



## **Reserves Policy**

### **Obligated Fund Balances and 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, 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 importance of having and maintaining healthy reserve balances became evident during the Great Recession. Temporary utilization of fund balance or reserves aided departments in offsetting decreases in revenue growth, funding reductions from various sources, and accommodating increased costs of doing business.

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

- Resources to address unanticipated or cyclical economic conditions.
- Resources for 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.
- Capacity to provide some level of protection against statutory changes to County revenues and impacts from Federal and State actions.

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

- Fund Balance Assigned for Contingencies - This reserve was established through the Strategic Financial Plan process for the purpose and use of covering unanticipated and severe economic downturns, major emergencies, or catastrophes that cannot be covered with existing appropriations. The current target for this reserve is 15% of ongoing annual General Purpose Revenues.
- Fund Balance Assigned for Capital Projects - This reserve was established through the Strategic Financial Plan process for the purpose and use of funding future capital projects, including information technology projects. Funds are withdrawn from this reserve and appropriated in the fiscal year in which the projects are expected to be encumbered or expended.



- Fund Balance Assigned for Maintenance and Construction - This reserve was established through the quarterly budget report process for the purpose and use of funding of future construction and maintenance projects. Funds would be withdrawn from this reserve and appropriated in the fiscal year in which the projects are expected to be encumbered or expended.
- Fund Balance Assigned for Teeter Loss Reserve - This reserve was established through Board Resolution 14-096 on October 28, 2014 to maintain a balance not less than 25% of the total delinquent secured taxes and assessments for participating entities in the County as calculated by the Auditor-Controller at the end of each fiscal year. This reserve provides flexibility to cover losses that may occur if tax-defaulted property sells for less than the amount necessary to cover outstanding tax and assessment liens on that property. In addition, this reserve may be used to pay down note purchases or cash finance the Teeter plan in the future.
- Fund Balance Assigned for Budget Stabilization - This reserve, established through the quarterly budget report process, ensures prudent reserve levels that are maintained and replenished on a regular basis. The current year target, based on the GFOA's best practice, is set at two months (approximately 17%) of General Fund operating revenues as budgeted in FY 2019-20.
- Reserve-like Appropriations - These are informal reserve amounts annually appropriated in the budget such as the Miscellaneous Contingency Reserve and Annual Leave Payouts.
- Reserve-like Funds - The reserve held by the Orange County Employees Retirement System (OCERS) on behalf of the County and established with the proceeds of the 1994 Pension Obligation Bonds is an example of a reserve-like fund. 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. 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 – These are restricted reserves set aside in non-General Funds for specific purposes. Department type reserves are limited to the purpose and use for which the non-General Fund was established.

All of the aforementioned are reserves customarily modified at the time of budget adoption (Government Code Section 29085) or at fiscal year-end (in accordance with GASB 54 requirements). Changes to reserve amounts at other times require a 4/5 vote of the Board



of Supervisors in order to make such reserves available for appropriation to spend, if needed, during the fiscal year (Government Code Section 29130).

The County has provided for General Fund Obligated Fund Balances, 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’s policy follows GFOA’s current recommendation, which 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.”

As part of the 2010 Strategic Financial Plan, the Board granted the County Executive Office approval to implement GFOA best practice for funding reserves and to continue reviewing the management of those reserve funds. Regular monitoring of reserves ensures effective control and consolidation of resources, if appropriate, while maintaining proper designations and flexibility. There is no request to change the existing reserve policy with this Strategic Financial Plan.

**Reserve Targets and Descriptions**

Under GFOA recommended practice, the County establishes an overall reserve target, and allocates the calculated target among the classes of obligated fund balances as appropriate. The County may fund more or less to each reserve class, for a variety of reasons such as current financial conditions, the need to set aside for particular goals or directives, the need to bridge one-time gaps, etc. The goal is to ensure regular maintenance and replenishment of a prudent reserve balance.

In implementing the GFOA’s best practice, the County elected to establish a funding target based upon two months of General Fund operating revenues to lessen current and future risks such as revenue shortfalls and unexpected expenditures. As such, the current year target is set at two months (approximately 17%) of General Fund operating revenues as budgeted in FY 2019-20 as follows:

|   |                 |
|---|-----------------|
| General Fund Budgeted Revenues FY 2019-20         | \$3,678,513,352 |
| Less: Non-Operating & One-Time Items              | (490,656,801)   |
| Net FY 2018-19 Operating Revenues                 | 3,187,856,551   |
| Target - 2 Months General Fund Operating Revenues | \$ 531,309,425  |

The following table summarizes the current reserves by classification. When compared to the overall target, total General Fund reserves are \$191,529,119 above target, but



projected to fall 18% to \$156,583,326 by the end of the current fiscal year. Moreover, due to strategic and prudent allocation of one-time funding and sources, the Budget Stabilization Reserve for FY 2019-20 is anticipated to meet the GFOA recommended target of \$531,309,425. Going forward, as General Fund budgeted revenues are expected to increase over the five years of the Plan, the goal is to increase the Budget Stabilization Reserve in each year to maintain the GFOA recommended target. Increases to maintain the target could be achieved by allocation of General Purpose Revenue growth, allocation of one-time funding and sources, re-allocation of specific-use reserve balances, or any combination of the three. The 2019 SFP assumes use of General Purpose Revenue growth each year to meet the target amount.

|   | <b>Balance at 6/30/2019</b> | <b>Projected Change</b> | <b>Projected Balance at 6/30/2020</b> |
|---|-----------------------------|-------------------------|---------------------------------------|
| <b>Budget Stabilization Reserve</b>                           |                             |                         |                                       |
| Reserve for Budget Stabilization [Goal = \$531.3M]            | 508,554,912                 | 22,754,513              | 531,309,425                           |
| <b>Budget Stabilization Reserve Target</b>                    | <b>\$ 508,554,912</b>       |                         | <b>\$ 531,309,425</b>                 |
| Stabilization Reserve Over/(Under) Target                     | \$ -                        |                         | \$ -                                  |
| <b>Specific-Use Reserve Classification</b>                    |                             |                         |                                       |
| Catastrophic Event Contingencies [Goal = 15% of GPR = \$128M] | \$ 65,000,000               | \$ -                    | \$ 65,000,000                         |
| Reserve for Capital and IT Projects                           | 84,928,915                  | (32,784,355)            | 52,144,560                            |
| Reserve for Maintenance & Construction                        | 11,600,204                  | (2,161,438)             | 9,438,766                             |
| Teeter Loss Reserve   | 30,000,000                  | -                       | 30,000,000                            |
| <b>Subtotal - General Fund (GF) Specific-Use Reserves</b>     | <b>\$ 191,529,119</b>       | <b>\$ (34,945,793)</b>  | <b>\$ 156,583,326</b>                 |
| <b>Grand Total - General Fund (GF) Total Reserves</b>         | <b>\$ 700,084,031</b>       | <b>\$ (12,191,280)</b>  | <b>\$ 687,892,751</b>                 |

An alternate approach used by some credit rating agencies is to evaluate the County's available fund balance as a ratio of the General Fund's assigned and unassigned fund balances (from the County's Comprehensive Annual Financial Report [CAFR]) as a percentage of total expenditures. A threshold of 15% of expenditures or greater is considered strong. On a Generally Accepted Accounting Principles (GAAP) basis, the County's percentage in FY 2017-18 was 14% of expenditures and the preliminary percentage for FY 2018-19 is 12%. The County prepays its pension contribution and reports the prepaid amount as Nonspendable Fund Balance rather than Unassigned Fund Balance in the CAFR as required by Governmental Accounting Standards Board (GASB) Statement Number 54. However, if the prepaid costs for General Fund short term Taxable Pension Obligation Bonds (POB) were to be considered as available, which they are, the percentages change to 25% and 24% for fiscal years 2017-18 and 2018-19 (preliminary), respectively. The following table demonstrates the available fund balance for FYs 2017-18 and 2018-19 (preliminary):



Amounts in thousands

|                              | 2017-18<br>CAFR [1] | 2017-18<br>CAFR [2] | 2018-19<br>Prelim CAFR [1] | 2018-19<br>Prelim CAFR [2] |
|------------------------------|---------------------|---------------------|----------------------------|----------------------------|
| Fund Balance                 |                     |                     |                            |                            |
| Non-Spendable                | 378,418             | 5,245               | 396,541                    | 1,995                      |
| Non-Spendable-POB            |                     | 373,173             |                            | 394,546                    |
| Restricted                   | 31,815              | 31,815              | 49,989                     | 49,989                     |
| Assigned                     | 179,119             | 179,119             | 147,686                    | 147,686                    |
| Unassigned                   | 219,426             | 219,426             | 196,517                    | 196,517                    |
| Total Fund Balances          | 808,778             | 808,778             | 790,733                    | 790,733                    |
| General Fund<br>Expenditures | 3,181,763           | 3,181,763           | 3,297,168                  | 3,297,168                  |
| Calculated %                 | 14%                 | 25%                 | 12%                        | 24%                        |

[1] Fund balance amounts in CAFR are calculated by Auditor-Controller based on Generally Accepted Accounting Principles (GAAP)

[2] Calculated % assumes that the non-spendable fund balance associated with the County's short term Taxable Pension Obligation Bonds (POB) is available to the General Fund.

**General Fund Obligated Fund Balances**

Obligated Fund Balances are formal reserves and currently include Fund Balance Assigned for Contingencies, Fund Balance Assigned for Operations, Fund Balance Assigned for Capital Projects, Fund Balance Assigned for Maintenance and Construction, Fund Balance Assigned for Teeter Loss Reserve and Fund Balance Assigned for Budget Stabilization. The reserves defined in the following pages are General Fund Obligated Fund Balances that are neither restricted nor committed as defined by Governmental Accounting Standards Board (GASB) Fund Balance Reporting policy.



**Contingencies**

|                                   |   |
|-----------------------------------|---|
| Target                            | 15% of ongoing annual General Purpose Revenues (excluding FBA, transfers & other one-time revenue) or, currently, \$127,575,297 |
| Projected Balance @ June 30, 2020 | \$65,000,000 (7.6% of ongoing General Purpose Revenues)   |
| Variance from target              | \$62,575,297 below target   |

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%.

Please see the following table for specific details of the contingency reserve:

| <b>Contingencies</b>           |  |
|--------------------------------|--|
| Fund 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) |
| Expiration Date                | Ongoing  |
| Interest Earnings              | Credited to General Fund   |
| Plan for reducing the variance | This Strategic Financial Plan recommends no change to this reserve.  |



**Assigned for Capital Projects**

|                                   |                          |
|-----------------------------------|--------------------------|
| Target                            | \$50,000,000             |
| Projected Balance @ June 30, 2020 | \$52,144,560             |
| Variance from target              | \$2,144,560 above target |

Draws from the Capital Project reserve are anticipated in FY 2020-21 based on known requests from departments during the 2019 SFP development process; however, those projects have yet to be submitted for approval by the Board. Planned uses of capital projects reserves in FY 2020-21, without replenishment, will result in an estimated balance at June 30, 2021 of \$37,547,909, which is \$12,452,091 below target. The \$2.1 million to repay OC Waste and Recycling (OCWR) for costs associated with construction of the new Animal Care Center will be repaid by participating cities and added back to reserves.

The following table provides specific details of the capital projects reserve:

| <b>Reserve for Capital Projects</b> |  |
|-------------------------------------|--|
| Fund Number                         | 100  |
| Authority                           | Adopted Strategic Financial Plan (SFP)   |
| When established                    | June 20, 2004  |
| Budgeted                            | Schedule 4 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 |
| Expiration Date                     | Upon completion of designated projects   |
| Interest Earnings                   | Credited to the General Fund   |



| <b>Reserve for Capital Projects (continued)</b> |   |
|---|---|
| Plan for reducing the variance                  | This Strategic Financial Plan recommends no change to this reserve; however, additional contributions to the reserve will be recommended from fund balance and allocated through a First Quarter Budget Report. |

**Assigned for Maintenance and Construction**

|                                   |             |
|-----------------------------------|-------------|
| Projected Balance @ June 30, 2020 | \$9,438,766 |
|-----------------------------------|-------------|

The following table provides specific details of the maintenance and construction projects reserve:

| <b>Reserve for Maintenance and Construction</b> |  |
|---|--|
| Fund Number                                     | 100  |
| Authority                                       | Approved Quarterly Budget Report   |
| When established                                | November 17, 2015  |
| Budgeted  | Schedule 4 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 |
| Expiration Date                                 | Upon completion of designated projects   |
| Interest Earnings                               | Credited to the General Fund   |
| Plan for reducing the variance                  | This Strategic Financial Plan recommends no change to this reserve.                                    |





**Assigned for Teeter Loss Reserve**

|                                   |  |
|-----------------------------------|--|
| Target                            | Varies with fluctuations in delinquent secured taxes and assessments, but use could include the following: possible transfer back to Fund 656 in the event of an economic downturn; pay down notes; future cash financing of Teeter plan |
| Projected Balance @ June 30, 2020 | \$30,000,000   |

The following table provides specific details of the Teeter Loss reserve:

| <b>Assigned for Teeter Loss Reserve</b> |  |
|---|--|
| Fund Number                             | 100  |
| Authority                               | Board Resolution No. 14-096 in accordance with R&T Code 4703.2   |
| When established                        | October 28, 2014   |
| Budgeted                                | Schedule 4 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 |
| Expiration Date                         | N/A  |
| Interest Earnings                       | Credited to the General Fund   |



**Assigned for Budget Stabilization Reserve**

|                                   |               |
|-----------------------------------|---------------|
| Target                            | \$531,309,425 |
| Projected Balance @ June 30, 2020 | \$531,309,425 |
| Variance from target              | Target Met    |

Please see the following table for specific details of the Target reserve:

| <b>Reserve for Budget Stabilization</b> |   |
|---|---|
| Fund Number                             | 100   |
| Authority                               | Approved Quarterly Budget Report  |
| When established                        | November 17, 2015   |
| Budgeted                                | Schedule 4 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  |
| Expiration Date                         | N/A   |
| Interest Earnings                       | Credited to the General Fund  |
| Plan for reducing the variance          | This Strategic Financial Plan recommends no change to this reserve; however, additional contributions to the reserve will be recommended from General Purpose Revenue growth or fund balance and will be allocated through the Annual Budget adoption process and/or the First Quarter Budget Report. |



**Appropriated Reserve-type Funds**

**Miscellaneous Contingency Reserve & Annual Leave Payouts**

These appropriations are maintained in the Budget Control 004 Miscellaneous Fund budget within the County General Fund. The purpose and use of the appropriations is to provide additional appropriations to General Fund Departments through the end of the fiscal year for budgetary shortfalls, unanticipated one-time expenditures, emergencies, and opportunities. The appropriations are typically distributed during the quarterly budget report process and require a 4/5 Board of Supervisors vote for transfers of these funds per Government Code Section 29125(a)(2). The FY 2019-20 beginning balance is \$19,939,811 with an additional \$1,000,000 earmarked by the Board on November 23, 2010 to establish funding for unanticipated annual leave payouts impacting small departments (approximately 100 employees or less). Five to ten million dollars is typically budgeted each year; but the FY 2019-20 balance of \$19.9 million includes potential funding for renovation of the Yale Shelter. Future Strategic Financial Plans may recommend changes to the current balance as funds are needed or become available.

Actions taken during the November 19, 2019 Board meeting resulted in a reduction to the contingency appropriations of approximately \$2.2 million to fund the Property Tax System modernization and additional staffing costs for the Office of Care Coordination organizational change.

Please see the following specific details of the Miscellaneous contingency and Annual Leave Payouts appropriations:

| <b>Miscellaneous Contingency Reserve &amp; Annual Leave Payouts</b> |   |
|---|---|
| Fund/Budget Control Number  | 100-004   |
| Authority   | Board adoption of the Final Budget              |
| Budgeted  | Yes   |
| Board approval required   | 4/5 Board of Supervisors vote to transfer funds |
| Target  | \$10,000,000                                    |
| Expiration Date   | Re-budgeted annually                            |
| Interest Earnings   | Credited to the General Fund                    |



**Reserve Type Funds - OCERS Retirement Investment Account**

The balance of this account at June 30, 2019 was \$143,646,635. 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 and any draws from the account.

|                                   |  |
|-----------------------------------|--|
| Projected Balance @ June 30, 2020 | \$153,701,899 including projected net investment earnings/<losses> and draws |
|-----------------------------------|--|

Please see the following table for specific details of the OCERS Investment Account:

| <b>Retirement Investment Account</b> |                            |
|--------------------------------------|----------------------------|
| Fund Number                          | Held by OCERS              |
| Authority                            | Board agreement with OCERS |
| When established                     | 1994                       |
| Interest Earnings                    | Credited to this account   |