



CITY OF MORRO BAY CITY COUNCIL AGENDA

The City of Morro Bay provides essential public services and infrastructure to maintain a safe, clean and healthy place for residents and visitors to live, work and play.

NOTICE OF SPECIAL MEETING

**Tuesday, September 25, 2018
Veterans Memorial Hall – 4:30 P.M.
209 Surf St., Morro Bay, CA**

ESTABLISH QUORUM AND CALL TO ORDER

PUBLIC COMMENT FOR ITEMS ON THE AGENDA

SPECIAL MEETING AGENDA ITEMS:

- I. ADOPTION OF RESOLUTION NO. 78-18 RESCINDING RESOLUTION NO. 33-15 IN ITS ENTIRETY AND ADOPTING THE GENERAL FUND EMERGENCY RESERVE AND INTERNAL SERVICE FUNDS RESERVE AND PROVIDE FEEDBACK REGARDING THE HARBOR ACCUMULATION FUND RESERVE POLICY AND MORRO BAY TOURISM BUSINESS IMPROVEMENT DISTRICT RESERVE POLICY

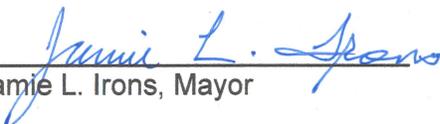
RECOMMENDATION: Council adopt Resolution No. 78-18, rescinding all previous General Fund Emergency Reserve Fund resolutions, establishing the General Fund Emergency Reserve Policy and Internal Services Reserve Fund Policy and provide feedback regarding the Harbor Accumulation Fund Reserve Policy and Morro Bay Tourism Business Improvement District Reserve Policy.

- II. RECEIVE REPORT AND PROVIDE FEEDBACK ON THE FISCAL EMERGENCY PLAN ECONOMIC TRIGGERS

RECOMMENDATION: Receive report and provide feedback on fiscal emergency plan economic triggers.

ADJOURNMENT

DATED: September 20, 2018



Jamie L. Irons, Mayor

THIS AGENDA IS SUBJECT TO AMENDMENT UP TO 24 HOURS PRIOR TO THE DATE AND TIME SET FOR THE MEETING. PLEASE REFER TO THE AGENDA POSTED AT CITY HALL FOR ANY REVISIONS OR CALL THE CLERK'S OFFICE AT 772-6205 FOR FURTHER INFORMATION.

IN COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT, IF YOU NEED SPECIAL ASSISTANCE TO PARTICIPATE IN A CITY MEETING, PLEASE CONTACT THE CITY CLERK'S OFFICE AT LEAST 24 HOURS PRIOR TO THE MEETING TO INSURE REASONABLE ARRANGEMENTS CAN BE MADE TO PROVIDE ACCESSIBILITY TO THE MEETING.

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AGENDA NO: I

MEETING DATE: September 25, 2018

Staff Report

TO: Honorable Mayor and City Council

DATE: September 17, 2018

FROM: Jennifer Callaway, Finance Director

SUBJECT: Adopt Resolution No. 78-18 Rescinding Resolution No. 33-15 in its entirety and adopting the General Fund Emergency Reserve and Internal Service Funds Reserve and Provide Feedback Regarding the Harbor Accumulation Fund Reserve Policy and Morro Bay Tourism Business Improvement District Reserve Policy

RECOMMENDATION

Staff recommends the City Council adopt Resolution No. 78-18, rescinding all previous General Fund Emergency Reserve Fund resolutions, establishing the General Fund Emergency Reserve Policy and Internal Services Reserve Fund Policy and provide feedback regarding the Harbor Accumulation Fund Reserve Policy and Morro Bay Tourism Business Improvement District Reserve Policy.

BACKGROUND

At the July 10, 2018 City Council meeting, the Council requested the development of a fiscal emergency plan be added to future Council items. In addition, the Council previously requested financial policies be added to a future Council agenda for review and discussion. On August 28, 2018, staff brought forward an action plan outlining the process to complete both a fiscal resiliency plan and formation of Accounting Policies and Procedures. Council approved staff's recommended plan and, as such, staff has proceeded with discussion of fiscal emergency plan and economic triggers to be identified in that plan.

DISCUSSION

The Government Finance Officers Association (GFOA) provides fund balance guidelines for the General Fund as well as guidance in developing policies that define acceptable use and management of reserves. More comprehensive policies provide clearer guidance on the use and management of reserves. The chart below summarizes recommended components of an effective reserve policy.

Prepared By: JC

Dept Review: _____

City Manager Review: SC

City Attorney Review: JWP

Policy Element	Definition	Essential	Important	Discretionary
Reserve Target Levels	State reserve targets or target ranges	X		
Conditions for Use of these Reserves	Define the conditions under which a reserve can be used	X		
Authority over Reserves	Specify who has authority to use reserves	X		
Definition and Purpose of Reserves	Define reserves and present reason for maintaining them		X	
Funding the Target Amount	Establish plan for funding the reserve if it is below the target		X	
Replenishment of Reserves	Provide guidance on how reserves will be replenished once used		X	
Excess Reserves	Provide guidance on how reserves in excess of their targets can be used			X
Periodic Review of Targets	Direct staff to review the reserve target levels			X

Based on the above recommendations, staff is proposing changes to the General Fund Emergency Reserve Resolution and has drafted policies to maintain reserve funding for the Harbor and Tourism funds, as well as the City's Internal Service Funds.

General Fund Emergency Reserve Fund

The City Council conducted a budget workshop on May 20, 2015, and during that meeting, the City Manager presented previously-shown information from the Management Partners' 2015 financial forecast that predicted a deficit in 2017, and dips in the General Fund Emergency Reserve Fund (GFERF) to accommodate the decline and recovery of the Fund. The City Council requested a Resolution to redefine the GFERF, allowing deficit spending during the forecasted recession.

On June 1, 2015, the City Council adopted Resolution No. 33-15, establishing the General Fund Emergency Reserve Fund (GFERF).

GFOA recommends a reserve with a minimum fund balance of 17% be maintained for the majority of funds. A 17% General Fund unassigned fund balance is marginally adequate and is not properly preparing the City for major financial impact such as the dramatic increase in employee costs. Another global financial crisis can quickly consume a 17% General Fund balance (approximately two-months' worth of regular operating revenues or expenditures). In determining the appropriate reserve level, GFOA recommends an agency consider a variety of factors such as: 1) the predictability of revenues and the volatility of expenditures; 2) perceived exposure to significant one-time outlays; 3) potential drain upon resources from other funds, as well as, the availability of resources in other funds; 4) potential impact on an entity's bond ratings and corresponding increased cost of borrowed funds; and 5) commitments and assignments.

Members of the California Society of Municipal Finance Officers (CSMFO) often conduct surveys among its 2,000 members, which represent over 300 agencies. The City of Orange conducted a reserve survey in early 2018 and provided a summary of the 17 agencies that responded to the survey for the General Fund and Internal Service Funds. For the General Fund, the various agencies have a reserve range of 5% minimum to 60% maximum, with 20% being the most

common level. Agencies define reserves differently, using terms such as economic uncertainties, emergency/disaster, catastrophic or contingency.

Given the City is heavily dependent on economic sensitive revenue sources, such as Transient Occupancy Tax and Sales Tax, staff recommends a higher reserve level be maintained to help augment the General Fund during economic downturns. With that guiding principle, staff recommends the GFERF policy be simplified and defined as minimum and target funding levels at 25% to 28% level of annual, on-going operating expenditures, excluding transfers. That is consistent with the Water and Sewer Reserve Policies previously adopted by Council and the proposed reserve policies for the Harbor and Tourism funds that are discussed later in this report.

A draft GFERF policy is provided as Exhibit A to Attachment 1 to this staff report for Council consideration and feedback. Adoption of Resolution 78-18 would rescind Resolution 33-15 establishing the GFERF and adopt the proposed new GFER policy and Internal Service Funds Reserve Policy.

Harbor Accumulation Fund Reserve Policy

In June 2018, the Council adopted a reserve policy for the water and sewer funds. At that time, staff mentioned a Harbor Accumulation Fund Reserve Policy would be brought forward for future consideration and discussion. As such, staff has prepared the attached draft Harbor Accumulation Fund Reserve Policy (Attachment 2). The Policy establishes the minimum reserve level at fifteen percent of on-going annual expenditures with a target funding level of twenty-five percent of on-going annual expenditures. Based on the adopted Fiscal Year (FY) 2018/19 budget, the minimum reserve level (15% of on-going expenditures) would be approximately \$250,000 with a target reserve level of approximately \$417,000. With the close out of FY 2017/18 staff will evaluate the fund balance and report back to Council with the mid-year budget update on funding level in the reserve and comparison to the reserve policy minimum and target levels. If the accumulation reserve fund level falls short of the minimum level, then staff will present a plan to return cash accumulation reserves to their minimal target levels within three years as per the proposed policy. Given the current Harbor capital asset needs and funding challenges to meet those needs, staff anticipate an equal challenge in maintaining any Harbor Accumulation Fund reserve balance.

The draft policy is being presented to the Council for feedback and direction. Staff will incorporate feedback from the Council and present a revised draft policy to the Harbor Advisory Board for comment. Staff will bring back the proposed reserve policy and any comment from the Harbor Advisory Board for final adoption by the City Council in October 2018.

Morro Bay Tourism Business Improvement District Fund Reserve Policy

The Tourism Business Improvement District (TBID) was originally mostly operated by the Tourism Board with the City monitoring cash and paying the District's bills. In 2013, the City separated TBID into a 501(c)(6) and a business manager was hired to operate the new entity. In June 2016, the City resumed administrative control over the TBID, merging Tourism under the City's management.

With Transient Occupancy Tax (TOT) being a leading revenue generator for the City's General Fund, tourism activities and promotion are paramount to the City's fiscal health. Therefore, the objective of the merger to the City was for the City to carry out tourism operations and marketing.

The City-managed TBID Fund was designed to be self-supporting, with revenue generating from hotel stays primarily funding the activities of the fund and previously defined General Fund contributions (\$60,000 minimum funding plus 20% of TOT receipts above \$3 Million). Due to

variances in revenues and expenditures, the TBID Fund experienced excess revenues over expenditures over several years, but most significantly in FY 2015/16 resulting in fund balance of approximately \$280,000.

Again, as tourism activities generate significant revenues for the City, staff recommends an accumulation fund reserve be established and has developed a draft Morro Bay Tourism Business Improvement District Fund Accumulation Reserve Policy for Council consideration and direction, which is provided as Attachment 3. Staff proposes a minimum of twenty percent of on-going annual expenditures be maintained in the newly established accumulation reserve fund with a target funding level of twenty-five percent of on-going annual expenditures. Based on the adopted FY 2018/19 TBID Budget, minimum reserve funding level would be approximately \$195,000 with the target reserve funding level of approximately \$244,000.

There is currently sufficient fund balance in the TBID Fund (Fund 007) to meet the target funding reserve level of \$244,000. Staff would report back to the Council with the mid-year budget update on FY 2017/18 actual year-end balances as with the Harbor Accumulation Reserve and other Reserve Funds.

Similarly, as with the Harbor Accumulation Reserve Policy, the draft TBID policy is being presented to the Council for feedback and direction. Staff will incorporate feedback from the Council and present a revised draft policy to the TBID Board for comment. Staff will bring back the proposed reserve policy and any comment from the Board for final adoption by the City Council in October 2018.

Internal Service Fund Reserve Policy

Internal Service Funds are established to provide centralized cost centers for shared expenses and services in order to efficiently track costs and manage resources. Costs are then allocated back to the operational programs based on usage to more accurately determine cost of services.

The City's Internal Service Funds include eight internal service/support funds: Information Technology, facility maintenance, vehicle replacement, capital replacement, compensable leave, and three equipment replacement funds, one each for the water, sewer and harbor enterprise funds. In addition, the City has one insurance Internal Service Fund, Risk Management, which includes workers compensation. The Internal Service Fund Reserve Policy, provided as attachment 4, includes recommended minimum and target fund balance reserves for seven of the City's eight Internal Service Funds. The attached policy does not include a recommendation for the Risk Management Fund, at this time, as staff continues to benchmark and determine an appropriate recommendation for minimum and target funding levels. A discussion of risk management is scheduled to occur on November 13, 2018.

As each Internal Service Fund is accounted for as a separate entity, the proposed policy defines minimum and target funding levels based on various metrics for each type of Internal Service Fund. Members of the California Society of Municipal Finance Officers (CSMFO) often conduct surveys among its 2,000 members, which represent over 300 agencies. Staff surveyed California cities to benchmark recommendations to other cities, however, received only three responses, from the City of Saratoga, La Palma and Garden Grove. As discussed earlier, the City of Orange's reserve survey obtained 17 responses; however, only eight of those responding agencies have Internal Service Fund (ISF) reserve policies, and the reserve levels vary significantly among the agencies. The City of Pittsburg established within its municipal code ISF reserves equal to 30% of all respective operating budget expenses. The City of Newport Beach approved by Council resolution a compensated absences reserve policy equal to 50% of it's long-term liability. The City of Mission

Viejo has a reserve policy for its computer, equipment and vehicle internal service funds; however, those reserves are kept within the General Fund.

Based on the results of staff's survey, the City of Saratoga does not specify minimum and target funding levels per their reserve policies (with an exception for compensated absences); whereas, the City of La Palma outlines various metrics to establish funding levels for each of its ISFs.

Overall, there is no consistency in the types of ISFs among agencies, the reserve levels for such funds, or even the adoption of any policy. Since the ISF reserve policy is not a statutory requirement, municipal agencies all treat the issue differently. Each city operates differently and has its unique fund structure, financial policies and expectations. Staff is recommending minimum and target reserve levels for the City's ISFs, with the recommendations being a balance between operational efficiency, maintaining healthy reserves for the City and developing clear guidelines and a process for simplifying the calculation and maintenance of the reserves.

The proposed metrics included in the draft policy are generally modeled after those utilized by the City of La Palma. The City of Garden Grove hired Revenue & Cost Specialists, LLC to review that city's ISF Reserves and make conservative recommendations on funding levels. Revenue Cost Specialists reviewed the City of La Palma's reserve policies as part of that study. The chart below summarizes the reserve levels established by the comparison cities and those proposed in the draft internal service policy provided as Exhibit B to Attachment 1.

Summary of Recommended Fund Balance Levels				
Internal Service Fund	City of Saratoga	City of La Palma	City of Garden Grove	Proposed City of Morro Bay
Information Technology	No Recommendation	100% of replacement value of IT Network	50% of replacement cost	\$100,000 to \$150,000
Vehicle/Equipment Replacement	No Recommendation	33% of Replacement Value	50% of replacement cost	20% to 33% of replacement value
Facility Maintenance	No Recommendation	50% of rolling 6-year average of expenses	N/A	\$50,000 to \$75,000
Compensated Absences	33% of outstanding liability	100% of outstanding liability	100% of outstanding liability	25% to 33% of outstanding Liability

By establishing reserve levels, the City will be obligated to charge each department for its ISF operations, compelling the City to increase the amounts charged to departments for ISF activities. In light of other looming financial concerns and constrains, most notably with forecasted CalPERS increases, that will place an additional burden on an already constrained budget; however, it is a recommended best practice to ensure the fiscal health and stability of the City.

Based on the minimum and target funding levels proposed in the draft policy, if approved by Council, then staff would work to identify funding shortfalls and propose a plan to bring the ISFs up to the minimum fund levels within a three-year period, as prescribed within the policy. At this point, staff's assessment is the facilities and vehicle replacement reserves are underfunded, however, staff will bring refined year-end figures back with the mid-year budget update once the FY 2017/18 is closed. At this time, staff would also propose a funding strategy to ensure all of the ISFs are reaching the recommended minimum funding levels.

CONCLUSION

Having clearly defined financial policies that reflect the City's values will serve as the foundation for decision-making in tough fiscal times and will aid in preserving the City's long-term fiscal health and vitality. Staff recommends Council review the proposed policies and adopt Resolutions No. 78-18. With Council direction, staff will present the Harbor Accumulation Fund Reserve Policy and TBID

Accumulation Fund Reserve Policy to their respective boards for comment and return to Council in October with adopting resolutions.

ATTACHMENTS

1. Resolution No. 78-18
 - a. Exhibit A – General Fund Emergency Reserve Policy
 - b. Exhibit B – Internal Services Fund Reserve Policy
2. Draft Harbor Accumulation Fund Reserve Policy
3. Draft Morro Bay Tourism Business Improvement District Fund Reserve Policy

RESOLUTION NO. 78-18

**RESOLUTION OF THE CITY COUNCIL
OF THE CITY OF MORRO BAY, CALIFORNIA,
RESCINDING RESOLUTIONS NO. 33-15 IN ENTIRETY, AND ESTABLISHING A GENERAL
FUND EMERGENCY RESERVE POLICY AND INTERNAL SERVICE FUNDS RESERVE POLICY**

**THE CITY COUNCIL
City of Morro Bay, California**

WHEREAS, on June 28, 1993, the Morro Bay City Council adopted Resolution No. 55-93, which adopted the Fiscal Year 1993-94 Budget and Appropriations Limit; and

WHEREAS, Section 5 of Resolution No. 55-93 states *“A reserve for emergencies of \$800,000 shall be established out of the City’s General Fund. This amount will be reported in the General Fund’s Equity section of the balance sheet. The City Administrator must receive prior approval from the City Council for any use of these reserve funds;”* and

WHEREAS, with this Resolution, the Morro Bay City Council is rescinding Section 5 of Resolution No. 55-93; and

WHEREAS, on May 24, 2010, the Morro Bay City Council adopted Resolution No. 27-10, which established the parameters for use of the General Fund (Accumulation) Reserve; and

WHEREAS, with this Resolution, the Morro Bay City Council is rescinding Resolution No. 27-10 in its entirety; and

WHEREAS, on June 28, 2011, the Morro Bay City Council adopted Resolution No. 42-11, which amended the parameters of Resolution No. 27-10; and

WHEREAS, on June 9, 2015, the Morro Bay City Council adopted Resolution No. 33-15, which rescinded Resolution No. 42-11 in its entirety; and

WHEREAS, with this Resolution, the Morro Bay City Council is rescinding Resolution No. 33-15 in its entirety; and

WHEREAS, staff recommends the City Council adopt the proposed General Fund Emergency Reserve Policy, which demonstrates the City’s commitment to fiscal responsibility and prudent management and is consistent with Government Accounting Standards.

WHEREAS, staff recommends the City Council adopt the proposed Internal Service Funds Reserve Policy, which demonstrates the City’s commitment to fiscal responsibility and prudent management and is consistent with Government Accounting Standards.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Morro Bay, California:

1. Section 5 of Resolution No. 55-93 and Resolutions 27-10, 42-11 and 33-15 in their entirety are hereby rescinded; and
2. the “General Fund Emergency Reserve Policy,” as set forth in Exhibit A, attached hereto

- and incorporated herein, is hereby approved; and
3. the "Internal Service Funds Reserve Policy," as set forth in Exhibit B, attached hereto and incorporated herein, is hereby approved.

PASSED AND ADOPTED, by the City Council of the City of Morro Bay, at a regular meeting thereof held on the 25th day of September 2018, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

JAMIE L. IRONS, Mayor

ATTEST:

DANA SWANSON, City Clerk



COUNCIL POLICY

GENERAL FUND EMERGENCY RESERVE POLICY

Policy Statement

The City of Morro Bay (City) is a full-service city, providing essential services to over 10,000 residents related to public safety, planning, building, public works and recreation. In addition, the City has a vibrant tourism industry, attracting thousands of visitors annually, all of whom utilize City services in some fashion. As such, it is prudent for the City to establish and maintain reserve funds to mitigate a variety of emergency situations and ensure that core, essential services are maintained. The City first established a General Fund Emergency Reserve in 1993, which has since been modified four times by Council resolution, the most recently being in 2015 per Resolution 33-15. The City Council of the City has been proactive in setting aside emergency reserves and recognizing the need to utilize reserves during recessionary periods.

The City Council sets legislative financial management policies, as recommended by staff and advisory committees. This General Fund Emergency Reserve Policy (Policy) is designed to establish guidelines to ensure fiscal stability of the City and provide guidance to staff in the financial management of City operations.

Purpose

A properly designed reserve policy is not only a financial best practice, but also sends a positive signal to ratepayers, investors, regulatory, and credit rating agencies the City is committed to maintaining the long-run fiscal strength of the City. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, working capital, and capital improvements, are consistent with Government Accounting Standards and are important to the City as they help to:

- Maintain the short-term and long-term financial health of the City
- Maintain stable user fees for customers and help ensure manageable rate increases
- Fund unanticipated expenditure contingencies, including emergencies
- Ensure funds exist for system and infrastructure improvements
- Ensure cash exists for the timely payment of bills
- Act as a significant positive credit factor in bond ratings

After the City's financial records are finalized and audited, with legal obligations and liability reserves funded, revenues in excess of expenditures are closed out to the General Fund Emergency Reserve. A base amount, both minimum and target levels, are established by Council with adoption of this policy. Anything above the target funding level in the General Fund Emergency Reserve will be distributed in the following order:

1. Allocated to Internal Service Funds to meet or maintain target funding levels, if short-falls exist.
2. Allocated to a CalPERS paydown Fund, up to 50% of the remaining available funds to allocate.

3. Allocated to per Council direction during the mid-year budget update and annual budget adoption process.

Definitions

The General Fund Emergency Reserve (“GFER”) is classified as an “Unrestricted-Undesignated Reserve,” representing funding that is being set aside to provide temporary financing for budget stabilization caused by fiscal downturns, unanticipated extraordinary expenditures related to a natural disaster or calamity, or from an unexpected liability or funding decrease created by a legislative action. Those moneys may be used for any lawful purpose, as approved by the City Council, and have not been designated for specific capital and operating needs. The following Unrestricted-Undesignated Reserve Policy addresses the level, use and replenishment of those types of unrestricted cash. The GFER will be accounted for within the General Fund.

Unrestricted-Undesignated Reserve Policy

The General Fund will have sufficient Unrestricted-Undesignated cash accumulated to maintain or improve its credit ratings, ensure operating and maintenance costs will be paid in a timely manner, pay debt service obligations, invest in needed capital improvements and equipment replacement and other uses on a timely basis. In addition, the GFER will maintain sufficient cash accumulation to minimize impacts from economic downturns, departmental expenditure freezes due to market volatility, other economic impacts on demands, contingencies, and regulatory changes.

This GFER Policy outlines minimum and target funding levels.

Minimum Level: Equal to twenty-five percent of annual on-going operating expenditures (excluding transfers out) based on the most recent adopted budget.

Target Level: Equal to twenty-eight percent of annual on-going operating expenditures (excluding transfers out) based on the most recent adopted budget.

Example:

FY 2018/19 General Fund Expenditures (on-going annual expenditures, excluding transfers)	\$13,704,544
Target Level 28%:	<u> x 0.28</u>
Target Cash Accumulation	\$ 3,837,272

In calculating the minimum target funding level, one-time expenditures and transfers out are not considered in the base for determining the operating expenditures. The minimum target funding level is intended to ensure sufficient resources to pay budgeted operating and maintenance expenses, recognizing the timing differences between payment of expenditures and receipt of revenues. It also provides a source of funding to allow the City to operate during short term fluctuations in revenues and/or expenditures.

Withdrawal & Replenishment of Accumulation Reserves

The City will treat the minimum levels as practical reserve floors and allow reserves to increase or decrease within the minimum and target levels, as approved by City Council during the annual budget process.

To the extent cash in the GFER is above the target levels, the Council has the flexibility to direct staff to utilize those available funds to fund internal service funds to target levels, fund other one-time operating needs, capital projects (reducing the need for future debt), or pay down liabilities in accordance with this policy as defined in the purpose statement above.

Reserve levels below the minimum target reserves would leave the City exposed to operational risks. The City may only draw down the reserve levels with Council approval and the City Manager, in conjunction with the Finance Department, will implement plans to return cash accumulation reserves to their minimum target levels within three years and subject to approval by City Council.

Reporting and Oversight

GFER levels will be monitored during the fiscal year and reported in the quarterly financial reports, as provided by the Finance Department. GFER minimum and target levels will be analyzed annually by the Finance Department and an over/under reserve determination shall be made in conjunction with year-end financial results. Those results will be reported to the City Council as part of the year-end financial report presentation. If GFER levels need adjustment due to new risk factors or changes in the industry, then that information will be brought to the City Council as part of the year-end report or sooner, as determined by the City Manager and Finance Department.

This Policy will be reviewed during the City's annual budget process, and updated, if needed, as a result of material changes in the risk exposures or new conditions that required changes in this Policy.

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COUNCIL POLICY

INTERNAL SERVICE FUNDS RESERVES POLICY

Policy Statement

Internal Service Funds are established to provide centralized cost centers for shared expenses and services in order to efficiently track costs and manage resources. Costs are then allocated back to the operational programs based on usage to more accurately determine cost of services.

The City of Morro Bay's internal service funds include eight internal service/support funds: Information Technology, facility maintenance, vehicle replacement, capital replacement, compensable leave, and three equipment replacement funds, one each for the water, sewer and harbor enterprise funds. In addition, the City of Morro Bay (City) has one insurance internal service fund, Risk Management, which includes worker's compensation.

As each fund is accounted for as a separate entity, operational revenues less expenditures result in either a positive or negative fund balance at any given point in time – Internal Service Funds are similar to the separate checking and savings accounts a person may use for different purposes. At year end, each fund's net balance is represented at the "Fund Balance Reserve."

The City Council sets legislative financial management policies, as recommended by staff and advisory committees. This Internal Service Fund Reserves Policy (Policy) is designed to establish guidelines to ensure fiscal stability for the City, accumulating funds and maintaining adequate reserves to repair and replace infrastructure, equipment and/or insurance needs that may be either planned or unexpected, and provides guidance to staff in the financial management of the City.

Purpose

A properly designed reserve policy is not only a financial best practice, but also sends a positive signal to constituents, investors, regulatory, and credit rating agencies that the City is committed to maintaining the long-run fiscal strength. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, working capital, and capital improvements, are consistent with Government Accounting Standards and are important to the City as they help to:

- Maintain the short-term and long-term financial health of the City
- Fund unanticipated expenditure contingencies
- Ensure funds exist for unexpected and planned infrastructure, equipment and insurance needs
- Ensure cash exists for the timely payment of bills
- Act as a significant positive credit factor in bond ratings

The intent of the Internal Service Funds Reserves is twofold:

1. To ensure sufficient resources exist in each internal service fund to pay for annual ongoing expenses while maintaining a reasonable reserve to fund replacement purchases (i.e. annual vehicle replacement); and,
2. Establish a fund balance level for each fund that is reasonable and prevents the over-accumulation of resources beyond what is needed for normal operating needs plus any amount required for emergency or contingency needs. hold appropriate levels of reserves

to support cash flow needs and minimize interfund loans, as well as maintain a reasonable fund balance for contingency purposes.

Therefore, this policy will enumerate minimum fund balance levels for each Internal Service Fund based on specific fund-type metrics. This Policy will also address the, use, and replenishment of those types of unrestricted reserves. The Internal Service Funds Reserves will be accounted for within individual and specific funds designated for each reserve.

Information Technology Services Fund

Information Technology Services provide for the delivery of technology-based services throughout the City's operations, including maintenance of the City's information systems and infrastructure, program implementation, internet, landline, and wireless communications systems, cloud-based technology, and support of all existing information technology as well as new technology initiatives. For technology oversight, security, and efficiency, information technology costs are managed collectively and funded through a charge-back to the various funds and departments. At year end, unspent funding flows into Unrestricted Net Position. Accumulated funds are held in the Information Technology Services Fund for working capital cash flow. Requests for use of the reserve are approved by Council through budget adoption or by a Council approved budget adjustment Resolution during the year.

This Information Technology Services Fund outlines minimum and target funding levels.

Minimum Level: \$100,000

Target Level: \$150,000

The target reserve level should allow for periodic upgrades and enhancements to the City's collection of information and communications technology, while also providing sufficient funds to meet annual operating costs.

Vehicle Replacement and Enterprise Fund Equipment Replacement Funds

The Vehicle and Equipment Maintenance program provides for the maintenance, and servicing of the City's fleet and major equipment to ensure all vehicles and equipment comply with manufacturer's recommendations and safety requirements. The Vehicle Replacement Fund is for all General Fund-owned equipment such as the City's Police, Fire, Public Works, Recreation and pooled vehicles. The City has three equipment maintenance funds, one each for the enterprise funds of water, sewer and harbor. Each individual enterprise fund supports their own equipment maintenance fund and those funds are restricted to the specific enterprise activity.

To fund the program, vehicle & equipment replacement costs transfers into the funds are accounted for through the budget process. The enterprise fund operating revenue funds account for the enterprise fund equipment replacement funds while the General Fund is the primary funding source for the Vehicle Replacement Fund.

Accumulated funds will be held in the Vehicle and Equipment Replacement Funds for working capital cash flow. At year end, unspent funding flows into Unrestricted Net Position. Requests for use of the reserve are approved by Council through budget adoption or by a Council approved budget adjustment resolution during the year.

The Vehicle Replacement Fund, to be funded by the General Fund, minimum and target funding levels are as follows:

Minimum Level: Equal to twenty percent of the replacement value of the general fund fleet.

Target Level: Equal to thirty-three percent of the replacement value of the general fund fleet.

The Enterprise Equipment Replacement Funds, to be funded by the specific enterprise fund, minimum and target funding levels are as follows:

Minimum Level: Equal to twenty percent of the replacement value of the general fund fleet.

Target Level: Equal to thirty-three percent of the replacement value of the general fund fleet.

The replacement value shall be calculated based on the most recently updated Vehicle Insurance Coverage list, or other internal tracking list developed by staff. The target reserve level will provide sufficient funds should there be a need for a one-time, larger than normal expenditure related to fleet services. State and Federal reimbursements for use of City-owned equipment, i.e. for fire strike-team support, shall be placed in the appropriate vehicle or equipment replacement fund to support future maintenance or replacement of those vehicles.

Facility Maintenance Fund

The Facility Maintenance Fund provides for maintenance and non-major repairs and building improvement services for all City-owned facilities that are not part of an enterprise fund (*i.e.* water, sewer or harbor). Additionally, the fund supports the maintenance and repair needs of the tenants of City-leased buildings and properties as defined in the lease agreements. The program's funding has primarily been derived from rental income from City-owned leased facilities; however, the City is transitioning to funding the program through charge backs to departments based on building space usage.

Accumulated net operations are held in the Facility Maintenance Fund for working capital cash flow. At year end, unspent funding flows into Unrestricted Net Position. Requests for use of the reserve are approved by Council through budget adoption or by a Council approved budget adjustment resolution during the year.

The Facility Maintenance Fund, to be funded by the General Fund, minimum and target funding levels are as follows:

Minimum Level: \$50,000

Target Level: \$75,000

Given the age of the City's facilities, increased maintenance needs are anticipated. The target funding level of \$75,000 represents a reasonable contingency for unanticipated maintenance issues which do not rise to the capital project level.

Compensated Absences Reserve

Under the Unassigned Fund Balance classification, the Compensated Absences Reserve is established to smooth expenditure fluctuations resulting from the payout of accrued leave to employees at service separation and distribution payouts.

Use of the reserve occurs when total annual compensated absences payouts exceed budgeted salary funds. Large payouts decrease the compensated absences liability at year-end, thereby supporting the practice of utilizing the reserve as needed. Year-end reconciling allocations to and from the reserve are approved through Council's budget resolution adoption each fiscal year, with the liability and resulting reserve amounts determined as part of the year-end close process.

The Compensated Absences Reserve minimum and target funding levels are defined as follows:

Minimum Level: Equal to twenty-five percent of the compensated absences liability that is established at year-end.

Target Level: Equal to thirty-three percent of the compensated absences liability that is established at year-end.

City staff will report to Council on Fund Reserve levels in comparison to the minimum and target funding levels defined by this policy during the annual budget adoption process. Reserve funding in excess of one-third (thirty-three percent) of the liability will be available for the Council to allocate during the budget process.

Withdrawal & Replenishment of Accumulation Reserves

The City will treat the minimum levels as practical reserve floors and allow reserves to increase or decrease within the minimum and target levels, as approved by City Council during the annual budget process.

To the extent moneys in any of the above funds are above the target levels, the Council has the flexibility to direct staff to utilize those available funds to pay for other capital needs, other one-time expenditures, or pay down liabilities as long as the funds legally support that purpose.

Reserve levels below the minimum target reserves would leave the City exposed to operational risks. If the City draws down the reserves below the minimum targeted level, then the City Manager, in conjunction with the Finance Department, will implement plans to return cash accumulation reserves to their minimum target levels within three years and subject to approval by City Council.

Reporting and Oversight

The Internal Service Funds Reserve levels will be monitored during the fiscal year and reported in the quarterly financial reports, as provided by the Finance Department. Internal Service Fund Reserves minimum and target levels will be analyzed annually by the Finance Department and an over/under reserve determination shall be made in conjunction with year-end financial results. Those results will be reported to the City Council as part of the year-end financial report presentation and annual budget adoption process. If Internal Service Fund Reserves levels need adjustment due to new risk factors or changes in the industry, then information will be brought to the City Council as part of the year-end report or sooner, as determined by the Finance Department.

This Policy will be reviewed during the City's annual budget process, and updated, if needed, as a result of material changes in the risk exposures or new conditions that required changes in this Policy.



COUNCIL POLICY

HARBOR ACCUMULATION FUND RESERVE POLICY

Policy Statement

The City of Morro Bay (City) Harbor Department is responsible for the management of the City's Tidelands Trust stewardship of the State-granted tidelands in Morro Bay, providing for waterfront property and lease management, public service, public safety, and municipal code enforcement on the waterfront, waters and beaches of Morro Bay. The Harbor Department is also responsible for the Harbor facilities maintenance, repair, capital improvement and replacement.

The City Council sets legislative financial management policies, as recommended by staff and advisory committees. This Harbor Accumulation Fund Reserve Policy ("Policy") is designed to establish guidelines to ensure fiscal stability of the Harbor Fund and provide guidance to staff in the financial management of the Harbor Department.

Purpose

A properly designed reserve policy is not only a financial best practice, but also sends a positive signal to ratepayers, investors, regulatory, and credit rating agencies the City is committed to maintaining the long-run fiscal strength of the Harbor Department. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, rate stability, working capital, and capital improvements, are consistent with Government Accounting Standards and are important to the Harbor Department as they help to:

- Maintain the short-term and long-term financial health of the Harbor Department
- Maintain stable user fees for customers and help ensure manageable rate increases
- Fund unanticipated expenditure contingencies, including emergencies
- Ensure funds exist for system and infrastructure improvements
- Ensure cash exists for the timely payment of bills
- Act as a significant positive credit factor in bond ratings

Definitions

The Harbor Accumulation Fund Reserve will be classified as an "Unrestricted-Undesignated Reserve." Those moneys may be used for any lawful purpose, as approved by the City Council, and have not been designated for specific capital and operating needs. The following Unrestricted-Undesignated Reserve Policy addresses the level, use and replenishment of those types of unrestricted cash. The Harbor Accumulation Fund Reserve will be accounted for within fund balances held in the Harbor Accumulation Fund.

Unrestricted-Undesignated Reserve Policy

The Harbor Department will have sufficient Unrestricted-Undesignated cash accumulated to maintain or improve its credit ratings, ensure operating and maintenance costs will be paid in a timely manner, pay debt service obligations, invest in needed capital improvements and equipment replacement and other uses on a timely basis. In addition, the Harbor Accumulation Fund Reserve will maintain sufficient cash accumulation to minimize user fee increases and departmental

expenditure freezes due to market volatility, economic impacts on demands, contingencies, and regulatory changes.

This Harbor Accumulation Fund Reserve Policy outlines minimum and target funding levels.

Minimum Level: Equal to fifteen percent of annual on-going operating and maintenance expenses based on the most recent adopted budget.

Target Level: Equal to twenty five percent of annual on-going operating and maintenance expenses based on the most recent adopted budget.

Example:

FY 2018/19 Harbor Operating Fund Total Expenditures (on-going annual expenditures)	\$1,666,706
Target Level 25%:	<u> x0.25</u>
Target Cash Accumulation	\$ 416,677

In calculating the minimum target funding level, one-time expenditures are not considered in the base for determining the operating expenditures. The minimum target funding level is intended to ensure sufficient resources to pay budgeted operating and maintenance expenses, recognizing the timing differences between payment of expenditures and receipt of revenues. It also provides a source of funding to allow the Harbor Department to operate during short-term fluctuations in revenues and expenditures.

Withdrawal & Replenishment of Accumulation Reserves

The Harbor Department will treat the minimum levels as practical reserve floors and allow reserves to increase or decrease within the minimum and target levels, as approved by City Council during the annual budget process.

To the extent cash in the Harbor Accumulation Fund Reserve is above the target levels, the Council has the flexibility to direct staff to utilize those available funds to pay for capital projects (reducing the need for future debt), or pay down liabilities related to the Trust lands.

Reserve levels below the minimum target reserves would leave the Harbor Department exposed to operational risks. If the City Council authorizes the reserves to fall below the minimum targeted level, then the Harbor Department, in conjunction with the Finance Department will implement plans to return cash accumulation reserves to their minimum target levels within three years and subject to approval by City Council.

Reporting and Oversight

Harbor Accumulation Fund Reserve levels will be monitored during the fiscal year and reported in the quarterly financial reports, as provided by the Finance Department. The Harbor Accumulation Fund Reserve minimum and target levels will be analyzed annually by the Harbor Department and an over/under reserve determination shall be made in conjunction with year-end financial results. Those results will be reported to the City Council as part of the year-end financial report presentation. If Harbor Accumulation Fund Reserve levels need adjustment due to new risk factors or changes in the industry, then that information will be brought to the City Council as part of the year-end report or sooner, as determined by the Finance Department, in consultation with the Harbor Department.

This Policy will be reviewed during the City's annual budget process, and updated, if needed, as a result of material changes in the risk exposures or new conditions that required changes in this Policy.



COUNCIL POLICY

MORRO BAY TOURISM BUSINESS IMPROVEMENT DISTRICT ACCUMULATION FUND RESERVE POLICY

Policy Statement

The City of Morro Bay Tourism Business Improvement District (MBTBID) was merged under the City's management in June 2016 to carry out tourism operations and marketing. With Transient Occupancy Tax being the leading revenue generator for the City's General Fund, the City of Morro Bay relies heavily on tourism and tourist driven activity and events. Therefore, it is in the City's best interest to reserve monies to continue funding tourist related activities during economic downturns when revenues generated into the TBID would likely decline.

The City Council sets legislative financial management policies, as recommended by staff and advisory committees. This MBTBID Accumulation Fund Reserve Policy ("Policy") is designed to establish guidelines to ensure fiscal stability of the MBTBID Fund and provide guidance to staff in the financial management of the Tourism Department.

Purpose

A properly designed reserve policy is not only a financial best practice, but also sends a positive signal to ratepayers, investors, regulatory, and credit rating agencies the City is committed to maintaining the long-run fiscal strength of the Tourism Department. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, working capital, and capital improvements, are consistent with Government Accounting Standards and are important to the Tourism Department as they help to:

- Maintain the short-term and long-term financial health of the Tourism Department
- Fund unanticipated expenditure contingencies
- Ensure funds exist for tourism promotion
- Ensure cash exists for the timely payment of bills
- Act as a significant positive credit factor in bond ratings

Definitions

The MBTBID Accumulation Fund Reserve will be classified as an Unrestricted-Undesignated Reserve. Those moneys may be used for any lawful purpose, as approved by the City Council, and have not been designated for specific operating needs. The following Unrestricted-Undesignated Reserve Policy addresses the level, use, and replenishment of those types of unrestricted cash. The MBTBID Accumulation Fund Reserve will be accounted for within fund balance of a newly created MBTBID Accumulation Fund.

Unrestricted-Undesignated Reserve Policy

The Tourism Department will have sufficient Unrestricted-Undesignated cash accumulated to ensure operating and maintenance costs will be paid in a timely manner, invest in any capital improvements and equipment replacement, continuously promote tourism and tourism events within the City of Morro bay, and other uses on a timely basis. In addition, the MBTBID

Accumulation Fund will maintain sufficient cash accumulation to minimize departmental expenditure freezes due to market volatility, economic impacts on demands, and contingencies.

This MBTBID Accumulation Fund Reserve Policy outlines minimum and target funding levels.

Minimum Level: Equal to twenty percent of annual on-going operating and maintenance expenses based on the most recent adopted budget.

Target Level: Equal to twenty-five percent of annual on-going operating and maintenance expenses based on the most recent adopted budget.

Example:

FY 2018/19 MB TBID Operating Fund Total Expenditures	\$ 997,135
Less: Accumulation Fund Transfer	<u>- 21,653</u>
Total on-going annual expenditures	\$ 975,482
Target Level 25%:	<u>x0.25</u>
Target Cash Accumulation	\$ 243,871

In calculating the minimum and target funding levels, one-time expenditures are not considered in the base for determining the operating expenditures. The minimum target funding level is intended to ensure sufficient resources to pay budgeted operating and maintenance expenses, recognizing the timing differences between payment of expenditures and receipt of revenues. It also provides a source of funding to allow the Tourism Department to operate during short term fluctuations in revenues and/or expenditures.

Withdrawal & Replenishment of Accumulation Reserves

The Tourism Department will treat the minimum levels as practical reserve floors and allow reserves to increase or decrease within the minimum and target levels, as approved by City Council during the annual budget process.

To the extent Unrestricted-Undesignated Accumulation Reserves are above the target levels, the Council has the flexibility to direct staff to utilize those available funds to pay for tourist related events or needs, or pay down liabilities.

Reserve levels below the minimum target reserves would leave the Tourism Department exposed to operational risks. If the City Council authorizes the reserves to fall below the minimum targeted level, then the Tourism Department, in conjunction with the Finance Department will implement plans to return cash accumulation reserves to their minimum target levels within three years and subject to approval by City Council.

Reporting and Oversight

MBTBID Accumulation Fund Reserve levels will be monitored during the fiscal year and reported in the quarterly financial reports, as provided by the Finance Department. The MBTBID Accumulation Fund Reserve minimum and target levels will be analyzed annually by the Tourism Department and an over/under reserve determination shall be made in conjunction with year-end financial results. Those results will be reported to the TBID Board and City Council as part of the year-end financial report presentation. If MBTBID Accumulation Fund Reserve levels need adjustment due to new risk factors or changes in the industry, then that information will be brought to the TBID Board and City Council as part of the year-end report or sooner, as determined by the Finance Department, in consultation with the Tourism Department.

This Policy will be reviewed during the City's annual budget process, and updated, if needed, as a result of material changes in the risk exposures or new conditions that required changes in this Policy.



AGENDA NO: II

MEETING DATE: September 25, 2018

Staff Report

TO: Honorable Mayor and City Council **DATE:** September 17, 2018
FROM: Jennifer Callaway, Finance Director
SUBJECT: Receive Report and Provide Feedback on the Fiscal Emergency Plan
Economic Triggers

RECOMMENDATION

Receive report and provide feedback on the fiscal emergency plan economic triggers.

BACKGROUND

At the July 10, 2018 City Council meeting, the Council requested that the development of a fiscal emergency plan be added to future Council items. In addition, the Council previously requested that financial policies be added to a future Council agenda for review and discussion. On August 28, 2018, staff brought forward an action plan outlining the process to complete both a fiscal resiliency plan and formation of Accounting Policies and Procedures. Council approved staff's recommended plan and, as such, staff has proceeded with discussion of fiscal emergency plan and economic triggers to be identified in that plan.

DISCUSSION

On September 5, 2018, the Employee Budget Advisory Group (Group) met to discuss the concept of a fiscal resiliency plan, the fiscal emergency component of that plan and ideas and thoughts on economic conditions or circumstances that would trigger the fiscal emergency plan. The Group consists of 14 City employees, representing the various departments and work groups within the City. The Group identified and discussed the following economic triggers, which would stimulate the fiscal emergency plan:

1. Natural disaster
2. Human caused disaster
3. State take-aways of local revenues
4. Large, unexpected costs
5. Economic downturn: (Defined as below)
 - Two consecutive quarters of declining revenues in the major revenues sources identified in the current labor group MOUs that could result in cost of living increases (sales tax, transient occupancy tax and property tax).

Identification of triggers is meant to create a transparent process and formula for short-term mitigations measures when fiscal first aid may be needed. With concurrence on the economic triggers component, Finance Department staff and the Group will begin to work on developing short-term mitigation measures that could be enacted should the triggers be met.

Prepared By: <u> JC </u>	Dept Review: _____
City Manager Review: <u> SC </u>	City Attorney Review: <u> JWP </u>

The economic triggers were then discussed with the Citizens Finance Advisory Committee (CFAC) on September 18, 2018. The CFAC discussed the components of a fiscal resiliency plan, the aspects of the fiscal emergency component of the that plan and the five identified economic triggers. CFAC concurred with the five proposed economic triggers and suggested no additional triggers be added. CFAC made the following comments suggestions regarding the proposed triggers and overall Fiscal Emergency Plan:

- Refine the term “Emergency” in context to the plan or clarify that this plan is not intended to trigger a special election to support a tax measure to increase revenue.
- Provide clarifying language and examples for each trigger so it is clear what the intent is, for example large, unexpected costs would include a catastrophic infrastructure failure or non-routine infrastructure need, and language reference “May include, but not be limited too.”
- Provide thresholds as either a percent or estimate range that would trigger the plan. For example, a natural disaster of low-cost value would not trigger the plan but a large natural disaster with extensive costs would.
- Parameters for when the City Manager may need to respond immediately within the mitigation measures and when there is time for discussion with council regarding mitigation measures.
- Clarify what funds may be used in any mitigation measures and any legal restrictions for use of those funds.

Staff concurs with the recommendations offered by CFAC as outlined above.

CONCLUSION

Having a clear strategy in place for fiscal emergencies that reflects the City of Morro Bay’s values will serve as the foundation for decision-making in tough fiscal times and will aid in preserving the City’s long-term fiscal health and vitality. As staff continues to develop the short-term fiscal emergency plan, staff will be bringing back components of the plan to ensure we are keeping with Council’s intent. Staff would appreciate feedback on the proposed economic triggers that staff can then incorporate into the fiscal emergency plan. The next discussion point for the Group, CFAC and Council will be mitigation measures enacted when the identified economic conditions are triggered.

ATTACHMENTS

None.