

HUTCHINSON CITY COUNCIL POLICY - 4

SUBJECT: UNRESERVED FUND BALANCES

DATE: March 1, 2010

PURPOSE: Unreserved fund balances are important for the financial health of the City of Hutchinson. Some of the reasons to maintain such balances are listed below:

1. *Cash flow for the continuation of municipal services from one fiscal year to the next without interruption.* The City's expenses do not stop with the change from one budget year to the next. The City must have adequate cash reserves to carry over from one year to the next so that services are not interrupted until new revenues arrive.
2. *The mitigation of risks.* Whether affected by economic slowdown or catastrophic weather events, the City may find itself in need of cash reserves to face either substantial revenue shortfalls or unanticipated expenditures. Adequate cash reserves will help reduce the need to issue debt to meet the extraordinary financial needs of the City.
3. *Evidence of financial stability and credit worthiness.* When the City must issue debt, rating agencies and bond holders look to the adequacy and management of unreserved fund balance in the General Fund to ascertain the City's financial health and its capacity to repay the debt. This analysis directly impacts the City's bond rating and interest rates on bonds to be issued.
4. *Cash for unforeseen opportunities.* On occasion, the City has opportunities to take advantage of special purchases or to retain or increase jobs in the community, but needs to have the available cash to complete the transaction.
5. *Property tax and utility rate stability.* Unreserved fund balances may be used to stabilize property tax and utility rates as swings in the economy effect more elastic revenues, such as sales tax. Adequate fund balances allow the City to withstand many brief economic downturns without raising the mill levy or utility rates to offset other losses of revenue.

The level of unreserved fund balances should be determined after an analysis of the economic circumstances leading to the possible use of balances. Those circumstances may include, but not be limited to the amount of available cash from other City funds, the level of risk for revenue shortfalls and/or unanticipated expenditures faced by the City, the overall economy of the community, and the City's ability to secure bridge financing, and the frequency of tax disbursements from the State.

DEFINITIONS:

Cash Balance – The sum of cash and investments of an accounting fund.

Unreserved Fund Balance – The portion of net assets of an accounting fund that is not legally restricted or otherwise committed by the governing body for future use.

General Fund – The City’s primary operating fund that accounts for City services not otherwise specified in a separate fund.

Special Revenue Funds – Accounts for proceeds of designated revenue sources used to finance specified activities as required by law or administration.

Debt Service Fund – Accounts for proceeds of designated revenue sources used to finance general obligation debt.

Internal Service Funds – Accounts for the financing and administration of general services provided to various departments of the City.

Capital Funds – Accounts for capital improvements and capital equipment financed from general obligation bonds, special revenue funds, enterprise funds, general fund, and grants.

Enterprise Funds – Accounts for activities for which a fee is charged to external users for goods and services.

POLICY: It is the policy of the City of Hutchinson to adhere to the following fund balance statements:

1. *Minimum unreserved fund balances* shall be maintained at the end of each fiscal year commensurate with the levels described in the table below:

FUND	UNRESTRICTED FUND BALANCE
General Fund	\$2,000,000 for mitigation of risk due to natural disaster; + \$2,000,000 for tax stabilization during economic decline; + one month previous year operating expense for working capital.
Special Revenue Fund: Refuse	An amount equal to 8.3% of current year original or revised budget expenditures for new fiscal year working capital (one month).
Debt Service Fund	An amount adequate to cover budgeted interest payments in first quarter of following year + unforeseen fees.
Internal Service Fund: Risk Management	3 x highest claims expenditures in the last 3 years.
Internal Service Fund: Workers Compensation	3 x highest settlement expenditures in the last 3 years.

Internal Service Fund: Health & Dental	35% of prior year claims.
Enterprise Fund: Waterworks	one month previous year operating expense for working capital; + one month previous year operating expense for risk mitigation & emergency equipment replacement; + 5% of previous year water use charges for rate stabilization during low usage years.
Enterprise Fund: Sewer	one month previous year operating expense for working capital; + one month previous year operating expense for risk mitigation & emergency equipment replacement; + 5% of previous year sewer use charges for rate stabilization during low usage years.

2. *Excess unreserved fund balances* exceeding the minimum balance requirements in the General Fund, Special Revenue Funds, Debt Service Fund, and Enterprise Funds at the end of each fiscal year may be used in one or a combination of the following ways:

- Debt reduction;
- One-time expenditures that do not increase recurring operating costs that cannot be funded through current revenues. Emphasis will be placed on one-time uses that reduce future operating costs.
- Establishment of or increase in reserves for internal service programs, equipment replacement, capital projects, emergencies, or disaster recovery.
- Start-up expenditures for new programs provided that such action is approved by the governing body and is considered in the context of multi-year projections of revenue and expenditures as prepared by the Finance Department.

In the event the unreserved fund balance of an Internal Service Fund exceeds the minimum balance requirement for that fund, the excess may be used in one or a combination of the following ways:

- Reduce charges for services levied against other funds;
- Return the excess balance to the fund(s) from which it was originally derived.

3. Should the unreserved fund balance fall below the target level, the City Manager and City Council will prepare and implement a plan to restore the balance to the target level.