Homer City Hall
491 E. Pioneer Avenue
Homer, Alaska 99603
www.cityofhomer-ak.gov

City of Homer
Agenda

City Council Committee of the Whole
Monday, June 10, 2019 at 5:00 PM
City Hall Cowles Council Chambers

CALL TO ORDER, 5:00 P.M.

AGENDA APPROVAL (Only those matters on the noticed agenda may be considered, pursuant to City Council's Operating Manual, pg. 6)

CONSENT AGENDA

a. Ordinance 19-27, An Ordinance of the City Council of Homer, Alaska Amending Homer City Code Chapter 11.36, "Vegetation in Rights-of-Way" to amend HCC 11.36.020 And Add HCC 11.36.030 "Removal for Compliance-Public Works Director Discretion," to Permit Public Works Director to Authorize Removal of Vegetation to Bring Roads Constructed Prior to City Regulation into Compliance with City Laws and Construction Procedures. Stroozas.

REGULAR MEETING AGENDA

DISCUSSION TOPIC(S)

a. General Fund and Reserve Balance Policies (20 minutes)

COMMENTS OF THE AUDIENCE

ADJOURNMENT

Next Regular Meeting is Monday, June 24, 2019 at 6:00 p.m., Worksession at 4:00 p.m. and Committee of the Whole at 5:00 p.m. All meetings scheduled to be held in the City Hall Council Chambers located at 491 E. Pioneer Avenue, Homer, Alaska.

City of Homer
www.cityofhomer-ak.gov

Office of the City Manager
491 East Pioneer Avenue
Homer, Alaska 99603
citymanager@cityofhomer-ak.gov
(p) 907-235-8121 x2222
(f) 907-235-3148

Memorandum

TO: Mayor Castner and Homer City Council

FROM: Katie Koester, City Manager

DATE: June 5, 2019

SUBJECT: Fund Balance and Reserve Balance Policy Recommendations

The purpose of this memo is to summarize the research and analysis that went into the recommendation that the City of Homer develop a general fund fund balance and reserve balance policy. The memo tries to call out major policy changes and considerations, best practices and recommendations and decision points so Council can consider each touchpoint.

FUND BALANCE

According to the Municipal Research and Services Center (MSRC), fund balance is a term used to describe the difference between a fund's assets and liabilities and describes the net position of local government funds (MRSC.org, 2019).

Keeping a healthy fund balance is important to provide a government with cash flow and options to respond to emergencies and better withstand unexpected issues (earthquake, tsunami, essential infrastructure failure, revenue volatility) that pose significant threat to public health, safety, life, property or economic activity. Nevertheless, it is important to realize that that fund balance is constituent tax money and should not accumulate in excess.

Fund Balance Policy Considerations

Appropriate Level. It is important to note that the City of Homer GF fund balance is a snapshot in time and fluctuates with cash flow, expenditures and revenue. Homer City Code 3.05.035 dictates that appropriations shall lapse at the end of the fiscal year to the extent they have not been fully expended or encumbered (HCC online) but remains silent on a target or a goal funding amount for fund balance.

Sizing the fund balance requires estimating highly uncertain events. Government Finance Officers Association (GFOA) recommends performing a risk analysis and thorough financial assessment following a "*Triple-A" Risk-Based Approach* to determine how much to keep in reserves:

- *Accept* that we are subject to uncertainty, including events that we haven't even imagined.
- *Assess* the potential impact of the uncertainty. Historical references provide useful baselines.

• *Augment.* The range of uncertainty we really face will almost always be greater than we assess it to be, so we should augment that range. Historical reference cases provide a baseline, but that baseline may not be adequate to account for all realistic future possibilities. (https://www.gfoa.org/sites/default/files/GFR_OCT_12_10.pdf)

GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. Risk analysis then informs how far above the minimum a municipality should maintain its general fund reserve. https://gfoa.org/fund-balance-guidelines-general-fund. In literature review, GFOA has recommended GF fund balance levels ranging from 2 to 6 months operating budget. Some municipalities had targets as low as 10% of operating budget.

The proposed policy recommends City of Homer maintain 50% (or 6 months' worth) of operating budget in fund balance. This is a conservative number given a variety of risk factors: how frequently Council uses fund balance for non-emergency expenditures; our dependence on sales tax revenue, which is traditionally a more volatile revenue source; our susceptibility to natural disasters and cash flow.

Restrictions. GFOA recommends that reserve amounts be categorized by component making the purpose of the reserve more transparent. Policy should identify and clearly state the purposes for which the funds are intended (which should include, at a minimum, an emergency reserve for one-time events like earthquakes, and a stabilization reserve to offset economic downturns).

GFOA further recommends that the reserve policy clearly state the purposes for which the funds are *not* allowed to be used, for example, to fund ongoing operations or to start new programs; and for the policy to establish the authorization to access the funds (requiring, for example, a two-thirds vote or a formal declaration of a state of emergency).

Replenishing. GFOA further recommends that reserve policy should establish the method and timing for fund replenishment when funds dip below an identified level.

RESERVES

Reserves exist to fund anticipated and predictable expenditures to maintain and replace major assets. The City of Homer uses approximately 20 different reserve accounts in three different reserve categories: Fleet, Depreciation/Capital, and Capital Project Funds. Capital Project Funds account for financial resources used for the acquisition or construction of major capital facilities.

The Fleet Reserves and Depreciation/Capital Reserves fund routine major maintenance and replace smaller capital items. These expenditures are outside the scope of the operating budget and are generally one-time expenses over $25,000. Examples of projects funded through reserves are the replacement of a roof at City hall, a new patrol vehicle for the Homer Police Department or a feasibility study for a proposed improvement.

Fleet Reserves provide for the replacement of the City's fleet of vehicles on a planned rotation basis as their useful life expires. The June 5, 2019 memo "City Fleet Summary and Current/Impending Needs"

(attached) provides a detailed snapshot of the City's fleet needs from 2019-2020. As you can see in the fleet replacement schedule developed by Superintendent Gardner, GF Fleet Reserves funded none of the scheduled replacements for 2019, deferring $53,333 to 2020. In 2020, six pieces of equipment valued over $1.5 Million are due to be replaced. Each piece of equipment not replaced when its "years of life remaining" expires adds additional cost to the upcoming calendar years and runs the risk of increasing the City's maintenance costs in order to take care of an outdated fleet.

Depreciation/Capital Reserves provide consistent funding to maintain capital assets at a level such that it protects the taxpayer's capital investments and minimizes future maintenance and replacement costs. While it's difficult to accurately quantify the amount of money deferring maintenance wastes, some research indicates that consistent maintenance can reduce the lifecycle costs of long service life infrastructure like roads, bridges, tunnels, drainage systems, water and sewer system by as much as 75-90%, primarily by extending the life of capital assets and making costly replacements less frequent. The percentage of lifecycle savings will be lower for facilities because of their relative shorter service life, but it underscores the importance of maintenance of assets. (*Dornan, Daniel L, GASB 34's Impacts on Infrastructure Management, Financing & Reporting. June 2000.* https://www.researchgate.net/publication/237266261_GASB_34's_Impacts_on_Infrastructure_Management_Financing_Reporting*)*

Reserve Policy Considerations for Capital Asset Repair and Maintenance

Appropirate Level. Resolution 2006-101 establishes a reserve goal of 40% of depreciable assets. However, this goal is unrealistic as the City has only ever been able to reach about 10% of the value of depreciable assets. A more realistic goal based on asset management forecasts will make a more useful policy.

Mayor Castner has proposed a target for reserves that is no more than four times the average spending. Under this model, every year the budget would include a replacement of ¼ of the previous four years of spending. This model will even out over time as deferred maintenance needs are taken care of and the amount Council needs to set aside for maintenance becomes a predictable part of the budget cycle.

The City's investment in deprecation and regular maintenance has been lacking over the last ten years due to budget constraints and a lack of appetite to dedicate funds to care for what we have. Deferring maintenance is generally one of the first things a City does to cut costs in difficult years. When the City defers maintenance, it is essentially liquidating its capital assets by allowing them to deteriorate in order to free up cash for other programs. The consequences are not apparent for many years. Over time, though, the practice can be costly for both City government and future taxpayers in terms of deferred maintenance costs and fixes that become more extensive and expensive. The HERC is an example of a building that has suffered deferred maintenance to the point where the Borough gave the facility to the City of Homer and the costs to repair or replace the facility are high.

To establish adequate reserve amounts, GFOA recommends an inventory of all municipal capital assets, development of an asset management plan that identifies the most outstanding needs and a depreciation schedule. I am working to provide Council with that information, but with a capital assets valued at over $100 million City-wide, it is likely to be a long list, labor intensive to create, and large

number. The number is more manageable for fleet as we have established schedules and can anticipate lifespan for fleet and apparatus.

Another best practices guideline for facilities management (developed by the National Academy of Sciences, Engineering & Medicine and widely cited in the facilities management literature) is for property owners to reserve, on average, two to four percent of the replacement value of a facility annually for capital asset repair and maintenance.

It is important to note, that although the metric is replacement value, 2-4% annual spending on major maintenance it does not provide for replacement at end of life. Nor does is the metric expected to cover operational maintenance. It includes:

- preventative maintenance of equipment and systems for which a specific operator is not assigned and which if disabled, would interfere with an essential operation, endanger life or property, or involve high cost or long lead time for replacement;
- programmed major maintenance whose cycle exceeds one year (e.g. painting, roofs);
- predictive testing and inspection;
- routine repairs (like replacement of a failed boiler) and replacement of obsolete items. (Budgeting for Facilities Maintenance and Repair Activities: Report Number 131, 1996 https://www.nap.edu/read/9226/chapter/1.)

Currently, the City of Homer GF reserve is used to maintain 14 buildings and structures and a variety of other constructed assets, primarily at our parks. Using AMLJIA replacement values, the current replacement value (CRV) of these assets is $27,868,382.

			Purchase	Useful Life	AMLJIA CRV
Airport	Building	Airport Terminal	1993	40	$ 3,352,338
Gen Govt	Building	City Hall	1977	40	$ 3,927,269
Gen Govt	Building	HERC	2000	40	$ 2,570,000
Library	Building	Library	2006	40	$ 7,117,792
Parks & Rec	Building	Downtown Restrooms	2014	30	$ 492,130
Parks & Rec	Improvements	Ben Walters Park Restroom*	1984	40	$ 338,280
Parks & Rec	Improvements	End of Road Restroom*		40	$ 215,000
Parks & Rec	Improvements	Jack Gist Park*	2008	10	$ 251,992
Parks & Rec	Improvements	Karen Hornaday Park Ph 1*	2014	20	$ 433,416
Public Safety	Building	Fire Hall Buildings & Improvements	1980	40	$ 2,582,339
Public Safety	Building	Skyline Fire Station	2015	40	$ 611,172
Public Safety	Building	Police Station (Heath St. location)	1984	40	$ 2,063,271
Public Safety	Building	New Animal Shelter	2005	40	$ 979,478
Public Works	Building	Public Works Building	1986	40	$ 2,383,852
Public Works	Building	Public Works Pole Barn	2005	40	$ 343,705
Public Works	Building	Public Works Storage Shed	2016	40	$ 206,348
					$ 27,868,382

The guideline suggests that the City would expend from $557,368 to $1,114,735 per year in reserves for long-term maintenance of the City's existing General Fund capital assets.

AMLJIA replacement values are based on *estimates* for buildings under $5 million and on actual appraisals for buildings over $5 million. Many of the estimates are low. Additionally, the range does not account for funds needed to "catch up" on past years of deferred maintenance. Without an actual facilities inventory and capital asset management plan, however, this offers another method to consider when sizing the reserve fund. *Please note that CRVs for park improvements were based on current book value from the City's Depreciation Schedule.

Weather or not the Council uses a percent of assets, historical spending, or some other formula, setting a target balance for reserves in an important policy decision for Council.

Consolidation The proposed policy consolidates all reserve funds into one account in the general fund. The pros to this methodology are that it ensures the highest and best need is funded at any given point. A negative is it becomes difficult to set aside funding and justify funding for smaller or lower priority projects. It also becomes more difficult to track the capital expenditure needs department. Furthermore, departments or interest groups may see that their needs are not getting addressed when specific reserves are not identified. This is an important policy call for Council to discuss.

If reserve accounts are consolidated into one fund, an asset management plan, if developed could prioritize use of reserve funds (highest need to lowest) or the assessment could be used by Departments and/or Council to assign priority use of annual reserve funds.

CAPITAL IMPROVEMENT FUND

This policy introduces a new fund, the capital improvement (CI) fund. The City has innumerable potential expenses that might not go on a depreciation schedule or are too large to be funded out of the reserve fund as proposed with additional restrictions. A CI fund provides a place for Council to place funds for larger projects to either provide seed money or accomplish items on the Capital Improvement Plan. The purpose of this account is not to establish a replacement fund for major infrastructure, but rather provide a place for holding funds for needed capital projects, be they replacement projects like a new police station or new projects that the Council and community has identified.

An approach I've seen in other City's CIP's is a restructure of the CIP where the first year of the six-year plan represents the approved Capital budget scheduled for expenditure, which is incorporated into the City's annual budget. The CIP becomes an appendix to the budget.

PRIORITIZATION OF FUNDS

The attached policy prioritizes filling funds in a cascading manner: first into fund balance to achieve the six-month target, then to reserves (renamed Capital Asset Repair and Maintenance Account, or CARMA) to meet the reserve requirement, and finally to the CI fund. Establishing an expectation of where available dollars will go is another important policy decision for Council.

This is consistent with many fund balance policies that prioritize maintaining existing capital infrastructure before building new facilities. This prioritization makes sure adequate resources are allocated to preserve existing infrastructure before targeting resources to build new facilities that will also carry operating and maintenance obligations.

RECOMMENDATION
Council discuss and provide input on the proposed fund balance and reserve balance policy and establishment of a capital improvement funds. Topics to discuss are itemized below:

1. GF Fund Balance
    a. What should that number be?
    b. What restrictions should or could be placed in code that limit the spending of those funds?
    c. What does replenishment look like?
2. Reserve Balance
    a. Is no more than four times the average spending a reasonable goal?
    b. Should restrictions on what can be funded from here be further codified?
    c. Should all general fund reserve funds be consolidated into one fund?
3. Capital Improvement Fund
    a. Should this fund be established?
    b. What would a ranking system look like?
    c. Is the purpose of the fund established in the draft policy adequate?
4. Prioritization of Funds

Enc:

Fleet Memo

Policy Recommendations Paper

Draft Policy

City of Homer
www.cityofhomer-ak.gov

Office of the City Manager
491 East Pioneer Avenue
Homer, Alaska 99603
citymanager@cityofhomer-ak.gov
(p) 907-235-8121 x2222
(f) 907-235-3148

Memorandum

TO: Mayor Castner and Homer City Council

FROM: Katie Koester, City Manager

DATE: June 5, 2019

SUBJECT: City Fleet Summary and Current/Impending Needs

Background
The City's fleet consists of over 120 pieces of equipment ranging from graders and plows to police cars and fire trucks with a total replacement cost value estimated at $11.7 million dollars. Each piece of equipment has a specific use for the City depending on the department it serves. The Police, Fire, Public Works, Port/Harbor, and Administrative Departments preserve the integrity of their fleet by conducting regular maintenance on the equipment while City Council also transfers funds to their respective fleet reserve accounts for future replacement and acquisition needs. In regards to transfers, the Administrative Department is the only exception as there have been no transfers into the Admin Fleet Reserve Account for the past 5 years

The most recent fleet acquisition needs presented in the 2019 Budget included continuing the replacement of the Police Department's aged Chevrolet Impalas with all-season four wheel drive Ford Explorers and replacing Port and Harbor's truck mounted sanding unit. The Public Works Water and Sewer Division requested a ½ ton pickup truck used to haul parts and fittings to various job sites however this request was denied this calendar year due to budgetary concerns.

The chart below details each *general fund-supported* department's fleet reserve budget and account balance as adopted in the 2019 budget; the estimated 2019 balance reflects expenditures encumbered by the 2019 budget.

2019 General Fund-Supported Department Fleet Reserve Budget and Account Balance

Account	Dept.	Approved 2019 Budget	Est. 2019 Balance
152-0375	Admin (City Hall)	$41,929	$41,929
152-0383	Public Works (GF)	$141,959	$22,959
152-0382	Police	$296,853	$208,853
152-0381	Fire	$355,433	$355,433
Total GF $		**$836, 174**	**$629, 174**

Superintendent Gardner compiled a fleet replacement schedule detailing the City's fleet based on department, the internal City-assigned equipment number, equipment year and make, current age, total expected life, years remaining, replacement cost, and mileage/hours currently on the piece of equipment ("Attachment A1" and "Attachment A2"). In order to determine the vehicle's total expected life, interviews were conducted with mechanics and Department Heads to discuss the use of the equipment, type of use, and maintenance history over time.

Based on Attachment A1, the below tables summarizes General Fund fleet replacement needs for calendar years 2019 and 2020 with equipment ranging from 0 to 2 years of remaining life.

2019

DEPT	Year	DESCRIPTION	CURRENT AGE		TOTAL EXPECTED LIFE	YEARS OF LIFE REMAINING	NEEDS TO BE REPLACED IN THIS YEAR	REPLACEMENT COST	FUNDING SOURCE
PWHDE	1992	International Vacuum Truck	27	Years	25	-2	2017	N/A	GF/W/S
PWHDEA	1995	Patchman Asphalt Mixer	25	Years	25	0	2019	$ 40,000	GF/W/S
PWLV	1989	1989 GMC 3/4 TON	29	Years	29	0	2019	N/A	GF/W/S
PWLV	1987	1987 CHEVY FLAT BED - PAINT TRUCK	32	Years	32	0	2019	N/A	GF
PWLV	1999	1999 FORD E250 VAN	20	Years	20	0	2019	$40,000	GF
FDHDE	2002	2002 POLARIS 6-WHEELER	17	Years	17	0	2019	N/A	GF

2019 GF Deferred Total: $53,333

2020

DEPT	Year	DESCRIPTION	CURRENT AGE		TOTAL EXPECTED LIFE	YEARS OF LIFE REMAINING	NEEDS TO BE REPLACED IN THIS YEAR	REPLACEMENT COST	FUNDING SOURCE
PWHDE	1995	410D John Deere Backhoe	24	Years	25	1	2020	$ 120,000	GF/W/S
HPDLV	2009	2009 CHEV IMPALA	10	Years	11	1	2020	$40,000	GF
HPDLV	2009	2009 CHEV IMPALA	10	Years	11	1	2020	$40,000	GF
FDLV	1990	BRUSH 1 - 1990 FORD	29	Years	30	1	2020	$95,000	GF
FDHDE	1987	1987 Tanker 1 Huri	32	Years	33	1	2020	$650,000	GF
FDHDE	1989	1989 Tanker 2 E-One	30	Years	31	1	2020	$650,000	GF

2020 GF Total: $1,515,000

No department's fleet reserve account will cover their upcoming acquisition needs as listed above. Therefore, the City prioritizes replacing life and safety equipment first while other pieces of equipment are maintained past their total expected life. Parts on these older models can be very expensive and difficult to come by. For example, in 2017 Public Works ordered a replacement mullboard for the City's 31 year old grader, which is no longer made by the manufacturer and had to be acquired after market. Also in 2017, Public Works had to find a used radiator for the older steamer truck as this part is not made by the manufacturer. Maintaining older pieces of equipment can be not only challenging, but also increase maintenance costs to the point where, over time, it outweighs purchasing new equipment. Superintendent Gardner shared that some pieces of equipment can be purchased used, however the advantage of used equipment has to take into account the City's ability to capitalize on government discounts when purchasing new.

The City does recycle older vehicles by changing the intended use of the equipment. For example, when Chief Robl's Durango was replaced with a new patrol car, the Durango then replaced Public Work's 1989 GMC pick-up truck, which is now listed as a surplus vehicle.

Fleet Replacement/Acquisition Reserve Account and Future Planning

Mayor Castner has proposed to consolidate all reserve funds into one account in the General Fund and fund it at no more than four times the average spending. Thus far this model has been applied to General Fund only, but time permitting Administration will be working with the Mayor on establishing similar policies for Port/Harbor and Public Works' Water/Sewer Division since they are enterprise funds, which are intended to be self-contained and separate from the general fund.

Overall, there is merit behind having one independent fleet reserve account in the general fund given the predictable replacement needs of the City's fleet. The fleet replacement schedule is a useful tool for City Council members when planning for the future fleet replacement/acquisition needs of each department and deciding what fleet need is most pressing that calendar year. This replacement schedule does not propose to automatically fund fleet replacement when each piece of equipment reaches its predicted end of life; staff will still perform an analysis of replacement based on life expectancy, intended use, and other factors like a mechanical analysis of the vehicle/equipment. It is my intention that the fleet replacement schedule and recommendations from staff on individual vehicle/equipment replacement would be provided to Council in the budget process. The fleet replacement schedule will also give guidance on Council contributions to fleet reserves.

Attachment A1

2019-2020 Fleet Replacement Schedule

	DEPT	Year	DESCRIPTION	CURRENT AGE		TOTAL EXPECTED LIFE	YEARS OF LIFE REMAINING	NEEDS TO BE REPLACED IN THIS YEAR	REPLACEMENT COST	FUNDING SOURCE	ALREADY FUNDED BY BUDGET
2019	PWHDE	1992	International Vacuum Truck	27	Years	25	-2	2017	N/A	GF/W/S	
	PWHDEA	1995	Patchman Asphalt Mixer	25	Years	25	0	2019	$ 40,000	GF/W/S	
	PWLV	1989	1989 GMC 3/4 TON	29	Years	29	0	2019	N/A	GF/W/S	
	PWLV	1987	1987 CHEVY FLAT BED - PAINT TRUCK	32	Years	32	0	2019	N/A	GF	
	PWLV	1999	1999 FORD E250 VAN	20	Years	20	0	2019	$40,000	GF	
	FDHDE	2002	2002 POLARIS 6-WHEELER	17	Years	17	0	2019	N/A	GF	
	PWLV	1994	1994 FORD 4X4 F-150 P/U	25	Years	25	0	2019	$30,000	W/S	
	PWLV	1997	1997 FORD F-350 4x4 UTILITY TRUCK	22	Years	22	0	2019	$52,250	W/S	X
	PWLV	2000	2000 K2500 4X4 W/SERVICE BODY	19	Years	19	0	2019	$46,350	W/S	X
	PHLV	1994	HV-1 - 1994 FORD F-150 PU	25	Years	25	0	2019	$30,000	PH	
	PHHDE	1995	1995 Grove Manlift MV11	24	Years	24	0	2019	$30,000	PH	
	PHHDE	1999	1999 20' Skiff with 90 HP Honda Motor	20	Years	20	0	2019	$50,000	PH	

2019 GF Deferred Total	**$53,333**
2019 PH Enterprise Deferred Total	**$110,000**
2019 W/S Enterprise Deferred Total	$155,267
	-$98,600
	$56,667

N/A = will not be replaced

2020	PWHDE	1995	410D John Deere Backhoe	24	Years	25	1	2020	$ 120,000	GF/W/S
	HPDLV	2009	2009 CHEV IMPALA	10	Years	11	1	2020	$40,000	GF
	HPDLV	2009	2009 CHEV IMPALA	10	Years	11	1	2020	$40,000	GF
	FDLV	1990	BRUSH 1 - 1990 FORD	29	Years	30	1	2020	$95,000	GF
	FDHDE	1987	1987 Tanker 1 Huri	32	Years	33	1	2020	$650,000	GF
	FDHDE	1989	1989 Tanker 2 E-One	30	Years	31	1	2020	$650,000	GF
	PHHDE	1995	1995 T2 Fish Carcass Dump Trailer	24	Years	25	1	2020	$12,000	PH

2020 GF Total	$1,515,000
2020 PH Enterprise Total	$12,000
2020 W/S Enterprise Total	$80,000

Key

PWHDEA = Public Works Heavy Duty & Equipment Attachments
LV = Public Works Light Vehicles
HDE = Public Works Heavy Duty Equipment
PHLV = Port/Harbor Light Vehicles
CH = City Hall
PHHDE = Port/Harbor Heavy Duty & Equipment
HPDLV = HPD Light Vehicles
FDLV = Fire Department Light Vehicles
FDHDE = Fire Department Heavy Duty & Equipment

2021-2044 Fleet Replacement Schedule

Attachment A2

Supplemental Information: 2021-2044

DEPT	Year	DESCRIPTION	CURRENT AGE		TOTAL EXPECTED LIFE	YEARS OF LIFE REMAINING	NEEDS TO BE REPLACED IN THIS YEAR	REPLACEMENT COST	FUNDING SOURCE
PWLV	2001	2001 CHEV S-10 EXTEND CAB	18	Years	20	2	2021	$30,000	GF
PWLV	2006	2006 FORD F-350 4X4	13	Years	15	2	2021	$45,000	GF
PWLV	2013	2013 FORD F-550 2-TON 4X4 Truck/Sander	6	Years	8	2	2021	$48,000	GF
PWHDE	1986	140G Cat Grader	33	Years	35	2	2021	$200,000	GF
PHLV	1995	MV1 - 1995 CHEV S-10 4X4 PU	24	Years	26	2	2021	$30,000	PH
HPDLV	2009	2009 CHEV IMPALA	10	Years	12	2	2021	$40,000	GF
FDLV	1997	MEDIC 1 (1997 FORD 4X4 F350)	22	Years	24	2	2021	$200,000	GF
FDLV	2006	2006 FORD EXPEDITION - COMMAND VEHICLE	13	Years	15	2	2021	$75,000	GF
PWHDEA		Grader Wing x3	22	+ Years	25	3	2022	$60,000	GF
PWHDEA		Grader Snow Gate x3	22	+ Years	25	3	2022	$30,000	GF
PWLV	1992	1992 FORD RANGER	27	Years	30	3	2022	$30,000	W/S
PWLV	1994	1994 FORD PU	25	Years	28	3	2022	$30,000	GF
PWLV	1994	1994 CHEV SVC TRK	25	Years	28	3	2022	$40,000	GF/W/S
PWLV	1997	1997 FORD RANGER XLT 4X4	22	Years	25	3	2022	$30,000	GF/W/S
PWHDE	1987	950 Cat Loader	32	Years	35	3	2022	$210,000	GF/W/S
HPDLV	2007	2007 FORD EXPEDITION	12	Years	15	3	2022	$40,000	GF
HPDLV	2007	2007 FORD EXPEDITION	12	Years	15	3	2022	$40,000	GF
FDLV	2003	UTILITY 1 - 2003 FORD F-350, CREW CAB	16	Years	19	3	2022	$75,000	GF
PWLV	1995	1995 FORD F-150 4X4	24	Years	28	4	2023	$30,000	GF
PWLV	1998	1998 FORD EXPEDITION XLT - 4X4	21	Years	25	4	2023	$40,000	GF
PWLV	2003	2003 FORD F-550 2-TON 4X4	16	Years	20	4	2023	$40,000	GF
PWHDE	2003	Toolcat 5600	16	Years	20	4	2023	$60,000	GF
PHLV	1993	1993 CHEV STEP-SIDE VAN	26	Years	30	4	2023	$30,000	PH
PHLV	2003	2003 FORD F-250 4X4 Plow Truck Ice Plant	16	Years	20	4	2023	$40,000	PH

Key

PWHDEA = Public Works Heavy Duty & Equipment Attachments
PWLV = Public Works Light Vehicles
PWHDE = Public Works Heavy Duty Equipment
PHLV = Port/Harbor Light Vehicles
CH = City Hall
PHHDE = Port/Harbor Heavy Duty & Equipment
HPDLV = HPD Light Vehicles
FDLV = Fire Department Light Vehicles
FDHDE = Fire Department Heavy Duty & Equipment

PHLV	2003	2003 FORD F-250 4X4 Plow Truck Maintenance	16	Years	20	4	2023	$40,000	PH
HPDLV	2008	2008 CHEV VAN (JAIL VAN)	11	Years	15	4	2023	$40,000	GF
FDLV	2001	UTILITY 3 - 2001 F-550 FORD	18	Years	22	4	2023	$95,000	GF
FDHDE	2008	2008 Polaris 6x6 Wheeler ATV	11	Years	15	4	2023	$15,000	GF
PWLV	1999	1999 RANGER	20	Years	25	5	2024	$30,000	GF
PWLV	1999	1999 RANGER TRUCK	20	Years	25	5	2024	$30,000	W/S
PWLV	1999	1999 FORD F-550 2 TON 4X4	20	Years	25	5	2024	$30,000	GF
PWLV	2016	2016 FORD F-550 2-TON 4x4 Truck/Sander	3	Years	8	5	2024	$48,000	GF
PWHDE	1984	Ford Steam Truck 4x6	35	Years	40	5	2024	$80,000	GF/W/S
PWHDE	1989	Ford F800 Bucket Truck	30	Years	35	5	2024	$50,000	GF
PWHDE	1994	720A Champion Grader	25	Years	30	5	2024	$240,000	GF
FDHDE	1983	1983 Engine 4 Spartan	35	Years	40	5	2024	$650,000	GF
FDHDE	2009	2009 Achilles Inflatable Boat	10	Years	15	5	2024	$17,500	GF
PWLV	2000	2000 K2500 4X4 W/SERVICE BODY	19	Years	25	6	2025	$34,000	W/S
PWLV	2000	2000 DODGE DURANGO	19	Years	25	6	2025	$30,000	GF/W/S
PWHDE	1980	12G Cat Grader	39	Years	45	6	2025	$250,000	GF
PWHDE	2000	Freightliner End Dump Truck	19	Years	25	6	2025	$187,000	GF/W/S
PHLV	2010	2010 F-350 4X4 Plow Truck	9	Years	15	6	2025	$40,000	PH
PHHDE	2000	2000 Fish Carcass Trailer	19	Years	25	6	2025	$12,000	PH
PWHDEA		Bomag Gravel Compactor	23	Years	30	7	2026	$15,000	GF/W/S
PWLV	2006	2006 FORD F-150 4X4	13	Years	20	7	2026	$30,000	W/S
PWLV	2006	2006 FORD F-150 4X4	13	Years	20	7	2026	$30,000	GF/W/S
PWLV	2006	2006 FORD F-150 4X4	13	Years	20	7	2026	$38,000	W/S
PHLV	2001	2001 F550 USED OIL VAC TRUCK	18	Years	25	7	2026	$60,000	PH
PWHDEA	1987	Faire Snow Blower for Loader - backup	32	Years	40	8	2027	$80,000	GF
PWLV	2002	2002 JEEP WRANGLER	17	Years	25	8	2027	$30,000	GF/W/S
PWLV	2007	2007 FORD F-150 4X4	12	Years	20	8	2027	$30,000	W/S
FDLV	2002	MEDIC 2 (2002 FORD F350)	17	Years	25	8	2027	$200,000	GF
FDHDE	2002	2002 Utility Trailer for 6 Wheeler	17	Years	25	8	2027		GF

Key

PWHDEA = Public Works Heavy Duty & Equipment Attachments
PWLV = Public Works Light Vehicles
PWHDE = Public Works Heavy Duty Equipment
PHLV = Port/Harbor Light Vehicles
CH = City Hall
PHHDE = Port/Harbor Heavy Duty & Equipment
HPDLV = HPD Light Vehicles
FDLV = Fire Department Light Vehicles
FDHDE = Fire Department Heavy Duty & Equipment

PWLV	2008	2008 FORD F-250 4X4 FLATBED	11	Years	20	9	2028	$38,000	GF
PHLV	2008	2008 FORD F-350 4X4 Plow Truck	11	Years	20	9	2028	$40,000	PH
HPDLV	2003	2003 FORD EXCURSION	16	Years	25	9	2028	$40,000	GF
HPDLV	2013	2013 FORD EXPEDITION	6	Years	15	9	2028	$40,000	GF
FDLV	2013	UTILITY 2 2013 FORD EXPEDITION	6	Years	15	9	2028	$95,000	GF
PWHDE	2004	EW 180B Volvo Wheeled Excavator	15	Years	25	10	2029	$250,000	GF/W/S
PHHDE	2004	2004 Fish Carcass Trailer	15	Years	25	10	2029	$12,000	PH
HPDLV	2014	2014 FORD EXPLORER	5	Years	15	10	2029	$40,000	GF
PHLV	2005	2005 FORD F-150 2WD	14	Years	25	11	2030	$30,000	PH
HPDLV	2015	2015 FORD EXPLORER	4	Years	15	11	2030	$40,000	GF
HPDLV	2015	2015 FORD EXPLORER	4	Years	15	11	2030	$40,000	GF
FDHDE	1999	1999 Rescue 1 Freightliner Truck	30	Years	41	11	2030	$650,000	GF
PHLV	2011	2011 FORD ESCAPE HYBRID	8	Years	20	12	2031	$30,000	PH
PHHDE	2006	2006 Komatsu Loader WA100M-5	13	Years	25	12	2031	$70,000	PH
CH	2006	2006 FORD FREESTYLE AWD	13	Years	25	12	2031	$32,000	GF
PWHDEA		OJK 125 Meleter - Asphalt Crack Sealer	17	Years	30	13	2032	$35,000	GF
PWLV	2012	2012 CHEVY COLORADO EXT CAB	7	Years	20	13	2032	$30,000	GF/W/S
PWLV	2012	2012 CHEVY COLORADO CREW CAB	7	Years	20	13	2032	$30,000	GF
PWHDE	2002	163H Cat Grader	17	Years	30	13	2032	$225,000	GF
PWHDE	2007	D37 Komatsu Dozer	12	Years	25	13	2032	$100,000	GF
PHHDE	2002	2002 25' Peregrine Harbor Tug w Twin 150 HP	17	Years	30	13	2032	$130,000	PH
HPDLV	2017	2017 FORD EXPLORER INTERCEPTOR	2	Years	15	13	2032	$40,000	GF
HPDLV	2017	2017 FORD EXPLORER INTERCEPTOR	2	Years	15	13	2032	$40,000	GF
FDLV	2016	MEDIC 3 (2016 FORD F3HZ)	3	Years	16	13	2032	$200,000	GF
FDHDE	2017	2017 Argo Model 8x8 Frontier-S	2	Years	15	13	2032	$25,000	GF
PWHDEA	2018	Diamond Brush Cutter for Loader	1	Years	15	14	2033	$82,000	GF
PWHDEA	2003	Trailmax Heavy Equipment Trailer	16	Years	30	14	2033	$25,000	GF/W/S
PWLV	2008	2008 FORD F-350 SD FLATBED	11	Years	25	14	2033	$45,000	GF/W/S
PHHDE	2008	Genie Z-45/25 Articulating Boom Lift	11	Years	25	14	2033	$65,000	PH

Key

PWHDEA = Public Works Heavy Duty & Equipment Attachments
PWLV = Public Works Light Vehicles
PWHDE = Public Works Heavy Duty Equipment
PHLV = Port/Harbor Light Vehicles
CH = City Hall
PHHDE = Port/Harbor Heavy Duty & Equipment
HPDLV = HPD Light Vehicles
FDLV = Fire Department Light Vehicles
FDHDE = Fire Department Heavy Duty & Equipment

HPDLV	2018	2018 FORD EXPLORER AWD 4DR K8AT	1	Years	15	14	2033	$40,000	GF
PWHDEA	2004	Tex Steamer Unit for Truck E160	15	Years	30	15	2034	$30,000	GF/W/S
PWLV	2014	2014 F-150	5	Years	20	15	2034	$30,000	W/S
PWLV	2014	2014 F-150	5	Years	20	15	2034	$30,000	GF
PWHDE	2009	Isuzu Sweeper Truck Vacuum	10	Years	25	15	2034	$200,000	GF
PHLV	2009	2009 CHEV COLORADO	10	Years	25	15	2034	$30,000	PH
FDHDE	2008	2008 Engine 2 KME Custom Pumper	12	Years	27	15	2034	$650,000	GF
PHLV	2010	2010 FORD F-150 NEW TO CREW 2014	9	Years	25	16	2035	$30,000	PH
FDHDE	2005	2005 Mako Air Compressor at HVFD	14	Years	30	16	2035	$65,000	GF
PWHDEA	2011	Larue Snow Blower for Loader	8	Years	25	17	2036	$150,000	GF
PWLV	2016	2016 CHEVY EXPRESS 2500 VAN	3	Years	20	17	2036	$40,000	GF
PWHDE	2006	PC160LC-7 Track Excavator	13	Years	30	17	2036	$175,000	GF/W/S
PWHDE	2006	Freightliner Steam Truck 2x4	13	Years	30	17	2036	$80,000	GF/W/S
PHLV	2016	2016 F-SERIES SD F350 4X4 Sander	3	Years	20	17	2036	$40,000	PH
PHHDE	2011	Bobcat Versa Handler	8	Years	25	17	2036	$70,000	PH
PHLV	2012	2012 CHEVROLET SILVERADO 1500 1/2 TON	7	Years	25	18	2037	$30,000	PH
PWHDE	2003	644H JD Loader	16	Years	35	19	2038	$200,000	GF/W/S
PHLV	2013	2013 F-150 PICKUP	6	Years	25	19	2038	$30,000	PH
FDHDE	2008	2008 Utility Trailer for 6 Wheeler	11	Years	30	19	2038	$4,500	GF
PWHDEA		Wacker Plate Compactor	0	Years	20	20	2039	$4,000	GF/W/S
PWHDE	2014	Pelican Sweeper	5	Years	25	20	2039	$237,000	GF
PWHDE	2015	Mac End Dump Truck	4	Years	25	21	2040	$187,000	GF/W/S
PWHDEA	2016	Light Duty Car Hauler Trailer	3	Years	25	22	2041	$8,000	GF
PWHDEA	2012	Steamer Unit for Truck E176	7	Years	30	23	2042	$30,000	GF/W/S
FDHDE	2017	Big Tex Utility Trailer	2	Years	25	23	2043	$4,500	GF
PWHDE	2018	Sewer Vac Truck	1	Years	25	24	2044	$500,000	GF/W/S

Key

PWHDEA = Public Works Heavy Duty & Equipment Attachments
PWLV = Public Works Light Vehicles
PWHDE = Public Works Heavy Duty Equipment
PHLV = Port/Harbor Light Vehicles
CH = City Hall
PHHDE = Port/Harbor Heavy Duty & Equipment
HPDLV = HPD Light Vehicles
FDLV = Fire Department Light Vehicles
FDHDE = Fire Department Heavy Duty & Equipment

Katie Koester
Capstone
Final 5.7-2019

Introduction

The goal of this paper is to develop a General Fund Fund Balance and Reserve Balance policy for the City of Homer. In order to do achieve that lofty goal, the paper establishes common definitions of these terms and methodology for reviewing recommendations and finding the best fit for the City of Homer. The current state and local fiscal climate is taken into consideration, as are the implications, both legal and in human resources, of the absence of a policy, or the 'do nothing' option. Best practices are analyzed from literature, professional organizations and the experiences of similarly sized municipalities around the country. A deep dive into the City of Homer's current practices in fund balance and reserve management exposes challenges the municipality faces. Finally, this paper concludes with a recommendation on maintaining a fund balance reserve target and a three-pronged approach to reserve balance policy that takes capital asset management into consideration. The appendix of this paper has a draft policy establishing General Fund Fund Balance and Reserve Balance policies for consideration by the Homer City Council.

Definitions

What is a fund balance policy? How does it differ from a reserve policy? According to the Municipal Research and Services Center (MSRC), fund balance is a term used to describe the difference between a fund's assets and liabilities and describes the net position of local government funds (MRSC.org, 2019). Fund balance policies are necessary to make sure there is enough actual money on hand to pay the bills even though tax revenue and cash flow may be cyclical in nature. It is also critical to have funds on hand to be able to meet unanticipated, or emergency expenditures. The definition of an emergency could be an unexpected sharp and sudden reduction in revenue or increased spending due to a natural disaster. May municipalities spend a great deal of time defining what an emergency is to their community through strategic planning and code changes so as to protect the corpus of the fund balance.

Fund balance is a constantly moving number since it is a snapshot in time of what the overall position of the fund is. Generally speaking, the City of Homer aims to keep 6 months operating budget, or $6 million in General Fund Fund Balance. If annual revenue versus expenditures falls short, the difference is made up in fund balance. Conversely, if there is a surplus, it rolls into fund balance. Homer City Code 3.05.035 dictates that appropriations shall lapse at the end of the fiscal year to the extend they have not been fully expended or encumbered (HCC online) but remains silent on a target or goal funding about for fund balance.

It is difficult for the layperson to distinguish between reserves and fund balance. Some municipalities use fund balance more as a capital reserve account, but they are fundamentally different with different purposes.

Methodology

This paper analysis a combination of best practices derived from the General Finance Officers Association (GFOA) and literature from other professional organizations. GFOA has gone so far as to develop a rating system and numeric tool to help municipalities in setting fund balance goals. The second part of the analysis was to review what other municipalities have implemented for target levels and how they got to

those levels. With the exception of the Kenai Peninsula Borough, these municipalities were recommended through the Municipal Research and Services Center (MRSC), a Washington nonprofit that provides professional advice and policy recommendations to citizens and local governments (MRSC.org).

Background: Politics and Economics

State Fiscal Climate

The State of Alaska is facing a fiscal crisis not seen since the oil crash in the 1980s. This has triggered a state-wide recession and cuts to government – both state programs and contracts with local governments to provide state services. This has resulted in job losses in state and local government. In addition to cuts that have been already made, there are threats of more cuts from the Dunleavy administration and general uncertainty that is stimming growth in the economy as lawmakers have failed to reach an agreement on how to resolve the fiscal crisis (ADN, 2018).

State budget cuts and general economic uncertainty has effected the City of Homer in very real ways; in 2015 the City laid off six employees and contracted spending. A successful request to change a dedicated sales tax to help fund general government has helped the City keep their head above water; however officials are watching Juneau carefully for cuts to programs that have a direct impact on the City of Homer operating budget like contracts with community jails, decreases to the on behalf payments into Public Employees Retirement System (PERS) and erosion of Community Assistance. Other cuts that the administration has proposed will have a more indirect impact on City finances by putting pressure on Borough government (who will in turn pressure the cities and residents) and changing our economic landscape with reductions in locally available well-paying jobs and a potential decrease in the capacity of the education system.

City of Homer Political and Fiscal Climate

The Homer City Council is a non-partisan body. Nevertheless, members vary in their philosophies on the role of government and the value of saving for capital improvement projects versus bonding.

For example, conservatives have long criticized government for policies that squirrel away money instead of offering tax relief. In this regard, policies that establish generous savings accounts for government can be seen as irresponsible and unfair to the taxpayers. Nevertheless, conservatives are fiscally conservative by their nature and favor limiting spending on non-core services in favor of ensuring there is adequate savings for emergencies without forcing new taxes. Progressive thought puts more value on increased taxes for increased government services. However, sometimes that philosophy puts pressure on reserve funds and savings account as the temptation to spend money on expanding services is great. The key, and what this paper hopes to address, is to find a balance between the competing demands of funding government through reasonable taxes with adequate savings for both maintenance and emergencies. One thing the Homer City Council can agree on is the need for a fund balance and reserve balance policy. Members on all sides have been requesting administration develop a policy for some time.

Vulnerabilities

An absence of city code to direct the use of fund balance and how to adequately manage reserves leaves a municipality vulnerable on multiple fronts. There is vulnerability to legal challenges without language to authorize the transfer of funds. Furthermore, a lack of reasonable policy and expectations in fund balance

and reserve balance management can lead to irresponsible fiscal habits that compromise an organizations ability to fund basic services. A delicate balance needs to be struck that ensures adequate funding to maintain city services, city infrastructure and prioritize employee safety.

Legal Implications

The potential ramifications of improper financial management can be far reaching, and a solid fund balance and reserves policy is part of responsible financial management. Alaska law requires a single audit for all first class and home rule municipalities. The audit ensures the public that funds are being spent in accordance with established practices (Alaska Division of Community and Regional Affairs, online). Findings on the audit, or an audit that is not made in a timely manner, jeopardizes an entity's ability to receive state and federal funds. This puts a dollar value and very real consequences on proper accounting practices and best practices.

A fund balance policy also protects from the illegal transfer of funds without proper authority. For example, in the City of Homer all transfers over $25,000 need to be approved by City Council. This has made some members question how an overage gets automatically rolled into fund balance, which is current practice, instead of expressly appropriated by Council. While administration is not behaving illegally by leaving the funds where they accumulate (HCC 3.05.035 authorizes appropriations to lapse to the fund they originated from at the end of the fiscal year), there is the appearance of impropriety, which can sometimes be just as bad. Another example where operating without policy can create legal vulnerability is keeping funds and transfers between funds separate. The City of Homer has an enterprise fund (Port and Harbor) that is kept separate from the General Fund. Any comingling of those funds would be against City code, and single audit standards, which could have legal consequences.

Human Resources

In the public sector, employees are the biggest expense. Municipalities provide services, and employees are needed to provide those services. Personnel costs constitute 44% of the budget of the City of Homer (City of Homer Budget, p.33 FY2019). While it is wise and prudent to have a reserve policy that puts away enough to fund major maintenance and essential repairs, getting that balance right is critical or you are putting aside money at the expense of your operating budget and compromising your ability to hire employees and adequately perform the services the public demands. Often part of a reserve policy is a required annual minimum transfer, either as a dollar amount or as a percent of operating budget. Nevertheless, this is also often the first place to cut – or not to fund, when times become lean. Councils have to develop a policy that is flexible enough that they can be responsive in lean years and adjust the transfer to reserves without having to lay off workforce to meet reserve balance goals. This means in the good years, the policy needs to mandate a sufficient transfer to buffer against the unexpected. If the policy cuts too close to the bone, you run the risk of not being able to adapt to changing conditions and quickly run out of funds not only for major maintenance and repairs, but also for staffing and providing essential services. On the flip side, if you over prioritize the growth of the municipality's fund balance or reserves, it is at the expense of hiring employees to provide services. For example, at the City of Homer we do not have enough police officers to have double coverage on every shift. This means if something really terrible and involved happens, our staff could have no back up. This of course has legal implications, as discussed previously, and puts our staff at great risk to harm. If we had a very large and comfortable police reserves that we added to every year, one could question if those fund would not be better spent on hiring more staff to mitigate risk and protect the safety of our employees.

Employee safety is a critical element of why a reserve policy is essential. Reserves are used to fund the replacement of essential equipment like vehicles, and fund safety improvements at facilities. A grate to cover exposed wells to protect water and sewer employees from confined spaces is a great example of an expenditure from reserves that recently happened in the City of Homer budget to protect employees. Safe vehicles is another great example, as is turn out gear for fire fighters – the City of homer just purchased 2 new patrol vehicles and 10 sets of turn out gear from our reserves to the tune of $110,000. From a broader perspective, providing a safe, comfortable and pleasant work environment where employees can be productive and thrive is also the responsibility of an employer. This was one of the core messages behind a campaign to fund a new police station for our officers - $2.7 million of which was funded from City funds on hand. This seed money was able leverage approval of a $5 million bond from voters tied to an increase in sales tax. This was possible because the City of Homer had reserves to initiate this project and move it beyond the 'dream' stage.

Best Practices and Case Studies

Fund Balance

GFOA recommends performing a risk analysis and thorough financial assessment to determine recommended level of fund balance. The recommended levels found in the literature ranged from 2 -6 months operating budget, though some municipalities had targets as low as 10% of operating budget (GFOA, 5024). Various factors determine whether or not municipal savings should be on the higher or lower end of that range including how the fund is used, how volatile revenue is, impact on bond ratings, and the level of exposure to significant one-time outlays. The literature encourages municipalities to undergo a risk analysis of all these factors. For example, pressure on the fund balance from other funds, such as a poor performing enterprise fund that has to be buoyed up by the general fund, will naturally necessitate a higher balance (MRSC, 2019). Where this pressure on the fund balance is most often seen is when municipalities have insufficient capital reserves, a topic we will discuss later, and have to dip into the 'rainy day fund' to cover necessary major maintenance and capital expenditures. However, one big no-no is using Fund Balance for ongoing operations; it should only be used for one-time expenditures. Generally speaking, the one-time outlays of cash from Fund Balance are unpredictable and the municipality should have as part of their policy plan in place to replenish the fund balance. Such surprise expenditures could take the form of natural disasters, cuts from State or Federal government, and litigation.

Volatility of revenue is another consideration. A fund balance is designed 'to provide sufficient cash flow to meet operating needs' so a policy has to take into consideration when revenue is taken in (when property taxes are remitted, for example) and how predictable the revenue is (MRSC, 2019). Property tax is considered a very stable form of revenue; conversely, sales tax can be more volatile. Therefore, if your municipality depends primarily on sales tax revenue a higher target is appropriate. A third factor to consider is external reasons you might need a large savings account, such as to maintain a favorable bond rating. As part of the risk analysis, GFOA recommends not only considering these factors, but defining how likely each one is to happen (i.e., how likely is a major earthquake?).

Reserves

Reserves should be considered separately from fund balance, though they are interrelated and affect each other, as described above. Reserves exist to fund anticipated and predictable expenditures to maintain and replace major assets. In some ways, an adequate reserve policy is easier to decipher and defend than a fund

balance policy because the anticipated costs are very real and predictable. Nevertheless, it takes time and expertise to determine the adequate levels of funding for reserves, or capital asset management, as GFOA terms it. Adequate capital asset management involves taking a physical inventory of capital assets on a regular basis and translating this into a depreciation schedule that is regularly and adequately funded. In addition to an annual assessment of capital assets by a qualified engineer, GFOA recommends developing an educational campaign every few years to bring the decision making body and public up to speed on why it is necessary to save and plan for major maintenance and depreciation (GFOA, 501). One aspect of a capital asset management plan that varies (based on philosophical approach to government finances) is whether municipalities plan for replacement cost. Many argue that debt should be used to replace major infrastructure, versus saving and paying in advance, as a mechanism for the current user or beneficiary to pay for the current assets. This is compounded by the fact that often saving for replacement requires so much to be put into savings that there is not the political appetite to either leave the savings untouched for a long enough period or collect sufficient revenue to fund it. The 'pay as you go' philosophy needs additional financial management and oversight as it can be more risky.

Communication is the key to any good capital asset management plan. Not only do you have to spend time and effort ensuring that the data inputted is accurate and defensible, but you have to convince taxpayers that it is wise and prudent to plan for the future. In order to do this, GFOA recommends using condition ratings, replacement life cycles, actual expenditures and long-term trends (GFOA, 501).

What other municipalities are doing

Best practices from other communities can be a great starting place for developing both a Fund Balance policy and capital asset management plan. However, it is important to note that each municipality will be different in how their finances are structured, limitations and rules that govern how they are used, and most importantly the political will and financial landscape.

The town of Atherton, California has a simple but easy to follow policy that begins with a clearly stated purpose, to "provide quick response to weather economic uncertainty, unexpected situations such as natural disasters, provide sufficient cash flow to avoid the need for short-term borrowing" (Atheron Fund Balance Policy for General Fund). As part of this policy, Atherton assesses the risk to fund balance according to 3 funds up into 3 distinct categories: emergency, economic uncertainty and working capital. Using these metrics, they have set an absolute floor of 15% of the Town's annual General Fund expenditures.

Closer to home, the Kenai Peninsula Borough (KPB), Alaska has developed a fund balance policy based on five major components: 1) working capital requirements, 2) bond rating and debt service, 3) revenue volatility amount, 4) unexpected expenditure and 5) future capital expansion and contingencies (KPB, March 2018). The KPB policy has a text book quality to it – each element enumerated above has a mathematical formula attached to that, when looked at comprehensively creates a minimum and maximum fund balance for each fiscal year for each fund, including the General Fund. It is worth noting that this strategy does not use a percentage of operating budget as a target, but rather develops a numerical range. One critique could be that though very logical and numbers driven, the complexity of the model makes it difficult to communicate and thereby justify to decision makers and taxpayers.

The Village of Barrington, Illinois establishes a minimum for fund balance by fund based on the specific risk factors to each fund. For example, General Fund is limited to three months operating revenue where the street maintenance program has a higher threshold of 50%. This not only ensures sufficient savings to

maintain this critical program, but as a way to 'forward fund' street and road maintenance (Village of Barrington, 2009-2010 Biennial Budget). Barrington is an established community outside of Chicago with a very high value property tax base, which means its revenue is considered relatively stable by GFOA standards.

The City of Ferndale, Washington goes so far as to call the fund balance the 'rainy day fund' in policy and stresses the prudent and limited use of it. However, the target for fund balance is low by GFOA standards, 10% of operating expenditures. The municipality is aware of this deficiency and established a goal of increasing this to 20% 'if a new major retailer comes online after 2012' (City of Ferndale). The City has a separate Facilities Capital Reserve with a dedicated funding source for "unforeseen City facilities capital expenditures" of $300,000.

The final community examined was the Community of Leavenworth, Kansas with a robust fund balance policy that sets a goal of 25% operating budget for General Operating Reserves. Their plan further details that any surpluses should be limited to one-time operational expenditures, a planned capital facilities expenditure, or increasing the general fund operating reserve (Leavenworth). It is important to have a plan in place that replenishes fund balance when it dips below the desired levels. Leavenworth's policy goes on to define optimum levels of savings by fund depending on the specific nature, risk factors and volatility of the fund. The Leavenworth case is a good case study when looking at debt as there is considerable policy developed around how to manage healthy debt service ratios by fund when a high level of debt is incurred.

The City of Homer Experience – Current Practice and Recommendations

Fund Balance

City of Homer Current Practice

The City of Homer has no stated policy in code or otherwise for how fund balance is managed. Rather, the administration and Council work under the assumption that the City of Homer should have at a minimum six months operating revenue (or $6 million for FY2019) in General Fund Fund Balance. When overall General Fund budget comes in under, or over, it impacts fund balance through no action of City Council. For example, if the City comes in $250,000 under budget in a fiscal year, those funds grow Fund Balance. Conversely, if expenditures exceed revenue, Fund Balance takes the hit. This unstated policy has come under criticism as of late and Council wants to have more agency in this transaction in order to be able to dedicate surplus funds to an expenditure of their choosing.

Recommendation

After analyzing GFOA best practices and what other municipalities do, I recommend the City of Homer adopt a formal policy that aims to maintain General Fund Fund Balance at 50% of one-year operating expenses. This may seem high compared to other municipalities analyzed, however, my reasoning stems from the following factors:

1) The City Council uses Fund Balance for general spending. In many instances in the past three years, City Council has spent funds directly from fund balance. The most notable project was $800,000 on a remodel of the Fire Hall. If this is going to be a common practice, the fund needs to have sufficient revenue to still be healthy with those dips, or there needs to be the political will to

only dip into fund balance for emergency expenditures. If the latter is the case, I would recommend developing a solid policy on what constitutes an emergency.

2) Although the City does have a reserve fund, between the two this constitutes the entirety of the City of Homer's general fund 'savings.' Other municipalities have emergency funds, capital improvements funds, permanent funds or other places whereby funds are set aside for either emergencies or major expenditures.

3) GFOA recommends a higher fund balance if your funding source is more volatile. The City of Homer primarily depends on sales tax revenue, which is considered more volatile than property tax revenue. Furthermore, given the fiscal situation of the state budget and uncertain impact cuts will have on the overall economy, a conservative approach is recommended.

4) A higher fund balance is recommended by GFOA if your region is prone to natural disasters Homer lies within both an earthquake zone and tsunami zone; either one of those events could have catastrophic short and longer-term impacts that we need to be prepared to handle.

4) A higher fund balance is necessary to be able to maintain cash flow. Property taxes, 1/3 of general fund revenue, are only paid once a year. Sales tax, the bulk of revenue, is paid quarterly but the bulk of it is earned during the summer months.

The question has come up with City Council of what to do when the fund balance exceeds six months operational expenses, which is where it sits for FY2019. Should the excess be spent? Should it be transferred into a reserve account or possibly a permanent fund with less restrictive investment policy where it is able to earn a greater rate of return for the City? My recommendation would be to create a capital projects fund for major capital projects that can serve as seed or match money in the future. We know we are facing many large infrastructure replacement projects such as the Homer Education and Community Recreation Complex, a new public works complex and the wholesale replacement of a fire fleet that is, on average, over 30 years old. In the absence of state and federal money, having local capital to seed these major projects is going to be key to the long-term health of the City.

Reserves

Current Practice

In the case of the City of Homer, there are approximately 20 different reserve accounts that range from fleet reserves to information and technology reverse sub funds for funding IT infrastructure. These funds pay for routine capital expenditures that are outside the scope of the operating budget and are generally one-time expenses over $25,000. The City of Homer does have a reserves policy on the books, Resolution 2006-101 establishes a goal of 40% of depreciable assets. However, this goal is unrealistic as the City has only ever been able to reach about 10% of the value of depreciable assets. The ambitious nature of the goal makes it not useful to administration or policy makers and the City Council is begging for more concrete standards that they can justify.

Investment in deprecation and regular maintenance has been lacking over the last 10 years at the City due to budget constraints and a lack of appetite to take care of what we have. For example, the fire department fleet is entirely beyond its lifespan and there is no sustainable fleet management plan. In lean years, spending on major maintenance and transfers to reserves is sacrificed to maintain the operating budget –

which makes average spending a poor metric of demand. In addition, major replacement and repairs has depended in the past on robust capital budget and grants, both of which have dried up in the last five years.

Recommendation

After reviewing the literature, best practices, and current City of Homer practices, I believe the City should take a three-pronged approach to reserve management: 1) inventory deferred maintenance and get infrastructure to an adequate baseline 2) establish a goal of keeping reserve funds at a balance of 4 years average spending and 3) establish a capital assets account where funding is set aside for major maintenance or replacement.

The City needs to perform a detailed analysis of our infrastructure and produce a schedule that identifies the most outstanding needs to bring infrastructure up to a reasonable level. This will result in a concentrated push to fund and perform deferred maintenance tasks. This will require an influx of cash and staff capacity to take care of the most egregious projects and establish a schedule for others. From this, we can work backward on how much we should be investing annually in maintaining the infrastructure, plan for replacement at its end of life and put adequate funds away in reserves to fund anticipated expenditures. However, this approach is staff and resource intensive. It is a large project that would be handled by the overstretched Public Works department and likely require hiring outside engineers. Furthermore, there would be significant ongoing cost to keep this list updated and relevant. There is also the very real fear that this number will be so high that there will be no political appetite to save, or spend, at recommended levels.

Once maintenance projects that have been ignored for years are taken care of, budgeted for, or at least planned for, a reasonable and much more conservative approach to reserve management can be implemented. One approach that has been suggested by the current Mayor, Ken Castner, is to cap the necessary reserve spending amount at the four times the average annual spending. Under this scenario, the Council would prioritize replenishing the fund annually with whatever the four-year average in spending is. For the general fund, this only works if you consolidate the 20 separate reserve funds since spending annually in one reserve can be sporadic and not consistent enough to derive reliable averages. Combining these funds may provide the ability to more effectively direct funds to the greatest need, versus departments taking a proprietary approach to available funding.

Evaluating Success

While the recommendations developed in this paper are sound and justifiable for the City of Homer at this moment in time, it is important to revisit the effectiveness of the policy as circumstances change and the City has experience with the policy. For example, if the political climate and comfort level for saving versus borrowing changes within the community and the Council, the target amount for fund balance and reserves may need to be adjusted. Another variable that will influence the effectiveness of the policy is available revenue. If times become lean, it may be impossible to fund at the recommended levels while continuing to provide basic services. If this becomes the case, Council needs to make a policy decision on how to prioritize resources. An unexpected windfall may also prompt tweaking of the policy as the highest and best use of unexpected dollars is explored by Council. Lastly, an emergency draw on fund balance, such as a fiscal crisis or natural disaster will prompt a careful analysis of the policy as Council and management work to rebuild recommended reserve levels.

In addition to being incorporated into city code, the fund balance and reserve balance policy should be integrated as a part of the budget process and published document to prompt review and reflection on a regular basis.

Conclusion

In conclusion, the City of Homer is overdue for a fund balance and reserve balance policy. Though the current practice established in code of surplus funds reverting back to their originating source allowed for a healthy and responsible growth of fund balance, putting reasoning, definitions and targets further institutionalizes this practice. Another problem the City of Homer had was an unrealistic target for reserve funding, 40% of depreciable assets. With millions of dollars in depreciable assets, it became unrealistic to set aside more than 10% making the goal meaningless.

This paper proposes a conservative and reasonable approach to general fund fund balance policy setting a target amount of 6 months operating budget. The recommendations are more divergent from current practice when it comes to the reserve policy. The paper recommends combining all funds into one common general fund reserve and capping it at four times average spending. This only works with the third recommendation of the paper, the establishment of a capital improvement fund to save money for major capital projects and council priorities. The paper further recommends prioritizing the replenishment of the funds in the order listed: fund balance, reserves, and finally capital improvement.

The changes proposed in this paper will require thoughtful deliberation and discussion by Council with input from the Manager, Finance Director and department heads that know their budgets, facilities, and anticipated expenditures best. Decisions on restrictions on spending, prioritization of funds, and what the prudent level of reserves are a matter of policy influenced by the political and economic climate and the personal philosophies of each member. It is a conversation I am looking forward to observing. I appreciate the Council's commitment to good governance and budgeting by pursuing this topic and setting aside time for its careful consideration.

Works Cited

Alaska Division of Community and Regional Affairs. https://www.commerce.alaska.gov/web/dcra/LocalGovernmentOnline/FinancialManagement/FinancialAuditsandStatements.aspx

Anchorage Daily News (ADN), February 17, 2018. https://www.adn.com/business-economy/2018/02/17/iser-recession-hitting-downstream-industries/

Antonelli, A (2000). The Right Way to Use the Surplus. The Heritage Foundation, March 15, 2000. www.heritage.org

City of Homer FY 2019 Budget. https://www.cityofhomer-ak.gov/finance/city-homer-2019-adopted-budget

City of Homer Resolution 06-101. A Resolution of the City Council of Homer Alaska Expressing its Intent and Desire Regarding the Reserve Fund Balance Contained in the General Fund. https://www.cityofhomer-ak.gov/cityclerk/city-resolutions-1983-2010

Government Finance Officers Association (GFOA). Capital Asset Management. 501. www.gfoa.org

Government Finance Officers Association (GFOA). Fund Balance Guidelines for the General Fund. 5024. www.gfoa.org

Government Finance Officers Association (GFOA). Working Capital Targets for Enterprise Funds, 425. www.gfoa.org

Homer City Code. Chapter 3.05 Budget. https://www.codepublishing.com/AK/Homer/

Kavanagh, S & Skinner, K. (2013). Sizing Your Reserves: A Risk Based Approach. Government Finance Review, October 2013, pp.11-16.

Kenai Peninsula Borough (KPB) Fund Balance Policy. March 2018. www.kpb.gov

MSRC.org, 2019. http://mrsc.org/getdoc/e996c596-8df3-4f69-9c66-d28270596f12/fund-balance-and-reserve-policies.aspx

The Civic Federation (2009). How Much Fund Balance is Too Much? Not Enough? Just right? December 16, 2009. www.civicfed.org

City of Homer

Fund Balance Policy for the General Fund

General Fund Fund Balance

Purpose

To help the City of Homer provide quick response to weather economic uncertainty, unexpected situations such as natural disasters, and provide sufficient cash flow to avoid the need for short-term borrowing. This policy establishes the appropriate level of reserves which the City will strive to maintain in its General Fund balance; how the target balances will be funded; and the conditions under which fund balance can be used.

Funding Target

Funding of general fund balance targets will generally come from excess revenue over expenditures or one-time revenues. The target fund balance for the fund is six months general fund annual operating expenditures.

Conditions for Use

The use of fund balance shall be limited to unanticipated, emergency non-recurring needs. If the annual audit determines there is more than six months general fund operating revenue in fund balance, it can be appropriated by Council to other funds or to fund qualifying expenditures. Fund balance shall not be used for normal or recurring annual operating expenditures.

Capital Asset Repair and Maintenance Account (CARMA)

Purpose

Capital asset management is essential to extending the life and use of taxpayer funded major assets, facilities and infrastructure. Funds should be set aside annually to ensure funding is available to replace fleet, repair facilities, and replace equipment.

Funding Target

The City will strive to hold no less than four times average annual expenditure in general fund reserves. All general fund reserves will be combined into one fund. This ensures that the highest and best need for the city is prioritized in any given year. The general fund reserves will be replenished by appropriation in the budget process by taking the average of the actual spending for the four prior years.

Any revenue available in excess of ¼ average annual spending will be available for appropriation by Council into the Capital Improvement Fund or other Capital expenditures as determined by Council.

Conditions for Use

Reserve funds should be used to fund fleet replacement, repairs to facilities, and replacement equipment. Reserve funds are not intended to fund major capital projects such as new facilities.

Capital Improvement Fund

Purpose

The purpose of the Capital Improvement Fund is to help fund major capital projects and/or new infrastructure for the City of Homer.

Funding Target

Funding of the Capital Improvement Fund will come from excess revenue over expenditures or one-time revenues.

Conditions for Use

Major Capital projects are defined as projects that have been prioritized through the City of Homer Capital Improvement Plan and, in general, have a total project cost of $1 million or more. The Capital Improvement Fund is not intended to fund 100% of major capital projects, but rather be a place to accumulate funds as seed money or match funding in anticipation of larger, multiyear projects.

Prioritization of Funds

The funds will be funded in the following priority order: 1) general fund fund balance, 2) CARMA and 3) Capital Improvement Fund.