

## **RESERVES POLICY**

### **Reserves Available to the General Fund**

#### **Introduction**

The County of Orange Reserves Policy, Phase I, inventoried the existing reserves available to the General Fund and guides the creation, maintenance and use of reserves. It provides flexibility to the County in dealing with future planned capital expense needs, unanticipated or cyclical economic conditions, emergencies, catastrophes, temporary cash flow shortages, unexpected large one-time expenses, opportunities to use funds to produce future ongoing savings and some level of protection against statutory changes to County revenues.

Phase I of the reserves policy covers reserves and reserve-type funds available to the County General Fund. Phase II will cover non-general funds and departmental (program-restricted) reserves.

Examples of recent events demonstrating the need for reserves include the Governor's original FY 04-05 proposed budget that would have caused an ongoing \$62 million reduction of the County's general purpose revenues. This was subsequently reduced to a reduction of \$27.7 million per year for two years. In addition the State passed on a share of the Federal child support system penalty (\$4 million per year for two years), deferred reimbursement of mandated cost claims, and FY 03-04 Vehicle License fees were reduced by \$26.5 million; repaid by the State in July 2005.

This policy includes both formal and informal reserves. It includes provisions for reserves as reported on Schedule 3 of the County Budget Book compiled by the Auditor-Controller, appropriated reserve-type funds and reserve-type funds held by the Orange County Employees Retirement System (OCERS). A summary schedule of the reserve balances, additions, uses and target amounts is attached.

#### **Provisions for Reserves**

Provisions for Reserves are formal reserves as reported on Schedule 3 of the Auditor-Controller Budget Book. There is currently a Reserve for Contingencies and a Strategic Priority Reserve (also labeled Reserve for Operations [Strategic Plan]) with two parts (one for specific capital improvements and one unallocated).

Reserve for Contingencies: This reserve was established through the Strategic Financial Plan process. It is normally modified at the time of adopting the budget (Government Code Section 29085). Changes to reserve amounts at other times require a 4/5 vote of the Board of Supervisors. A 4/5 vote is also required to make such reserves available for appropriation to expend these funds if needed during the fiscal year (Government Code Section 29130). The purpose and use of this reserve is to cover unanticipated and severe economic downturns, major emergencies or catastrophes that cannot be covered with existing appropriations. The target

amount for this reserve is 10% of ongoing annual General Purpose Revenues (excludes fund balance available and one-time amounts and transfers) or \$42,460,000. The 10% compares to Government Finance Officers Association (GFOA) guidelines of 5% to 10% and to surrounding counties that use targets from 5% to 15%. The current balance is \$23,000,000, a \$19.5 million variance from target. Future Strategic Financial Plans may recommend changes to this reserve within the target amounts as funds become available.

Strategic Priority Reserve—Capital: This reserve was established through the Strategic Financial Plan process. It is normally modified at the time of adopting the budget. Changes to reserve amounts at other times require a 4/5 vote of the Board of Supervisors. A 4/5 vote is also required to make such reserves available for appropriation to expend these funds if needed during the fiscal year (Government Code Section 29130). The purpose and use of this reserve is currently for specific items shown on the attached detail sheet. In some cases, the amounts represent “down payments” on the capital improvements that will need to be augmented by other funds. Funds would be withdrawn from this reserve and appropriated in the fiscal year in which the projects are expected to be encumbered or expended. The current balance is \$16,844,885. Seven million was added in the First Quarter Budget Report, and \$3 million is anticipated for use this fiscal year. Future Strategic Financial Plans may recommend changes to the projects and/or amounts in this reserve.

Strategic Priority Reserve—Unallocated: This reserve was established through the Strategic Financial Plan process and built up with periodic additions of unanticipated General Fund Balance available at the close of prior fiscal years. It is normally modified at the time of adopting the budget. Changes to reserve amounts at other times require a 4/5 vote of the Board of Supervisors. A 4/5 vote is also required to make such reserves available for appropriation to expend these funds if needed during the fiscal year (Government Code Section 29130). The purpose and use of this reserve is to provide flexibility to the County in dealing with future planned capital expense needs, unanticipated or cyclical economic conditions, emergencies catastrophes, unexpected large one-time expenses and opportunities and some level of protection against statutory changes to County revenues. The balance after the second year of reductions from the FY 04-05 local government revenue shift is \$44,950,263. Via Board approval of the First Quarter Budget Report, \$50.5 million was added to this reserve. Future Strategic Financial Plans may recommend changes to this reserve as funds are needed or become available.

### **Appropriated Reserve-type Funds**

These are informal reserve amounts annually appropriated in the budget. There are currently four of these: Vacancy Factor & Miscellaneous Reserve, Provision for Contingencies, Debt Prepayment Fund and Designated Special Revenue Fund.

Vacancy Factor & Miscellaneous Reserve: This appropriation is contained in the 004 Miscellaneous Budget within the County General Fund. It was first established in the FY 99-00 budget when the CEO implemented a salary & wages budget policy based on historical vacancy factors. The purpose and use of this reserve is to provide additional appropriations to a general fund department should its actual vacancy factor fall below the budgeted vacancy factor for most of the fiscal year and the department has insufficient appropriations to make it to the end of the fiscal year. It may also be used for significant unanticipated emergencies, catastrophes, one-time expenses and opportunities. A 4/5 Board of Supervisors vote would be required if these funds are transferred outside the general fund. The current balance is \$5,000,000. If a portion of the reserve is used during any fiscal year the full \$5,000,000 is re-budgeted the following fiscal year. One million was added to this reserve in the First Quarter Budget Report but is already anticipated for use in the current fiscal year. Future Strategic Financial Plans may recommend changes to the current balance as funds are needed or become available.

Debt Prepayment Fund (14V): This fund was established through the Strategic Financial Plan process during FY 99-00, with the target amount for this reserve set at \$122,625,000. The purpose and use of this reserve was to reduce the County's amount of debt and realize corresponding savings in principle and interest payments. A 4/5 Board of Supervisors vote would be required if these funds are transferred out of this fund. In July 2005, the County refinanced its bankruptcy debt and utilized the majority of the reserves. The current balance is \$62,929. It is anticipated that this fund will be closed in the Third Quarter FY 05-06 as a result of the recent refinancing.

Designated Special Revenue Fund (15S): This fund was established in FY 96-97 and is now governed through the Strategic Financial Plan process. The purpose and use of this fund is to cover temporary cash flow shortages in other County funds as authorized annually by the Board and to fund strategic priorities identified in the Strategic Financial Plan. These priorities currently include deferred maintenance, projects to remedy Americans with Disabilities Act (ADA) infrastructure deficiencies and partial funding for a new regional animal care facility. The June 30, 2005 balance was \$20,928,004. Future Strategic Financial Plans may recommend changes to these projects and amounts as new priorities are identified and funds are needed or become available.

### **Reserve-type Funds held by OCERS**

Currently there is a reserve held by the Orange County Employees Retirement System on behalf of the County. This reserve is called the Retirement Investment Account.

Retirement Investment Account: This account was established with the proceeds of the 1994 Pension Obligation Bonds. The purpose and use of this account includes the offset of County retirement expenses and reducing the County's share of the retirement system unfunded liability. The balance of this account as of June 30, 2005 was \$152,475,205. A portion of retirement system earnings are credited to this account. The FY 05-06 budget plans on using \$11,000,000 (a portion of the current year estimated interest earnings) of this account to offset FY 05-06 retirement expenses. Future debt defeasance strategy and Strategic Financial Plans may recommend changes to the use of this account. Use of this account to offset the County's retirement expenses may free up existing or future general fund resources for other purposes.

### **Phase II**

Phase II of the County's Reserves Policy will cover non-general funds and departmental (program-restricted) reserves. Due to the fact that Phase II will include over 65 individual funds or accounts, it will be completed in about 12 months. Quarterly Budget Reports may include status updates of the Phase II project.

## SCHEDULE OF RESERVES

Fund/ Agency Code Name	6/30/05 Balance	FY 05-06 Add	FY 05-06 Use	FY 05-06 Balance	Target	Variance From Target
<b><u>Provisions for Reserves (1)</u></b>						
Reserve for Contingencies	\$ 18,000,000	\$ 5,000,000	\$ -	\$ 23,000,000	\$ 42,460,000	\$ 19,460,000
Strategic Priority Reserve--Capital	16,844,885	7,000,000	(3,000,000)	20,844,885		
Strategic Priority Reserve--Unallocated	54,742,274	50,500,000	(9,792,011)	95,450,263		
<b><u>Appropriated reserve-type funds</u></b>						
004 Vacancy Factor & Miscellaneous	5,000,000	1,000,000	(1,000,000)	5,000,000		
14V Debt Prepayment Fund	116,178,472	37,762	(116,153,305)	62,929		
15S Designated Special Revenue	20,928,004	6,054,982	(1,612,000)	25,370,986		
<b><u>Reserve-type funds held by OCERS (2)</u></b>						
Retirement Investment Account	152,475,205	11,000,000	(11,000,000)	152,475,205		
<b>Total General Reserves</b>	<b>\$ 384,168,840</b>	<b>\$ 80,592,744</b>	<b>\$ (142,557,316)</b>	<b>\$ 322,204,268</b>		

(1) Excludes accounting reserves for cash difference, inventory of materials & supplies, imprest cash and loans. These accounting reserves are maintained by the Auditor-Controller and are governed by generally accepted accounting principles and tie to specific balance sheet accounts.

(2) OCERS - Orange County Employees Retirement System

### Reserve for Contingencies

Fund/Agency Number	100
Authority	Government Code Section 29085
When established	Budget Adoption
Budgeted	Schedule 3 of the County Budget
Board approval required	4/5 vote to change amount during the year or to appropriate and make available for use during the year (Government Code Section 29130)
Purpose	Unanticipated and severe economic downturns, major emergencies or catastrophes that cannot be covered with existing appropriations
Target	10% of ongoing annual General Purpose Revenues (excluding FBA, transfers & other one-time revenue) or, currently, \$42,460,000
Expiration Date	Ongoing
Current Balance	\$23,000,000
Variance from target	\$19,460,000
Interest Earnings	Credited to General Fund
Plan for reducing the variance	Combined with Provision for Contingencies reserve in 2005. Future Strategic Financial Plans may identify additional available funds.

**Strategic Priority Reserve—Capital**

Fund/Agency Number	100
Authority	Adopted Strategic Financial Plan (SFP)
When established	June 20, 2004
Budgeted	Schedule 3 of the County Budget
Board approval required	4/5 vote to change amount during the year or to appropriate and make available for use during the year
Purpose	Specific items as shown below
Target	N/A
Expiration Date	Project completion
Current Balance	\$16,844,885
Variance from target	N/A
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

Reserve Account Detail

	6/30/2005 Balance	FY 05-06 Add	FY 05-06 Use	FY 05-06 Balance	FY 06-07 Activity	FY 06-07 Balance
CAPS Upgrade	\$ 5,000,000	\$ 5,000,000	\$ (1,500,000)	\$ 8,500,000	TBD	\$ 8,500,000
Assessment Tax System	9,200,000	2,000,000	(1,500,000)	9,700,000	TBD	9,700,000
Computer System	2,200,000	-	-	2,200,000	TBD	2,200,000
Los Pinos Land Acquisition	444,885	-	-	444,885	TBD	444,885
<b>Total</b>	<b>\$ 16,844,885</b>	<b>\$ 7,000,000</b>	<b>\$ (3,000,000)</b>	<b>\$ 20,844,885</b>	<b>\$ -</b>	<b>\$ 20,844,885</b>

**Strategic Priority Reserve—Unallocated**

Fund/Agency Number	100
Authority	Adopted Strategic Financial Plan (SFP)
When established	1996
Budgeted	Schedule 3 of the County Budget
Board approval required	4/5 vote to change amount during the year or to appropriate and make available for use during the year
Purpose	Provide flexibility to the County in dealing with future planned capital expense needs, unanticipated or cyclical economic conditions, emergencies catastrophes, unexpected large one-time expenses and opportunities, and some level of protection against statutory changes to County revenues
Target	Driven by the SFP
Expiration Date	N/A
Current Balance	\$44,950,263
Variance from target	N/A
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

**Vacancy Factor & Miscellaneous Reserve**

Fund/Agency Number	100-004
Authority	Board adoption of the Final Budget
When established	June 29, 2004
Budgeted	Yes
Board approval required	Majority vote to transfer appropriations within the General Fund. 4/5 vote to transfer out of the General Fund.
Purpose	Provide additional appropriations to a general fund department should its actual vacancy factor fall below the budgeted vacancy factor for most of the fiscal year and the department has insufficient appropriations to make it to the end of the fiscal year. May also be used for significant unanticipated emergencies, catastrophes, one-time expenses and opportunities.
Target	\$5,000,000
Expiration Date	Re-budgeted annually
Current Balance	\$5,000,000
Variance from target	\$ 0
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

### Debt Prepayment Fund

Fund/Agency Number	14V
Authority	Board Adoption of the Final Budget
When established	June 29, 2004
Budgeted	Yes
Board approval required	4/5 vote to transfer funds out of 14V
Purpose	Reduce the County's amount of debt and realize corresponding savings in principle and interest payments
Target	N/A
Expiration Date	When debt is defeased; anticipated closure in 3 <sup>rd</sup> Quarter 05-06 as a result of debt refinancing in July 2005
Current Balance	\$62,929
Variance from target	N/A
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	Bankruptcy debt refinanced in July 2005

**Designated Special Revenue Fund**

Fund/Agency Number	15S
Authority	Board Adoption of the Strategic Financial Plan (SFP)
When established	June 29, 2004
Budgeted	Yes
Board approval required	4/5 vote to transfer appropriations out of Fund 15S
Purpose	To cover temporary cash flow shortages in various County funds as annually authorized by the Board. To fund strategic priorities as identified in the Strategic Financial Plan. See detail below.
Target	N/A
Expiration Date	N/A
Current Balance	\$20,928,004
Variance from target	N/A
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

Account Detail

	<b>6/30/2005 Balance</b>	<b>FY 05-06 Activity</b>	<b>6/30/2006 Balance</b>	<b>FY 06-07 Activity</b>	<b>6/30/2007 Balance</b>
Relocate Animal Shelter	\$ 4,546,375	\$ (250,000)	\$ 4,296,375	\$ -	4,296,375
Deferred Maintenance/ADA	5,262,157	(1,362,000)	3,900,157	(3,860,000)	40,157
Future Strategic Priorities	11,119,472	-	11,119,472	118,669	11,238,141
From Fund 13N - Loan Repayment	-	6,054,982	6,054,982	2,569,442	8,624,424
<b>Total</b>	<b>\$ 20,928,004</b>	<b>\$ 4,442,982</b>	<b>\$ 25,370,986</b>	<b>\$ (1,171,889)</b>	<b>\$ 24,199,097</b>

### Retirement Investment Account

Fund/Agency Number	Held by OCERS
Authority	Board agreement with OCERS
When established	1994
Budgeted	N/A
Board approval required	N/A
Purpose	Helps fund County retirement expenses and reduces the County's share of the retirement system unfunded liability
Target	N/A
Expiration Date	N/A
Current Balance	\$152,475,205 at June 30, 2005
Variance from target	N/A
Interest Earnings	Credited to this account
Plan for reducing the variance	N/A
Other Comments	Use of this account to offset the County's retirement expenses may free up existing or future general fund resources for other purposes.