



## THE CITY OF SAN DIEGO

## M E M O R A N D U M

DATE: September 10, 2010

TO: Members of the Budget & Finance Committee  
Members of the City Council

FROM: Mary Lewis, Chief Financial Officer *Mary Lewis*

SUBJECT: City of San Diego Revised Reserve Policy

The Fiscal Year 2011 Annual Budget changed the timing of the contributions to the General Fund Reserve, Public Liability Fund Reserve, and Workers' Compensation Fund Reserve. The Reserve Policy was revised to incorporate these changes to the reserve contributions and includes additional updates to replace outdated information and terminology.

Attached is the Draft City of San Diego Revised Reserve Policy, which amends the previous policy revision approved (by Resolution No. R-303941) on July 29, 2008. The document format has changed considerably from a memorandum to a City Council Policy document; therefore, a redline version of this document is not useful as a guide to changes and not attached. However, the primary changes are outlined below.

*General Fund Reserves*

- Section 1.3 and 1.4: Language has been changed to reflect that appropriations from the Appropriated Reserve and Unassigned General Fund balance are initiated by the Mayor as budget adjustments and approved by City Council. This language change is also reflected in the Glossary.
- The timing of the contributions to the General Fund Reserve has changed and the reserve levels will be maintained at 7% in Fiscal Year 2011. The 8% target level is expected to be achieved by Fiscal Year 2013.
- The Unappropriated Reserve has been redefined as the Unassigned General Fund Balance based on new GASB 54 requirements which require a change in terminology to describe fund balances.

*Development Services Fund Reserve*

- This Operating Reserve has been reclassified as an Appropriated Reserve.
- The anticipated date that the Appropriated Reserve will reach its reserve target of 7% has been extended from Fiscal Year 2013 to Fiscal Year 2016.
- The Subdivision Account Liability and Work-in-Progress Liability (Unearned Revenue) sections have been removed.

*Risk Management Reserves*

- The timing of the contributions to the Public Liability Fund Reserve and the Workers' Compensation Fund Reserve has changed and the reserve targets of 15% and 22% respectively will be maintained in Fiscal Year 2011. The 50% target for these reserves is now expected to be met by Fiscal Year 2018, which was previously Fiscal Year 2014.
- The target contribution amounts and cumulative contribution amounts by Fiscal Year are now included.
- The General Fund contribution to the Public Liability Fund Reserve and the contribution to the Workers' Compensation Reserve will be reassessed every two years and incorporated into the budget process.

*Water Enterprise Fund Reserves*

- The funding levels for the Water Enterprise Fund Operating Reserve have been revised based on current operating costs, resulting in a total cumulative target of \$35.0 million projected to be achieved by Fiscal Year 2013. Also, the days of operation associated with the Fiscal Year 2012 target have been revised from 70 days to 65 days.
- An exception on the use of the Capital Reserve due to an unforeseen emergency has been added and requires the approval from the Chief Financial Officer or Chief Operating Officer to draw from the reserve.
- Language has been added to the Rate Stabilization Fund Reserve section indicating that use of the funds is limited to the operation and maintenance of the water system to maintain the required legal coverage ratios at 1.2 times.
- Language has been added to state that the Independent Rates Oversight Committee (IROC) oversees the Dedicated Reserve from Efficiency and Savings (DRES) and its use in accordance with the approved guidelines.

*Sewer Enterprise Fund Reserves*

- The Wastewater Enterprise Fund Reserve Policy is now referred to as the Sewer Enterprise Fund Reserve Policy.
- The funding levels for the Sewer Enterprise Fund Operating Reserve have been revised based on current operating costs, resulting in a total cumulative target of \$48.4 million projected to be achieved by Fiscal Year 2013.
- An exception on the use of the Capital Reserve due to an unforeseen emergency has been added and requires the approval from the Chief Financial Officer or Chief Operating Officer to draw from the reserve.
- Language has been added to the Rate Stabilization Reserve section indicating that use of the funds is limited only for the operation and maintenance of the sewer system to maintain the required legal coverage ratios of 1.2 times.
- Language has been added to state that the Independent Rates Oversight Committee (IROC) oversees the Dedicated Reserve from Efficiency and Savings (DRES) and its use in accordance with the approved guidelines.

*Refuse Disposal & Recycling Enterprise Funds Reserves*

- Appropriated Reserves have been established for the Refuse Disposal and Recycling Enterprise Funds, with reserve targets set at 15% of Operating Revenues. The reserve target of \$4.6 million for the Refuse Disposal Fund and \$2.4 million for the Recycling Fund is projected to be achieved by Fiscal Year 2015.

*Appendices*

- Definitions are now included as Appendix A (Glossary).
- The DRES attachment has been removed and DRES is explained in the body of the policy.

Maintaining, regularly updating, and adhering to an appropriately constructed reserve policy is a good business practice recognized by the Government Finance Officers Association, and is among the factors considered by credit rating agencies and the investment community when assessing the credit-worthiness of an organization. A biennial review of the Reserve Policy will be performed and any changes to the Reserve Policy will be brought forward for Budget & Finance Committee review and for City Council consideration and approval.

Thank you.

Mary Lewis

Attachment

cc: Honorable Mayor Jerry Sanders  
Jay M. Goldstone, Chief Operating Officer  
Wally Hill, Assistant Chief Operating Officer  
Ken Whitfield, City Comptroller  
Eduardo Luna, City Auditor  
Julio Canizal, Financial Manager  
Kevin Casey, Director of Council Affairs  
Andrea Tevlin, Independent Budget Analyst  
Kelly Broughton, Director of Development Services  
Greg Bych, Director of Risk Management  
Chris Gonaver, Director of Environmental Services  
Lakshmi Kommi, Director of Debt Management  
Roger Bailey, Director of Public Utilities



# City of San Diego Reserve Policy



September 2010

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**OVERVIEW**

One of the key attributes of a financially stable organization is appropriate reserves. Adequate reserves position an organization to weather significant economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, catastrophic events caused by human activity, or excessive liabilities or legal judgments against the organization. In concert with the City's other financial policies,<sup>1</sup> the City's Reserve Policy serves as an important tool to guide the use of City resources in meeting the City's financial commitments and provides a framework for addressing unexpected future events in a fiscally prudent manner.

The City's Reserve Policy documents the City's approach to establishing and maintaining adequate reserves across the spectrum of City operations, including General Fund, risk management, and enterprise operations. The policy is designed to:

- Identify City operations and functions for which reserves should be established and maintained, considering risks to the operation from unexpected events and the availability of other resources to address such events, and the volatility of expenditures and revenues of the operation;
- Establish target reserve levels and the methodology for calculating reserve levels;
- Provide a time-frame for meeting reserve targets, using a phased approach where necessary so that reserve goals are balanced appropriately with current budget availability;
- Establish criteria for the use of reserves and the process to replenish reserves.

Maintaining, regularly updating, and adhering to an appropriately constructed reserve policy is a good business practice recognized by the Government Finance Officers Association, and is among the factors considered by credit rating agencies and the investment community when assessing the credit-worthiness of an organization. The City recognizes that the Reserve Policy is a cornerstone of the organization's fiscal health. As such, a biennial review of the Reserve Policy will be performed and any changes to the Reserve Policy will be brought forward for City Council consideration and approval.

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<sup>1</sup> The City's financial policies include the City Budget Policy, the City Debt Policy, the General Fund User Fee Policy, the CIP Prioritization Policy, and the City Investment Policy.

## CHAPTER I - GENERAL FUND RESERVE POLICY

The General Fund is the main operating fund that pays for general services provided by the City, such as public safety, parks, and library services. The General Fund accounts for all general revenues of the City not specifically levied or collected for other City funds and for expenditures related to the rendering of the City's general services.

City Charter Section 91 requires the City to create and maintain a "General Reserve Fund" to meet the cash obligations of the City for four months, or other necessary period of each fiscal year prior to the collection of taxes. It further stipulates the fund may be expended only in the event of a public emergency by the affirmative vote of two-thirds of the City Council. The City Attorney's opinion concerning Charter Section 91, dated September 27, 2007, states "To the extent that the City has cash on hand to cover four months of the fiscal year prior to the receipt of taxes, the charter provision would be satisfied by funding the General Reserve Fund at a fiscally prudent level of 5% to 15%." The cash on hand requirement is met through the City's pooled investment fund and the issuance of Tax and Revenue Anticipation Notes.<sup>2</sup> In conformance with the Charter, the City established the Emergency Reserve, a component of General Fund Reserves as described in Sections 1.1 and 1.2 below.

### 1.1 General Fund Reserves

General Fund Reserves include the *Emergency Reserve*, the *Appropriated Reserve*, and the *Unassigned General Fund Balance*.<sup>3</sup> The target level for General Fund Reserves will be 8% of annual General Fund revenues. The City expects to reach this level no later than fiscal year 2013 according to the following schedule:

#### General Fund Reserves Targets

<b>Date</b>	<b>Target (% of General Fund Revenues)</b>
June 30, 2010	7.00%
June 30, 2011	7.00%
June 30, 2012	7.50%
June 30, 2013	8.00%

<sup>2</sup> The City's Investment Policy stipulates that the City's pooled investment fund will be comprised of a core and liquidity portfolio. The liquidity portfolio is designed to ensure that the projected expenditures related demands for cash can be met over a six-month period. Cash flows are calculated and monitored to determine the required amount of operating cash. The liquidity portfolio established by the Investment Policy meets and exceeds the City Charter Section 91, which requires the City to have an available source of cash in order to meet the legal demands against the City for the first four months of each fiscal year prior to the collection of taxes. The City has historically borrowed funds (Tax and Revenue Anticipation Notes) at the beginning of each fiscal year to ensure that there is sufficient cash prior to the receipt of property tax.

<sup>3</sup> GASB Statement No. 54 Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

While the General Fund Reserves include the Appropriated Reserves and Unassigned General Fund balance, these reserves will only be considered in addition to the Emergency Reserve for purposes of calculating the General Fund Reserves levels. After the targeted General Fund Reserve levels are achieved, only the Emergency Reserve will be used for calculating the General Fund Reserves level for Charter Section 91 purposes, and the Appropriated Reserves and Unassigned General Fund balance will be considered as additional reserves. (See Section 1.2 - Emergency Reserve for additional information).

### **1.2    *Emergency Reserve***

An Emergency Reserve is to be maintained for the purpose of sustaining General Fund operations in the case of a natural disaster or unforeseen catastrophic event caused by human activity, such as a terrorist attack. The Emergency Reserve will not be accessed to meet operating shortfalls or to fund new programs or personnel. This reserve may be expended only in the event of a public emergency, as determined by a two-thirds vote of the City Council, when such expenditures are necessary to ensure the safety, lives, and property of the City and its inhabitants.

The Emergency Reserve target level will be 8% of General Fund Revenues. Until the City reaches the 8% Emergency Reserve target level, the balance in the Emergency Reserve will be combined with the balances in the Appropriated Reserve and Unassigned General Fund balance to calculate the reserve level. However, at no time will the balance in the Emergency Reserve fall below 5%, unless such requirement is specifically waived through an action of the City Council due to an unforeseen emergency requiring the use of the Emergency Reserve.

### **1.3    *Appropriated Reserve***

An Appropriated Reserve may be maintained for the purpose of paying for unanticipated operational needs that arise during the fiscal year, but which were not anticipated during the budget process. Funds appropriated to this reserve will be identified and appropriated to a single account within the General Fund annual budget. There will be no maximum or minimum amount appropriated to this Reserve in any given year. Any funds that are not expended in a given fiscal year will revert back to the General Fund unassigned fund balance and may then be re-appropriated in the subsequent year, consistent with the Reserve Policy. Any expenditure of funds from this reserve will require the recommendation of the Mayor and approval by a majority of the City Council.

### **1.4    *Unassigned General Fund Balance***

The General Fund Unassigned Fund Balance includes all amounts not restricted, committed or assigned for a certain purpose. Unassigned amounts are available for any governmental purpose and can be appropriated in the event of an unanticipated requirement for additional funds where the Emergency Reserve would not be appropriate. Should the funds in the Appropriated Reserve be exhausted in a fiscal year, the Unassigned General Fund balance may be used. Recommendations to appropriate funds from the Unassigned General Fund balance will be initiated by the Mayor and will require approval by a majority of the City Council.

**CHAPTER II - DEVELOPMENT SERVICES FUND RESERVE POLICY**

The Development Services Fund accounts for the City’s development review and inspection services, which are funded directly by fees and charges paid by Development Services’ customers. The fund is intended to be self-supporting.

**2.1 Appropriated Reserve**

The Appropriated Reserve is intended to provide financial stability during economic downturns. The reserve may be used to meet current expenditures following an unanticipated decline in workload resulting in decreased revenues. The target reserve level for the Appropriated Reserve is 7% of operating expenses. The 7% target is expected to be reached by fiscal year 2016 according to the following schedule:

**Development Services Fund  
Appropriated Reserve Targets**

<b>Target Date</b>	<b>Target (% of Operating Expenses)</b>
June 30, 2010	3.00%
June 30, 2011	3.50%
June 30, 2012	4.00%
June 30, 2013	4.50%
June 30, 2014	5.00%
June 30, 2015	6.00%
June 30, 2016	7.00%

**CHAPTER III - RISK MANAGEMENT RESERVE POLICY**

The Risk Management Public Liability, Workers' Compensation, and Long Term Disability Funds are intended to provide funding sources for certain claims made against the City. The Public Liability Fund supports claims arising from real or alleged acts on the part of the City, including claims for bodily injury, property damage, inverse condemnation, false arrest, and errors and omissions. The Workers' Compensation Fund is a citywide fund that addresses workers' compensation claims for all departments and all funds, while the Long Term Disability Fund provides non-industrially disabled City employees with income and flexible benefits coverage.

**3.1 Public Liability Fund Reserve**

The City will maintain Dedicated Reserves equal to 50% of the value of outstanding public liability claims. This reserve level recognizes that not all claims will be due and payable at one point in time and that not all claims will be awarded, yet there may be more than one large claim that could require an immediate payment. A smoothing methodology using the annual actuarial liability for the three fiscal years most recent to the evaluation date will be used to determine the value of outstanding public liability claims for purposes of calculating the reserve level. The average value of the annual actuarial liability is currently \$114.5 million, based on fiscal years 2007 through 2009. The City targets to reach the 50% reserve level by fiscal year 2018, which requires that approximately \$5.7 million be contributed annually to the Public Liability Fund Reserve as set forth in the following schedule:

**Public Liability Fund Reserves Targets**

<i>Target Date</i>	<i>Target Contribution (In Millions)</i>	<i>Cumulative Contribution (In Millions)</i>	<i>Percentage of Average Annual Value of Actuarial Liability<sup>(1)</sup></i>
June 30, 2010	--	\$17.1 <sup>(2)</sup>	15%
June 30, 2011	--	\$17.1	15%
June 30, 2012	\$5.7	\$22.8	20%
June 30, 2013	\$5.7	\$28.5	25%
June 30, 2014	\$5.7	\$34.3	30%
June 30, 2015	\$5.7	\$40.0	35%
June 30, 2016	\$5.7	\$45.8	40%
June 30, 2017	\$5.7	\$51.5	45%
June 30, 2018	\$5.7	\$57.2	50%

<sup>(1)</sup> Based on the average value of the annual actuarial liability for the three fiscal years 2007 through 2009, or \$114.5 million.

<sup>(2)</sup> Unaudited.

The General Fund contribution to the Public Liability Fund Reserve will be reassessed every two years and incorporated into the budget process, in order to ensure that the targeted goal is met in a manner that is balanced with other budget priorities.

### 3.2 Workers' Compensation Fund Reserve

The City will maintain Dedicated Reserves equal to 50% of the value of the outstanding claims. A smoothing methodology using the annual actuarial liability for the three fiscal years most recent to the evaluation date will be used to determine the value of outstanding claims for purposes of calculating the reserve level. The average value of the annual actuarial liability is currently \$155.0 million, based on the fiscal years 2007 through 2009. The City targets to reach the 50% reserve level by fiscal year 2018, which requires that approximately \$6.2 million be contributed annually to the Workers' Compensation Reserve as set forth in the following schedule:

#### Workers' Compensation Fund Reserves Target Levels

<i>Target Date</i>	<i>Target Contribution (In Millions)</i>	<i>Cumulative Contribution (In Millions)</i>	<i>Percentage of Average Annual Value of Actuarial Liability<sup>(1)</sup></i>
June 30, 2010	--	\$34.3 <sup>(2)</sup>	22%
June 30, 2011	--	\$34.3	22%
June 30, 2012	\$6.2	\$40.5	26%
June 30, 2013	\$6.2	\$46.7	30%
June 30, 2014	\$6.2	\$52.8	34%
June 30, 2015	\$6.2	\$59.0	38%
June 30, 2016	\$6.2	\$65.2	42%
June 30, 2017	\$6.2	\$71.3	46%
June 30, 2018	\$6.2	\$77.5	50%

<sup>(1)</sup> Based on the average value of the annual actuarial liability for the three fiscal years 2007 through 2009, or \$155.0 million.

<sup>(2)</sup> Unaudited.

The contribution to the Workers' Compensation Fund Reserve will be reassessed every two years and incorporated into the budget process, in order to ensure that the targeted goal is met in a manner that is balanced with other budget priorities.

### 3.3 Long-Term Disability Fund Reserve

Currently, the balance in the Long-Term Disability (LTD) Fund is estimated to total \$5.25 million (unaudited). The reserve target for this fund will be equal to \$12.0 million and will be achieved by fiscal year 2013 as recommended in the Long-Term Disability Actuarial Report, dated September 21, 2009. The City will increase the reserve by a minimum of \$2.25 million in fiscal year 2011 and a minimum of \$2.25 million annually thereafter to achieve the reserve target of \$12.0 million by fiscal year 2013. The City is evaluating the feasibility of purchasing an insurance policy to cover this benefit as an alternative to the current practice of self-insurance.

**CHAPTER IV - WATER ENTERPRISE FUND RESERVE POLICY**

The Water Enterprise Fund accounts for specific services funded directly by fees and charges to City water customers. The fund is intended to be self-supporting.

**4.1 Appropriated Reserve**

The Appropriated Reserve is budgeted annually for unanticipated expenditures. It may be used to fund either operating or capital needs. If this reserve is used to cover unanticipated operating expenses, the Department Director’s approval is required; however, if used for unanticipated capital needs, City Council action is required.

The reserve is budgeted at \$3.5 million annually with the intent to maintain the reserve balance at the same level for future years based on historical requirements. An annual review of this level will be conducted by the Department to determine adequate funding levels.

**4.2 Operating Reserve**

The Operating Reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This reserve is based on the annual operating budget for the fiscal year (less the water purchase budget and the Appropriated Reserve) and the reserve level is defined as the number of days of operation the reserve could support in the event of a major disruption to the Water Fund revenues.

In fiscal year 2010, the estimated balance for this reserve was \$20 million (unaudited), which covers approximately 60 days of operations. The schedule below provides target funding levels to increase the reserve to a 70-day reserve by fiscal year 2013:

**Operating Reserve Targets**

<i>Target Date</i>	<i>Cumulative Target (In Millions)</i>	<i>Days of Operation</i>
June 30, 2011	\$30.9	65
June 30, 2012	\$31.7	65
June 30, 2013	\$35.0	70

Use of the funds is restricted to emergency situations resulting from loss of revenue and the reserve must be replenished by the next fiscal year. The Chief Operating Officer and/or Chief Financial Officer will have the authority to approve expenditures from the Operating Reserve.

**4.3 Capital Reserve**

The Capital Reserve is intended for unanticipated capital needs. The reserve is budgeted annually at \$5.0 million in the Capital Improvements Budget. City Council approval is required to draw from the reserve. An exception exists if an unforeseen emergency condition arises resulting in the need to immediately repair or replace an existing asset; in this case, approval from the Chief Financial Officer or the Chief Operating Officer is required to draw from the reserve.

**4.4 Rate Stabilization Reserve**

This policy will serve to keep a stable balance in this reserve, currently at \$20.5 million as of June 30, 2010 (unaudited), in order to mitigate future rate increases and to maintain the legal covenant ratios in accordance with the respective bond installment purchase agreements. Use of the funds is limited only for the operation and maintenance of the water system to maintain the required legal coverage ratios at 1.2x. If the reserve is drawn to support the system's legal coverage level at 1.2x, it will be replenished to the previous levels at the earliest opportunity. Deposits into the reserve are made from current system revenues.

The utilization of this Reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

**4.5 Secondary Purchase Reserve**

This reserve is established to purchase additional water supply in case of a major drought or unforeseen emergency that diminishes the City's normal supply. The size of the reserve is equal to 6% of the annual water purchase budget (including commodity charge and fixed costs). The reserve may be funded by any lawful source. City Council action is required in order to appropriate these reserves.

**4.6 Dedicated Reserve from Efficiency and Savings (DRES)**

This reserve was established in fiscal year 2008 to protect and preserve savings from efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvement Program (CIP) or operations and maintenance of the water and wastewater systems. The savings will be used to accelerate water and wastewater CIP schedules or to minimize future rate increases. For a four year period aligned with the rate case, annual savings not required to comply with established policies or legal documents will be transferred into the DRES based on the approved procedures. The Independent Rates Oversight Committee (IROC) oversees the DRES and its use in accordance with the approved guidelines.

**CHAPTER V - SEWER ENTERPRISE FUND RESERVE POLICY**

The Sewer Enterprise Fund accounts for specific services funded directly by fees and charges to City sewer customers. The fund is intended to be self-supporting.

**5.1 Appropriated Reserve**

The Appropriated Reserve is budgeted annually for unanticipated expenditures. It may be used to fund either operating or capital needs. If this reserve is used to cover unanticipated operating expenses, the Department Director’s approval is required; however, if used for unanticipated capital needs, City Council action is required.

The reserve is budgeted at \$3.5 million annually with the intent to maintain the reserve balance at the same level for future years based on historical requirements. An annual review of this level will be conducted by the Department to determine adequate funding levels.

**5.2 Operating Reserve**

This reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This Reserve is calculated based on the annual operating budget (less any appropriated reserves) for the fiscal year. Use of the funds is restricted to emergency situations resulting from loss of revenue and the reserve must be replenished by the next fiscal year. During fiscal year 2010, the balance for this reserve included approximately \$33.6 million (unaudited) for 50 days of operations for the Wastewater fund. In addition, the Participating Agencies in fiscal year 2010 provided approximately \$4.2 million (unaudited) for their proportionate share of the Metropolitan Sewer System which will be adjusted annually.

The schedule below provides the proposed Wastewater Fund reserve balances, excluding the Participating Agencies share, for upcoming fiscal years to bring this reserve to a 70-day reserve by fiscal year 2013:

**Operating Reserve Targets**

<i>Target Date</i>	<i>Cumulative Target (In Millions)</i>	<i>Days of Operation</i>
June 30, 2011	\$35.6	55
June 30, 2012	\$40.2	60
June 30, 2013	\$48.4	70

The Chief Operating Officer and/or Chief Financial Officer will have the authority to approve expenditures from the Operating Reserve.

**5.3 Capital Reserve**

The Capital Reserve is intended for unanticipated capital needs. The reserve is budgeted annually at \$5.0 million in the Capital Improvements Budget. City Council approval is required to use the reserve. An exception exists if an unforeseen emergency condition arises resulting in the need to immediately repair or replace an existing asset; in this case, approval from the Chief Financial Officer or the Chief Operating Officer is required to use the reserve.

**5.4 Rate Stabilization Reserve**

This policy will serve to keep a stable balance in this reserve, currently \$20.3 million as of June 30, 2010 (unaudited), in order to mitigate future rate increases and to maintain the legal covenant ratios in accordance with the respective bond Installment Purchase Agreements. Use of the funds is limited only for the operation and maintenance of the sewer system in the context of maintaining the required legal coverage ratios at 1.2x. If the reserve is drawn to support the system's legal coverage level at 1.2x, it will be replenished to the previous levels at the earliest opportunity. Deposits into the reserve are made from current system revenues.

The utilization of this Reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

**5.5 Dedicated Reserve from Efficiency and Savings (DRES)**

This reserve was established in fiscal year 2008 to protect and preserve savings from efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvement Program (CIP) or operations and maintenance of the water and wastewater systems. The savings will be used to accelerate water and wastewater CIP schedules or to minimize future rate increases. For a four year period aligned with the rate case, annual savings not required to comply with established policies or legal documents will be transferred into the DRES based on the approved procedures. The Independent Rates Oversight Committee (IROC) oversees the DRES and its use in accordance with the approved guidelines.

## **CHAPTER VI - REFUSE DISPOSAL & RECYCLING ENTERPRISE FUNDS RESERVE POLICY**

The Refuse Disposal Enterprise Fund was established to separate tipping fee revenues from the General Fund. The tip fees support active and inactive landfill operations and are levied on landfill users, including the City of San Diego.

The Recycling Enterprise Fund and Assembly Bill (AB) 939 Fee were established as a result of the Integrated Waste Management Act of 1989. AB 939 authorized local jurisdictions to impose fees based on the types or amounts of solid waste generated to be used to pay actual costs incurred in preparing, adopting, and implementing integrated waste management plans.

### **6.1 Appropriated Reserves**

The Appropriated Reserves act as a contingency for unanticipated, non-emergency needs that are identified during the fiscal year. These reserves may only be drawn upon to support operational needs when there are unanticipated revenue shortfalls caused by an economic slowdown or recession. The Appropriated Reserves may also be used for one-time, high priority programs or activities.

The Department Director will be responsible for approving the use of the reserve for unanticipated operating expenses. City Council action will be required to approve the use of the reserve for unanticipated capital needs.

The Appropriated Reserves target level is 15% of operating revenues, which equates to reserve balances of approximately \$4.6 million for the Refuse Disposal Fund and \$2.4 million for the Recycling Fund based on fiscal year 2010 revenues. The Refuse Disposal Fund reserve is budgeted at \$920,000 annually and the Recycling Fund is budgeted at \$480,000 annually with the intent to achieve the target level by fiscal year 2015. An annual review of this level will be conducted by the Department to determine adequate funding levels.

The targeted reserve levels are projected to be achieved by fiscal year 2015 based on the following schedule:

#### **Refuse Disposal Fund and Recycling Fund Reserve Targets**

<b><i>Target Date</i></b>	<b><i>Refuse Disposal Fund Target Contribution</i></b>	<b><i>Recycling Fund Target Contribution</i></b>
June 30, 2011	\$920,000	\$480,000
June 30, 2012	\$920,000	\$480,000
June 30, 2013	\$920,000	\$480,000
June 30, 2014	\$920,000	\$480,000
June 30, 2015	\$920,000	\$480,000
Total Reserve	\$4,600,000	\$2,400,000

## **CHAPTER VII – COMPLIANCE WITH RESERVE POLICY**

### **7.1 Reporting Use of Reserve Funds**

Any requests for the use of reserves will be accompanied by a current status report of the affected reserve fund and impacts on the future reserve levels.

### **7.2 Reserve Expenditures**

Unless specified otherwise in the Reserve Policy, expenditures from any reserve will require a recommendation of the Mayor and City Council action to appropriate the funds. The Mayor may recommend reserve expenditures through the budget process or at regular or special City Council meetings for City Council consideration and approval.

### **7.3 Replenishment of Reserves**

Should a particular reserve fall below the targeted reserve level set forth in the Reserve Policy, the Mayor will develop a plan to replenish the reserve in a reasonable time-frame. The proposed plan will be presented to the Budget and Finance Committee and the City Council as part of the subsequent fiscal year budget.

### **7.4 Deviations from the Reserve Policy**

No deviations from the Reserve Policy will be allowed except as recommended by the Mayor and approved by the City Council. Proposed exceptions to the Reserve Policy will be presented first to the Chief Financial Officer and/or Chief Operating Officer, and then to the Budget and Finance Committee. After the Budget and Finance Committee review and recommendation, the proposed exception will be presented to the City Council for action.

### **7.5 Updates to Reserve Policy**

Any changes, additions, or deletions to the Reserve Policy will be brought forward to the Budget and Finance Committee for review followed by a presentation to the City Council for formal action.

The Reserve Policy will be reviewed at least biennially and discussed if changes are necessary to ensure the policy is effective, and remains current with general accounting and financial best practice standards, as well as any regulatory changes that may occur over time.

**CITY OF SAN DIEGO RESERVE POLICY**

**HISTORY:**

Adopted by Ordinance No. O-19679 on November 20, 2007

Revised by Resolution No. R-303941 on July 29, 2008

## **APPENDIX A - GLOSSARY**

### **Appropriated Reserves**

In addition to Emergency Reserves, certain funds may maintain reserves that may be appropriated by City Council and set aside during the budget process as a contingency for unanticipated, non-emergency needs that are identified during the fiscal year. These reserves may only be drawn upon to fund unexpected expenditures (such as a spike in energy prices or materials costs) and revenue shortfalls due to an unexpected economic slowdown or recession. The Appropriated Reserve may also be used for one-time, high priority programs or activities. In the case of Enterprise Funds, the reserves may be used to support operations due to unanticipated revenue shortfalls. Recommendations to use Appropriated Reserves will be made by the Mayor, and will require approval by a majority of the City Council, with the exception of the Enterprise Funds.

### **Capital Reserves**

Capital Reserves (or Capital Improvement Program [CIP] Reserves) are intended to provide funding for unanticipated capital expenses. The use of these funds will require City Council action.

### **Dedicated Reserves**

Dedicated Reserves are similar to Appropriated Reserves, but are set aside for specific purposes for non-capital projects or activities that require multiple year funding. Dedicated Reserves may also be established for special one-time purchases or major activities that have been approved by the City Council. Use of the reserves is restricted to the identified purpose(s). City Council will review the Dedicated Reserves biennially during the budget process and such reserves will be carried over to future fiscal years until the project or activity is completed or closed, as authorized by the City Council.

### **Dedicated Reserve from Efficiency and Savings**

A Dedicated Reserve from Efficiency and Savings ("DRES") for both the Water and the Sewer Fund is established to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset future rate increases.

### **Emergency Reserves**

Certain funds, such as the General Fund, will maintain an Emergency Reserve which may only be used for qualifying emergencies, such as a natural disaster, terrorist attack, or other unforeseen catastrophic event caused by human activity. The Emergency Reserve may be expended only in the event of a public emergency, as determined by a two-thirds vote of the City Council.

**General Fund Reserves**

General Fund Reserves include the General Fund Emergency Reserve, the General Fund Appropriated Reserve, and the Unassigned General Fund balance. For the purpose of the Reserve Policy and when referring to the General Fund Emergency Reserve, the term "Emergency Reserve" is used synonymously with "Working Capital."

**Operating Reserves**

The Operating Reserve for an Enterprise Fund, such as the Water Utility or the Wastewater Utility, is intended to be used should a catastrophe occur that prevents the utility from operating according to its normal course of business. Use of the reserve is restricted to emergency situations resulting in loss of revenue and the reserve must be replenished in accordance with the timeframe established in the respective policies. The Chief Operating Officer and/or Chief Financial Officer will have the authority to approve expenditures from the reserve.

**Rate Stabilization Reserves**

The purpose of Rate Stabilization Reserves is to ensure that legal requirements relating to annual debt service coverage, as set forth in bond indenture agreements, are fulfilled. This type of reserve is more typical for Enterprise Fund financings. The reserve targets are calculated based on the legal requirements outlined in the applicable bond financing documents, and maintained throughout the term of the bonds.

**Unassigned General Fund Balance**

Unassigned General Fund balance constitutes the difference between the assets and liabilities of a fund and are available for any governmental purpose. A positive fund balance indicates that the assets of the General Fund exceed its liabilities.

**Working Capital**

Working Capital is current assets (cash or equity in pooled cash and liquid investments and receivables less than 60 days) minus current liabilities (payables) and encumbrances and other restrictions. Working Capital does not include long-term assets such as certain longer term investments, loans receivable, fixed assets, inventory, and equipment. For the purpose of the Reserve Policy and when referring to the General Fund Emergency Reserve, the term "Working Capital" is used synonymously with "Emergency Reserve."

