

DATE ISSUED: October 9, 2002 **REPORT NO.** 02-228 Rev.

ATTENTION: Honorable Mayor and City Council
~~The Committee on Rules, Finance and Intergovernmental Relations~~
Docket of October 14, 2002

SUBJECT: City Manager's Proposal Regarding General Reserves

REFERENCE: Blue Ribbon Committee Report on City of San Diego Finances –
February 2002
Blue Ribbon Recommendations/Rules Committee Actions – Memo April 2002
City Manager's Proposal Regarding General Reserves – Report No. 02-170
City Manager's Proposal Regarding General Reserves – Report No. 02-186
Mayor's Memorandum on General Fund Reserve – August 7, 2002
City Manager's Proposal Regarding General Reserves – Report No. 02-212
Mayor's Memorandum on General Fund Reserve – September 24, 2002

SUMMARY

Issue – Should the City Council adopt a new Council Policy to: 1) maintain the General Fund Reserve at a minimum of 3% of the General Fund revenues, 2) establish a goal to bring General Reserves to a level that is 7% of General Fund revenues, which includes the goal of bringing the General Fund Reserve to 5% of General Fund revenues within 10 years (by Fiscal Year 2014), 3) increase the General Fund Reserve by at least 10% of the General Fund revenue increase in excess of 2% in any fiscal year in which General Fund revenues increase by more than 2% over the prior year budgeted revenues until the 5% goal is achieved, and 4) authorize the City Manager to recommend suspension of compliance with this policy in any fiscal year in which anticipated revenues will be insufficient to maintain existing City services?

Manager's Recommendation – Adopt a new Council Policy to: 1) maintain the General Fund Reserve at a minimum of 3% of the General Fund revenues, 2) establish a goal to bring General Reserves to a level that is 7% of General Fund revenues, which includes the goal of bringing

the General Fund Reserve to 5% of General Fund revenues within 10 years (by Fiscal Year 2014),

3) increase the General Fund Reserve by at least 10% of the General Fund revenue increase in excess of 2% in any fiscal year in which General Fund revenues increase by more than 2% over the prior year budgeted revenues until the 5% goal is achieved, and 4) authorize the City Manager to recommend suspension of compliance with this policy in any fiscal year in which anticipated revenues will be insufficient to maintain existing City services.

Other Recommendations– The Blue Ribbon Committee Report on City of San Diego Finances February 2002 (Blue Ribbon Committee Report) recommended increasing (general) reserves to 7 – 10% of General Fund revenues.

Fiscal Impact – Fiscal Year 2003 - None

Fiscal Year 2004 – Establishing an initial General Fund Reserve level of 3% in Fiscal Year 2004, assuming a conservative increase of 2% in General Fund revenues for Fiscal Year 2004, would require a minimum increase to the General Fund Reserve of approximately \$900,000.

BACKGROUND

On April 15, 2002 the City Council adopted the Blue Ribbon Committee Report. The first recommendation of the Committee was:

Recommendation #1; Evaluate and determine what an adequate reserve level is for the City. At this time, the Committee recommends increasing the reserves to be between 7 to 10% of General Fund revenues.

In a memo dated April 4, 2002, the Mayor directed the City Manager to prepare a proposal to the Committee on Rules, Finance and Intergovernmental Relations to evaluate and determine an adequate reserve level for the City. In order to ensure that the level of General Reserves is sufficient to address unforeseen contingencies, the City's revenue sources, its economic environment, budgetary fixed costs, and the debt for which the General Fund is obligated were analyzed.

On July 24, 2002, the City Manager presented to the Committee on Rules, Finance and Intergovernmental Relations a proposal to increase General Reserves to a goal of 5 - 7% of General Fund revenues. A representative of the San Diego County Taxpayers' Association recommended that the 5 - 7% goal be focused on increasing the General Fund Reserve rather than General Reserves as a whole. The Committee on Rules, Finance and Intergovernmental Relations agreed that efforts to increase General Reserves should focus on the General Fund Reserve component and that the other general reserves serve as an added advantage. Accordingly, the Mayor directed the City Manager to return to a subsequent Rules Committee meeting to continue the discussion on adequate General Reserve as well as General Fund Reserve goals. The City Manager was also directed to provide additional information on the City's outstanding debt obligations including Certificates of Participation (COPs).

On August 7, 2002, the City Manager presented to the Committee on Rules, Finance and Intergovernmental Relations a revised proposal to increase General Reserves. In addition to proposing a General Reserves goal of 5 - 7% of General Fund revenues, the proposal included a separate goal to increase the General Fund Reserve to a goal of 3 – 5% of General Fund Revenues.

At the August 7 Rules Committee meeting, Mayor Dick Murphy presented a memorandum proposing the following:

- 1) The General Fund Reserve shall be set at a minimum of three percent (3%) of annual General Fund revenues.
- 2) The General Fund Reserve shall be increased to five percent (5%) of the annual General Fund revenues as soon as it is financially feasible.
- 3) In any fiscal year in which General Fund revenues increase \$10 million or more from the prior fiscal year, ten percent (10%) of the increased General Fund revenues shall be put into the General Fund Reserve until the General Fund Reserve reaches five percent (5%) of General Fund revenues.

The Committee on Rules, Finance and Intergovernmental Relations inquired under what conditions or circumstances the General Reserves would appropriately be used, and how they would be replenished if ever accessed. There was also discussion about establishing a “goal” as opposed to a strict mandate of what percentage of revenues should be allocated to the General Fund Reserve annually, in order to provide the Mayor and Council with the flexibility to examine and consider all budget priorities and obligations, and to make allocations to the General Fund Reserve accordingly.

In addition, a representative of the San Diego County Taxpayers’ Association concurred with the Mayor’s memorandum, and suggested that a fixed percentage, rather than a percentage range, be established for both the General Fund Reserve and the General Reserves. She also agreed that having a reserve level goal rather than a mandated annual set-aside was preferable to provide flexibility.

In subsequent discussions between the Mayor and the City Manager, it was agreed to modify the recommendations and discuss with the Rules Committee. The modified recommendations are:

- 1) The General Fund Reserve shall be set at a minimum of three percent (3%) of annual General Fund revenues.
- 2) Establish a goal to bring the General Fund Reserve to 5% of the annual General Fund revenues within 10 years (by Fiscal Year 2014).
- 3) In any fiscal year in which General Fund revenues are projected to increase by more than 2% over the prior year’s budgeted revenues, the City Manager shall propose in his Annual Budget an increase to the General Fund Reserve equal to at least 10% of the General Fund revenue increase in excess of 2%. The requirement shall terminate when the General Fund Reserve reaches 5% of General Fund revenues.
- 4) If the City Manager determines that anticipated revenues in any fiscal year will be insufficient to maintain existing City services, the City Manager may recommend to the Mayor and City Council that they temporarily suspend compliance with this Council Policy (see Attachment A) for the upcoming fiscal year. A majority vote of the City Council can temporarily suspend compliance with this policy for that fiscal year.

DISCUSSION

Since the inception of the General Fund Reserve in Fiscal Year 1993, there has not been an occurrence or incident that warranted utilization of these reserves for any purpose. Despite current and past economic downturns, the City of San Diego has undertaken measures to reduce expenditures to mitigate revenue shortfalls rather than considering utilization of reserve funds; this practice will be applied in any future fiscal years where there are revenue shortfalls or overexpenditures, absent direction by the Mayor and City Council to utilize reserves for this purpose.

Circumstances or conditions that may warrant use of these funds would include natural disasters or a catastrophe such as that faced by New York City last year; State budget impacts; or excessive liabilities or judgments against the City. Even under such conditions, however, the City would strive to limit or avoid use of reserves to the greatest extent possible. However, were it to be necessary to access reserve funds, the City Manager would make a recommendation to the City Council; utilization of the reserves would require approval by the majority of the City Council.

Replenishment of reserves in the event of utilization would be identical to the current plan for increasing the General Fund Reserve: the City Council may allocate whatever level of funding they deem appropriate, given competing operational priorities such as public safety, deferred maintenance, pre-negotiated salary requirements, and retirement contributions, toward replenishment of the General Fund Reserve. Additionally, in the event of a natural disaster or catastrophe that renders the City eligible for federal or State reimbursement, a commitment could be made to allocate part or all of such reimbursements to the General Fund Reserve.

The following table depicts the growth of the General Fund Reserve since its inception in Fiscal Year 1993.

Table 1. General Fund Revenues and General Fund Reserve by Fiscal Year

Fiscal Year	General Fund Revenues (Actual in Millions)	General Fund Reserve (Millions)
2003	\$729.3 ¹	\$21.4
2002	\$727.4 ¹	\$21.4
2001	\$709.9	\$19.5
2000	\$652.5	\$13.8
1999	\$583.9	\$ 6.2
1998	\$558.3	\$ 6.1
1997	\$513.8	\$ 6.0
1996	\$498.3	\$ 5.7
1995	\$483.7	\$ 5.5
1994	\$472.1	\$ 4.0
1993	\$462.7	\$ 4.0

¹Budgeted

The following table shows the current status of the General Fund Reserve and the General Reserves, as well as the anticipated status of these reserves for Fiscal Year 2004.

Table 2. Estimated Fiscal Year 2003 and 2004 General Reserves Status

Reserve Description	Fiscal Year 2003 Amount (millions)	Percent of General Fund Revenues (estimated)	Fiscal Year 2004 Amount (millions)	Percent of General Fund Revenues (estimated)
General Fund Reserve	\$21.4 ¹	2.94%	\$22.3 ¹	3.00%
GASB 31 Reserve	\$2.0	0.27%	\$2.0	0.27%
Convention Center Reserve	\$6.9	0.95%	\$6.9	0.93%
MTDB/Trolley Reserve	\$2.1	0.29%	\$2.1	0.28%
Balboa Park/Mission Bay Reserve	\$3.5	0.48%	\$3.5	0.47%
Ballpark Reserve	\$2.3	0.32%	\$7.5	1.01%
Library System Reserve	\$0.0	0.00%	\$5.0	0.67%
Total General Reserves	\$38.2	5.25%	\$49.3	6.63%

¹Includes \$4.7 million that may be used to fund Library bond issuance in FY 2004.

Based on a 2% General Fund revenue increase projected in Fiscal Year 2004, the allocation required to bring the General Fund Reserve up to 3% of General Fund revenues would leave approximately \$13.7 million to allocate for other needs, which is not sufficient to cover even the projected additional salary requirements (estimated at \$12.4 million before the Police Officers' Association contract negotiations) for Fiscal Year 2004. It is therefore important to emphasize that the 3% figure is a challenge, especially in fiscal years where there is limited growth in revenues, in that there are unavoidable budgetary expenses and obligations that must be addressed prior to setting aside funds for the General Fund Reserve.

It is also important to keep in mind that the level of the overall General Reserves, based on the revenue estimates used in this report, are anticipated to remain at a respectable 6.63% of General Fund revenues for Fiscal Year 2004. That being the case, the City's bond ratings should not be negatively impacted even in the event that the General Fund Reserve is not brought up to the full 3% of General Fund revenues in Fiscal Year 2004.

CONCLUSION

Taking into account the broad margin for variance in the revenue projections used for this analysis, it is reasonable to assume that it may take at least 10 years to achieve a General Fund Reserve level that represents 5% of annual General Fund revenues. While the City will actively pursue the goal of reaching the 5% mark within 10 years beginning in Fiscal Year 2005, economic conditions and budgetary obligations and priorities will determine whether this goal can be achieved within that time frame.

Conversely, should revenues exceed the projections used in this report in ensuing fiscal years, enabling the City to meet its operational priorities and obligations with a revenue surplus, it is within the City Council's discretion to allocate more funds to the General Fund Reserve than what is depicted in the

City Manager’s recommendation, thereby potentially shortening the time frame within which the 5% goal is achieved.

Respectfully submitted,

Lisa Irvine
Financial Management Director

Approved: Michael T. Uberuaga
City Manager

IRVINE/MJK

Attachment 1: [General Fund Reserve Council Policy](#)