.97%
Hawthorne	14,149,382	3,981,885	29,743,550	13.39%
Santa Monica	120,298,972	0	124,937,433	0%
RPV	7,094,144	3,534,398	7,740,781	45.66%
Torrance	18,095,000	4,641,000	99,797,000	4.65%
Long Beach	31,621,000	2,500,000	298,613,000	0.84%
Hermosa Beach	2,251,551	548,549	11,517,357	4.76%

Source: FY 1996/97 Comprehensive Annual Financial Reports (CAFR) from each of the above cities.

Of the above cities, only one, Rancho Palos Verdes has an undesignated, unreserved fund balance percentage of expenditures as high as Carson. It is more usual to find an unreserved, undesignated fund balance of approximately 5%, a figure which is cited by the Government Finance Officers Association (GFOA), as "commonly used." Even in Rancho Palos Verdes, a city comprising almost 13.6 square miles with 143 miles of streets, a \$3.5 million unreserved, undesignated fund balance which could be used as a contingency for disaster or major public works improvements, does not seem high. In addition, Rancho Palos Verdes does not report any designations. As you know, a designation does not carry the legal force of a reservation so it can be characterized as "unobligated." Carson, on the other hand, reports an additional \$4,876,080 in designated fund balance, bringing the percentage of unreserved, unobligated fund balance to 60% of the budgeted expenditures.



While Santa Monica does not report an unreserved, undesignated fund balance, they do have a designated fund balance of \$51,577,190. The City of Santa Monica also has a prudent reserve policy in which they note, "maintenance of an unreserved, unobligated fund balance of approximately 12% of budgeted expenditures is necessary and prudent due to national and state uncertainties and to protect against unanticipated financial impacts on the City such as a natural disaster." To comply with this policy, their CAFR does show a designation of \$14,900,000 for "Future Expenditures." This policy allows Santa Monica to designate investments that will best serve the City, and their designations include \$20.6 million to construct and equip a new public safety facility, \$4.4 million for vehicle replacement, and \$3.6 million for "Civic Area Developments." The Cities of Long Beach and Torrance maintain similar designations. In Torrance, there is a \$2.1 million designation labeled as "Economic Uncertainties," which allows the City to achieve a "balance equal to 5% of the General Fund operating budget to provide a funding source in the case of a revenue shortfall or other economic anomaly." In Long Beach, the city charter requires a \$2,500,000 undesignated, unreserved General Fund balance. This amount is supplemented by an additional \$8,875,000 designated for "emergencies," which, when combined with their undesignated, unreserved fund balance, amounts to 3.81% of their budgeted operating expenditures.

When designating a prudent reserve for fund balance, GFOA recommends that cities consider the following factors: reliability of revenue sources, timing of cash inflows and outflows, presence of an obligation to repay long-term debt, as well as a potential drain on governmental fund resources posed by deficits in other funds (e.g. enterprise funds). In each of these areas, the City of Carson is in a reasonably strong position.

For example, as calculated from the chart on the following page, the average monthly revenue received from all revenue sources so far this year is \$2,976,312 and the average for the strongest three revenue categories - taxes, licenses & permits, and intergovernmental - is \$2,579,852. For the last five years, this revenue stream has been relatively dependable. Even in FY 1991/92, during the economic downturn, these three revenue sources combined for \$26,413,454, averaging \$2,201,121 per month. Therefore, the City has a historically proven revenue stream of at least \$2.2 million per month.



June 2, 1998

Month	Revenues Received	Top Three Revenue Categories
July '97	2,412,508	1,864,033
August '97	2,393,004	2,041,211
September '97	2,654,843	2,098,987
October '97	2,241,792	1,786,012
November '97	2,336,441	2,336,441
December '97	3,643,190	3,320,105
January '98	2,553,110	2,205,770
February '98	2,615,931	2,418,007
March '98	3,036,874	5,163,122
April '98	<u>5,875,435</u>	<u>5,163,122</u>
Totals	29,763,128	25,798,527

Expenditures year-to-date have followed a relatively consistent pattern and are generally less than the monthly cash flows. This trend is shown below:

Month	Expenditures
July '97	2,024,853
August '97	2,374,567
September '97	2,368,424
October '97	2,995,182
November '97	2,549,881
December '97	3,161,066
January '98	2,963,872
February '98	2,343,542
March '98	2,785,391
April '98	<u>2,592,340</u>
Totals	26,159,118

The average monthly expenditures year-to-date are \$2,615,912, which total about \$360,000 less per month than the average revenues received. Therefore, the City would not normally be in a position of needing to draw on reserves to pay for monthly expenditures.

The City has no general long-term bonded indebtedness. The Redevelopment Agency has outstanding tax allocation bonds payable from incremental property tax generated in redevelopment project areas. The City does not operate any enterprise



funds that could significantly drain General Fund balance resources. The City does, however, operate the Self Supporting Fund, which in recent years has run an annual deficit of between \$200,000 to \$500,000. Council is continually looking for ways to correct this problem so that this annual deficit can be decreased and not pose a threat to the General Fund balance.

All of the above information indicates that the City's financial position is strong, and that its fiscal management policies of sound budgeting have corrected any long-term problems. It is not the intent of this staff report to encourage Council to fund recurring expenses (e.g. salaries and operations and maintenance) with fund balance reserves, but rather to give Council the confidence to establish a designation of prudent reserve that will allow investment in capital projects already planned, and necessary capital equipment purchases that have been long delayed due to budget constraints.

Although the City is strong in each area that the GFOA recommends to consider when establishing a prudent reserve, staff does believe that due to the conservative nature of this City and the continuous uncertainty about the stability of state subventions, that using the GFOA figure of 5% is too low for Carson. **Therefore, staff is recommending a prudent reserve designation of 20% of budgeted expenditures for the upcoming fiscal year (\$36.8 million), which would require an unobligated, unreserved fund balance of \$7.4 million. This amount should provide a sufficient contingency to provide for economic uncertainties and other unforeseen expenditures.**

Finally, staff would like to recommend that in addition to establishment of a prudent reserve, the following reservations and designations be established or augmented:

	<u>Current Amount</u>	<u>Recommended Increase</u>	<u>New Total</u>
Reserved for encumbrances*	757,662	0	757,662
Reserved for inventory*	456,750	0	456,750
Reserved for construction projects	785,278	0	785,278
Reserved for lease agreements*	1,806,102	0	1,806,102
Designated for future projects	580,000	0	580,000
Designated for self insurance	2,014,007	1,985,993	4,000,000
Designated for equipment replacement	918,633	3,000,000	3,918,633
Designated for economic uncertainties	0	7,400,000	7,400,000
Designated for remaining park projects	0	1,250,000	1,250,000

* These reserves change annually based on the total outstanding encumbrances, inventory, and lease obligations at year-end.



Based on a projected June 30, 1998 total general fund balance of approximately \$25.2 million, the above reserves and designations would leave a remaining unreserved, undesignated general fund balance of \$4.2 million.

If it is Council's desire to approve this concept of a "prudent reserve" and to approve the above, or similar, reserves and designations, the changes to fund balance will be made at the time we close the FY 1997/98 books.

V. FISCAL IMPACT

Approval of this item will re-align the reserves/designations of the City's General Fund Balance.

VI. EXHIBITS

None

A:\PRUDENT.AGN SFL

Reviewed by:

Community Development	Engineering Services
Finance	Facilities & Maintenance
Public Safety	Recreation & Community Services

Action taken by City Council	
Date <u>6/2/98</u>	Action <u>Moved to Approve the policy of twenty percent (20%) of a "prudent reserve" & that such reserve & fund balance designations be applied to the FY 1998/99 LO/F 3/0/0/2- C&MD</u>



City of Carson
Historical General Fund Budget and General Fund Balance

	General Fund Budget	Annual Surplus/ (Deficit)	General Fund Balance	20% Prudent Reserve
FY 1996/97	\$ 32,367,634	\$ 2,140,143	\$ 22,795,621	\$ 7,153,378
FY 1997/98	\$ 35,766,888	\$ 4,465,568	\$ 27,261,189	\$ 8,001,273
FY 1998/99	\$ 40,006,366	\$ 2,437,471	\$ 29,698,660	\$ 8,262,594
FY 1999/00	\$ 41,312,972	\$ 2,674,860	\$ 32,373,520	\$ 9,917,511
FY 2000/01	\$ 49,587,556	\$ 10,226,658	\$ 42,600,178	\$ 10,341,699
FY 2001/02	\$ 51,708,497	\$ (685,782)	\$ 41,914,396	\$ 11,540,844
FY 2002/03	\$ 57,704,219	\$ (11,688,440)	\$ 30,577,568	\$ 10,691,295
FY 2003/04	\$ 53,456,474	\$ (5,161,288)	\$ 25,416,280	\$ 11,165,027
FY 2004/05	\$ 55,825,133	\$ 1,501,598	\$ 26,917,878	\$ 12,248,697
FY 2005/06	\$ 61,243,484	\$ 914,164	\$ 27,832,042	\$ 12,434,882
FY 2006/07	\$ 62,174,408	\$ 5,674	\$ 27,837,716	\$ 13,497,021
FY 2007/08	\$ 67,485,104	\$ (3,452,709)	\$ 24,385,007	\$ 13,304,504
FY 2008/09	\$ 66,522,519	\$ (3,595,614)	\$ 20,789,393	\$ 13,525,372
FY 2009/10	\$ 67,626,858	\$ (2,607,684)	\$ 18,182,124	\$ 12,396,134
FY 2010/11	\$ 61,980,672	TBD	TBD	TBD

