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Staff Report

Meeting Date:	September 7, 2022
Agenda No.	Item 5
Agenda Item Title:	Commission Policy Development: Fiscal Reserves
Proposal:	None
Environmental Determination:	Not a project under CEQA
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ANALYSIS

Overview

In 2017, staff worked with the Commission's Policy Committee in exploring development of a fiscal reserve policy. The Policy Committee was unable to recommend a fiscal reserve policy after extensive discussion. (This staff report is largely identical to that prepared in 2017, and is being presented to the Budget Committee for consideration.)

The Commission has evolved from having very small "Fund Balances" on the order of $25,000, to balances that are on the order of $400,000. A fiscal reserve policy would guide staff and the Budget Committee in preparation of future budgets, indicating when Fund Balances (or "reserves") are at appropriate levels.

Staff has prepared a preliminary report describing the variety of reserve mechanisms that the Budget Committee might consider, and is seeking guidance to support drafting a formal policy, if indicated.

Background

Public agencies generally maintain reserve fund accounts, either generally or for specific types of potential expenses, to be used in case of short-term funding gaps. In fact, the Commission often evaluates whether public agencies under its purview maintain adequate fiscal reserves when conducting Municipal Service Reviews.

Even with its diminutive size as a public agency, and given a steady source of primary funding (apportionments from public agencies that enjoy LAFCO oversight), staff believes it prudent for the Commission to evaluate potential contingencies that might require funding outside of the annual budget and apportionment process.

The Commission might also consider another category of use for fiscal reserves: making agency apportionments "even" and predictable over time by using reserves when agency apportionments fall (e.g. when local government agencies experience significant decreases in revenues).

Types of Reserves

In a survey of about two dozen other LAFCOs, staff was able to identify several types and categories of fiscal reserves, though there is no apparent best or even common practice with regard to fiscal reserve policies.

"Categorical Reserves"

Many LAFCOs have budget line items for “categorical reserves”. These accounts typically have a set target, and are specifically intended for only one type of contingency. Examples include:

- A potential litigation reserve, intended to be used when LAFCO is engaged in unforeseen litigation.
- An accrued employee salary or benefit reserve, intended to cover employee costs that have accrued but that are unscheduled. For example, employees may accrue paid vacation time, and seek payment for that time upon retirement, resignation, or termination.
- A general operating reserve, intended to cover Commission operations for some period of time if normal funding sources are interrupted.

“General Reserve” or “Fund Balance”

All LAFCOs surveyed had a budget category that captured accrued funds from the differences between budgeted revenues and expenses, denominated as either a general reserve or a fund balance.

The general reserve/fund balance is notable in that it is undesignated (can be used for any purpose). Although some LAFCOs appear to have a “target” level for a general reserve/fund balance, we could locate no examples of policies that explicitly describe the management of this category.

General reserves/fund balances are also notable in that they can be accessed to reduce agency apportionments – essentially refunded. This facility could be used to “smooth” agency apportionment levels; for example by supplementing revenues when funding agencies are experiencing declining revenues due to economic conditions.

(As an example, the Commission is operating on annual apportionment revenue of about $800,000. If, in an upcoming year, economic conditions resulted in lower property tax revenues for our supporting agencies, the Commission might lower apportionments and supplement the reduction using general reserve funds.)

Discussion

Categorical Reserves

Of the types of categorical reserves described above, staff believes that establishing an accrued employee benefit reserve would be prudent. For example, when the previous Executive Officer resigned in 2015, the payout for accrued vacation leave was not factored into the budget for that fiscal year.

Staff would propose seeking an annual valuation of accrued employee benefits and including a line item in future budgets identifying that potential expense. As an alternative, to avoid annual estimates of potential accrued, benefits, the Commission could establish an estimated valuation and maintain that balance subject to review every three or five years.

Of the other categorical reserves described above, staff has some ambivalence.

On its face, maintaining a litigation reserve would appear to provide some insurance against an unforeseen matter where the Commission is subjected to litigation. However, staff has no basis for evaluating what potential there is for unseen litigation, and further, how to ascertain a level of funding that would provide some respite from litigation costs.

Similarly, staff cannot conceive of a case whereby expected revenues were not received from apportioned agencies, or a case where other expenses (non-litigation) would be unforeseen.

For both of these categories, staff does note that the Commission has express regulatory authority to seek funding from the County, in the form of a loan against future apportionments (which the Commission can set for each fiscal year), to cover unforeseen budgetary shortfalls. Staff has yet to confirm whether the County has the facility to provide loans, however.

General Reserve

Staff recommends that the Commission establish the practice of designating the accruals from differences in budgeted revenues and expenses as a “general reserve” rather than a “fund balance”.

(A review of recent budgetary performance indicates that the preponderance of the accrued funds has come from generally lower expenditures than planned for in annual budgets, and from application fees, which are not included in the budget process.)

Leaving the general reserve undesignated allows the Commission to allocate funds to staff projects, initiatives, and activities, or other contingencies, at the Commission’s discretion.

Staff seeks Budget Committee guidance on what level of general reserve to target. Some LAFCOs appear to set a defined funding target, others appear to set a target as a percentage of the total Commission budget.

One possible approach would be to set a target range for the general reserve, e.g. between 25% and 50% of the current fiscal year budget. If funds accrued above the 50% target, these would be refunded to apportioning agencies.

For reference, here is a history of the Budgeted (not actual) fund balance (what we are now recommending as “general reserves”) levels for Sonoma LAFCO since the 2010-11 FY:

Fiscal Year	Ending Fund Balance	% of Budget
2010-11	$ 38,345	8 %
2011-12	$ 51,603	11 %
2012-13	$ 39,209	8 %
2013-14	$ 32,456	6 %
2014-15	$ 64,404	11 %
2015-16	$ 48,904	9 %
2016-17	$ 289,142	46 %
2017-18	$ 293,858	47 %
2018-19	$ 106,260	13 %
2019-20	$ 148,768	19 %
2020-21	$ 347,244	41 %
2021-22	$ 516,417	55 %

Staff is keenly aware that accumulation of a large fund balance presents an opportunity to lower agency apportionments, so setting a target level would assist in future budget preparations, triggering reduced apportionments when a target level is reached.

RECOMMENDATION

Staff is seeking guidance and direction from the Budget Committee regarding whether a "Fiscal Reserve Policy" should be prepared, and what features the policy should have.