



Kent Taylor Civic Hall
200 NE Second Street
McMinnville, OR 97128

City Council Work Session Agenda
Wednesday, September 16 2020
6:00 p.m. – Work Session

*Welcome! The public is welcome to attend, however if you are not feeling well, please stay home and take care of yourself. In accordance with Governor Kate Brown's Executive Order we are limiting the amount of people at Civic Hall and if we meet capacity we may ask you to leave. **With new face covering mandate all who wish to attend public meetings must wear a face mask or some kind of face covering is required.***

*You can live broadcasts the City Council Meeting on cable channels Xfinity 11 and 331,
Frontier 29 or webstream here:*

www.mcm11.org/live

You may join online via Zoom Meeting:

<https://mcminnvilleoregon.zoom.us/j/92632048845?pwd=d2NJL29sOHBjdG8vWUU2Y2dKM1R2UT09>

Zoom ID: 926-3204-8845

Zoom Password: 602369

Or you can call in and listen via zoom: 1-253- 215- 8782

ID: 926-3204-8845

1. CALL TO ORDER
2. DISCUSSION – McMinnville Reserve and Fund Balance Policy
3. PRESENTATION/DISCUSSION –Urban Growth Boundary (UGB) Remand Response Update
4. ADJOURNMENT

Kent Taylor Civic Hall is accessible to persons with disabilities. A request for an interpreter for the having impaired or for other accommodations for persons with disabilities should be made a least 48 hours before the meeting to the Claudia Cisneros, City Recorder (503) 435-5702.



City of McMinnville
Finance Department
230 NE Second Street
McMinnville, OR 97128
(503) 434-2350
www.mcminnvilleoregon.gov

Memo

DATE: September 16, 2020
TO: Mayor and City Councilors
FROM: Jennifer Cuellar, Finance Director
SUBJECT: Work Session - City's Reserve and Fund Balance Policy

STRATEGIC PRIORITY & GOAL:



CITY GOVERNMENT CAPACITY

Strengthen the City's ability to prioritize & deliver municipal services with discipline and focus.

Report in Brief:

The Audit Committee met three times in July and August to discuss the City's approach to reserves and fund balance. An overview of the draft Reserve and Fund Balance Policy and the issues discussed in the Audit Committee meetings on this subject are the topic of this work session. Feedback from this work session is sought to give guidance to staff on the Reserve Fund Balance Policy draft in order to bring a final version to Council for consideration and adoption at an upcoming public meeting.

Background:

On October 11, 2011, the McMinnville City Council passed Resolution 2011-30 Adopting a Fund Balance Policy¹ for the General Fund. The policy established 25% of annual expenditures as the minimum fund balance level in the General Fund.

For the last four budget cycles, the City has budgeted progressively fewer resources in the General Fund's ending fund balance category, choosing to prioritize current expenditures over sequestering funds in reserve categories (contingencies and ending fund balance classes). In actual terms, however, the City has consistently ended the year within the 25% ending fund balance parameters (through FY19 financials; FY20 financials are still in process). While actuals have remained above the ending fund balance standard, we do see over time a downward trend in annual actual ending fund balance levels.²

The Government Finance Officers Association (GFOA) recommendation³ for ending fund balance level is that the proportion of reserves compared to regular operating expenses be set in the context of the jurisdiction's particular characteristics, with a minimum of two months operating expenditures.

As of FY2010-11, the Governmental Accounting Standards Board (GASB) required a new classification structure of fund balances be reported in the governmental fund financial statements.⁴

The Audit Committee met three times (7/14/2020, 8/5/2020 and 8/26/2020) to review the City's budgeted and actual fund balance trends as well as best practices and literature regarding municipal reserve policies. In the first meeting, the City's Municipal Advisor, Duncan Brown from PFM, gave a presentation on the factors that affect creditworthiness and led an in depth discussion of reserve levels, financial trends and how they factor into

rating agency evaluations.⁵ The Committee discussed the elements desired in an updated Reserve and Fund Balance Policy and gave feedback on the draft policy presented in the third meeting.

Packets for each Audit Committee meeting and the PFM presentation are available on the City's website.

Discussion:

The Audit Committee discussed options and came to conclusions on the following areas of interest as they relate to reserve and fund balance standards. Staff has researched best practice, provided resources and analyzed the city's budgeting and actuals trends to support their deliberations.

Reserve and Fund Balance Policy's purpose

After Committee deliberation and review of best practice and a number of municipal reserve policy examples, the draft policy's purpose is defined as the desire to establish a standard for all city funds that promotes responsible financial management by adhering to best practices and maintaining adequate levels of fund balance to mitigate current and future risks while assuring the delivery of quality, meaningful services to the community. This policy is intended to make the city more resilient and well positioned to:

- Ensure present and future municipal service levels
- Withstand the next economic downturn or fiscal stress (natural disaster, other emergency, revenue or cash short fall)
- Promote equitable and stable rate, charge and fee structures
- Protect the City's creditworthiness and bond rating
- Provide flexibility to respond to unanticipated opportunities
- Consider long-term financial planning needs, including retirement system rate increases

Prudent reserve level for the General Fund

GFOA's recommended minimum of two month's operating expenditures is the reserve target set in the policy. Further, the policy outlines a three to five year time frame for building back to this standard. The factors leading to these proposed policy conditions include:

- Creditworthiness will be enhanced by having a realistic plan and making incremental progress toward the goal
- Near- and medium- term financial realities remain unclear given the impact of the slow motion public health emergency so committing to a faster move to the target might unduly disrupt the provision of services to the community
- Oregon municipalities, and McMinnville in particular, are uniquely sheltered from economic downturns due to a relatively low reliance on the most volatile categories of general fund resources (charges for services, sales tax or income tax)⁶

Define updated reserve calculation components

From a budgeting perspective, reserve will be calculated as 2/12ths of general fund operating (personnel plus materials and services categories) costs for the year. On a percentage basis, this is 16.67% of total annual operating. Two budget categories will be summed to represent the General Fund's reserve (contingency plus unassigned ending fund balance).

This change means the value of the volunteer firefighter's Length of Service Award Program (LOSAP) will no longer be included as a budgeted reserve category. When this money is excluded, the gap between budgeted reserves and the reserve target widens.

Should the City choose to add discrete committed or assigned fund balance categories for future expenditures, financial planning reasons or other savings purposes, a determination will be made at that time whether these will be included or excluded from the budgeted reserve calculation.

Communication on reserve levels

The primary methodology for communicating on reserve and fund balance levels will continue to be via the City's budget process.

The Audit Committee and City Manager requested that the policy also explicitly outline other criteria that should trigger discussions on the topic of reserves. The draft policy calls out examples such as a change in the City's credit rating, negative economic consequences of external events such as natural disasters or downturns in the economy and significant positive or negative variations of actual year end reserve as compared with budget.

An example of this kind of discussion is already scheduled to take place this year in December when we have a better sense of the impact of COVID-19, where the ending fund balance from FY2019-20 will land and an indication of near-term property tax receipt stability.

Reserve targets for all city funds

The draft policy sets reserve standards for all of its funds, not just the General Fund.

Depending on the characteristics and purposes of the City's various funds, different reserve target levels are appropriate. Discussion of the pertinent criteria in play for determining a prudent reserve level is included in the draft policy for each fund.

The draft policy also notes the technical accounting difference in how reserves are expressed for governmental funds, "fund balance," and its equivalent in enterprise funds, "working capital."

In addition, the scope of the policy clarified that the City's discretely presented component unit, McMinnville Water and Light, is not governed by this policy.

Budget practice

Staff will continue to propose departmental budgets that serve the prioritization of activities and service delivery based on MacTown 2032 Strategic Priorities and Council goal setting activities. A key input that will be incorporated into budgeting going forward will come from the upcoming core services analysis and prioritization work.

The City's focus on rebuilding a stronger reserve level means that annual budget planning will include a reserve floor sufficient to meet that year's reserve target level.

To minimize the impact on reducing dollars available for current service delivery budgets, the City will tighten up budgeting on staffing and annual carrying cost estimates, moving away from reliance on a historic trend of General Fund actuals coming in better than budgeted. Property tax trends and sensitivity analysis of year end reserve status will no longer exclusively present the historic assumption that the City's budgeted ending fund balance will come in under actual.

Another predictable result of these changes in practice will be the need for mid-year and year-end budget amendments across a broader spectrum of the City's operations than the Council has seen in the past. Tighter budget margins also create a higher vulnerability to budget law violations.

Compliance clean up

The draft policy adds components required by GASB pronouncement number 54 on fund balance reporting. The City had added the reporting categories to its accounting system and implemented the standards in its financial statements. By adding the explicit language regarding unrestricted fund balance categories and the hierarchy of use of balances for qualifying expenditures, the City is more transparently adhering to generally accepted accounting principles (GAAP) for municipal entities.

The draft Reserve and Fund Balance Policy⁷ is the final attachment included in the work session documents for this topic.

Attachments:

1. Resolution 2011-30 Adopting a Fund Balance Policy for the General Fund
2. Budgeted and Actual Fund Balance Trend Data
3. GFOA Fund Balance Guidelines for the General Fund
4. GASB 54 Fund Balance Summary
5. PFM Presentation 7/14/2020
6. Revenue and Risk with Trend Data
7. Draft Reserve and Fund Balance Policy

Fiscal Impact:

Establishing a more complete and updated Reserve and Fund Balance Policy will set standards allowing the City to reverse its negative fund balance trend, building back reserves over time. Having a plan and making progress on it will have a positive impact on the analysis of our credit worthiness and, ultimately, interest rate levels the jurisdiction is able to secure when it goes to the debt markets in the future.

Making the decision to build fund balance means that current expenditures over the next several years will likely be under pressure because municipal cost curves, driven largely by personnel annual percentage increases (wages, health insurance and retirement costs), typically exceed annual percentage increases in annual revenue sources (property taxes, charges for services, franchise fees, etc.). For the City of McMinnville, from FY13 through FY19, the year over year increase in personnel costs alone out-paced the annual increase in property tax every year.

To the extent that the City can move forward plans which will create reliable and adequate funding sources for critical public services that better balance the carrying cost and capital investments required to maintain those services, the concentration on cost-side solutions to building back the reserves will be mitigated.

Tools to assist in developing financial planning models which project reserve levels based on multiple scenarios exist that can sit on top of the City's current accounting system. Long term financial projections done for the budget process are built with excel spreadsheets though robust scenario analysis is limited, requiring considerable handwork to maintain. These kinds of tools can range in cost from \$10,000 to \$50,000 in annual carrying cost depending on the range of functionality, quality of graphic output, public facing reporting options and other factors.

Recommendation:

Work session discussions do not result in specific action for the meeting.

City of McMinnville

Fund Balance Policy for the General Fund

Purpose: The City of McMinnville has historically maintained prudent reserves in all funds, but has not had a written policy adopted by the City Council. This policy establishes a fund balance goal for the General Fund and is intended to serve as a guide for important budgetary decisions made by the City Council, Budget Committee, and management.

As a best financial management practice, the City of McMinnville will maintain a prudent fund balance to:

- 1) Provide sufficient resources to meet cash flow needs;
- 2) Assist in maintaining an investment grade bond rating capacity;
- 3) Cover unforeseen emergencies; and
- 4) Set aside funds for major capital projects or equipment purchases, when deemed appropriate.

An adequate fund balance is critical because it lessens the impact of revenue shortfalls and/or unanticipated expenditures. The fund balance also serves as a source of bridge funding, allowing the City to maintain or transition to sustainable service levels.

An adequate fund balance provides sufficient cash flow at the beginning of the fiscal year when General Fund expenditures typically exceed revenues. Current year property tax revenues are not received until November and December; therefore, from July through October, current property tax revenues are not available to pay operating expenditures. Governments can borrow internally from other funds that have sufficient cash reserves or from external sources; however, borrowing poses potential risk and causes additional expense. A more prudent approach is to maintain sufficient cash in the fund balance to cover cash flow needs during that time.

Definition: "Fund balance" as referred to in this policy is defined as any amounts that are not legally or contractually required to be maintained intact; externally restricted by grantors, contributors, laws or regulations; or restricted by law through constitutional provisions or enabling legislation.

Policy: The City of McMinnville's Policy is to maintain, at a minimum, a fund balance in the General Fund sufficient to avoid the necessity of internal or external borrowing at the beginning of the fiscal year when current property tax revenues are unavailable. Generally, 25% of General Fund annual expenditures provides an adequate cash reserve to cover operating expenditures from July through October.

While covering the cash flow needs of the General Fund, the cash balance is also available to cover unforeseen emergencies. This could include City response to floods, wind storms or other natural disasters, as well as an unusual demand for services, such as police overtime incurred due to an increase in burglaries.

Future financial needs and challenges identified through the City's long term fiscal forecast and planning process should be considered when determining an appropriate level of fund balance. The City's forecast model projects General Fund fund balances for three years and incorporates assumptions related to revenue and expenditure trends. Current fiscal year budgetary decisions should take into consideration future fund balances as projected in the fiscal forecast.

A higher fund balance provides a lower level of financial risk and provides the City more time to react to unfavorable financial conditions or unanticipated events. However, the lower level of risk provided by substantial cash reserves should be balanced with the needs of the community and the City Council's goals and objectives.

RESOLUTION NO. 2011 - 30

A Resolution Adopting a Fund Balance Policy for the General Fund.

RECITALS:

During the budget process in the spring of 2011, the City Council and the Budget Committee discussed the General Fund fund balance. While the City has always maintained an adequate fund balance, there has never been a written policy in place establishing guidelines regarding the appropriate amount of the balance.

On September 28, 2011, the City's Audit Committee reviewed a draft policy presented by Finance Director Marcia Baragary. After discussion, the Committee unanimously voted to recommend the policy, as presented, to the City Council.

The Fund Balance Policy for the General Fund establishes a fund balance goal for the General Fund and is intended to serve as a guide for important budgetary decisions made by the City Council, Budget Committee, and management. An adequate fund balance is critical because it lessens the impact of revenue shortfalls and/or unanticipated expenditures. The fund balance also serves as a source of bridge funding, allowing the City to maintain or transition to sustainable service levels.

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"Fund balance" as referred to in this policy is defined as any amounts that are not legally or contractually required to be maintained intact; externally restricted by grantors, contributors, laws or regulations; or restricted by law through constitutional provisions or enabling legislation.

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF McMinnville, OREGON as follows:

1. That the attached Fund Balance Policy for the General Fund is hereby adopted.
2. That this Resolution shall take effect immediately upon passage and shall continue in full force and effect until revoked or replaced.

Adopted by the City Council of the City of McMinnville at a regular meeting held the 11th day of October 2011 by the following votes:

Ayes: Hill, Jeffries, May, Menke, Ruden

Nays: _____

Approved this 11th day of October 2011.



MAYOR

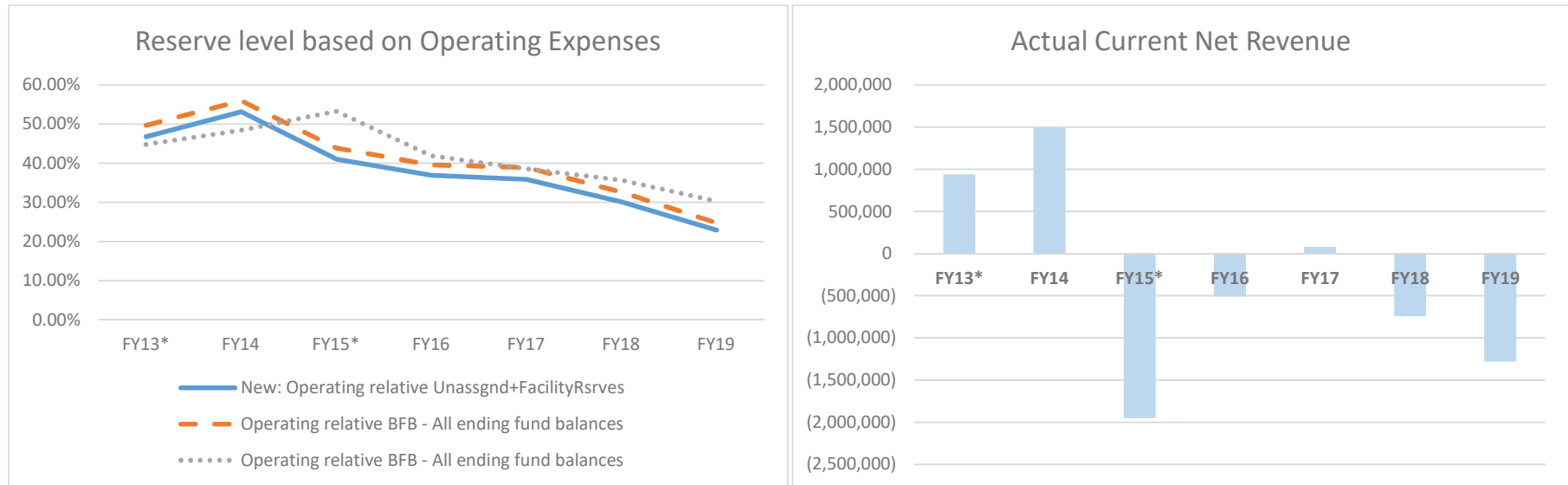
Approved as to form:



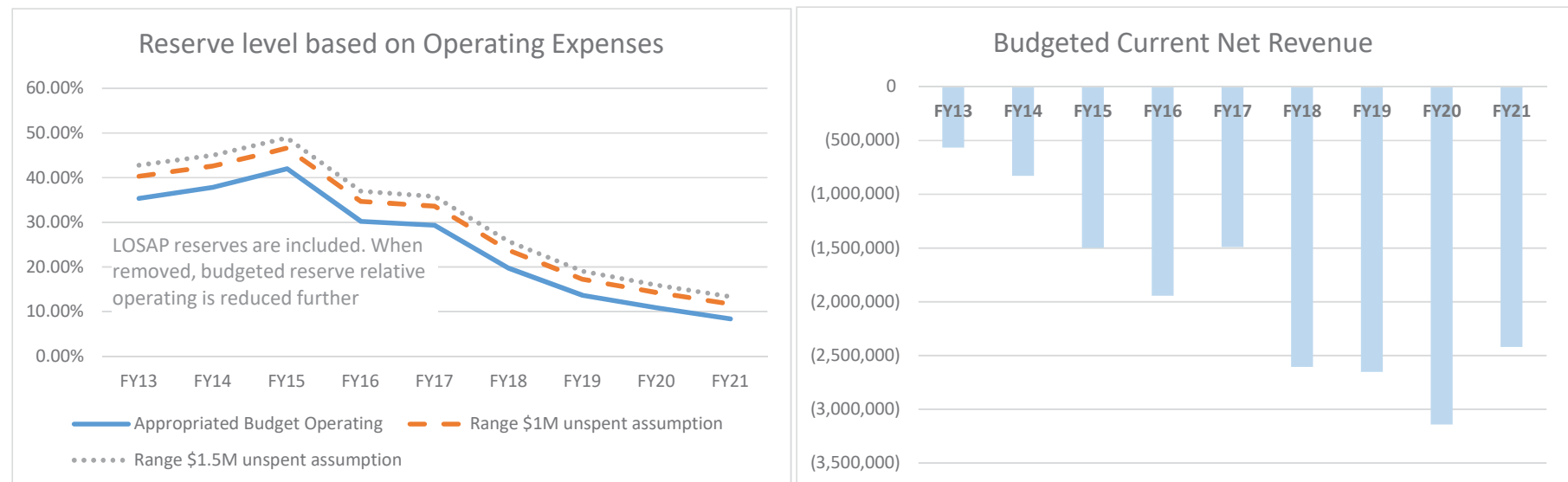
CITY ATTORNEY

City of McMinnville Reserve Trends

Actuals for Combined General Fund and Ambulance Fund



Appropriated Budget for Combined General Fund and Ambulance Fund



* Fiscal year data is restated as presented in subsequent CAFRs

8/8/2020 Update JCS

General Fund Ending Fund Balance - Appropriated Budgets

<u>General Fund + Ambulance</u>		FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Revenue										
	Beginning Fund Balance	7,696,555	8,696,049	10,615,900	8,638,793	8,332,212	7,518,110	6,641,807	6,375,308	4,938,718
A	Current Revenue	21,580,435	21,961,925	22,807,191	23,293,392	26,508,845	25,737,539	28,804,357	30,931,162	30,809,216
	Total Revenue	29,276,990	30,657,974	33,423,091	31,932,185	34,841,057	33,255,649	35,446,164	37,306,470	35,747,934
Expenditures										
B	Personal Services	15,398,225	16,199,019	16,686,784	17,616,580	18,542,715	19,784,579	21,601,892	23,420,294	23,742,706
C	Materials and Services	4,838,541	4,671,988	5,030,373	4,576,111	4,800,237	5,312,412	5,951,815	6,372,649	6,419,460
	Capital Outlay	262,479	311,168	479,324	429,471	190,044	291,491	679,600	635,606	923,151
	Debt Service	0	0	115,292	115,295	265,420	570,418	675,172	724,321	735,626
	Transfers Out	1,646,958	1,606,926	1,992,748	2,500,136	4,199,811	2,384,334	2,548,523	2,919,282	1,407,621
D	Total Current Expenditures	22,146,203	22,789,101	24,304,521	25,237,593	27,998,227	28,343,234	31,457,002	34,072,152	33,228,564
Appropriated Reserve Categories										
	Contingencies	1,050,000	1,050,000	1,050,000	1,050,000	1,200,000	1,200,000	1,200,000	1,200,000	1,900,000
	LOSAP Ending Fund Balance*	497,311	77,916	481,600	468,204	535,000	463,786	900,000	578,800	508,258
	Facility/Vehicle Reserve	623,230	600,000	0	75,000	112,500	37,500	622,461	0	0
	Unassigned Ending Fund Balance	4,984,110	6,163,323	7,586,970	5,101,388	4,995,330	3,248,629	1,025,296	1,455,518	111,112
E	Total Reserves*	7,154,651	7,891,239	9,118,570	6,694,592	6,842,830	4,949,915	3,747,757	3,234,318	2,519,370
Historical Analysis										
(E/(B+C))	Appropriated Budget Operating	35.35%	37.81%	41.99%	30.17%	29.31%	19.72%	13.60%	10.86%	8.35%
	Range \$1M unspent assumption	40.30%	42.60%	46.59%	34.67%	33.60%	23.71%	17.23%	14.21%	11.67%
	Range \$1.5M unspent assumption	42.77%	45.00%	48.89%	36.92%	35.74%	25.70%	19.05%	15.89%	13.33%
Reserves w/o LOSAP										
	Appropriated Budget Operating	32.90%	37.44%	39.77%	28.06%	27.02%	17.88%	10.34%	8.91%	6.67%
	Range \$1M unspent assumption	37.84%	42.23%	44.37%	32.56%	31.31%	21.86%	13.96%	12.27%	9.98%
	Range \$1.5M unspent assumption	40.31%	44.62%	46.68%	34.82%	33.45%	23.85%	15.78%	13.95%	11.64%
Current Net Revenue (A - D)		(565,768)	(827,176)	(1,497,330)	(1,944,201)	(1,489,382)	(2,605,695)	(2,652,645)	(3,140,990)	(2,419,348)
Percent of Expenditures (A/D)		-2.55%	-3.63%	-6.16%	-7.70%	-5.32%	-9.19%	-8.43%	-9.22%	-7.28%

Budget Buffer Analysis - Budgeted and Actual include LOSAP

Combined General Fund + Ambulance

Budgeted Beginning Fund Balance	7,696,555	8,696,049	10,615,900	8,638,793	8,332,212	7,518,110	6,641,807	6,375,308	4,938,718
Actual Beginning Fund Balance	8,649,816	9,589,557	11,081,092	9,130,462	8,620,713	8,700,766	7,959,773	6,503,164	
Gain	953,261	893,508	465,192	491,669	288,501	1,182,656	1,317,966	127,856	

General Fund Ending Fund Balance - NWS Actuals Governmental

General Fund + Ambulance		FY13*	FY14	FY15*	FY16	FY17	FY18	FY19
Revenue								
	Beginning Fund Balance	8,649,816	9,589,557	11,081,092	9,130,462	8,620,713	8,700,766	7,959,773
	Property Tax	10,687,582	10,918,129	11,253,504	11,861,826	12,291,488	12,625,747	13,699,308
	State Shared Revs	760,551	807,752	834,087	825,156	899,238	1,114,681	1,094,262
	Licen + Perm + Franchise	2,290,778	2,348,989	2,384,709	2,336,296	2,497,580	2,743,786	3,130,370
	Charges for Services	4,785,942	4,488,380	4,440,221	5,039,015	5,157,831	4,985,639	4,813,767
	Grants + Donations	682,947	728,312	769,976	877,594	918,330	1,189,845	1,232,843
	Fines + Misc	1,235,347	853,310	720,704	780,789	794,869	1,283,473	1,302,707
	Debt Proceeds/Loan Pymts	0	1,370,000	78,094	290,195	5,917,267	0	0
	Transfers In Other Funds	1,622,623	1,683,535	2,141,334	2,521,175	2,230,776	2,771,457	3,196,686
A	Current Revenue	22,065,769	23,198,407	22,622,630	24,532,046	30,707,379	26,714,629	28,469,943
	Total Revenue	30,715,584	32,787,964	33,703,722	33,662,508	39,328,092	35,415,395	36,429,716
Expenditures								
B	Personal Services	14,999,322	15,492,712	16,594,935	17,629,739	17,956,945	19,542,022	20,645,021
C	Materials and Services	4,282,520	4,300,430	4,193,891	4,147,864	4,387,730	4,822,826	5,606,821
	Capital Outlay	197,224	306,804	1,731,888	504,734	309,235	247,988	439,306
	Debt Service	0	0	115,291	115,291	3,617,851	569,776	633,998
	Transfers Out	1,646,958	1,606,926	1,937,254	2,644,167	4,355,565	2,273,010	2,426,922
D	Total Current Expenditures	21,126,025	21,706,872	24,573,260	25,041,795	30,627,326	27,455,622	29,752,069
Reserve Categories								
	Contingencies	0	0	0	0	0	0	0
	LOSAP Ending Fund Balance	562,639	557,316	593,735	572,141	673,697	606,790	655,396
	Facility/Vehicle Reserve	600,000	1,351,766	94,897	75,000	112,500	0	0
	Unassigned Ending Fund Balance	8,426,920	9,172,010	8,441,830	7,973,572	7,914,569	7,352,983	6,022,252
E	Total Reserves	9,589,559	11,081,092	9,130,462	8,620,713	8,700,766	7,959,773	6,677,647
Historical Analysis								
	Operating relative BFB	44.86%	48.45%	53.30%	41.93%	38.58%	35.71%	30.32%
	Operating relative EFB	49.73%	55.98%	43.92%	39.59%	38.94%	32.67%	25.44%
	New: Operating relative Unassgnd+FacilityRsrve:	46.82%	53.17%	41.06%	36.96%	35.92%	30.18%	22.94%
	Current Net Revenue (A - D)	939,744	1,491,535	(1,950,630)	(509,749)	80,054	(740,993)	(1,282,126)
	Percent of Expenditures (A/D)	4.45%	6.87%	-7.94%	-2.04%	0.26%	-2.70%	-4.31%

* Restated values as presented in subsequent CAFRs



Fund Balance Guidelines for the General Fund

Governments should establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund for GAAP and budgetary purposes.

In the context of financial reporting, the term *fund balance* is used to describe the net position of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net position of governmental funds calculated on a government's budgetary basis.¹ While in both cases *fund balance* is intended to serve as a measure of the financial resources available in a governmental fund; it is essential that differences between GAAP *fund balance* and budgetary *fund balance* be fully appreciated.

1. GAAP financial statements report up to five separate categories of fund balance based on the type and source of constraints placed on how resources can be spent (presented in descending order from most constraining to least constraining): *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.² The total of the amounts in these last three categories (where the only constraint on spending, if any, is imposed by the government itself) is termed *unrestricted fund balance*. In contrast, budgetary fund balance, while it is subject to the same constraints on spending as GAAP fund balance, typically represents simply the total amount accumulated from prior years at a point in time.
2. The calculation of GAAP fund balance and budgetary fund balance sometimes is complicated by the use of sub-funds within the general fund. In such cases, GAAP fund balance includes amounts from all of the subfunds, whereas budgetary fund balance typically does not.
3. Often the timing of the recognition of revenues and expenditures is different for purposes of GAAP financial reporting and budgeting. For example, encumbrances arising from purchase orders often are recognized as expenditures for budgetary purposes, but never for the preparation of GAAP financial statements.

The effect of these and other differences on the amounts reported as *GAAP fund balance* and *budgetary fund balance* in the general fund should be clarified, understood, and documented.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance in the general fund.

GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund for GAAP and budgetary purposes.³ Such a guideline should be set by the appropriate policy body and articulate a framework and process for how the government would increase or decrease the level of unrestricted fund balance over a specific time period.⁴ In particular,

governments should provide broad guidance in the policy for how resources will be directed to replenish fund balance should the balance fall below the level prescribed.

Appropriate Level. The adequacy of unrestricted fund balance in the general fund should take into account each government's own unique circumstances. For example, governments that may be vulnerable to natural disasters, more dependent on a volatile revenue source, or potentially subject to cuts in state aid and/or federal grants may need to maintain a higher level in the unrestricted fund balance. Articulating these risks in a fund balance policy makes it easier to explain to stakeholders the rationale for a seemingly higher than normal level of fund balance that protects taxpayers and employees from unexpected changes in financial condition. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.⁵ The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.⁶ Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time. In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

1. The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
2. Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
3. The potential drain upon general fund resources from other funds, as well as, the availability of resources in other funds;
4. The potential impact on the entity's bond ratings and the corresponding increased cost of borrowed funds;
5. Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose). Governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance, rather than on unrestricted fund balance.

Use and Replenishment.

The fund balance policy should define conditions warranting its use, and if a fund balance falls below the government's policy level, a solid plan to replenish it. In that context, the fund balance policy should:

1. Define the time period within which and contingencies for which fund balances will be used;
2. Describe how the government's expenditure and/or revenue levels will be adjusted to match any new economic realities that are behind the use of fund balance as a financing bridge;

3. Describe the time period over which the components of fund balance will be replenished and the means by which they will be replenished.

Generally, governments should seek to replenish their fund balances within one to three years of use. Specifically, factors influencing the replenishment time horizon include:

1. The budgetary reasons behind the fund balance targets;
2. Recovering from an extreme event;
3. Political continuity;
4. Financial planning time horizons;
5. Long-term forecasts and economic conditions;
6. External financing expectations.

Revenue sources that would typically be looked to for replenishment of a fund balance include nonrecurring revenues, budget surpluses, and excess resources in other funds (if legally permissible and there is a defensible rationale). Year-end surpluses are an appropriate source for replenishing fund balance.

Unrestricted Fund Balance Above Formal Policy Requirement. In some cases, governments can find themselves in a position with an amount of unrestricted fund balance in the general fund over their formal policy reserve requirement even after taking into account potential financial risks in the foreseeable future. Amounts over the formal policy may reflect a structural trend, in which case governments should consider a policy as to how this would be addressed. Additionally, an education or communication strategy, or at a minimum, explanation of large changes in fund balance is encouraged. In all cases, use of those funds should be prohibited as a funding source for ongoing recurring expenditures.

Notes:

1. For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.
2. These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.
3. Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.
4. See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).
5. In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.
6. In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues and/or expenditures, that decision should be followed consistently from period to period.

This best practice was previously titled Appropriate Level of Unrestricted Fund Balance in the General Fund.

Governmental Accounting Standards Series

**Statement No. 54 of the
Governmental Accounting
Standards Board**

**Fund Balance Reporting and
Governmental Fund Type Definitions**



Governmental Accounting Standards Board
of the Financial Accounting Foundation

Graphic Representation of GASB 54 Fund Balance Classifications

Governmental Accounting Standards Board Statement No. 54 Fund Balance Classifications

	Classification	Definition	Degree of Spendability
Restricted Fund Balance	Nonspendable	Resources that are not in a spendable form (inventories, prepaid items, or items required to be maintained intact).	Nonspendable
	Restricted	Resources constrained to specific purposes by external providers (creditors, grantors, contributors, and other levels of government) through laws and regulations.	
Unrestricted Fund Balance	Committed	Resources constrained by limitations the City imposes upon itself at its highest level of decision-making authority (City Council); limitations remain binding unless removed in the same manner.	
	Assigned	Resources a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates authority.	
	Unassigned	Resources available for any purpose; these resources are reported only in the General Fund.	Spendable



City of McMinnville, Oregon

Audit Committee Reserve Discussion: Credit Rating Considerations

July 14, 2020

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Discussion Topics

- I. Overview of Credit Ratings
- II. Moody's Local Government Methodology and Scorecard
- III. City of McMinnville Rating Report Highlights
- IV. Historical Trends and Peer Comparison
- V. Credit Spreads / Cost of Borrowing



What is a Credit Rating?

- Three major rating agencies are Moody's Investors Service, S&P Global Ratings, and Fitch Ratings
- Ratings assess the probability of the debt instrument returning all of the principal to the investor
- Municipal credit ratings are opinions of the investment quality of debt issuers and issues in the municipal bond market
- Underwriters and investors rely upon the credit quality judgment made by the rating agencies
- General obligation / full faith & credit ratings are generally scored along 4 or 5 categories:
 1. Economy & tax base
 2. Financial condition of the general fund
 3. Management
 4. Debt and pension obligations
 5. Institutional framework



Hierarchy of Credit Ratings

- Most municipal governments carry one or more investment-grade ratings
- Ratings are assigned to each credit (e.g., full faith & credit obligations, water revenue bonds, etc.)

	Moody's	S&P	Fitch
Investment Grade	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
Non-Investment Grade	Ba and below	BB and below	BB and below



Moody's Local Government Rating Scorecard

- Moody's uses a "scorecard" approach to provide a composite score of a local government's credit profile based on weighted factors as well as potential "below the line" notching factors
- Of the rating factors, only some are directly controllable by actions or inactions of the City

Broad Scorecard Factors	Sub-Factors	Sub-Factor Weighting	Level of Control
Economy/Tax Base (30%)	Tax Base Size (Full Value)	10%	Less/No Direct Control
	Full Value Per Capita	10%	Less/No Direct Control
	Wealth (Median Family Income)	10%	Less/No Direct Control
Finances (30%)	Fund Balance (% of Revenues)	10%	More Direct Control
	Fund Balance Trend (5-year Change)	5%	More Direct Control
	Cash Balance (% of Revenues)	10%	More Direct Control
	Cash Balance Trend (5-year Change)	5%	More Direct Control
Management (20%)	Institutional Framework	10%	Less/No Direct Control
	Operating History	10%	More Direct Control
Debt/Pensions (20%)	Debt to Full Value	5%	More Direct Control
	Debt to Revenue	5%	More Direct Control
	Moody's-Adjusted Net Pension Liability (3-Year Average) to Full Value	5%	Less/No Direct Control
	Moody's-Adjusted Net Pension Liability (3-Year Average) to Revenue	5%	Less/No Direct Control



City of McMinnville Rating – Moody's Investors Service

- On February 1, 2018, Moody's affirmed the "Aa3" rating on the City's outstanding general fund-secured obligations
 - Below are highlights of the February 2018 opinion and subsequent July 2019 annual comment:

Credit Strengths:

- Strong financial position with cash balance as a % of operating revenues (38.5%) comparable to US median, despite significant contractions from 2014-2018
- Reliance on property taxes that benefit from regular, moderate growth

Credit Weaknesses:

- Elevated fixed costs burden reduces operating flexibility
- Somewhat inflated yet manageable pension liability in comparison to Aa3 rating

Factors that could lead to an upgrade:

- Substantial tax base growth and economic diversification
- Appreciation in socioeconomic measures
- Material reduction in fixed costs burden
- Persistently stronger reserves and liquidity

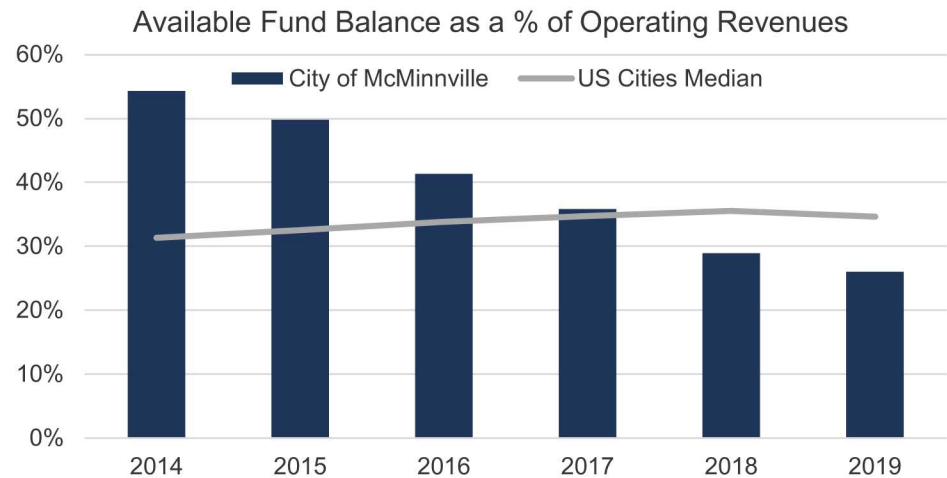
Factors that could lead to a downgrade:

- Significant deterioration of the city's financial position
- Material growth in leverage and fixed costs burden from debt and pension liabilities
- Trend of substantial tax base contractions or economic decline

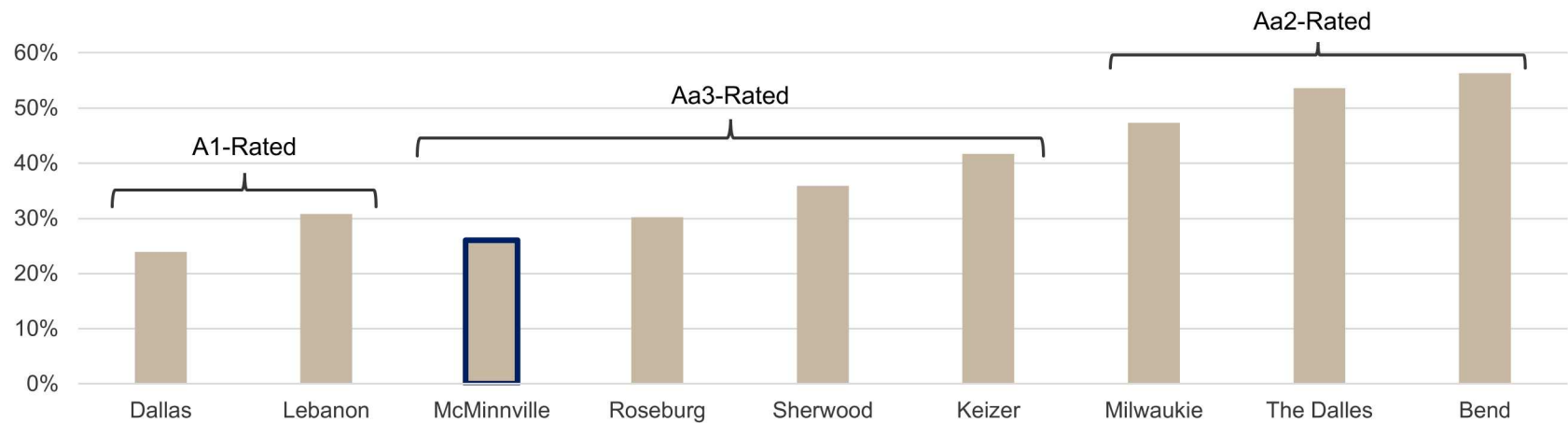


Credit Ratings – Moody’s Investors Service

- Moody’s notes the significant contraction of the City’s operating fund balance as a % of operating revenues over the past several years
- The chart below shows a comparison of this metric to selected in-state peer cities



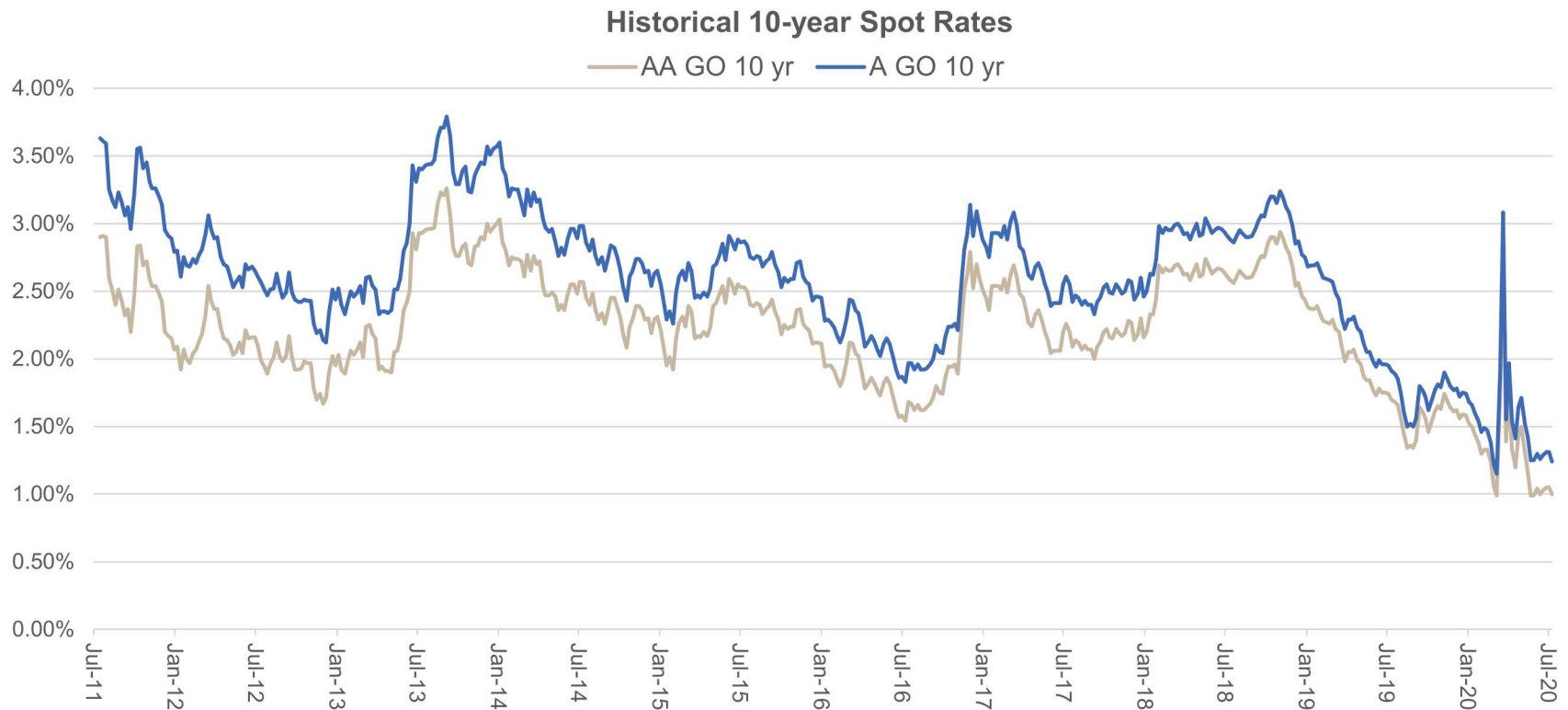
Peer Comparison – Available Fund Balance as a % of Operating Revenues (2019)





Credit Spreads

- Lower credit ratings typically translate to a higher cost of borrowing
- The “MMD” index is the industry standard means of evaluating tax-exempt bond rates
- The spread between the 10-year “A” MMD and 10-year “AA” MMD averaged 0.38% over the past ten years, and is currently 0.24%



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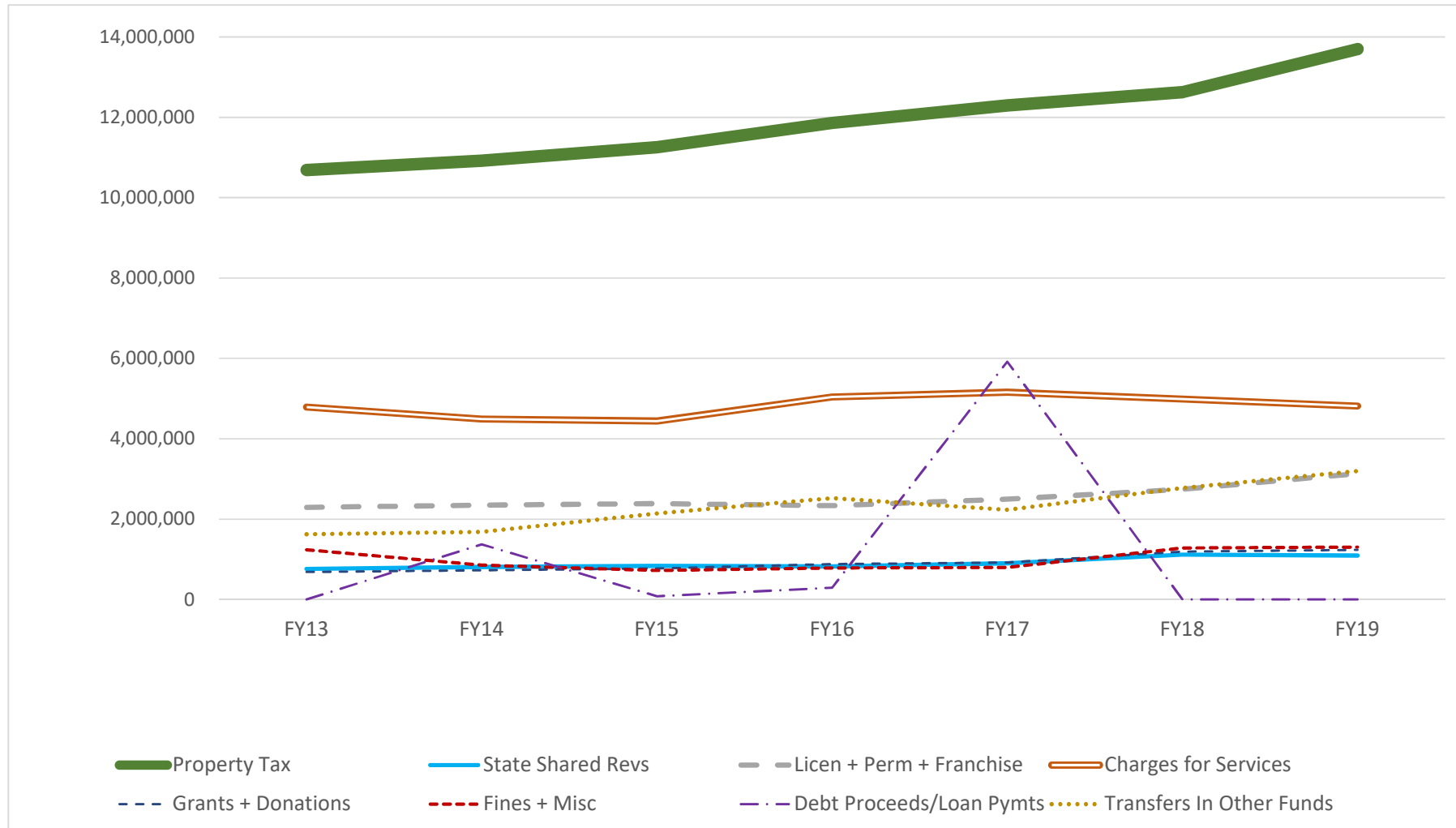
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Revenue and Risk in Municipal Organizations

Charges for services, sales tax and income tax are the most volatile revenue sources. The City Gen Fund has an avr of 20% of this type of revenue. Licenses, franchise fees and fines are less elastic - avr 15% of General Fund plus Ambulance - but can also move with business cycles. Most resilient revenue base is property tax, but if you lose big payers, that adds vulnerability. In the case of McMinnville, the top 10 tax payers make up less than 10% of the revenues, indicating a diversified tax base in terms of payers; our exposure is in tourism sector.

City of McMinnville - Revenue Picture



Reserve and Fund Balance Policy

Policy Adoption Date: _____ **Last Revision:** _____

Principle

Align our fiscal policies and practices to MacTown 2032's strategic priority of *City Government Capacity* to strengthen the City's ability to prioritize and deliver municipal services with discipline and focus.

Purpose

The City of McMinnville desires to establish a Reserve and Fund Balance Policy for all city funds that promotes responsible financial management by adhering to best practices and maintaining adequate levels of fund balance to mitigate current and future risks while assuring the delivery of quality, meaningful services to the community. This policy is intended to make the city more resilient and well positioned to:

- Ensure present and future municipal service levels
- Withstand the next economic downturn or fiscal stress (natural disaster, other emergency, revenue or cash short fall)
- Promote equitable and stable rate, charge and fee structures
- Protect the City's creditworthiness and bond rating
- Provide flexibility to respond to unanticipated opportunities
- Consider long-term financial planning needs, including retirement system rate increases

Scope

This policy outlines reserve and fund balance targets for all City funds. It recognizes the unique needs and characteristics of each fund and includes summary information by fund type along with information regarding each individual fund.

The policy does not address the reserve and fund balance targets for the related financial entity of McMinnville Water and Light as it is managed by a separate governing body.

Policy Guidance

The Government Finance Officers Association (GFOA), founded over 100 years ago, is the premier organization providing guidance and best practices in various areas of public finance to municipal governments. Its published Best Practices are approved by the GFOA executive board and identify policies and procedures that contribute to improved government management.

The GFOA's Fund Balance Guidelines for the General Fund recommends that jurisdictions:

- Maintain a minimum of two months of regular General Fund operating revenues or General Fund operating expenses
- Take into consideration the government's own unique circumstances and risk exposures
- Evaluate commitments and assignments and focus on unassigned fund balance rather than unrestricted fund balance

- Define use and replenishment of fund balance

The Governmental Accounting Standards Board (GASB) is the source of Generally Accepted Accounting Principles (GAAP) used by state and local governments in the US. The GASB issues pronouncements designed to provide tax payers, legislators, municipal bond analysts and others useful information for decision-making. GASB's major guidance related to fund balance is found in Statement No. 54, which defines five classifications of fund balance, summarized in the table below:

	Classification	Definition	Degree of Spendability
Restricted Fund Balance	Nonspendable	Resources that are not in a spendable form (inventories, prepaid items, or items required to be maintained intact).	Nonspendable
	Restricted	Resources constrained to specific purposes by external providers (creditors, grantors, contributors, and other levels of government) through laws and regulations.	
Unrestricted Fund Balance	Committed	Resources constrained by limitations the City imposes upon itself at its highest level of decision-making authority (City Council); limitations remain binding unless removed in the same manner.	
	Assigned	Resources a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates authority.	
	Unassigned	Resources available for any purpose; these resources are reported only in the General Fund.	Spendable

This policy focuses on the unrestricted fund balance categories as the City has direct control over these balances.

Policy

Fund balance targets and related policy considerations are described for each of the City's funds based on the specific characteristics and purposes of those governmental and proprietary funds in the sections that follow.

Fund Balance is defined as the difference between assets and liabilities in a governmental fund (General Fund, Special Revenue Funds, Debts Service Funds, and Capital Project Funds). Working capital is defined as the difference between current assets and current liabilities for non-governmental funds (Proprietary Funds that include Enterprise Funds and Internal Service Funds).

This policy formally adopts the GASB 54 hierarchy of fund balance classifications that the City has been utilizing, as required, in its annual financial statements.

- Committed fund balance is established, modified or rescinded by the City Council upon adoption of the annual budget or by resolution during a public meeting at any time in the year

- Assigned fund balance may be consigned for a specific purpose by the City Manager or his/her designee at any time during the year; budgeted assigned fund balance is included in City Council's annual budget adoption
- The City considers restricted balances to have been spent when an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available
- The City considers committed spent first, assigned spent next and unassigned fund balance spent last when an expenditure is incurred for purposes that may be used in more than one of these unrestricted fund balance classifications

General Fund

The General Fund has an unassigned fund balance target of two months operating expense. In the budget, this amount is calculated as 2/12ths of General Fund categories (1) personnel and (2) materials and services annual budgets. The reserve will be budgeted in the General Fund's contingency and unassigned ending fund balance categories.

The City of McMinnville seeks to fund this reserve target over the next three to five years (in or prior to the FY2025-26 budget cycle).

In any year that the unassigned fund balance target is not met, the circumstances and financial implications of the target shortfall will be discussed and approved by Council during the annual budget process. Once the City has achieved the targeted reserve level described above, any subsequent budget year that projects a shortfall in the General Fund's combined contingency and unassigned reserve balance standard must include a plan for rebuilding the reserve within one to three years of use.

Circumstances that impact reserve levels may arise at times that do not coincide nicely with the budget planning cycle which merit discussion with the executive team and governing body as well as taking mid-year adjusting actions. Examples of conditions which will trigger such action include changes to the City's credit rating, external situations which negatively impact significant revenue streams or drive extraordinary costs (natural disasters, economic downturns) and year-end reserve actuals with a significant positive or negative variation from budget estimates.

In addition to unassigned fund balance and budgeted contingency, the City's reserve calculation may include or exclude other specific committed and/or assigned fund balances. At the time of the drafting of this policy, the General Fund's only assigned fund balance is for the volunteer firefighter's Length of Service Award Program. These funds will no longer be included in the City's budgeted reserve calculation or actual ending fund reserve analysis.

Discrete committed or assigned fund balance categories may be added to the City's financial planning model and included in budgeted and actual reserve calculations. Typically these specially designated unrestricted fund balance categories are for purposes to set aside excess reserves or one time funds for special initiatives such as creation of a capital replacement fund, rainy day fund, retirement rate stabilization fund, etc. New fund balance categories will be calculated in the reserve according to the methodology defined when established; presented in

budget section(s) that discuss fund balance purpose, levels and trends; and programmed for expenditure in the manner defined at the reserve fund's inception.

Special Revenue Funds – no reserve requirement

A handful of City Funds are grants based or exist to provide transparency on particular revenue streams that are fully expended over a given time period. In these cases, reserves are not appropriate to expect or budget.

- 05 Special Assessment Fund
- 07 Transient Lodging Tax Fund
- 10 Telecommunication Fund

Special Revenue Funds – two month operating reserve requirement

Some special revenue funds are on-going concerns with staffing and other monthly and seasonal operations costs. In these cases, the standard to target a two months operating cost reserve budgeted in contingency and ending fund balance budget categories is merited.

- 20 Street Fund
- 70 Building Fund

Special Revenue Funds – variable reserve requirement

Other special revenue funds base reserve requirements on the functional and capital planning needs associated with its activities. Frequently these funds will have restricted funding sources that are associated with particular projects or activities. These funds may have a variable committed or assigned reserve level that is optimal for its circumstances over time so a specific reserve target cannot realistically be set by policy.

The City's debt service fund includes bonded debt that is funded with property tax but has debt service payments scheduled prior to the annual property tax cycle. These reserve commitments will vary according to the various payment schedules associated with the debt obligations.

These funds will calculate and discuss reserve needs as a part of the annual budget process. Reserve levels will be approved by the Council in its annual budget appropriation.

- 15 Emergency Communication Fund
- 25 Airport Maintenance Fund
- 45 Transportation Fund
- 50 Park Development Fund
- 60 Debt Service

Enterprise Fund

Wastewater Services' operating fund is designed to manage the on-going utility operation and, as such, includes staffing and materials and services costs. Its working capital needs will mirror the General Fund's fund balance target of a two month minimum operating expense level to set aside in contingency and ending fund balance categories each year. Its integrated Wastewater Capital Fund has strategically built up funds to address capital replacement needs and large capital infrastructure investments planned to keep the district

- 74 Wastewater Services Fund
- 77 Wastewater Capital Fund

A Storm Water Utility will be required as a result of changing federal and state regulatory guidelines to meet long-term environmental and risk mitigation objectives. Its budgeted and actual reserve calculations and levels will be consistent with Wastewater Services' standards to assure on-going operations as well as meet capital planning needs for this new critical infrastructure resource.

Internal Service Funds

The two internal service funds have characteristics that make a prudent working capital level for these two funds significantly distinct from each other.

- 80 Information Services Fund
- 85 Insurance Services Fund

The Information Services fund does have staffing and operating costs but in its case maintaining a two month operating reserve is not in the interest of the City because it would unnecessarily inflate the cost of services delivered to all the departments in the organization. Internal service funds such as this one seek to roughly offset annual costs with annual departmental contributions and maintain an inflation-based annual cost increment so that the cost levels are stable and predictable across the City. To this end, the Information Services fund will incorporate a reserve target to include capital investments and funds for extraordinary retirement costs and begin to fund this reserve in the next five years (in or prior to the FY2025-26 budget cycle).

Insurance Services reserves should be tied to our workers comp experience rate and combined deductible and out of pocket cost trends for the general liability cost. Insurance industry standards require 8% to 10% of annual revenue held in reserve. Using 10% of Insurance Services Fund costs as a guide, this internal service fund has been holding excess reserves at more than 10 times that minimum. In the budget cycles most proximate to this policy update (fiscal years 2018-19 through 2020-21) strategies to reduce excess reserves have been enacted including returning dollars to the funds that contribute annually for insurance services and paying for City positions that play risk mitigation roles serving the entire organization. For both internal service funds, distributions back to the departments that fund their operations may be made in the event either holds cash in excess of reserve needs. These distributions are based on proportions the departments pay in. Any distribution will be discussed as part of the annual budget process.

Internal Service Fund reserve levels and any annual distributions back will be approved by the Council in the annual budget appropriation.

Policy Review

On occasion, funds are added to the City's financial footprint to meet the needs of new projects, new debt issuances and new services. Specific minimum fund balance targets or reserve requirements may also change with time. The Reserve and Fund Balance policy will be revised periodically to remain current and relevant. An annual review of the status of fund balance levels will be included in annual budget documents. This review may spark proposals from staff or the Budget Committee for the Council to consider changes to the policy as needed.