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City of Alexandria, Virginia

MEMORANDUM

DATE: NOVEMBER 6, 2019

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: MARK B. JINKS, CITY MANAGER /s/

DOCKET TITLE:
Consideration of Modifications to the City's Debt-Related Financial Policies.

ISSUE: Modifying the City's financial policies to reflect an updated level of General Fund Fund Balance as a ratio of the City's General Fund Revenues,

RECOMMENDATION: That City Council adopt the proposed amendments to the City's Debt-Related Financial Policies (Attachment 1) in order to:

(1) Establish a Target of 15 percent for the *Spendable Fund Balance* as a percent of the General Fund Revenues.
(2) Delete *Unassigned/Uncommitted Fund Balance* as a percentage of General Fund Revenue as a measure; and
(3) Establish a replenishment policy to prioritize repayment of fund balance following draw down.

BACKGROUND: The City's Debt-related Financial Policies were initially adopted in 1987. These guidelines when they were adopted were considered innovative by the national bond rating agencies, and those debt-related financial policies have been used as a model by many other localities. The policies were substantially updated in 1997. With the exception of a few minor changes since then, these policies have continued to guide Council and staff in financing the 10-year Capital Improvement Program of the City, managing the impact of debt service on the operating budget and maintaining adequate fund balances to cope with unexpected financial problems or emergencies.

The City has established policies to help guide financial decisions, provide financial discipline, and ensure that spending decisions are made through the lens of sound financial management. In the United States there are 282 cities, counties and towns who possess a Aaa rating from Moody's Investor Service out of a possible

25,859 entities. The City's credit worthiness has long received the highest rating from Moody's (Aaa), as well as Standard + Poor's (AAA), indicating that Alexandria has an extremely strong capacity to meet current and projected financial commitments.

During the FY 2020 Budget Development process a question was raised regarding the appropriate level of the City's fund balance targets, and the Budget and Fiscal Affairs Advisory Committee (BFAAC) was asked to review the current target and develop a recommendation for City Council consideration. Throughout Summer 2019, BFAAC worked with staff from the City's Office of Management and Budget to develop a recommendation which was presented to City Council in a Memorandum dated, September 9, 2019. This Memorandum is included as Attachment 2.

In addition, the Alexandria City School Board is considering amendments to their fund balance policy. Currently, the policy stipulates that Commitments and Assignments of School Board reserves may not exceed 1 percent of the Final Operating Budget. The proposed policy would limit these reserves to a maximum of one half of one percent. Beginning in FY 2022, the Alexandria City School Board may reserve a quarter of a percent, increasing by an additional quarter percent in FY 2023. Use of the reserve would require Board approval. The proposal is expected to be considered by the School Board on November 14th. If adopted, City staff will prepare an endorsement recommendation for City Council consideration.

DISCUSSION: There are currently two measures related to fund balance in the City's Financial Policies:

(1) Spendable Fund Balance as a percent of General Fund revenues - No target with limit of 10 percent

(2) Uncommitted/Unassigned as a percent of General Fund revenues - 5.5 percent target and 4 percent limit

GASB 54 required changes in the classifications for reporting fund balance beginning with the FY 2010 Comprehensive Annual Financial Report. *Designated and undesignated* became *Committed, Assigned and Uncommitted/Unassigned*. The general intent of the new GASB54 standard was to improve the usefulness of information, by making it more clear the extent to which the government is bound to observe spending constraints related to fund balance. Simply put, (1) how "spendable" are these funds? and (2) who can repurpose them? Total *Spendable Fund Balance* represents the funds that are available for the City to use for unforeseen or one-time purposes. *Commitments* are established by City Council, and *Assignments* are established by the City Manager (and expended only if appropriated by City Council).

In FY 2013 and FY 2014, because of negative economic conditions, the City drew down fund balance ($13.7 million in FY 2013 and $3.9 million in FY 2014), resulting at the end of the fiscal year total expenditures exceeded total revenues. Current debt policies do not allow for the use of fund balance for more than 2 years in a row. Beginning in FY 2015, as the city's economic condition began to improve following the national Recession, and in conjunction with comments from both rating agencies concerning the City's reserve levels, a conscious effort was made to improve the larger *Spendable Fund Balance* as a percentage of General Fund revenues. In addition to capturing expenditure savings and surplus revenues, as the City's budget increased, a corresponding contribution to fund balance was factored into budget development to insure the maintenance of reserves as a percent of revenue. Since FY 2014, the City's Total General Fund fund balance has increased from $65.3 million to $129.0 million in FY 2018. Recently completed audited financial statements, reflect a forecasted FY 2019 General Fund Fund Balance of $143.2 million.

Some commitments and assignments are designed to help the City be prepared for situations that are extraordinary or do not have sufficiently defined properties to be an actual liability, such as natural disasters or economic contingencies, but also planned future spending such as affordable housing projects or support of the CIP. Although additional designations or commitments/ assignments help to increase the total fund balance, when they are utilized they result in volatility of City fiscal ratios. The most effective way to increase the total amount of *Spendable Fund Balance* available is to increase the amount of Uncommitted and Unassigned Fund Balance. It is important to note that these funds are available for any one-time, unforeseen or extraordinary event, if necessary and authorized.

The ratings agencies offer ratio recommendations but qualify those with conditions related to tax base stability. The ratings agencies also have a built-in conservative bias as they want to substantially reduce risk to bondholders from a government's financial status. The Government Finance Officers Association (GFOA) of the U.S. and Canada has a similar qualified best practice related to *Spendable Fund Balance* and suggests approximately 2 months of operational expenses as a level of reserves. This equates to 17 percent. It is important to note that recommendations related to *Spendable Fund Balance* are focused on the total, and not the subsets or components that make up *Spendable Fund Balance*.

The City's fund balance policy was established in 1987 with a significant update adopted in December 9, 1997. The original policy only included a ratio for unreserved fund balance with a target of 5.5 percent and a limit of 4.0. When the policy was revised in 1997, the target was deemed 'Not applicable' and a limit was set at 10 percent. Note that the language used was "limit," as in "lower limit," not "ceiling." At that time, an additional policy was added to reflect undesignated General Fund fund balance as a percentage of General Fund revenue. The target was set at 5.5 percent and the lower limit at 4 percent. The 1997 BFAAC report also noted that reservations are dictated by accounting standards, making the comparisons to other jurisdictions of *Unreserved Fund Balance* more consistent than comparing *Undesignated Fund Balance*. *Undesignated Fund Balance*, which would compare today with our *Uncommitted/Unassigned Fund Balance*, has some limitations in terms of comparability. The practice of making designations/commitments/assignments varies by jurisdiction and has varied considerably in practice in Alexandria in the past 20 years.

The table below reflects the current ratios reflected in the City's Policies and the proposed changes to the ratio, as well as terminology.

	Current Policies		**BFAAC Recommendatio**	
	Target	Limit	Limit	Target
Spendable (Unassigned/Uncomm General Fund Balance as a Perc of General Fund Rev	N/A	10.0%	Not Defined	15.0%
Unassigned General Fund Balan Percentage of General Fund Re	5.5%	4.0%	*DELETE AS MEASURE*	
Net Assets as a Percentage of G Revenu	5.5%	4.0%	*NO CHANGE*	

BFAAC is recommending and staff supports an adjustment to these changes to the City's Financial Policies as they relate to the City's Fund Balance. *Spendable Fund Balance*, which is the most useful benchmark of the City's ability to respond to uncertainties would remain in place with an established target of 15% and no defined Limit. BFAAC is recommending and staff supports the elimination of *Unassigned General Fund Balance as a Percentage of General Fund Revenue*.

Current policies related to utilization limits are recommended to remain unchanged, which allows for use of fund balance to fund currently operations for no more than two consecutive years. BFAAC also recommends and staff supports a replenishment policy. The City should feel comfortable drawing down fund balance in the event of an economic crisis or natural disaster. However, utilization should come with a very clear, agreed upon strategy for ensuring that the City replenishes fund balance over a reasonable period of time. Staff recommends that replenishment of fund balance be given priority over discretionary funding initiatives. Replenishment of fund balance to achieve the 15 percent target is recommended to occur within three fiscal years when General Fund Operating Reserves are drawn down to meet a "critical, unpredictable financial need."

FISCAL IMPACT: This action has no direct fiscal impact.

ATTACHMENTS:

1. Debt Related Financial Policy Guidelines
2. BFAAC Memorandum to City Council dated September 9, 2019

STAFF:

Laura Triggs, Deputy City Manager
Kendel Taylor, Director of Finance
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