



Item # _____

Meeting Date: April 28, 2015

AGENDA MEMORANDUM

To: Honorable Mayor and Members of Town Council

From: Trish Muller, Finance Director

Title: Discussion and Direction: Fund Balance Reserve Considerations

Executive Summary

At the November 18, 2014 meeting, Council was provided with information regarding Fund Balance Reserve Considerations. Staff was directed, at that time, to continue to work on refining the proposed revisions to Town fund balance policies consistent with recommendations presented and to present Council options for further consideration as part of the strategic planning process.

Reserves are the cornerstone of financial flexibility and they allow the Town to respond to unexpected challenges and opportunities in a timely manner. With prudent financial management and cautious planning, the Town has accumulated significant funds in fund balance. Periodically, it is prudent to evaluate Town policies and determine if they still fit the nature and direction of the Town. Reserves are a critical component of fiscal stability; however as stewards of tax payer and rate payer funds there is a need to examine when it may be appropriate to put the money to use for the community through capital projects, rate considerations or other means. The reserve philosophy should be a balance of conservative, long-term fiscal management and the pursuit of opportunities that benefit the Town and its residents.

The Town's current policy for operating reserves (**Attachment A**) is to maintain 3 months of operating expenses, which includes personnel, supplies and services, in the General Fund and 2 months operating expense in all other operating funds. The policy states the funds are to provide for emergencies. There is currently no guidance in the policy as to what constitutes an emergency or how the funds may be used.

Staff has undertaken a review of the current fund balance reserve policy and considered the level of unobligated fund balances. Staff has reviewed each fund and identified certain funds where there may be a possibility to utilize identified excess funds. The reserve considerations vary by fund as each fund has its own unique aspects.

Based on analysis, the funds fall into two groups:

- funds that may have potential excess reserves to be considered for future opportunities related to increasing growth levels in the Town
 - General Fund \$6.7M
 - Community Center Fund \$619k
 - Employee Benefit Fund \$770k
- fund reserves that are deemed reasonable given the specific fund's needs
 - Conservation Trust Fund, Philip S Miller Trust, Public Art, Police Forfeiture
 - Park/Rec Capital, Municipal Facilities, Fire Capital, Police Capital, Transportation Capital, General Long Term Planning Fund

- Water, Water Resources, Stormwater, Wastewater, Transportation, Development Services, Golf and Fleet Services funds

Based on staff analysis, the Town has adequate financial reserves to maintain a conservative fiscal philosophy while having the flexibility to use funds to capitalize on opportunities if, and when, they arise.

Discussion

Fund balance is a measure of financial resources or available cash in a fund. These balances are categorized by internal and external restrictions imposed on a given fund. Restrictions can be utilized to save money for a future capital project, set money aside for the unexpected, such as the fatal failure of an asset or in anticipation of a natural disaster.

In 2005, Town Council adopted a policy to maintain three months of operating expenses in the General Fund and two months operating in all other operating funds. The intent of the reserve was to protect the town in times of economic downturn. Although these funds are reserved, clear guidance does not currently exist for their use.

Consistent application of the current operating reserve policy and other accumulation of fund balances have resulted in some significant cash balances in certain Town funds. As part of our continuing financial analysis, we monitor these balances for reasonableness to ensure we are being fiscally responsible with tax payer and rate payer funds. While there may not be one specific “right” answer, a detailed prudent review of fund balances shows there is an opportunity to clarify the purpose of restrictions and consider the use of excess reserves for the ultimate benefit of the community.

In order to provide Council with a larger picture of the funds available, and the adequacy of reserves, staff has reviewed the fund balance reserve policies to clarify intentions and also determine recommendations for the reasonableness of fund balance levels.

Staff has analyzed each fund to assess the amount of fund balance available to cover unexpected expense, loss of revenue, or opportunities. In order to guide Council through the discussion, staff has organized the funds into two primary groups: funds that may have potential excess reserves to be considered for use; and, funds that are deemed to have reasonable reserves to sustain the specific fund’s needs.

Funds with potential excess reserves

General Fund

The Town’s **General Fund** is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. The functions accounted for in this fund include general government, police, fire, parks maintenance, zoning and historic preservation, and related capital projects.

2015 Amended Budget	General Fund - Reservations	General Fund - Proposed Reservations
Estimated Beginning Fund Balance	\$ 16,147,857	\$ 16,147,857
Revenues	41,210,952	41,210,952
Expenditures	42,946,081	42,946,081
Estimated Ending Fund Balance	14,412,728	14,412,728
Designations and Reservations		
Contractual Reserve	300,000	300,000
Operating Reserve	9,234,459	-
Operational Capacity Reserve	-	500,000
Revenue Stabilization Reserve	-	1,500,000
Catastrophic Events Reserve	-	1,000,000
Capital Reserve	-	1,765,000
Opportunity Reserve	-	1,000,000
TABOR Reserve	1,646,134	1,646,134
Total	11,180,593	7,711,134
Unobligated Fund Balance	\$ 3,232,135	\$ 6,701,594

The Town's current practice for the General Fund reserves includes three main categories: contractual reserve, operating reserve and TABOR reserve.

Contractual Reserves

Contractual obligations of the Town are shown as a reservation of the General Fund. The amount is \$300,000 in the 2015 proposed budget.

Operating Reserve

Current policy (**Attachment A**) requires a three month operating reserve based on operating expenses, including personnel, supplies and services. As shown above, this equates to \$9,234,459 or about 64% of total General Fund, fund balance. Although the general purpose of this reserve is to provide expense coverage in the event of an unplanned operating occurrence, the specific use of the reserve has not been defined. Part of our analysis in all funds is to determine specific needs for a reserve and be transparent in the designations.

Taxpayer Bill of Rights (TABOR) Reserve

TABOR requires emergency reserves of at least 3% of fiscal year spending (excluding bonded debt service). Local governments are prohibited from the use of these emergency reserves to compensate for economic conditions, revenue shortfalls, salary or benefit increases. If a municipality encounters an emergency that qualifies for the use of the TABOR reserve, the statute requires the municipality to reinstate the TABOR reserve balance in the same fiscal year. Because the language in TABOR does not describe what constitutes an emergency, only describing what the funds may not be used for, it may be concluded that there is an amount of latitude given to municipalities for use of the reserve. It is worth noting that the amounts proposed for Catastrophic Events, Capital Reserve and TABOR total \$4,411,134.

Proposed General Fund Reserves

Revenue Stabilization Reserve - Staff analysis shows that sales tax revenues for the Town have consistently increased over the last four years. Collection history proves the revenue stream is seasonal throughout the year, however not significantly influenced by the economy. Even in the midst of the economic downturn the Town experienced a modest 1.5% decline when other Front Range communities were experiencing an average decline of 6%. During this time, the Town was able to cut expenses, reduce workforce and implement furlough days to offset the decline in revenue; the operating reserve was not used during this period. Fortunately the decline in 2009 – 2010 was minimal

in magnitude and short lived. By doubling the largest amount of decline (1.5% x 2) experienced by the Town over the last six years, staff recommends 3% of the 2015 sales tax estimate, or \$1,140,000 and an additional \$360,000 reserve to account for other revenue streams that may be more volatile than sales tax, such as the motor vehicle tax. The total recommended revenue stabilization is \$1,500,000.

Catastrophic Events Reserve - Another factor to consider in analyzing the sufficiency of the General Fund reserves is the potential for increased expenses due to a natural disaster. Significant expense could be incurred in cleanup efforts and maintenance of public safety throughout the event. Although the Town may receive funding through FEMA, the State and CIRSA during such an event, it is important to have sufficient cash reserves available to meet immediate needs as reimbursements from third parties may not occur until months after the event. Staff recommends \$1,000,000 for current planning purposes.

Capital Reserve - The General Fund also maintains several capital assets which include buildings, structures, improvements, machinery and equipment. In order to plan for unexpected repair or asset failure, Town staff recommends a reserve of 2% of the original value of capital assets in the General Fund, or approximately \$1,765,000.

Opportunity - The Town has been financially able to take advantage of various opportunities over the past couple of years by having adequate reserves. These opportunities include economic development as well as accommodation for interfund loans to cover cash flow needs for a given project. Staff recommends an opportunity reserve in the General Fund in the amount of \$1M to give Council flexibility with various opportunities that may arise or to act as a replenishment option for the Economic Development Fund. In 2011, Town Council established the Economic Development Fund as a sub-fund of the General Fund to account for these development incentive opportunities. Town Council's ongoing commitment to funding incentives to attract and retain businesses and realize job growth includes maintaining \$2M in unobligated funds for this purpose.

Unobligated Fund Balance - Given the considerations and estimates noted above, there is approximately \$6.7M in unobligated General Fund reserves available for Council consideration with upcoming strategic planning. At Council discretion, these funds could be used to fund capital projects or used as an interfund loan to another fund to cover cash flow needs for capital projects.

Community Center Fund

The Community Center Fund accounts for the general operations of the Town's recreational facilities including a recreation center, two outdoor pools, inline skating rinks, multi-purpose ball fields, and a skate park. This fund also accounts for recreational and childcare programs and for the Miller Activity Complex.

2015 Amended Budget	Community Center Fund - Current Reserves	Community Center Fund - Proposed Reserves
Estimated Beginning Fund Balance	\$ 3,469,654	\$ 3,469,654
Revenues	6,881,122	6,881,122
Expenditures	9,163,409	9,163,409
Estimated Ending Fund Balance	1,187,367	1,187,367
Designations and Reservations		
Operating Reserve	900,584	-
Revenue Stabilization Reserve	-	200,000
Capital Replacement Reserve	-	368,524
Total	900,584	568,524
Unobligated Fund Balance	\$ 286,783	\$ 618,843

Based on Town policy, the Community Center Fund currently has an operating reserve of \$900,584 in the 2015 proposed budget. Town staff has analyzed revenue streams and other considerations of the community center fund and recommends a change in the way the reserve is calculated for this fund. Under prudent financial management, there are three primary considerations for fund balance reserves, revenue stabilization reserve, capital replacement / fatal failure reserve and operating capacity for a future facility.

Revenue Stabilization Reserve - The Miller Athletic Complex opened in October, 2014. As with any new business, it takes 3-4 years for the revenues to stabilize. As such, staff is recommending a declining reserve of 20% or \$200,000, 10% or \$100,000 and 5% or \$50,000 of MAC revenues in 2015, 2016 and 2017, respectively.

Capital Replacement Reserve - An additional consideration for Community Center Reserves is a capital replacement reserve. As facilities age, additional costs are incurred for repairs. Staff recommends a reserve, calculated as a percentage of net capital asset value, which increases with the age of the facility. The calculation above represents an average of 5% applied to the replacement value of capital assets within the community center fund. Staff will continue to refine the estimate, adjusting the percentage used in the calculation with the age of the asset.

Operational Capacity Reserve - The third reserve consideration for the community center fund is accumulating operating capacity for a future recreation center to maintain levels of service in a growing community. Operating capacity would be shown in the community center fund whereas the capital needs would come out of the Park and Recreation Capital Fund. As this point, there is no definitive timeframe for the construction of an additional recreation center. As such, no reserve will be shown in 2015 but will be considered in future years.

Unobligated Fund Balance – Based on staff's analysis and recommendation, the Community Center Fund has approximately \$620K in unobligated reserves at the end of 2015. These funds could be used to fund park and recreation purposes; or, could also be considered for an internal loan to another fund to cash flow a given project.

Employee Benefits Fund

The Employee Benefits Fund accounts for the accumulation and payment of health insurance claims; for the payment of premiums for various employee insurance policies (life insurance, long-term disability, accidental death and dismemberment, stop-loss insurance) and for the payment of fees to third-party administrators; and for disbursement of cafeteria plan monies.

2015 Amended Budget	Employee Benefits Fund - Current Reserves	Employee Benefits Fund - Proposed Reserves
Estimated Beginning Fund Balance	\$ 3,251,607	\$ 3,251,607
Revenues	7,060,683	7,060,683
Expenditures	7,155,685	7,155,685
Estimated Ending Fund Balance	3,156,605	3,156,605
Designations and Reservations		
Operating Reserve	10,121	-
Claims Reserve	1,438,226	1,438,226
Health Care Cost Reserve	-	801,150
	1,448,347	2,239,376
Unobligated Fund Balance	\$ 1,708,258	\$ 917,229
Employee portion of Fund Balance (16%)	\$ 273,321	\$ 146,757
Employer portion of Fund Balance (84%)	\$ 1,434,937	\$ 770,472

Claim and Health Care Cost Reserves - The Employee Benefit Fund is unlike other Town funds in that it is subject to significant swings in claim experience and also trends in the health care industry. To protect the other Town funds from absorbing additional expenses due to claim overruns, the Town's third party administrator recommends a reservation of fund balance of 3 months average claim experience. This equates to approximately \$1.4M. In addition to this reserve, staff recommends a reserve of approximately ½ of the remaining unobligated fund balance (approximately \$801,150) to prudently plan for long term health care cost increases.

Premiums paid by employees and by Town departments on behalf of the employees are contributed to this fund to cover claims and third party administration expense. Claims are estimated for budgeting purposes based on employee count, coverage type and current trending. Over the past few years, the town has benefited from claims running lower than budget resulting in an increase to fund balance. A portion of the unobligated fund balance (approximately 16% or \$146,757) is attributable to excess employee contributions and approximately 84% or \$770,472 represents excess town contributions.

After considering these reserves, there is approximately \$770k of tax payer and rate payer money that has been previously contributed to the employee benefit fund by other Town departments in excess of the amount needed to cover claims and other applicable expenses. If Council agrees with staff analysis, these funds would be available to fund future strategic initiatives, or as an interfund loan that could be used for to support opportunities in other Town funds.

Fund reserves deemed reasonable given the specific fund's needs

ENTERPRISE FUNDS

Water, Water Resources, Stormwater and Wastewater Funds

These funds are used to account for operations that are financed and operated in a manner similar to a private enterprise in that user charges are intended to pay for the operations. All activities necessary to provide such services are accounted for in these funds including administration, operations, maintenance, capital projects, and related debt service.

In addition to the operating reserve as instituted by Council, the Utilities department has identified other key reserves in order to ensure responsible financial management of the enterprise funds. Significant explanation of the proposed reserves for the Utilities funds is included since the amounts relative to these funds is much greater than that of any other Town fund. The recommended reserves are included for the Utilities funds here:

2015 Amended Budget	Water	Water Resources	Stormwater	Wastewater	Total
Estimated Beginning Fund Balance	\$ 12,143,428	\$ 76,796,722	\$ 6,550,677	\$ 10,940,750	\$ 106,431,577
Revenues	19,197,995	23,182,047	3,903,049	13,756,035	60,039,126
Expenditures	16,374,964	22,634,820	6,615,744	10,368,209	55,993,737
Estimated Ending Fund Balance	14,966,459	77,343,949	3,837,982	14,328,576	110,476,966
Designations and Reservations					
Operating Designations	1,311,108	662,240	342,332	851,775	3,167,455
Capital Reserve	4,829,249	69,891,889	3,495,650	10,211,036	88,427,824
Debt Service Reserve	-	4,621,825	-	-	4,621,825
Variable Interest Rate Reserve	-	1,632,000	-	-	1,632,000
Reserve for Catastrophic Failure	3,586,715	535,995	-	1,519,860	5,642,570
Rate Stabilization Reserve	1,000,000	-	-	-	1,000,000
Total Designations and Reservations	10,727,072	77,343,949	3,837,982	12,582,671	104,491,674
Unobligated Fund Balance	\$ 4,239,387	\$ -	\$ -	\$ 1,745,905	\$ 5,985,292

Operating Reserves

Generally, operating reserves in the Utilities funds are undesignated funds available for unforeseen expenses or revenue shortfalls or both. Each Utility fund has an operating reserve based on two months of operating and maintenance costs per the current Town policy. This policy was reviewed in light of industry standards and best management practices. The available information indicates that the reserve policy is reasonable and appropriate. For example, operating reserves of between one to three months of operating costs are typical according to guidance from the Water Environment Federation. Given the Town's cost structure and variability of revenues and expenses, Arcadis, the Utilities Department's rates and fees consultant, recommended that Utilities maintain Operating Reserves equal to three months of annual operations and maintenance expenses. Arcadis also noted correctly that additional significant incremental operations and maintenance costs would be realized over the next 5 to 10 years as the projects associated with the Long Term Renewable water program come on line. Beginning to increase operating reserves specifically in the Water Resources Fund now would avoid potential rate spikes in the near future.

Utilities also evaluated what types of events could warrant the use and the amounts of operating reserves based on our actual operations. Examples include a cyber-attack that impairs our ability to accept bill payments in our online or main billing systems for several months; sudden increases in chemical or energy costs due to changes in market conditions or shortages of raw materials; a flood which deposits a large amount of sand and debris on public roads; revenue deficiencies in the bond

fund created for payment of principal and interest on our revenue bonds; an increase in the interest rate above 3.5% on our variable interest rate Certificates of Participation; a change in our wastewater providers ability to dispose of biosolids; an extended drought which requires outdoor irrigation to be curtailed; a large change in development activity; or a significant change in the administration of water rights on Plum Creek by the State Engineers Office. Staff does recommend that the rate revenue stabilization reserve (see below for more on this reserve), which is really a specific type of operating reserve, be combined and absorbed into the Operating Reserve. Rather than restricting this reserve to fluctuations in revenues driven solely by weather, Staff believes flexibility in using this reserve for any of the purposes for which an operating reserve is typically created provides additional flexibility.

Capital Reserve

The Capital Reserve component includes reserves designated for specific capital projects, including renewals and replacements as well as improvements as is primarily seen in the Water Resources Fund. According to industry literature, typical capital reserves for Utilities are in the range of 2 percent of net asset value or 5 percent of prior year's revenue. As explained by an article through the Environmental Finance Center of the University of North Carolina at Chapel Hill, Utilities that primarily fund capital from rates and fees tend to have higher reserves than those that rely more on debt financing. Utilities' rates and fees consultant validated this through their recommendations to Utilities on capital reserves. The article noted reserves of 1.7 times annual operating expenses for Utilities from the study with this strategy (Castle Rock is between 1.4 and 2.5 depending on fund). Additionally, for Utilities that fund capital projects from rates and fees, rate volatility tended to be lower than Utilities that rely on debt financing for capital projects.

Based on Council direction, the primary strategy for funding future capital projects in recent years has been to fund those projects from rates and fees on a "pay as you go" basis (i.e. issue no new debt beyond our current obligations). Debt financing has been used in the past for the Water, Wastewater and Water Resources Funds and current debt totals around \$83M. In order to ensure funding is available for renewal and replacement and improvement projects included in the five year Capital Improvement Plan without causing single year rate spikes, Utilities has designated available funds to specific projects in the Capital Reserves. A listing of the current capital reserve designations is provided:

<i>Fund</i>	<i>Project</i>	<i>Amount Reserved</i>
Water	Liberty Village Yellow Zone	\$2,925,609
	Administration & Customer Service Building	1,403,640
	Ray Waterman Trtmnt Plant Filters, Media & Underdrains	<u>500,000</u>
	Total	\$4,829,249
Water Resources	Advanced Oxidation Facility & Dewatering at PCWPF	\$5,892,877
	Alternative Source of Supply Project	32,177,000
	WISE Project	20,695,237
	Plum Creek Diversion Structure	6,853,835
	Chatfield Reallocation Project	3,120,000
	Aquifer Storage and Recovery	525,000
	Administration & Customer Service Building	<u>627,940</u>
	Total	\$69,891,889
Stormwater	Douglas Lane Tributary Stabilization	\$750,000
	Industrial Tributary Stabilization	900,000
	Craig & Gould North Infrastructure Improvements	1,200,000
	Trib B Stabilization	7,485
	Administration & Customer Service Building	<u>638,165</u>
	Total	\$3,495,650

Wastewater	Administration & Customer Service Building	\$773,940
	Craig & Gould North Infrastructure Improvements	355,000
	Crystal Valley Ranch Upsize	395,000
	PCWRA Capital Buy-in	<u>8,687,096</u>
	Total	\$10,211,036

This approach to capital reserves was validated by Utilities independent rates and fees consultant. In fact, Arcadis recommended Utilities maintain higher capital reserves to provide an accounting for future impacts of needed renewals and replacements. This is especially true for the Water Fund where Utilities has as much as \$80M in fully depreciated assets. When Utilities benchmarked typical cash requirements for renewals and replacements against Utilities nationally through the American Water Works Association, the recommendations of the consultant were corroborated. It was determined that we are investing much less in renewals and replacements than the median for Utilities in the survey. As our infrastructure ages, additional capital reserves may be required to continue to rate fund capital renewals and replacements as recommended by our rates and fees consultant. For example, using the median expected renewal and replacements from AWWA, an additional \$4M of capital reserves could be easily justified in the future.

Most of the capital reserves are associated with the Long Term Renewable water program in the Water Resources Fund. Projects in the Water, Wastewater and Stormwater include more of a mix of renewals and replacements and improvements, with improvements still being the lion share of the reserves. Accumulating capital reserves for designated projects is an important piece of managing rates and fees and avoiding spikes in the same.

The Town continues to engage an independent firm to perform a rate and fee study each year which takes into account the capital funding strategy. The rates and fees assessed are based on long term strategic capital planning for the water funds and enable the enterprise to accumulate the funds needed to complete the projects. Long term financing options have been used in the past and may be evaluated for use in the future. For reference, the Utilities funds currently have a very low debt to asset ratio relative to other Utilities that participated in 2014 AWWA benchmarking survey. While staff continues to believe this is an indication of good financial management, use of more financing is a useful tool and could reduce reserve requirements in the future. Staff will continue to evaluate financing options as a part of the financial management of the funds and provide recommendations to council annually.

Debt Service Reserve

The Town maintains about \$4.6M in debt service reserves within the Water Resource Fund. The outstanding Certificates of Participation (COP) debt does not require a specific coverage ratio; in lieu of coverage, the Town is required to maintain this debt service reserve per the bond document. This is an external restriction that cannot be modified other than through a refunding or restructuring of the debt instrument.

Variable Interest Rate Reserve

In 2008, as part of the overall long-term water initiative, the Town issued \$74M in COP's to secure water storage rights in Reuter Hess Reservoir and also to construct the Plum Creek Water Purification Facility. At the time of issuance, Town management with the advisement of Council and the Towns Investment banker and financial consultant, determined a variable rate instrument would be most advantageous given the market conditions and economic outlook. The fixed rate at the time of issuance was approximately 3.35%; the actual rate over the past 6 years has averaged 1.7%. Each year interest expense is budgeted at 3.35%; however, actual interest has trended significantly lower. This saving has been identified and reserved in fund balance to offset future increases in interest rates above the budgeted 3.35%, potentially pay down the outstanding principal balance, or used if it's advantageous to fix a portion of the debt issuance to hedge against future rate increases. Approximately \$1.6M is reserved in the water resource fund. It is important to note that the cap on the variable interest rate COPs is 12%. If the interest rate were to spike to this level, annual principal and

interest payments would exceed this reserve by as much as \$6M, which supports the continued need for the operating reserves.

Reserve for Catastrophic Failure

The “fatal failure” reserve is a type of capital reserve that would be available in case of a catastrophic failure of a major asset within one of the funds. For the Water, Water Resources and Wastewater Funds, the amount reserved is approximately 2% of the original value of the capital asset. Again the current approach used by Utilities was reviewed in light of best industry practices. Results of this analysis showed that the current reserves are reasonable and consistent industry standards. As noted by Arcadis, the Utilities Department current emergency reserve target is consistent with common water industry practice. Utilities often set this target at 1 or 2 percent of asset value or equal to the replacement cost of a major or critical portion of the system. In order to fully vet the need for the catastrophic failure reserve, staff also looked at current insurance coverage for our major Utilities infrastructure assets.

Liability insurance provided through CIRSA specifically excludes underground infrastructure, but it will cover damages to third parties caused by any waterline breaks, sewer backups, etc. less the deductible (\$100,000) up to \$5M per claim. Any damages to aboveground infrastructure may or may not be covered depending on the cause of the damage. Mechanical/electrical system failures caused by internal factors, would be excluded from coverage. Internal factors include, but are not limited to the following:

- Planning, zoning, development, surveying, siting;
- Design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction, unless fire or explosion ensues and then only for direct loss or damage caused by such ensuing fire or explosion;
- Materials used in the repair, construction, renovation or remodeling;
- Maintenance;
- Wear and tear;
- Rust, corrosion, fungus, decay, deterioration, hidden or latent defect or any quality in property that causes it to damage or destroy itself;
- Settling, cracking, shrinking or expansion; or
- Dampness or dryness of atmosphere, changes in or extremes of temperature, marring or scratching.

Damage to aboveground infrastructure would be covered if catastrophic failure is caused by an act of God or nature (e.g. tornado) minus the deductible. As noted previously although the Town may receive funding through FEMA, the State and our insurance provider during such an event, it is important to have sufficient cash reserves available to meet immediate needs as reimbursements from third parties may not occur until months after the event.

Based on the review of insurance and the new replacement costs of many of Utilities critical assets, the existing catastrophic failure reserves will cover replacement of some of the critical assets. For example Utilities has a number of critical water tanks that could easily cost \$3M or more to replace. The failure of a large critical water transmission or sewer collection main could easily cost more than \$500,000 to repair or replace. If a raw water well suddenly had to be replaced due to some sort of failure, this cost could easily exceed \$1.5M. Existing reserves would not fully cover the complete loss of a water plant or reservoir, but could provide a reasonable start towards recovery. Finally, it should be noted that Utilities has been working to establish a fatal failure reserve in the Stormwater Fund, but adequate financial resources have not been available to fully fund it. Staff believes this should continue to be a financial goal in the next several years.

Rate stabilization

The Rate Stabilization reserve is specified by ordinance and has been set up to offset the potential loss in revenue due to weather conditions, primarily temperature, which result in a significant decrease in

water consumption and corresponding revenues. Utilities calculates this reserve by taking the coolest year on record over the last 30 years and looking at the reduction in demand that occurred. This reduction is extrapolated to the current customer base to come up with a reduced consumption and revenue based on current rates and fees. As the customer base grows, this reserve will correspondingly need to grow.

The 2015 proposed budget amount for this reserve is \$1,000,000 for the Water Fund. As noted under the section on operating reserves, staff believes the ordinance requiring this reserve should be updated to become part of the overall operating designation thereby creating additional functional flexibility in the use of reserves to meet needs.

Recommendations

Staff recommends maintaining the current reserve policies and approaches for Utilities funds in the near term with the noted exception that the rate revenue stabilization reserve should be combined with the operating reserves. There are currently some unobligated cash reserves in the Water (\$4.2M) and Wastewater (\$1.7M) Funds. The Utilities Department is in the process of developing an updated financial management plan that will complement the annual rates and fees study in 2015. Further recommendations for uses of any currently identified unobligated funds will be part of this analysis including evaluating options such as paying down debt, rate management, interfund loans to mitigate future rate increases (especially in the Water Resources Fund), economic development that benefits Utilities rate payers, additional transfers to the capital reserves for renewals and replacements in accordance with the recommendations of our rates and fees consultant, and unplanned capital opportunities among other potential options.

Golf Fund

The Golf Fund accounts for the activities related to the construction, operation and maintenance of the Town owned golf course, Red Hawk Ridge, at Castle Rock.

2015 Amended Budget	Golf Fund - Current Reserves	Golf Fund - Proposed Reserves
Estimated Beginning Fund Balance	\$ 1,911,320	\$ 1,911,320
Revenues	4,272,000	4,272,000
Expenditures	3,248,953	3,248,953
Estimated Ending Fund Balance	2,934,367	2,934,367
Designations and Reservations		
Operating Reserve	367,915	-
Revenue Stabilization Reserve	-	200,000
Capital Reserve	-	1,300,000
Debt Service Reserve	1,093,140	1,093,140
Total	1,461,055	2,593,140
Unobligated Fund Balance	\$ 1,473,312	\$ 341,227

Operating Reserve

Based on Town policy, the Golf fund has an operating reserve of \$367,915 in the 2015 Adopted budget.

Debt Service Reserve

The 2005 Golf Course Revenue Bonds require the Town to maintain a debt service reserve in the amount of \$1,093,140.

Capital Reserve - The proposed 2015 Budget for the Golf Fund includes a refinancing of the 2005 Golf Course bonds with incremental cash out of approximately \$1,000,000 for capital improvements on the course and clubhouse. This amount is shown in the proposed capital reserve and will be spent down as capital improvements in 2016 and 2017. An incremental capital reserve in the amount of \$300k is also included to account for unexpected equipment failure and repair.

Revenue Stabilization Reserve - In order to account for potential unexpected declines in revenue, which may extend in time or intensity beyond the controllable variable expenses, it's prudent to include an operating reserve based on average playable days. History has shown the Town typically has a "bad spring" or a "bad fall" as it relates to playable days for the golf course. In order to determine a worst case scenario for the golf course, Town staff analyzed a scenario with both a bad spring and a bad fall. The result of this analysis is a potential reduction of revenue of approximately \$200k less than an average year's revenue.

Development Services Fund

The Development Services Enterprise Fund accounts for revenues and expenses related to community development within the Town. Primary revenues are from user fees which include building and electrical permits, plan reviews and inspections.

2015 Amended Budget	Development Services - Current Reservations	Development Services - Proposed Reservations
Estimated Beginning Fund Balance	\$ 6,326,386	\$ 6,326,386
Revenues	4,852,321	4,852,321
Expenditures	4,379,248	4,379,248
Estimated Ending Fund Balance	6,799,459	6,799,459
Designations and Reservations		
Operating Reserve	717,713	-
Capital Opportunity Reserve	-	2,000,000
Revenue Stabilization Reserve	-	4,799,459
	717,713	6,799,459
Unobligated Fund Balance	\$ 6,081,746	\$ -

Based on current Town policy, Development Services Fund has an operating reserve of \$717,713 in the 2015 adopted budget. Town staff has analyzed revenue streams and other considerations of the Development Services Fund and recommends a change in the way the reserve is calculated for this fund. Under prudent financial management, there are two primary considerations for fund balance reserves, a Capital Opportunity reserve and Revenue Stabilization reserve.

Capital Opportunity

The Development Services Department currently functions within the Townhall building in the downtown area. This is the only enterprise fund that operates out of a general government facility. Currently, the fund pays rent for the facility rental of the Townhall building of \$136,500 per year. In light of the fact that the Development Services Fund has, for the past 6 years, operated at an annual surplus, it might be more cost effective to own, rather than lease space. It is, therefore recommended that a Capital Opportunity Reserve amount be set aside which could assist in the pursuit of an opportunity to invest in space which could, then be an asset for the enterprise fund.

Revenue Stabilization Reserve

The Development Services Fund is currently structured as an enterprise fund which operates very similarly to a for-profit business, charging for services rendered to obtain full cost recovery. This model is profitable in a moderate to high growth environment and correspondingly impacted in a declining or slow growth economy. The maintenance of a Revenue Stabilization Reserve could assist in a declining environment. While, in the past, when slower growth has occurred, Development Services Department has functioned along with the rest of the Town and effectively reduced expenses to correspond with the lower revenue. It is expected that the department would continue to function and adapt as appropriate; however, it is fiscally prudent to maintain the remaining fund balance as a Revenue Stabilization Reserve to accommodate the level of volatility associated with development.

Special Revenue and Capital Project Funds

The Transportation Fund is a special revenue fund that accounts for the accumulation of financial resources and expenditures for the construction, acquisition, installation, repair and maintenance of streets, bridges, sidewalks and public transit.

2015 Amended Budget	Transportation Fund - Current Reserves	Transportation Fund - Proposed Reserves
Estimated Beginning Fund Balance	\$ 4,335,313	\$ 4,335,313
Revenues	18,242,737	18,242,737
Expenditures	20,215,445	20,215,445
Estimated Ending Fund Balance	2,362,605	2,362,605
Designations and Reservations		
Operating Reserve	2,138,071	-
Revenue Stabilization Reserve	-	205,364
Capital Replacement Reserve	-	1,629,227
	2,138,071	1,834,591
Unobligated Fund Balance	\$ 224,534	\$ 528,014

Based on current Town policy, the Transportation Fund currently has an operating reserve of \$2,138,071 in the 2015 base budget. Town staff has analyzed revenue streams and other considerations of the Transportation Fund and recommends a change in the way the reserve is calculated for this fund. Under prudent financial management, there are two primary considerations for fund balance reserves, revenue stabilization reserve and capital replacement / fatal failure reserve.

Revenue Stabilization Reserve – The Transportation Fund receives a portion of the sales tax revenue collected by the Town. As noted in the General Fund Revenue Stabilization Reserve explanation, sales tax revenues are variable and largely dependent upon the economy. The reserve amount of \$1,140,000 within the General Fund is intended to serve as the sales tax revenue reserve and it may be a consideration to transfer funds into the Transportation Fund from the General Fund Revenue Stabilization Reserve, if deemed appropriate. It is also recommended that an additional amount be maintained in reserve within the Transportation Fund to account for other revenue streams that may be volatile, such as the motor vehicle tax, Douglas County Shareback, Building Use Tax, Highway User Tax and Road and Bridge Tax. If the methodology which is recommended for the General Fund revenue is followed, the amount would be 3% of these anticipated revenue streams for 2015. The total recommended revenue stabilization reserve for 2015 is \$205,364.

Capital Replacement/Catastrophic Failure Reserve - An additional consideration for Transportation reserves is a capital replacement reserve. Staff has taken time to analyze existing infrastructure risk in

light of existing annual maintenance programs; along with the consideration that infrastructure within the Transportation Fund is insured through the Town's property insurance provider. While it does make sense to maintain an amount of funds in a reserve, it is also reasonable to defer currently planned programs if an emergency occurred. Although extremely important, preventive maintenance can be deferred to a following year in order to free up funds that may be needed in an emergency or catastrophic event. The cost risk to this approach is that the deferred treatments may cost more in the future, and the type of maintenance needed may be a higher cost treatment as a result of the deferment and increased damage. The risk of such an event actually occurring is low, although can be very real as northern Colorado experienced in the 2013 flooding events. The approach of another municipality, Colorado Springs, was also examined, in this process. The capital reserve amount maintained by Colorado Springs is generated by focusing on the potential emergency replacement or repair of bridges within the city. This same approach could be utilized by Castle Rock. The cost of a two lane bridge that is 200 feet long is approximately \$1.6 million. This amount is reasonable, given that these structures are insured; however, if emergency repairs needed to occur, this would be sufficient to begin such repairs with the anticipation of insurance funding.

Other special revenue funds include the Conservation Trust Fund, Philip S. Miller Trust Fund, Public Art Fund and the Police Forfeiture Fund. Such funds are used to account for the proceeds of specific revenue sources that are legally or otherwise restricted to expenditure for specific purposes. These funds are not available to pay for capital or other expense outside of the given funds purpose.

Special Revenue Funds						
2015 Amended Budget	Conservation Trust	Philip S. Miller Trust	Public Art	Police Forfeiture	Total	
Estimated Beginning Fund Balance	\$ 1,116,444	\$ 124,099	\$ 79,099	\$ 23,822	\$ 1,343,464	
Revenues	1,363,637	313,726	25,310	23,911	1,726,584	
Expenditures	2,421,272	251,705	75,000	23,816	2,771,793	
Estimated Ending Fund Balance	58,809	186,120	29,409	23,917	298,255	
Committed for fund purpose	\$ 58,809	\$ 186,120	\$ 29,409	\$ 23,917	\$ 298,255	

Capital project funds include the Parks and Recreation Capital Fund, Municipal Facilities Capital Fund, Fire Capital Fund, Police Capital Fund, Transportation Capital Fund and the General Long Term Planning Fund. The main revenue source for the capital funds is impact fees. These are fees collected from builders to cover growth demands due to the new growth in the community. Accordingly, unobligated fund balances noted below are legally restricted for that purpose.

Capital Projects Funds							
2015 Amended Budget	Parks and Recreation	Municipal Facilities	Fire Capital	Police Capital	Transportation Capital	General Long Term Planning	Total
Estimated Beginning Fund Balance	\$ 1,859,263	\$ 1,313,947	\$ 2,581,258	\$ 271,094	\$ 39,717,855	\$ 1,902,133	\$ 47,645,550
Revenues	10,295,570	400,602	448,369	512,591	9,530,164	1,087,237	22,274,533
Expenditures	11,333,224	386,738	270,294	778,877	49,190,230	1,302,284	63,261,647
Estimated Ending Fund Balance	821,609	1,327,811	2,759,333	4,808	57,789	1,687,086	6,658,436
Unobligated Fund Balance	\$ 821,609	\$ 1,327,811	\$ 2,759,333	\$ 4,808	\$ 57,789	\$ 1,687,086	\$ 6,658,436

The unobligated fund balance in the special revenue and capital funds represents unreserved yet designated fund balance for the ultimate purpose of the fund. For example, the fire capital fund collects impact fees to be used for capital items necessitated by growth in the community. Although these funds are shown as unreserved, the funds are designated for growth related capital items.

As presented to Council in the Space Study consideration, the capital funds shown above are accumulated to pay for future projects. Often times, the cash flow does not match the timing of the capital need due to accelerated growth. As such, interfund loans may be needed to cover the cash flow of construction. Future impact fees are designated to pay back these internal loans. These loans are beneficial in a lower rate to the Town than could be obtained from external borrowing and it fulfills the cash flow to expedite construction due to growth.

Fleet Services Fund

The Fleet Services Fund accounts for centralized acquisition and maintenance of Town owned vehicles. Operation and vehicle replacement are funded by charges to user departments.

2015 Amended Budget	Fleet Fund
Estimated Beginning Fund Balance	\$ 1,853,230
Revenues	3,667,491
Expenditures	<u>3,753,029</u>
Estimated Ending Fund Balance	1,767,692
Designations and Reservations	
Reserved for Vehicle Replacements	<u>\$ 1,767,692</u>

The fund balance in the fleet fund represent monies paid into the fund by Town departments toward the future purchase of vehicles. The individual fund contributions are based specifically on the needs of the department. All of the fund balance of the fleet fund is reserved for future vehicle purchases.

Other considerations

Maintaining reasonable fund balance reserves is a critical component of conservative fiscal management. Although the adequacy of an entities reserve amount is assessed based on the municipalities own specific circumstances, the Government Finance Officers Association (GFOA) recommends, at a minimum, an operating reserve of no less than 2 months, or 16%, of operating expenditures. However, the 16% is only intended to be a baseline and should be viewed in light of circumstance directly attributable to the Town; it's not a one size fits all measurement.

Rating agencies also consider a municipality's reserves when rating a bond issue. The reserve amount is an indication of overall fiscal health and is considered with several other factors for each rating update. Opposing pressure from taxpayers and citizens' groups may view high levels of fund balance as "excessive". Therefore, it's important to balance fiscal flexibility with conservative financial management. There is no magic formula, rather a delicate balance of risk and opportunity.

Summary Townwide Perspective

The proposed reservations included herein have been incorporated in recent information supplied to Council within the presentations of budget amendments. It is important to view the proposed fund balance reservations on a total Townwide basis for a more complete picture. In that light, with budgeted revenue and expenditures incorporated, the proposed estimated ending funds available for the Town total over \$151M for 2015. Of this amount, the proposed reserves make up 90%, or \$136M, of this total, which leaves more than \$15M in unobligated funds that could be used to support the community in some way or remain unspent, as available fund balance. The 2015 Townwide budget, with proposed reserves included, is shown on the following table.

Townwide 2015 Amended Budget	All Funds - Proposed Reservations
Estimated Beginning Fund Balance	\$ 195,411,818
Revenues	172,459,384
Expenditures	<u>216,644,313</u>
Estimated Ending Fund Balance	151,226,889
Designations and Reservations	
Contractual Reserve	300,000
Operational Capacity Reserve	500,000
Revenue Stabilization Reserve	7,904,823
Catastrophic Events Reserve	6,642,570
Capital Reserve	93,861,348
Opportunity/Economic Development Reserve	1,000,000
TABOR Reserve	1,646,134
Bridge Reserve	1,629,227
Operating Designations	3,167,455
Debt Service Reserve	5,714,965
Variable Interest Rate Reserve	1,632,000
Claims Reserve	1,438,226
Health Care Cost Reserve	801,150
Committed for Fund Purpose	<u>9,896,792</u>
Total	\$ 136,134,690
Unobligated Fund Balance Total All Funds	<u>\$ 15,092,199</u>

Budget Impact

Implementation of this reserve policy will result in revised unobligated fund balance totals as represented in this memo. Totals may change pending completion of the 2014 Audit, which could affect the beginning fund balance for 2015.

Staff Recommendation

Work to develop an appropriate policy which would coincide with the recommendations herein.

Motion

"I move to direct Town staff to develop an ordinance to present to Council which would incorporate the proposed revisions to Town fund balance policies."

Attachments

Attachment A: Town of Castle Rock Reserves Policy