Memorandum

Financial Services

Date: December 3, 2008

To: Mayor and Council

From: Jerry Hart, Financial Services Manager (350-8505)

Subject: Proposed Financial Policy Revisions

At the December 1st Budget Workshop, the council directed staff to prepare revisions to our current financial policies that would further assist in ensuring the long-range financial sustainability of the city. This goal would in part be accomplished through implementation of a new requirement of staff to bring forward a five-year financial plan for the General Fund that is balanced in each year of the plan. In general, the proposed revisions can be summarized as follows:

- **Recurring expenditures must equal recurring revenues (i.e., balanced budget requirement)**

  This is a fundamental principle of sound budgeting practices which already exists in our current policy. A proposed policy revision simply extends this requirement to the five-year planning horizon of our long range financial plan. Additionally, a proposed revision clearly describes actions to be taken in the event (such as the current economic crisis) that recurring expenditures exceed recurring revenue. In such events, the drawdown of unrestricted fund balance is allowed in the short-term to temporarily fund non-recurring expenditures as long as it is in accordance with our fund balance reserve policies.

- **Maintains an unrestricted General Fund reserve target of 25% of revenue**

  This 25% reserve level has been maintained by the city for at least 25 years. The purpose of establishing the reserve at this level has been to provide some level of financial protection to the city against significant economic change or unanticipated emergencies. During times of financial stress, the policy revisions define the minimum level (20% of revenue) to which we will allow our reserve level to fall while we are addressing our financial challenges. Conversely, the policy revisions also would define the maximum level (30% of revenue) to which we would allow our reserve level to grow to provide an extra layer of protection as deemed warranted. (In the past, the separate “rainy day” reserve provided this extra layer of protection. Increasing the unrestricted reserve balance to the maximum level would serve the same purpose.)

Attached are the proposed revisions to the financial policies for your review and consideration. Staff is seeking direction on the proposed changes. Upon final direction, staff will place a financial policies resolution on a future formal agenda for council action. If you have any questions, please feel free to contact me.

City of Tempe Financial Policies
(per Resolution no. 2004.58, approved June 23, 2004)
For Discussion of Possible Policy Changes
December 2008

(A) Operating Budget Policies

Section 1a. Recurring City revenues will be sufficient to support recurring expenditures. Insert: IN THE EVENT THAT RECURRING EXPENDITURES EXCEED RECURRING REVENUES, NON-RECURRING DRAWDOWNS OF UNRESTRICTED GENERAL FUND BALANCE RESERVES ARE PERMITTED TO THE EXTENT THAT THEY ARE DONE IN COMPLIANCE WITH SECTION 1C OF CITY FINANCIAL POLICIES. ~~, with no draw-down of fund balances to support current operations.~~

Section 2a. Each enterprise operation of the City will maintain revenues, excluding development fees, sufficient to support the annual recurring costs of the enterprise operation and any reserve requirements established herein.

Section 3a. The City shall conduct annual rate reviews of its enterprise fund operations as part of its annual budget program.

Section 4a. Charges for services and other revenues will be reviewed on a scheduled basis and adjusted as deemed necessary to respond to cost increases or any other changing circumstances, all subject to the approval of the City Council.

Section 5a. A five-year long-range financial forecast, incorporating both revenues and expenditures of all City funds will be updated annually and presented to the City Council prior to the start of the City budget process. EACH YEAR OF THE FORECAST WILL BE BALANCED AS NECESSARY TO MAINTAIN THE FINANCIAL RESERVE LEVELS STIPULATED IN SECTION 1C OF CITY FINANCIAL POLICIES.

(B) Financial Reporting Policies

Section 1b. Accounting systems will comply with the standards issued by Government Accounting Standards Board and the Government Finance Officers Association.

Section 2b. An annual audit will be conducted on the City's Comprehensive Annual Financial Report by an independent certified public accounting firm.

Section 3b. Full disclosure of all financial activities and related matters will be provided in the annual financial statements and bond presentations.

Section 4b. Financial systems and procedures will be maintained to monitor expenditures, revenues and program performance on an ongoing basis.

Section 5b. The City shall comply with the state and federal regulations concerning financial management and reporting.

(C) Reserve Policies

Section 1c. An unrestricted General Fund balance reserve TARGET of ~~not less than~~ 25% of total annual General Fund revenues will be maintained for protection from potential emergencies and unforeseen circumstances. FOR PURPOSES OF DETERMINING YEARS TWO THROUGH FIVE OF THE FIVE YEAR LONG RANGE FORECAST, THE FOLLOWING RESERVE LEVELS SHALL APPLY:

YEAR TWO:	23% TO 27%
YEAR THREE:	22% TO 28%
YEAR FOUR:	21% TO 29%
YEAR FIVE:	20% TO 30%

IN THE EVENT THAT THE UNRESTRICTED RESERVE IS DRAWN BELOW 25% TO ADDRESS FINANCIAL CHALLENGES, EVERY EFFORT SHALL BE MADE TO RESTORE, AT MINIMUM, THE RESERVE TO THE TARGETED LEVEL.

Section 2c. An unrestricted retained earnings reserve of no less than twelve months of water/wastewater revenue shall be maintained in this enterprise operation to provide protection from potential emergencies and unforeseen circumstances, plus make provisions for adequate debt service coverage and cash flow for outstanding utility bonds.

Section 3c. An unrestricted retained earnings reserve of no less than 15% of golf enterprise revenue and 10% of solid waste enterprise revenue shall be maintained in these operations to provide protection from potential emergencies and other unforeseen circumstances.

Section 4c. Each annual operating budget will include a contingency appropriation sufficient to provide for temporary financing of unforeseen needs of an emergency nature for that year. The desired level of the contingency appropriation each year shall be based on the average of the three prior years' experience levels but no less than 2% of fund revenue for the current fiscal year.

Section 5c. Insurance reserves shall be maintained at a level which, together with any purchased insurance, will adequately indemnify the City's capital assets and its officers and directors against loss. Reserves for self-insurance shall be based on actuarial studies.

Section 6c. Fund balances above established reserve requirements may be used for one-time expenditures such as capital equipment or increased pay-as-you-go financing for the capital improvements program.

Section 7c. The City shall maintain a Debt Service Reserve in the amount of at least 8% of total outstanding tax-supported debt.

(D) Cash Management Policies

Section 1d. The investment of City funds shall be structured to ensure the highest levels of security while achieving the maximum return possible as provided for in Section 2-180 of the Tempe City Code.

Section 2d. The City will maintain a strong system of written internal controls designed to protect the investment of public funds.

(E) Capital Budget Policies

Section 1e. Estimated costs, potential revenue and funding sources shall be identified prior to any project being submitted for Council approval. A department which anticipates a capital project exceeding its adopted budget shall submit a plan to Council addressing the issue for its prior approval.
Section 2e. A five-year capital improvements program, as required by City Charter, will be developed and updated annually including anticipated funding sources. In addition, a prior year capital project status report shall be presented to the Council for information purposes when the capital improvement budget is considered.
Section 3e. The annual operating budget will provide for the adequate maintenance and the orderly replacement of the capital plant and equipment from current revenue where possible.
Section 4e. Capital improvement operating budget impacts will be coordinated with the development of the Operating Budget. Future operating, maintenance, and replacement costs will be forecast as part of the City's annual long range financial capacity study.
Section 5e. The City may provide for internal, pay-as-you-go financing for its capital improvement program. Funding may come from fund balance reserves or any other acceptable means of funding.

(F) Debt Policies

Section 1f. Debt will be used to finance long-term capital improvements and not used to finance recurring operating expenses. Debt may take the form of:

- **a.** General Obligation debt, supported by property tax revenues
- **b.** Revenue bond debt, supported exclusively by the revenues from a particular City enterprise (water, sewer, golf)
- **c.** Excise tax bonds, supported by general City revenue (i.e. sales tax)
- **d.** Special Assessment Improvement District debt, paid by property owners within the District, and backed by the value of the land and its improvement
- **e.** Short-term borrowing or lease/purchase contracts, supported by operating revenues

Section 2f. In accordance with state law, the total value of General Obligation bonds issued for the purposes of water, wastewater, artificial light, open space preserves, parks, playgrounds, and recreational facilities cannot exceed 20% of the assessed valuation. The total value of General Obligation bonds issued for all other purposes other than those listed above cannot exceed 6% of assessed valuation.
Section 3f. Borrowing for other than capital projects may be pursued only when the project being financed is of a long-term nature and special circumstances are present to justify its utilization.
Section 4f. Debt term should match the useful life of the capital projects funded. The average, weighted bond maturity schedule, on average, should be maintained at or below 15 years or should not exceed the useful life of the assets.
Section 5f. Debt repayment schedules shall be based upon level annual principal and interest payments.
Section 6f. The City will monitor overlapping debt issues by including overlapping jurisdictions debt burden into the City's financial reports.

Section 7f. Authorized debt shall be limited as follows unless authorization is obtained from the City Council to exceed these limits:

- **a.** General obligation bonds shall follow the guidelines established in the Debt Management Plan;
- **b.** Excise tax bonds shall maintain revenue coverage limits of at least 3 times debt service;
- **c.** Improvement District bonds shall not exceed 5% of the City's secondary assessed valuation;
- **d.** Short-term borrowing or lease/purchase contracts must be budgeted for within the annual City Budget.

Section 8f. The City will, unless otherwise justified, use bond proceeds within the established time frame pursuant to the bond ordinance, contract or other documents to avoid arbitrage. The City will maintain a system of recordkeeping and reporting to meet the arbitrage rebate compliance requirement of Federal Internal Revenue Service Regulation 1.148-11.

Section 9f. The City shall adhere to a Debt Management Program. This program will size the City's General Governmental tax supported debt based upon benchmarked criteria in order that the City not take on debt that would adversely affect its budget. These debt ratios will be updated at regular intervals and incorporated into the City's Debt Management Plan. These criteria include:

- **a.** Outstanding General Governmental tax-supported debt per capita
- **b.** Ratio of General Governmental tax-supported debt to the fair market value of Tempe property
- **c.** Ratio of General Governmental tax-supported debt per capita as a percent of per capita personal income.
- **d.** Ratio of General Governmental tax-supported debt service to general governmental expenditures.