

RESERVES POLICY

(Reserves Available to the General Fund)

Introduction

The County of Orange General Fund Reserves Policy provides guidance in the creation, maintenance and use of reserves. The policy covers formal and informal reserves, and includes provisions for reserves such as appropriations for contingencies, reserve-like appropriations such as those in Fund 15S, Designated Special Revenues, and reserve-like funds held by others such as the OCERS Investment Account. The policy also recognizes whether funds are legally required or discretionary, or have special restrictions.

The General Fund Reserves policy is designed to provide flexibility to the County and provide:

- Resources to address unanticipated or cyclical economic conditions
- Resources for against emergencies and/or catastrophic events
- Mitigation of the volatility of revenues and expenditures in managing temporary cash flow shortages
- Capacity to cover unexpected large one-time expenses and opportunities
- Capacity to fund capital investments
- Capacity to minimize borrowing costs and
- Capacity to provide some level of protection against statutory changes to County revenues and impacts from Federal and State actions

Past examples of events demonstrating the need for reserves include ongoing State budget actions that have reduced County revenue and deferred County cash flows. Such actions have become routine, beginning in FY 2004-05 when State budget action caused an ongoing \$27.7 million reduction of the County's general purpose revenues for two years. The State has routinely deferred or eliminated reimbursement of mandated cost claims and in FY 2003-04 Vehicle License fees were reduced by \$26.5 million and not repaid by the State until July 2005. In FY 2010-11 the delayed adoption of the State budget resulted in deferred funding to County operated State mandated programs. While some funding is projected in this latest budget, other funding will be reduced or cut.

The state of the current economy provides another example of the importance of having reserves. Use of reserves has been necessary since 2007 to aid Departments in offsetting the decrease in revenue growth, reductions from the State, and the increased cost of doing business.

The County has a variety of reserve funds available to both the General Fund and Non General Funds including:

- Reserves for Contingencies
- Reserves for Capital Projects
- Strategic Plan Reserves
- Reserve-like Funds
- Reserve-like Appropriations
- Department Type Reserves

The first three types of the County General Fund reserves are reported on Schedule 3 of the Auditor-Controller Budget Book.

All of the above are reserves normally modified at the time of the budget adoption (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 County has provided for General Fund Reserves (as reported on Schedule 3), developing specific targets for each reserve type based upon recommendations by The Government Finance Officers Association (GFOA) and best practices based upon review of reserve policies implemented by other local governments. The County is currently proposing a change in the methodology for establishing reserve targets based on a recently released “Best Practice” position paper issued by the GFOA. GFOA’s current recommendation, states that “at a minimum, general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.”

In addition to the update to the GFOA recommendation, in February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. This new standard, does not affect the calculation of fund balance, but it does shift the focus of fund balance reporting from the availability of fund resources for budgeting to the extent to which the government is bound to honor constraints related to the specific purposes for which amounts in the fund can be spent. Where funds were previously reported as reserved or unreserved, they will now be categorized as non-spendable, restricted, committed, assigned and unassigned. The new standard, to be implemented July 1, 2011 provides the County with the opportunity to review all reserve funds and undesignated fund balance to determine if there is opportunity to improve the way we manage reserves, such as moving other, small funds such as 15S or Departmental Funds, to the General Fund.

To that end, the County Executive Office is requesting that the Board:

- (1) Approve the implementation of the GFOA recommended best practice for funding reserves as summarized above and further defined below as it relates to the County’s specific financial position, and

- (2) Direct the County Executive Office to look at how reserve funds are currently managed County-wide to determine if there are opportunities to better manage and consolidate resources while still maintaining appropriate designations and flexibility.

Reserve Targets and Descriptions

Formerly, reserve targets were established independently of other reserves. Under the new GFOA recommended practice, The County would establish an overall target, and allocate the calculated target among the classes of reserves as appropriate. The County may fund more or less to each reserve class, for a variety of reasons such as its current financial condition, the need to set aside for particular goals or directives, the need to bridge one-time gaps, etc. The goal is to ensure there is a prudent reserve balance that is maintained and replenished timely.

In implementing the GFOA’s best practice, the County has elected to establish a funding target based upon two months of general fund operating revenues. Analysis of the average of two months of operating revenues for FY 2008-09 and FY 2009-10 as well as FY 2010-11 adopted budgeted revenues, yielded a funding target of approximately 16.7%.

As such, the current year target is set at two months (approximately 16.7%) of general fund operating revenues as budgeted in FY 2010-11 as follows:

General Fund Budgeted Revenues FY 2010-11	\$2,823,471,620
Less Non-Operating & One-Time Items	<u>(359,642,596)</u>
Net FY 2010-11 Operating Revenues	\$2,463,829,024
Target – 2 Months (annualized)	<u>\$ 410,638,170</u>

The table below summarizes the current targets by class (see discussion below for calculation). When compared to the overall target, General Fund reserves are \$100,818,544 below the new target.

Reserve Classification	Projected Balance 6/30/11	% of Total
Reserve for Contingencies	\$ 61,300,000	19.8%
Reserve for Capital Projects	12,376,181	4.0%
Strategic Plan Reserve	119,884,159	38.7%
Vacancy Factor/Misc. Reserve	5,000,000	1.6%
Designated Special Revenue	5,101,542	1.6%
OCERS Investment Account	106,157,744	34.3%
Total – Reserves Available to GF:	\$ 309,819,626	100.0%
Overall Target	410,638,170	n/a
Over/(Under) Funded @ 6/30/11	(\$ 100,818,544)	n/a

The significant variance below target is primarily due to the increase in the reserve target to 16.7% of General Fund revenues. It is also an impact of (1) the result of increasing costs that have outpaced revenue growth and (2) the use of one-time sources to support ongoing operations over the last three years in an effort to mitigate the impact a declining economy while Departments looked for ways to trend down and make structural changes.

Provisions for General Fund 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, a Reserve for Capital Projects, and a Strategic Plan Reserve. The reserves defined below are General Fund Reserves or specific fund types that can offset General Fund operations.

Reserve for Contingencies

This reserve was established through the Strategic Financial Plan process. 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 recommended to change from 10% to 15% of ongoing annual General Purpose Revenues** (excluding fund balance available and one-time amounts and transfers), or \$91,445,837. This compares to Government Finance Officers Association (GFOA) guidelines for funding contingencies at 15% or higher. A review of surrounding counties found contingency targets were set from 5% to 15%. The projected June 30, 2011 balance is \$61,300,000, approximately \$30,145,837 below the revised target.

The 2007 Santiago wildfires and 2008 wildfires, highlight the ongoing need for re-evaluating the potential for catastrophic events within the County. A significant event could create the need for a higher funding level of this reserve.

Please see the following summary table:

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	15% of ongoing annual General Purpose Revenues (excluding FBA, transfers & other one-time revenue) or, currently, \$91,445,837
Expiration Date	Ongoing
Projected Balance @ June 30, 2011	\$61,300,000
Variance from target	\$30,145,837 below target
Interest Earnings	Credited to General Fund
Plan for reducing the variance	This Strategic Financial Plan recommends no change to this reserve.

Reserve for Capital Projects

This reserve was established through the Strategic Financial Plan process. The purpose and use of this reserve is currently designated for specific projects shown on *Reserved for Capital* Projects detail sheet included in this section of the SFP. In some cases, the amounts represent “down payments” on 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 reserve balance at FY 2008-09 year-end was \$14,087,416 and declined to \$12,376,181 at June 30th of FY 2009-10. There are no planned additions to or use of funds in FY 2010-11.

There currently is no specific target for this reserve; however, we recommend establishing a target of \$50,000,000 based upon evaluation of the November 2010 Capital Improvement Plan. The projected June 30, 2011 balance of \$12,376,181 is \$37,623,819 below that level.

Please see the following summary table:

Reserve for Capital Projects	
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	\$50,000,000
Expiration Date	Upon completion of designated projects
Projected Balance @ June 30, 2011	\$12,376,181
Variance from target	\$37,623,819 below target
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	This Strategic Financial Plan recommends no change to this reserve.

Strategic Plan Reserve

This reserve was established through the Strategic Financial Plan process and built up with periodic additions of unanticipated General Fund FBA at the close of prior fiscal years. In the past, it was normally modified at the time of adopting the budget. In conjunction with the adoption of the FY 2010-11 Budget in June 2010, the Board directed that any future, excess fund balance available at fiscal year end be added to the reserve. 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, unexpected large one-time expenses and opportunities and some level of protection against statutory changes to County revenues. The reserve balance as of FY 2009-10 year-end was \$123,843,926. The current balance (after FY 2010-11 First Quarter Adjustments) and estimated year-end balance after all additions and uses during FY 2010-11 is \$119,884,159. Currently, none of this reserve has been allocated to Strategic Financial Plan requests as evaluation continues related to potential risks and impacts in the current year, FY 2010-11, and Departments and the County Executive Office are still evaluating service needs in the first fiscal year of the plan. Recommendation for usage or changes to this reserve may be made as funds are needed or become available, or as part of the FY 2011-12 annual budget process. The overall target is balanced with this reserve, creating a current year Strategic Plan Reserve Target of \$152,933,047 and a funding shortfall of \$33,048,888.

Please see the following summary table:

Strategic Plan Reserve	
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	\$152,933,047 (Driven by the SFP overall target)
Expiration Date	N/A
Projected Balance @ June 30, 2011	\$119,884,159
Variance from target	\$33,048,888
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

Appropriated Reserve-type Funds

These are informal reserve amounts annually appropriated in the budget. There are currently two of these type funds: Vacancy Factor & Miscellaneous Reserve and the Designated Special Revenue Fund.

Vacancy Factor & Miscellaneous Reserve

This appropriation is maintained in the Agency 004 Miscellaneous Fund budget within the County General Fund. It was first established in the FY 1999-00 budget when the CEO implemented a salary and 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, with \$1,000,000 earmarked by the Board on November 23, 2010 to establish funding for unanticipated annual leave payouts impacting small Departments. If a portion of the reserve is used during any fiscal year the full \$5,000,000 is re-budgeted the following fiscal year. Future Strategic Financial Plans may recommend changes to the current balance as funds are needed or become available.

Please see the following summary table:

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. Effective November 23, 2010, \$1,000,000 set aside per Board Direction to establish an annual leave payout account for unplanned leaves impacting small Departments (100 employees or less).
Target	\$5,000,000
Expiration Date	Re-budgeted annually
Projected Balance @ June 30, 2011	\$5,000,000
Variance from target	\$ 0
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

Designated Special Revenue Fund (15S)

This fund was established in FY 1996-97 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. The fund balance at year-end, FY 2009-10, was \$6,126,452. The estimated year-end balance after all additions and uses during FY 2010-11 is \$5,101,542. Approximately \$4.2 million of the balance in this fund has been earmarked for the proposed relocation of the Animal Care Shelter.

The County Executive Office is currently reviewing this fund for potential consolidation into General Fund Reserves to improve the transparency of reporting on appropriated reserve-type funds. Existing earmarks and designations would not change if the fund was consolidated. Recommendations for change, if any will be brought to the Board for their approval.

Please see the following summary table:

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	\$5,101,542
Expiration Date	N/A
Projected Balance @ June 30, 2011	\$5,101,542
Variance from target	\$0
Interest Earnings	Credited to the General Fund
Plan for reducing the variance	N/A

Reserve-type Funds held by OCERS

OCERS Retirement Investment Account

This is a reserve held by the Orange County Employees Retirement System on behalf of the County which 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 at June 30, 2010 was \$100,668,036 and \$106,546,464 at September 30, 2010. The assets held in the Investment Account are invested with the OCERS portfolio. As such, the balance in the account will change based on the performance of the investment assets. The FY 2010-11 budget plans for net use of \$11,000,000 from this account to offset retirement expenses and a projected balance at June 30, 2011 of \$106,157,744.

Please see the following summary table:

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.
Target	\$106,157,744
Expiration Date	N/A
Projected Balance @ June 30, 2011	\$106,157,744
Variance from target	\$0
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.

Department-type Reserves

As summarized in the introduction (see page 33, item 2), the County Executive Office requests the Board's direction to review all reserve funds and undesignated fund balances to determine if there is opportunity to improve the way reserves are managed. This review would include the possibility of consolidating in the General Fund, reserve-type accounts held by departments. Examples of these types of funds are Fund 145 Revenue Neutrality and Fund 13W Realignment.

2010 STRATEGIC FINANCIAL PLAN SCHEDULE OF RESERVES

Fund/ Agency Code Name	6/30/10 Balance	FY 2010-11 Add	FY 2010-11 Use	FY 2010-11 Balance	Target (3)	Variance From Target
<u>Provisions for Reserves (1)</u>						
100 Reserve for Contingencies (9815)	61,300,000	0	0	61,300,000	91,445,837	30,145,837
100 Reserve for Capital Projects (9813)	12,376,181	0	0	12,376,181	50,000,000	37,623,819
100 Strategic Plan Reserve (9812)	123,843,926	21,570,286	(25,530,053)	119,884,159	152,933,047	33,048,888
<u>Appropriated reserve-type funds</u>						
004 Vacancy Factor & Miscellaneous	5,000,000	0	0	5,000,000	5,000,000	0
15S Designated Special Revenue	6,126,452	0	(1,024,910)	5,101,542	5,101,542	0
<u>Reserve-type funds held by OCERS (2)</u>						
Retirement Investment Account	100,668,036	16,489,708	(11,000,000)	106,157,744	106,157,744	0
Total General Reserves	309,314,595	38,059,994	(37,554,963)	309,819,626	410,638,170	100,818,544

(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 (uses include market losses impacting investment earnings)

(3) Overall Target per new Policy \$410,638,170. Strategic Plan Reserve Target is calculated by subtracting targets for other reserve categories from the overall target.

2010 STRATEGIC FINANCIAL PLAN

Reserved for Capital Projects

	6/30/2010 Balance	FY 2010-11 Activity	6/30/2011 Balance	FY 2011-12 Activity	6/30/2012 Balance	FY 2012-13 Activity	6/30/2013 Balance	FY 2013-14 Activity	6/30/2014 Balance	FY 2014-15 Activity	6/30/2015 Balance	FY 2015-16 Activity	6/30/2016 Balance
General Fund (9813)													
Assessment Tax System (0002)	731,296	(731,296)	0	0	0	0	0	0	0	0	0	0	0
Computer System (0003)	2,200,000	0	2,200,000	0	2,200,000	0	2,200,000	0	2,200,000	0	2,200,000	0	2,200,000
Los Pinos Land Use (0004)	444,885	0	444,885	0	444,885	0	444,885	0	444,885	0	444,885	0	444,885
Criminal Justice Facilities (0005)	5,000,000	0	5,000,000	0	5,000,000	0	5,000,000	0	5,000,000	0	5,000,000	0	5,000,000
Undesignated Capital Projects	4,000,000	731,296	4,731,296	0	4,731,296	0	4,731,296	0	4,731,296	0	4,731,296	0	4,731,296
Total	12,376,181	0	12,376,181										
Designated Special Revenue Fund 15S													
Relocate Animal Shelter	4,167,438	0	4,167,438	0	4,167,438	0	4,167,438	0	4,167,438	0	4,167,438	0	4,167,438
General Fund Augmentations	1,024,910	(1,024,910)	0	0	0	0	0	0	0	0	0	0	0
Reserve for Loans	934,104	0	934,104	0	934,104	0	934,104	0	934,104	0	934,104	0	934,104
Total	6,126,452	(1,024,910)	5,101,542	0	5,101,542								