

Agenda Report

NOVEMBER 1, 1999

TO: City Council
THROUGH: FINANCE COMMITTEE
FROM: Jay M. Goldstone, Director of Finance
SUBJECT: Cash Management and Cash Reserve Policy

RECOMMENDATION

It is recommended that the City Council approve the Cash Management and Cash Reserve Policy as laid out in this Report.

BACKGROUND

In 1980, the City Council adopted a set of financial policies to address three areas of concerns. These were: 1) adequate operating reserves, 2) long-term capital requirements, and 3) the Fire and Police Retirement System. In August 1999, the City issued Pension Obligation Bonds which is anticipated to have addressed the funding issues surrounding the Retirement System.

The focus of this paper is to address adequate operating reserves for the major funds of the City by: 1) discussing the various reserve balances maintained by the City, 2) offering an updated discussion of this past policy, 3) expanding and/or modifying the past policy as appropriate, and 4) expanding the policy to include other funds as appropriate.

DEFINITION

For the purpose of this policy, the term "Reserves" is being used synonymously with "Cash". When reviewing the City's Comprehensive Annual Financial Report (CAFR), you will see fund balances figures (both reserved and unreserved) as well as retained earnings figures (both reserved and unreserved). For budgetary purposes and long-term financial planning, a combination of cash and fund balances must be taken into consideration; however, this policy is designed to focus on the City's ability to meet its

short-term and long-term obligations and to ensure that the City maintains the highest credit quality possible. In addition, this policy is designed to assist the City as it experiences significant swings in cashflows due to both economic cycles as well as unanticipated emergencies. Cash reserves may be in the form of actual cash or investments and does not refer to any other form of current or long-term assets such as a receivable, inventory, equipment, etc. This is an important distinction because any given City Fund may have a large fund balance on the balance sheet but no cash to support it. The City needs to maintain an adequate cash balance in order to be able to meet its ongoing obligations.

DISCUSSION

The City pools its cash for investment purposes and permits temporary short-term internal borrowing between funds to meet cash requirements at different points during the fiscal year. It is clearly recognized, however, that each fund must be able to stand on its own and fulfill the obligations for which it was established. The appropriate size of the cash reserve for a specific fund depends upon several factors. These include: 1) the timeliness of the cash flow stream, 2) the current economic environment influencing the revenue and expenditure stream throughout the fiscal year, and 3) the anticipated economic outlook which will influence future revenues, expenditures, and asset and liability additions and retirements.

Cash is segregated into the separate funds either as a requirement of the City's Charter, a City Ordinance, State regulation, grant requirement or due to operating policies as a means to set aside funding for specific purposes either already identified or anticipated.

The Department of Finance maintains over 70 separate funds on behalf of the City, its affiliated agencies, operating companies and commissions. The accumulated unaudited cash balance in these funds as of June 30, 1999 was approximately \$417.8 million. Of this amount, \$101.8 million represents bond proceeds, bond reserve funds, or payments for future debt service obligations and is held by fiscal agents. The remaining \$316.0 million is held by the City and managed directly by the Department of Finance.

The following policies focus on the City's major funds and/or those funds where the City Council has significant discretion. The policy will not address those funds which have been established to track specific grants or those funds which are highly restricted. In addition, the recommended policy may focus on either the maintenance or use of certain cash reserves.

GENERAL CASH MANAGEMENT

- A. The City will seek to maintain a diversified and stable revenue base to protect it from short-term fluctuations in any one revenue source.
- B. To emphasize and facilitate long-range financial planning, the City will maintain five and/or ten year financial projections of revenues and expenditures for its major funds.
- C. In order to achieve important public policy goals, the City has established various special revenue, capital project, debt service and enterprise funds to account for revenues whose use should be restricted to certain activities. Accordingly, each fund exists as a separate financing entity from other funds, with its own revenue sources, expenditures and fund equity.

Any transfers between funds for operating purposes are clearly set forth in the Financial Plan, and can only be made by the Director of Finance in accordance with the adopted budget. These operating transfers, under which financial resources are permanently transferred from one fund to another, are distinctly different from inter-fund borrowings, which are usually made for temporary cash flow reasons, and are not intended to result in a permanent transfer of financial resources by the end of the fiscal year. In summary, inter-fund transfers result in a change in fund equity, inter-fund borrowings do not, as the intent is to repay the loan in the near term.

From time-to-time, inter-fund borrowings may be appropriate. Other than temporary borrowing of cash, however, it is the policy of the City to obtain formal authorization from the City Council for inter-fund loans, notes or advances. Authorization is required if the borrowing is of a long-term nature, expecting to exceed one year. Existing inter-fund borrowing that will be repaid over a period exceeding one year will be exempt and grandfathered into the policy unless other wise directed by the City Council. Specifically,

1. The Director of Finance is authorized to approve temporary inter-fund borrowings for cash flow purposes whenever the cash shortfall is expected to be resolved within 180 days. The most common use of inter-fund borrowing under this circumstance is for grant programs like the Community Development Block Grant, where costs are incurred before a drawdown is initiated and received. The receipt of funds, however, is typically shortly after the request for funds has been made.
2. Any other inter-fund borrowing for cash flow or other purposes require case-by-case approval by the City Council.

3. Any transfers between funds where reimbursement is not expected within one fiscal year shall not be recorded as inter-fund borrowings, but rather as inter-fund operating transfers that affect equity by moving financial resources from one fund to another.

CASH RESERVE POLICIES

GENERAL FUND

- Purpose:** The General Fund is used to account for all general revenue of the City not specifically levied or collected for other City funds and for expenditures related to the rendering of general services by the City.
- Policy:** The General Fund shall maintain an 8% cash reserve balance. This percentage is to be applied against the entire General Fund appropriation.
- Rationale:** Historically, the City's policy has been to maintain a 10% reserve balance; however, this percentage has only been applied against certain operational appropriations. The net percentage affect of this would be similar to the policy being recommended. With the continued uncertainty of actions in Sacramento and the full impact of electric utility deregulation on the General Fund, it would be imprudent to reduce the cash reserve balance below this amount at this time.

COMPUTING AND COMMUNICATION SERVICES FUND

- Purpose:** The Computing and Communication Services Fund accounts for all operations of the Computing and Communications Division of the City Manager's Department, which includes such services as data processing, printing, mail services, radio communications, telephone, and voice services.
- Policy:** The Computing and Communication Services Fund should maintain a \$250,000 cash reserve at the beginning of each fiscal year for emergency equipment requirements. If during the course of the year this amount is drawn upon, it should be replenished in the subsequent fiscal year. In addition, adequate cash balances should be maintained to replace computer hardware and software, printing and communication equipment based upon a pre-established replacement schedule. This schedule should be reviewed annually and updated as needed.
- Rationale:** Built into the rates of the Information Technology and Services Division (ITSD) is a depreciation factor which provides funding for anticipated

replacement of equipment. This will avoid the need for the General Fund or any other operating fund to raise large sums of cash in any single fiscal year. On a case-by-case basis, decisions will be made either to finance capital purchases or pay cash for them. If any given purchase is financed, then the rates for the subsequent fiscal year(s) would incorporate adequate cashflow to cover the debt service.

BUILDING MAINTENANCE FUND

Purpose: The Building Maintenance Fund accounts for housekeeping and structural maintenance of City buildings, as well as paying the utility bills for all City buildings.

Policy: The Building Maintenance Fund shall maintain a 10% working capital cash reserve balance. This percentage should be applied against the entire Building Maintenance Fund appropriation.

Rationale: For the past several years, the Building Maintenance Fund has ended each fiscal year in a negative cash position. A plan has been put into place that will eliminate this deficit by the end of fiscal year 2001. At that time, rates charged by Public Works must be adequate to ensure that current revenues are sufficient to cover all current expenditures. The reserve balance will be used to cover any extraordinary/unanticipated expenses during the fiscal year. A long term maintenance schedule should be developed by the Public Works Department and a funding plan developed. Rates charged to departments may need to be adjusted to accommodate cash requirements.

FLEET MAINTENANCE FUND

Purpose: The Fleet Maintenance Fund accounts for the maintenance, repair and replacement of City vehicles and equipment.

Policy: The Fleet Maintenance Fund should maintain a \$250,000 cash reserve balance. In addition, adequate cash balances should be maintained to replace vehicles and equipment based upon a pre-established replacement schedule. This schedule should be reviewed annually and updated as needed.

Rationale: The Fleet Maintenance Fund has developed a replacement schedule for City vehicles and equipment. Occasionally, vehicles have to be replaced outside the normal schedule and a \$250,000 reserve balance would provide adequate cushion to address most unforeseen needs.

BENEFITS FUND

- Purpose:** The Benefits Fund accounts for employee compensated absences, retirement, and health benefits.
- Policy:** The Benefits Fund should maintain a 100% cash reserve to cover its short-term accounts payable and accrued liability obligations and a 75% cash reserve to cover its long-term employee obligations for compensated absences.
- Rationale:** This fund covers the amount of vacation, floating holiday, and overtime accrued to employees throughout the City. It is not expected that the City will have to cover 100% of these liabilities in any single fiscal year. As such, maintaining a 75% cash reserve balance should provide adequate coverage.

WORKERS' COMPENSATION FUND

- Purpose:** The Workers' Compensation Fund accounts for the disbursement of self-insured workers' compensation related expenses and approved payments in settlement of claims.
- Policy:** The Workers' Compensation Fund should maintain a 75% cash reserve to cover its projected claims payable obligations.
- Rationale:** The projected liability recorded each year on the City's financial statements is based upon known and anticipated claims filed by employees of the City. It is highly unlikely that all claims would become due and payable at once. In addition, the City budgets an amount each year it estimates will be necessary to cover that year's costs and claim payments. By maintaining a 75% cash reserve balance, the City should have adequate available funding in the event of any unusual activities. If the reserves are drawn upon in any given year, they would be replenished in the subsequent year(s) through an adjustment in the rates charged to the various departments.

GENERAL LIABILITY FUND

- Purpose:** The General Liability Fund accounts for the disbursement of general liability claims against the City.
- Policy:** The General Liability Fund should maintain a 75% cash reserve to cover its projected claims payable obligations.

Rationale: The projected liability recorded each year on the City's financial statements is based upon known and anticipated claims filed against the City. It is highly unlikely that all claims would become due and payable at once. In addition, the City budgets an amount each year it estimates will be necessary to cover that year's costs and claim payments. By maintaining a 75% cash reserve balance, the City should have adequate available funding in the event of any unusual activities. If the reserves are drawn upon in any given year, they would be replenished in the subsequent year(s) through an adjustment in the rates charged to the various departments.

BUILDING SERVICES FUND

Purpose: The Building Services Fund accounts for the operations of the Permit Center including all revenues and expenditures associated with issuing various building permits.

Policy: The Building Services Fund shall maintain a 10% working capital cash reserve balance. This percentage should be applied against the entire Building Services Fund appropriation. In addition, the Building Service Fund shall maintain a reserve balance adequate to cover automation and technology needs of the department.

Rationale: Building Services revenues can be very volatile due to changes in development and construction activities. As a result, maintaining a cash reserve will minimize the need to draw upon the General Fund to support these activities. There are a number of automation initiatives being reviewed by the Planning Department which have citywide implications. Funds need to be set aside should any of these initiatives be approved by the City Council.

SEWER CONSTRUCTION AND MAINTENANCE FUND

Purpose: The Sewer Construction and Maintenance Fund accounts for revenues received from sewer use and storm drain charges collected for the construction and maintenance of the City's sewer system.

Policy: The Sewer Construction and Maintenance Fund shall maintain a 30-day cash reserve. This amount should be calculated by taking 1/12th of the prior year's expenditures for operations (i.e., excluding capital expenditures). In addition, additional cash balances should be maintained to cover anticipated capital expenditures that will not be financed through the issuance of debt. This should be based upon a pre-established capital improvement schedule.

Rationale: Given the current predictability of the sewer utility's cash flow, staff believes that a 30 day cash reserve will be adequate to cover routine unanticipated operating expenditure requirements. In addition, setting additional funds aside for anticipated capital requirements will provide for more stable rates and greater surety for the funding of specific projects.

LIBRARY SERVICES FUND

Purpose: The Library Services Fund accounts for the operations of the City's public libraries and is comprised of funding from both a special voter approved parcel tax and the General Fund.

Policy: Any draws against the Reserve shall be to cover increased costs, to maintain service levels or to cover one-time operational requirements.

Rationale: The Library Services Fund receives 20% of its funding from the special library tax and 80% from the General Fund. Any revenues in excess of expenditures are placed in the Library Services fund balance. The growth in the special tax is specified in the voter approved ballot measure and this same growth rate is applied to increases in General Fund support. In order to ensure adequate funding for library services during the life of the tax, the cash reserves must be carefully managed.

PASADENA HOUSING AUTHORITY

Purpose: The Pasadena Housing Authority Fund accounts for funds received by the City to administer housing programs under contract with the U.S. Department of Housing and Urban Development.

Policy: The Pasadena Housing Authority shall maintain a cash reserve equal to six months of operations.

Rationale: This reserve requirement is suggested by the Housing and Urban Development standard guidelines so local housing authorities have adequate cash to meet operating needs. This will also protect the General Fund from having to cover cashflow shortfalls.

CHARTER CAPITAL PROJECTS FUND

Purpose: The Charter Capital Projects Fund accounts for certain resources identified by the City Council for the acquisition, construction, replacement or repair of municipal improvements where disbursements other than specific municipal improvement projects can be authorized only by a vote of the people.

Policy: The Charter Capital Projects Fund shall maintain reserves that will progressively build up and be maintained to meet the timing of planned capital projects per the Capital Improvement Plan forecasted budget. Interest earnings on any cash balances shall be used to help offset the General Fund debt service requirements on bonds issued for qualified capital projects.

Rationale: Proceeds in the Charter Capital Projects Fund are from the sale of surplus City assets. This source is not dependable and as such, the City must carefully decide how and when to spend principal balances from this Fund. Traditionally, only interest earnings have been used; however, occasionally, it has been more prudent to spend cash balances in lieu of issuing additional debt. These decisions will be made on a case-by-case basis.

LIGHT AND POWER FUND

Purpose: The Light and Power Fund accounts for the operations of the City's electric utility, a self-supporting activity which renders services on a user charge basis to residents and businesses as prescribed by the City Charter.

Policy: The Light and Power Fund shall maintain a 30-day cash reserve. This amount should be calculated by taking 1/12th of the prior year's expenditures for operations (i.e., excluding capital expenditures). Additional cash balances shall also be maintained to cover anticipated capital expenditures which will not be financed. This should be based upon a pre-established capital improvement schedule.

Rationale: Given the current predictability of the electric utility's cash flow, a 30 day cash reserve will be adequate to cover normal operating expenditure requirements. In addition, setting additional funds aside for anticipated capital requirements will provide for more stable rates and greater surety for the funding of specific projects. This policy does not address the Reserve for Stranded Investment which will be maintained separate and apart from the normal Light and Power Fund reserve.

WATER FUND

Purpose: The Water Fund accounts for the operations of the City's water utility, a self-supporting activity which renders services on a user charge basis to residents and businesses as prescribed by the City Charter.

Policy: The Water Fund shall maintain a 30-day cash reserve. This amount should be calculated by taking 1/12th of the prior year's expenditures for

operations (i.e., excluding capital expenditures). Additional cash balances shall also be maintained to cover anticipated capital expenditures which will not be financed. This should be based upon a pre-established capital improvement schedule.

Rationale: Given the current predictability of the water utility's cash flow, a 30 day cash reserve will be adequate to cover normal operating expenditure requirements. In addition, setting additional funds aside for anticipated capital requirements will provide for more stable rates and greater surety for the funding of specific projects.

REFUSE COLLECTION FUND

Purpose: The Refuse Collection Fund accounts for the operations of the City's refuse collection program, a self-supporting activity which renders services on a user charge basis to residents and businesses.

Policy: The Refuse Fund should maintain a 30 day working capital reserve. This amount should be calculated by taking 1/12th of the prior year's expenditures for operations (i.e., excluding capital expenditures). In addition, additional cash balances should be maintained to cover anticipated capital expenditures which will not be financed.

Rationale: Given the current predictability of the refuse cash flow, staff believes that a 30 day working capital will be adequate to cover normal operating expenditure requirements. In addition, setting additional funds aside for anticipated capital requirements will provide for more stable rates and greater surety for the funding.

ROSE BOWL OPERATING COMPANY

Purpose: The Rose Bowl Operating Company (RBOC) is comprised of two separate funds, the Rose Bowl Fund and the Golf Course Fund. The Rose Bowl Fund accounts for the operation, maintenance and capital expenditures for the Rose Bowl facility, while the Golf Course Fund accounts for the net revenue, contract monitoring and certain capital expenditures relating to Brookside Golf Course, the Clubhouse and surrounding areas under the sphere of influence of the RBOC.

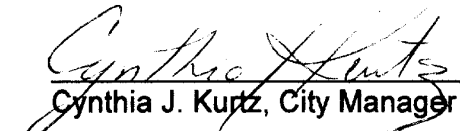
Policy: The General Fund of the City shall provide cash reserves for the RBOC in order to meet RBOC's required cashflow obligations. The RBOC shall ensure that cash balances never end the fiscal year in a negative position. The General Fund shall factor the RBOC's annual appropriation into its calculations when setting its cash reserve requirements.

Rationale: To the extent that there is insufficient cashflow of the RBOC to meet its obligations, the General Fund of the City becomes ultimately responsible. By having the General Fund provide the liquidity for the Rose Bowl, provides greater flexibility, reduces risk of insufficient cash and ultimately provides greater security for both the City and the RBOC.

FISCAL IMPACT

The fiscal impact of this policy is to provide for adequate cash balances to ensure that the City meets its cashflow obligations, maximizes earnings on investments, minimizes borrowing and maintains the highest credit rating on its bonds.

Respectfully Submitted,


Cynthia J. Kurtz, City Manager

Approved by:



Jay M. Goldstone
Director of Finance