



Best Practices in Fund Balance

How Much Should Your City Maintain?

Tennessee City Management Association

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Agenda

- ◆ What is Fund Balance
- ◆ Why Does Fund Balance Matter?
- ◆ How Much Should My City Maintain?



What is Fund Balance?

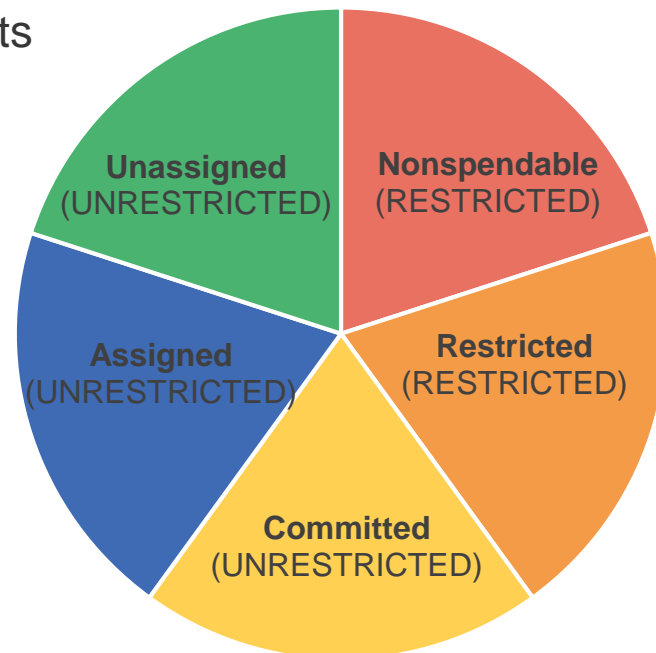


What is Fund Balance? **Generally**

- By its most basic definition, “fund balance” is simply the difference between **assets** and **liabilities**

Total Assets	Total Liabilities	Fund Balance
\$1,500,000	- \$500,000	= \$1,000,000

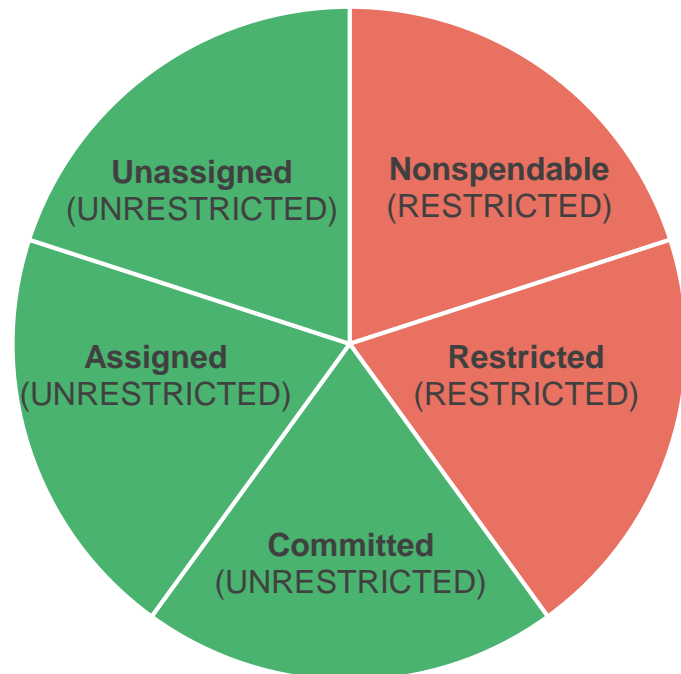
- Ultimately, the definition and appropriate level of fund balance a government needs to maintain and where it should be categorized will depend on who you’re asking
- The Government Accounting Standards Board (“GASB”) requires the below categorization of fund balance components





What is Fund Balance? **GFOA**

- ◆ The Government Finance Officer's Association (“GFOA”) recommends that governments maintain a fund balance of no less than “two months of regular general fund operating revenues or regular general fund operating expenditures”
- ◆ When GFOA discusses “fund balance” they are referring to unrestricted general fund balance





What is Fund Balance? **Moody's and S&P**

- ◆ Moody's Investors Service ("Moody's") uses fund balance as an indication of the level of resources available "over the short term to satisfy obligations"
 - *"Fund balance describes the **net financial resources available to an entity in the short term.** ...we include all reserves that our analysis finds is **available for operating purposes.** ...almost all will include at least the **General Fund unassigned plus assigned fund balance.**"*
- ◆ S&P Global Ratings ("S&P") uses fund balance as an indication of the level of resources "legally available for operations"
 - "The existing Available Fund Balances reflect the **most obvious and measurable form of flexibility...**"



Why Does Fund Balance Matter?



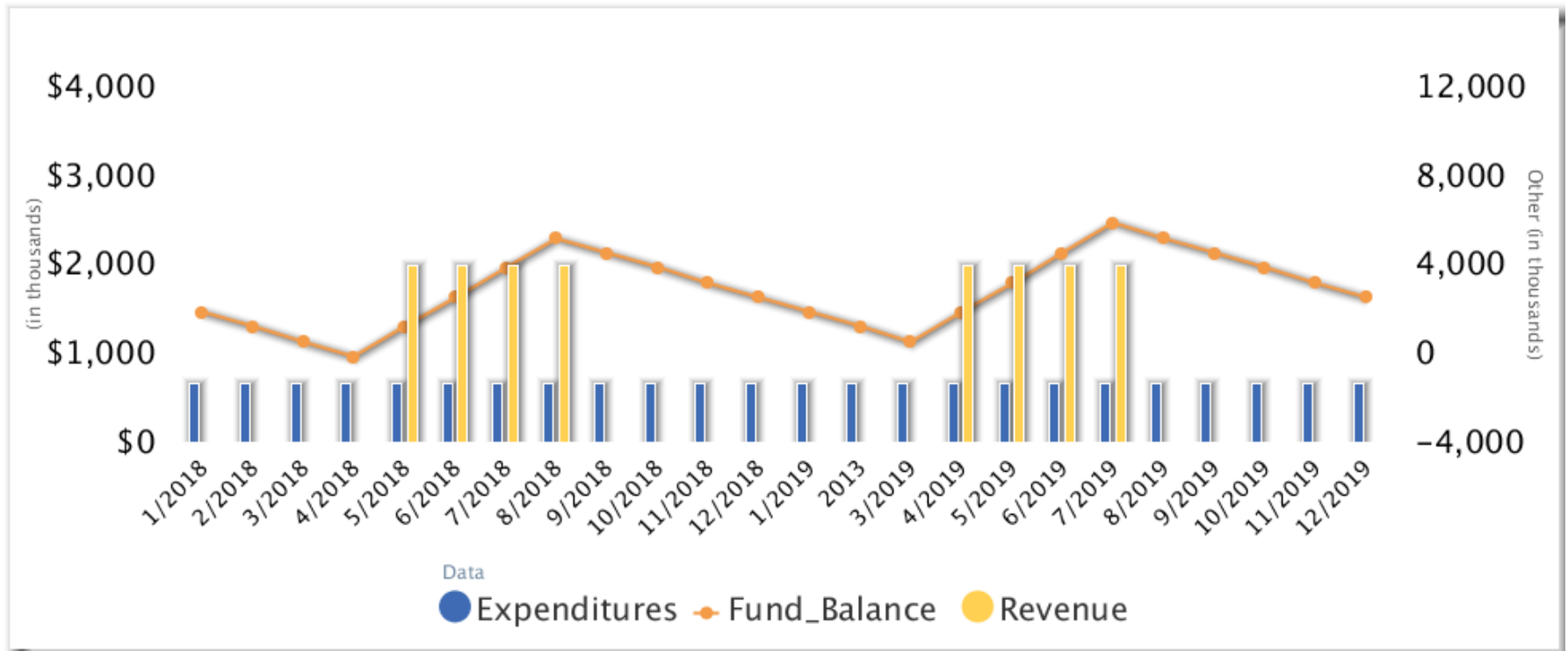
Why Does Fund Balance Matter? **Emergency Reserves**

- All governments are subject to risk, although the nature of those risks may vary with region, population size, economic profile, etc.
- Maintaining **unassigned fund balance** is one of the most important ways a community can mitigate risks and can be critical in weathering
 - economic downturn
 - natural disasters
 - volatile revenue or unexpected expenditure



Why Does Fund Balance Matter? Cash Flow Relief

- Most governments depend on revenues collected during a single period, but have consistent, year-round expenses





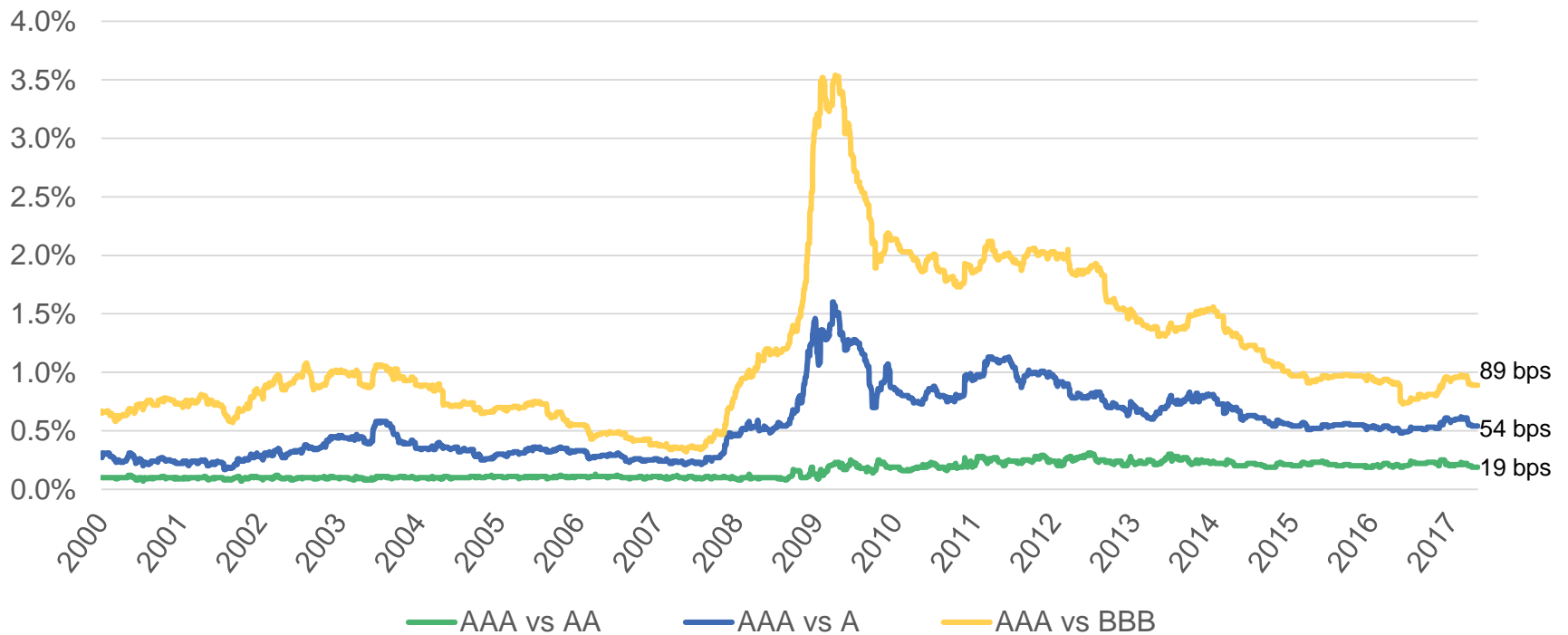
Why Does Fund Balance Matter? **Pay-Go Spending**

- ◆ Many governments use unassigned fund balance and other unrestricted resources to fund capital improvements
- ◆ Avoids debt service costs
- ◆ Ability to cash flow a project during construction



Why Does Fund Balance Matter? **Borrowing Cost Reduction**

- ◆ Fund balance is generally seen as **financial flexibility** by credit rating agencies and investors; when governments maintain more fund balance, they are viewed more favorably and can achieve **lower borrowing costs**





How Much Should My City Maintain?



How Much Should My City Maintain?

- ◆ Again, it depends on who you ask
 - Rating Agencies – Own methodology; generally based as a % of a governments' annual revenue and expenditure
 - GFOA – No less than 2 months of operating revenue or expenditure
 - Local Stakeholders – Question why they are continue to pay taxes if there is any unassigned fund balance outstanding at all
- ◆ How can your government, specifically, benefit from maintaining fund balance?
 - Determine your risks (weather/revenues/expenditures/etc.) or worst case scenario
 - Rely on Moody's and S&P's rating methodology as a framework



How Much Should My City Maintain? **Moody's and S&P**

Moody's Credit Ratios	Weight
Economy/Tax Base	30%
Finances	30%
Management	20%
Debt/Pension	20%

S&P Credit Ratios	Weight
Economy	30%
Budgetary Flexibility	10%
Budgetary Performance	10%
Liquidity	10%
Debt & Contingent Liability	10%
Management	20%
Institutional Framework	10%



How Much Should My City Maintain? **Moody's and S&P**

◆ Moody's Finances (30% of Total)

Ratio	Weight
Fund Balance / Operating Revenues	10%
5-Year Dollar Change in Fund Balance / Operating Revenues	5%
Cash Balance / Revenues	10%
5-Year Dollar Change in Cash Balance / Revenues	5%

◆ S&P Budgetary/Finances (30% of Total)

Ratio	Weight
Available Fund Balance / General Fund Expenditures	10%
Governmental Revs <i>minus</i> Governmental Exps / Total Gv't Exps	10%
Gv't Cash / Gv't D/S & Total Cash / Total Gv't Expenditures	10%



How Much Should My City Maintain? **Moody's**

Scorecard Summary - TCMA - Projected Years

	2016	2017
Moody's Scorecard		
Economy and Tax Base	1.00	1.20
Finances	4.17	4.17
Management	3.25	3.25
Debt and Pension	0.50	0.50
Final Score	2.30	2.36

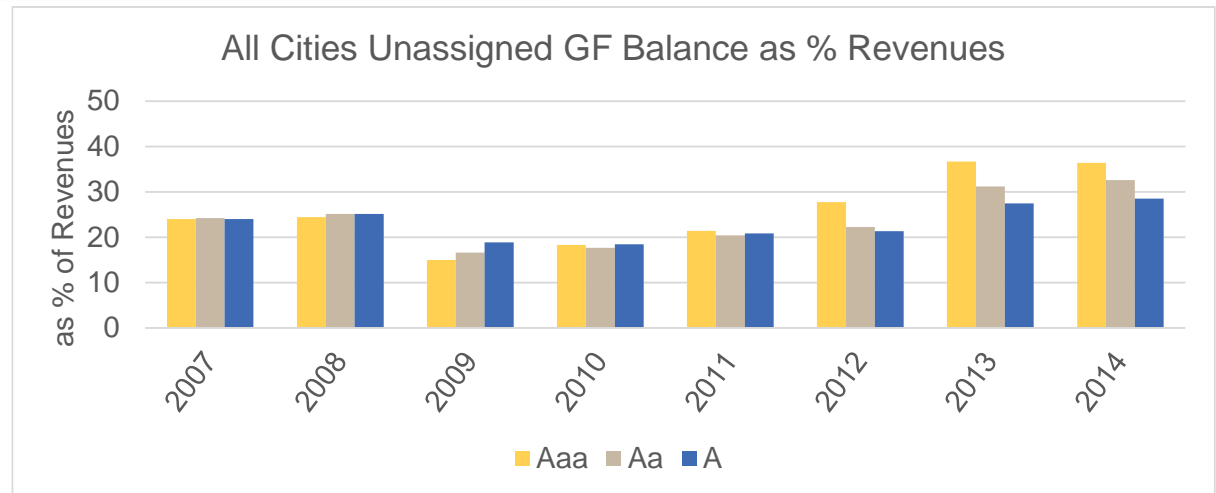
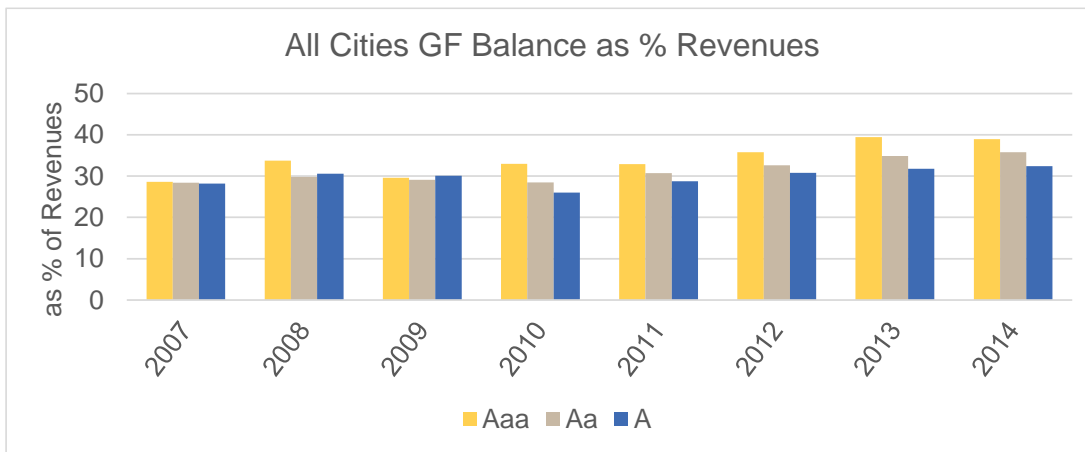
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Indicated Rating	Overall Weighted Score
Aaa	0.5 to 1.5
Aa1	1.5 to 1.83
Aa2	1.83 to 2.17
Aa3	2.17 to 2.5
A1	2.50 to 2.83
A2	2.83 to 3.17
A3	3.17 to 3.5
Baa1	3.50 to 3.83



Trends in Fund Balance Levels

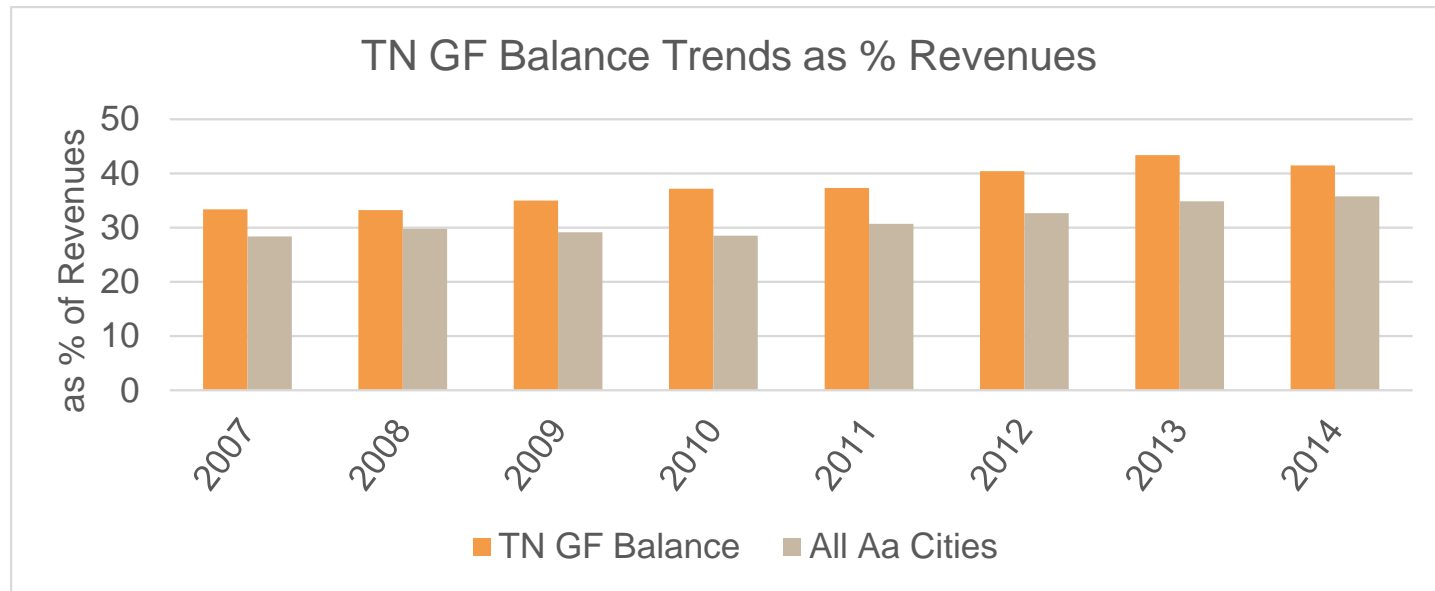
- As governments recovered from the recession, on average, they began to retain more resources in their general funds





Trends in Fund Balance Levels Tennessee

- ◆ In general, Tennessee Cities tend to keep higher reserve levels compared to all Aa rated Cities





How Much Should My City Maintain? Example Policies

- Minneapolis <http://gfoa.org/sites/default/files/u63/GFOAFinancialPoliciesDoc4EMinneapolisPolicy.pdf> :

Maintains 15% of the revenue budget in unallocated General Fund balance. Funds in excess are used to “avoid cash flow interruptions, generate interest income, avoid the needs for short-term borrowing, and assist in maintaining a triple-A bond rating.”

“Available fund balances shall not be used for ongoing operating expenditures, unless a determination has been made that available balances are in excess of required guidelines and that plans have been established to address any future operating budget shortfalls. Emphasis shall be placed on one-time uses that achieve future operating cost reductions. Fund balance is the cumulative years’ excess or deficit of all revenues and expense... “

- Gwinnett County <http://gfoa.org/sites/default/files/u63/GFOAGeneralFundOperatingReservePolicyexecuted.pdf> :

Minimum balance of reserves is 3 months of expenditures. If there are excess reserves they may be used for 1.

“...accrued liabilities, including but not limited to debt service, pension, and OPEB.. Priority will be given to those items that relieve budget or financial operating pressure in future periods.” 2. “Appropriated to lower the amount of bonds or contributions needed to fund capital projects in the County’s CIP.” 3. “One time expenditures that do not increase recurring operating costs that cannot be funded through current revenues...” 4. “Start-up expenditures for new programs, provided that such action is approved by the Board...”

- Village of Buffalo Grove <http://gfoa.org/sites/default/files/u63/GFOAFinancialPoliciesDoc4JBuffaloGrove.pdf> :

25% of operational budget. 1. “Draws for operational purposes will be only to cover extraordinary circumstances or to bridge a revenue gap...” 2. “Permanent draws would be for ‘investment’ or capital purposes or to provide some direct tax levy abatement funding for capital-related debt service.” 3. Some resources may be committed to cover pension fund shortfalls in annual funding...”

Q&A



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