

**MEMORANDUM**

TO: Management and Fiscal Policy Committee

FROM: Robert H. Drummer, Senior Legislative Attorney   
CHS Charles H. Sherer, Legislative Analyst

SUBJECT: Resolution to Approve Reserve and Selected Fiscal Policies  
Bill 36-10, Finance – Revenue Stabilization Fund – Amendments

A Resolution to Approve Reserve and Selected Fiscal Policies, sponsored by the Council President at the request of the Executive, was introduced on May 27, 2010. Bill 36-10, Finance – Revenue Stabilization Fund – Amendments, sponsored by the Council President at the request of the Executive, was also introduced on May 27, 2010. A public hearing for both the Resolution and the Bill is tentatively scheduled for June 22, 2010.

**Summary**

The Resolution would establish a goal of a structurally balanced budget where only recurring revenue is used to fund recurring expenses. The Resolution would also gradually increase the target total reserve over the next 9 years and thereby reduce the revenue available for agency spending. Bill 36-10 would amend the law governing the Revenue Stabilization Fund consistent with the proposed new fiscal policies governing the reserve. The Bill would modify the method of determining the mandatory annual contribution to the Fund and remove the current cap on the Fund.

The major policy issues are:

1. Should the Council adopt a policy goal of a structurally balanced budget?
2. Should the Council modify the method of calculating the total reserve?
3. Should the Council modify the amount of the target reserve?
4. Should the total reserve have a maximum size? If so, what should it be?
5. Should the Revenue Stabilization Fund continue to have a maximum size? If so, what should it be?

## Background

During FY10, three events occurred that caused the Executive to propose increasing the County's reserve: 1) the April 22 estimate of General Fund revenues in FY10 was \$238 million less than the estimate the Council made in May 2009 when the Council approved the FY10 budget; 2) three huge snow storms cost \$57 million more than was in the budget; and 3) Moody's Investors Service indicated that the County's AAA bond rating might be downgraded, based largely on their concern that the County's reserve is too low. In a memorandum dated May 21, 2010 regarding Reserve and Selected Fiscal Policies, the Executive recommended that the Council approve:

- a) a resolution to establish policies regarding reserves, including the Revenue Stabilization Fund (RSF), and other fiscal matters; and
- b) a Bill to change the RSF law.

The main purpose of the Resolution and Bill is to increase the reserve, which could require the Council to decrease expenditures and/or to increase revenues. Since revenues are at or close to their maximum, unless the Council exceeds the Charter limit on property taxes, expenditures are more likely to be reduced than revenues are to be increased. The Resolution and Bill would make a number of changes to existing policy and law to achieve the increase in reserve.

The calculation of the target reserve for FY11 using the "old"/current policy compared to using the proposed new policy is on ©21. The new reserve policy would both increase the percent of total resources for the target reserve and modify the definition of total resources used to calculate the target reserve.

The target reserve under the old policy is 6% of total resources, defined as:

1. Revenue in the 4 tax supported agencies;
2. Plus net transfers in from non tax supported funds (such as from the Department of Liquor Control and the Cable Fund);
3. Plus total reserve at the beginning of the year; and
4. Minus the RSF at the beginning of the year.

The target reserve under the proposed new policy would be 10% of Adjusted Governmental Revenue (AGR), defined as:

- (1) Tax-supported County governmental funds revenues, plus revenues of the:
- (2) County Grants Fund;
- (3) County Capital Projects Fund;
- (4) tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;
- (5) tax supported funds of Montgomery College, not including the County's local contribution; and

- (6) tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

Components 1 and 4 through 6 are the same as is currently used to calculate the amount of target reserve at 6%. Components 1 and 4 through 6 are listed separately in the definition of AGR to coincide with the accounting definitions used in the County's financial statements, but they represent the tax supported revenues in the 4 tax supported agencies. The second and third components are not currently used, but Finance Department staff recommend including them in the proposed new 10% goal because the County has to advance County cash and wait for collection or reimbursement for most of the revenue. The amount of the existing reserve at the beginning of the year is currently used to calculate the 6% target reserve, but would not be used to calculate the 10% target reserve under the proposed policy. A simpler way of describing AGR under the proposed new policy would be:

1. Revenue in the 4 tax supported agencies;
2. Plus the County Grants Fund; and
3. Plus the County Capital Projects Fund.

The Grants Fund includes activity relating to operating grants funded primarily by Federal and State grants. The Capital Projects Fund includes activity relating to the capital improvements program (CIP) projects.

Because the 6% and the 10% targets are multiplied by different bases, the 10% policy would not necessarily, but would usually, result in a higher reserve. For FY11, the 10% goal would have resulted in a reserve at the end of FY11 that is \$163.1 million higher than the 6% goal, so the Council would have had to reduce spending or increase revenue by that amount.

To mitigate the impact of increasing the amount of the reserve from 6% of tax supported resources to 10% of AGR, the Executive proposed phasing in the increase over the 9 year period FY12-20. As shown on ©22, Finance and OMB project that phasing in the 10% goal would result in lower spending and a higher reserve each year. **This would be the impact of the proposed new goal.**

Council staff recommends approval of the Resolution and Bill with changes noted below.

### Issues Relating to the Resolution

#### **1. Should the Council establish a policy goal of a structurally balanced budget?**

Action Clause 1 in the Resolution states:

“1. Structurally Balanced Budget

*Montgomery County will have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.”*

If non-recurring revenues are used to fund recurring expenses in one year, and if the non-recurring revenue does not recur the following year, then there will be a shortfall in revenues because the expense will recur. Note that neither transfers in nor reserve at the beginning of the year can be used to fund the budget under the proposed policy. The amount of reserve at the beginning of the year can and does vary from year to year, so not using it to fund recurring expenses makes sense. However, at least some (if not most) of the transfers in, such as the transfer from the Department of Liquor Control (DLC), is recurring, and Council staff recommends that the recurring portion of transfers in be used to fund recurring expenses. In other words, the ceiling on the operating budget would be recurring revenues plus recurring transfers in.

**Note that the reserve should not be used to fund the budget under the proposed new policy, so budgeted reserve would never decrease and would continue to increase each year due to the proposed mandatory contribution to the Revenue Stabilization Fund (RSF) in Bill 36-10, until the total reserve (RSF plus General Fund) reached the ceiling, if any.** (Actual reserve would of course decrease if revenue were less than budgeted and/or spending was more than budgeted.)

Budgeted expenditures under the proposed policy cannot exceed recurring revenues (plus recurring transfers in) less the mandatory contribution to the required reserve.

**Council staff recommendation:** modify Action Clause 1 as follows:

1. Structurally Balanced Budget

Montgomery County ~~[[will]]~~ must have a goal of a structurally balanced budget, ~~[[, that is, budgeted]]~~ Budgeted expenditures should not exceed projected recurring revenues plus recurring net transfers in minus the mandatory contribution to the required reserve for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.

2. **Should the total reserve have a maximum size?**

Action Clause 2 in the Resolution states:

“2. Reserves

*Montgomery County will have a goal of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund Balance to an amount equal to approximately 10% of Adjusted Governmental Fund revenues, representing tax-supported governmental and agency revenues, including operating grant and CIP revenues. This goal will be reflected in the Revenue Stabilization Fund law.”*

Bill 36-10 would remove the ceiling on the size of the RSF, and the mandatory contribution in County Code §20-68(a) would permit the size of the RSF to increase without limit, as explained below in the discussion of the Bill.

Council staff believes that the Council should specify a maximum size of the total reserve (GF plus RSF) and recommends that this maximum size be 10% of AGR, as implied by Action Clause 2 above. Council staff believes that there should be a limit on how much taxpayer money is set aside for contingencies. Finance staff believes that the proposal to eliminate the existing cap described below in the discussion of the Bill is prudent since the 10% maximum size can only be exceeded by a mandatory contribution based upon 50% of excess revenue. Finance staff also noted that the 10% target reserve is less than the 2 months of operating expenses recommended as a target reserve by the Government Finance Officers Association (GFOA). The GFOA recommendations for the appropriate level of unrestricted fund balance is at ©23-24.

With regard to the General Fund (GF) reserve, §310 of the Charter limits the reserve in the GF to 5% of the GF revenue in the preceding fiscal year. The Executive's May 21, 2010 memorandum recommended setting aside this 5% maximum every year. Council staff agrees and would include this in Action Clause 2.

**Council staff recommendation:** amend Action Clause 2 as follows:

## 2. Reserves

Montgomery County ~~[[will]]~~ must have a goal of achieving the Charter §310 maximum for the reserve in the General Fund of 5% of General Fund revenues in the preceding fiscal year, and of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund ~~[[Balance to an amount equal to approximately]]~~ reserve to a maximum of 10% of Adjusted Governmental Fund revenues, ~~[[representing tax-supported governmental and agency revenues, including operating grant and CIP revenues]]~~ as defined in the Revenue Stabilization Fund law. This goal ~~[[will]]~~ must be reflected in the Revenue Stabilization Fund law.

## 3. **Should the Council establish a priority for the use of one-time revenues?**

Action Clause 3 states:

### “3. Use of One-Time Revenues

*One-time revenues and revenues in excess of projections will be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or Retiree Health Benefits Prefunding (OPEB).”*

Council staff recommends that the Council add a sentence to this policy statement requiring priority consideration to unfunded liabilities, Retiree Health Benefits Prefunding (OPEB) and Pension Benefits Prefunding.

**Council staff recommendation:** amend Action Clause 3 as follows:

### 3. Use of One-Time Revenues

One-time revenues and revenues in excess of projections ~~[[will]]~~ must be applied first to restoring reserves to policy levels or as required by law. ~~[[In the event that]]~~ If the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities ~~[[such as Pension or Retiree Health Benefits Prefunding (OPEB)]]~~. Priority consideration should be given to unfunded liabilities for Retiree Health Benefits (OPEB) and Pension Benefits Prefunding.

### 4. **Should all of the policy statements be restated as goals rather than requirements?**

Action Clauses 4 and 5 are stated as mandatory requirements. The Council cannot adopt binding fiscal policies through a resolution of this nature. Binding fiscal policies should be established in County law. Therefore these action clauses should be reframed as goals rather than requirements, consistent with the remainder of the Resolution.

**Council staff recommendation:** amend Action Clauses 4 & 5 as follows:

#### 4. PAYGO

*The County ~~[[will]]~~ should allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.*

#### 5. Fiscal Plan

*The County ~~[[will]]~~ should adopt a fiscal plan that is structurally balanced, and that displays expenditures and other uses of resources within annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.*

Council staff notes that the adoption of a fiscal plan will follow logically after the Council acts on the Resolution and the Bill.

### **Issues Related to the Bill**

#### **1. Should the definition in the Bill of Adjusted Governmental Revenue (AGR) be used?**

The Bill would add, in §20-65, Definitions, a new definition for Adjusted Governmental Revenue (AGR) to be used to calculate the mandatory contribution to the RSF. AGR would also be

used as the base for calculating the target reserve under the Resolution. See lines 9-18 of the Bill at ©2. AGR would be the sum of:

- (1) Tax-supported County governmental funds revenues, plus revenues of the:
- (2) County Grants Fund;
- (3) County Capital Projects Fund;
- (4) Tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;
- (5) Tax supported funds of Montgomery College, not including the County's local contribution; and
- (6) Tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

As stated above, Components 1 and 4 through 6 are the same as is currently used to calculate the amount of target reserve at 6%. Components 1 and 4 through 6 are listed separately in the definition of AGR to coincide with the accounting definitions used in the County's financial statements, but they represent the revenues in the 4 tax supported agencies. The second and third components are not currently used, but Finance staff recommend including them in the proposed new 10% goal because the County has to advance County cash and wait for collection or reimbursement for most of the revenue. The amount of the existing reserve at the beginning of the year is currently used to calculate the 6% target reserve, but would not be used to calculate the 10% target reserve under the proposed policy. Since the County has to advance County cash, the County needs some additional reserve to ensure that the cash is in the bank. **Council staff recommendation:** approve the definition of AGR as introduced in the Bill.

## 2. Should the Bill include a definition for excess revenue?

The Bill at lines 73-77 at ©4, uses the concept of excess revenue for determining the mandatory contribution to the RSF. Although the Bill clearly describes the use of the concept, a separate definition in the Bill would make it easier to use the concept in the Bill and corresponding fiscal policies. **Council staff recommendation:** add the following definition after line 25 at ©2:

Excess revenue means the amount, if positive, by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the fiscal year exceed the original projections for these amounts.

The term "original projection" is already defined in the law.

The mandatory contribution in §20-68 would be amended as follows:

*Amend lines 67-77 as follows:*

- (a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:

- (1) the annual percentage increase in the certified revenues projected for the next fiscal year, and
- (2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of [[the]] any excess revenue [[amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts]]; or

### 3. Should the RSF have a maximum size?

The Bill would repeal the maximum size for the RSF contained in §20-67. As discussed earlier, the 10% of AGR goal in the Resolution would have resulted in an additional \$163.1 million in additional spending reductions or increased taxes in FY11. With the mandatory contributions to the RSF contained in the Bill and no cap, the RSF can grow to significantly larger size with no control. As discussed earlier, Finance staff point out that the mandatory contribution to the RSF can only result in a target reserve greater than 10% of AGR by 50% of excess revenues under the Bill. If the Council decides to amend the Bill to keep a cap on total reserve, Finance staff would recommend that the maximum size be greater than the 10% target goal.

The County has some significant mandatory funding obligations. For example, almost 57% of the total combined FY11 agency expenditures are dedicated to the Montgomery County Public Schools (MCPS). Under the State Education Law, increases in State education funding are contingent on the County meeting its maintenance of effort level (MOE) or receiving a waiver from the State Board of Education. An oversized RSF could reduce the County's ability to meet the MOE level and also reduce the County's opportunity to receive a waiver from the State.<sup>1</sup> **Council staff recommendation:** amend the Bill to add a maximum size for the total reserve, which would be the sum of the RSF and the General Fund reserve.

*Add the following definition after line 47 of the Bill at ©3.*

Total reserve means the sum of the reserve in the Fund plus the Unrestricted General Fund Balance.

**Council staff recommends** that the total reserve be 10%, which is the target goal in the Resolution.

*Amend lines 54-63 at ©4 as follows:*

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<sup>1</sup> The State's recent enactment of a new law mandating arbitration to resolve an impasse over the terms of a new collective bargaining agreement with school employee unions is likely to insert additional pressure on the County School Board to provide increased salary and benefits for school employees. See Senate Bill 590.

**20-67. [Fund sources and maximum size.] ~~[[Reserved.]]~~ Maximum size.**

- (a) The Fund must not exceed 10 percent of the average aggregate annual revenue derived from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund in the 3 preceding fiscal years.
- (b) The Director must compute the maximum amount of the Fund annually and report that amount to the County Council not later than June 15.
- (c) The Fund is in addition to any surplus that may be accumulated under Section 310 of the County Charter.]

On the date the Council approves the operating budget, the estimated total reserve in the approved operating budget must not exceed 10% of the estimated Adjusted Governmental Revenues.

The 10% limit on total reserves would also need to be reflected in the mandatory contribution set forth in §20-68. **Council staff recommends** the following amendment:

*Amend lines 65-82 at ©4-5 as follows:*

[(a) Subject to the limit set in Section 20-67(a), the] ~~[[The]]~~ Subject to the limit in Section 20-67, the mandatory annual contribution to the Fund must equal the greater of:

- (a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:
  - (1) the annual percentage increase in the certified revenues projected for the next fiscal year, and
  - (2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of ~~[[the]]~~ any excess revenue ~~[[amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts]]~~; or
- (b) [[an annual amount that does not exceed]] 0.5 percent of the actual Adjusted Governmental Revenues for the current year ~~[[, but which does not result in the sum of the current year-end projected Unrestricted General Fund Balance and the Fund to exceed 10 percent of the Adjusted Governmental Revenues]]~~.

Since both mandatory contributions are based on actual revenues, the mandatory transfer for a fiscal year would be made as part of the year end closing process as is done under the current law.

The 10% ceiling on total reserves must also be reflected in §§20-69 and 20-70 as follows:

*Amend lines 93-100 at ©5 as follows:*

**20-69. Discretionary contributions to Fund.**

The County Executive may recommend and the County Council may by resolution approve additional contributions to the Fund [if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded] subject to the limit in Section 20-67.

**20-70. Transfer of contributions.**

The Director must transfer the mandatory contributions required by Section 20-68 and any discretionary contributions under Section 20-69 from the General [fund] Fund to the Fund at the end of each fiscal year, subject to the limit of Section 20-67.

**4. Should the permitted uses of the Fund be clarified?**

Council staff believes the conditions on using the Fund are unnecessarily complicated and restrictive. The current law requires certain economic triggers to occur before the Council can approve using the Fund by majority vote. However, current law also permits the Council to use the Fund without the economic triggers if approved by a supermajority of 6 Councilmembers. Eliminating the option to approve a transfer from the Fund by a simple majority of Councilmembers would both simplify the process and make it more difficult for the Council to approve a transfer from the Fund. **Council staff recommendation:** amend §20-72 as follows:

*Amend lines 106-139 at ©6-7 as follows:*

**20-72. Use of Fund.**

[(a) After holding a public hearing and seeking the recommendation of the Executive, and if the Council finds that reasonable reductions in expenditures are not sufficient to offset the shortfall in revenue, the Council may by resolution approved by the Executive transfer an amount from the Fund to compensate for no more than half of the difference between the original projection of total General [fund] Fund revenues for that fiscal year and a revised forecast of the General Fund revenues projected for the same fiscal year. If the Executive disapproves a resolution within 10 days after it is transmitted and the Council readopts it by a vote of 6 Councilmembers, or if the

Executive does not act within 10 days after it is transmitted, the resolution takes effect.]]

[[b) However, a transfer must not be approved unless 2 of the following conditions are met:

- (1) The Director estimates that total General Fund revenues will fall more than 2 percent below the original projected revenues.
- (2) Resident employment in the County has declined for 6 consecutive months compared to the same month in the previous year.
- (3) The [[local] most recent regional index of leading economic indicators, published by the Center for Regional Analysis, George Mason University, or a successor index determined by the Department of Finance, has declined for 3 consecutive months.]]

[[c) The cumulative transfers from the Fund in any single fiscal year must not exceed half of the balance in the Fund at the start of that fiscal year.]]

[[d) The funds transferred may only be used to support appropriations which have become unfunded.]]

[[e)]] By an affirmative vote of 6 Councilmembers, the Council, after holding a public hearing and seeking the recommendation of the Executive, may transfer [[amounts]] any amount from the Fund to the General Fund [[without regard to the limits and conditions in subsections (a)-(c)]] to support appropriations which have become unfunded.

### Other Issues for Discussion

1. The two reserves discussed are in the General Fund and the Revenue Stabilization Fund, because these are the largest. However, six other major funds have or can have a reserve, which is included in the current 6% goal but would **not** be included in the new 10% goal. These funds are Mass Transit, Fire, Recreation, MNCPPC, College, and MCPS (never budgeted for a reserve but always has some actual reserve at the end of the year, resulting from not spending the entire appropriation).

The Executive did not propose a reserve goal for these funds, but all of them are funded partly by property tax revenue, so there is a limit on the amount of reserve they can have, if property tax is at the Charter limit. **In fact, since all resources from all funds are used to calculate target reserve, but the target reserve is allocated to the GF + the RSF, then the reserve in the remaining funds would be zero.**

Council staff believes the new policy should include these funds and has asked Executive staff for suggestions.

2. Should we again consider putting Mass Transit, Fire, and Recreation in the General Fund, to strengthen the General Fund?

| <u>This packet contains:</u>                              | <u>Circle</u> |
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Bill No. 36-10  
Concerning: Finance - Revenue  
Stabilization Fund - Amendments  
Revised: May 25, 2010 Draft No. 2  
Introduced: May 27, 2010  
Expires: November 27, 2011  
Enacted: \_\_\_\_\_  
Executive: \_\_\_\_\_  
Effective: \_\_\_\_\_  
Sunset Date: None  
Ch. \_\_\_\_\_, Laws of Mont. Co. \_\_\_\_\_

## COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

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By: Council President at the Request of the County Executive

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**AN ACT to:**

- (1) repeal the limit on the size of the Revenue Stabilization Fund;
- (2) modify the requirement for mandatory County contributions to the Revenue Stabilization Fund; and
- (3) generally amend the law governing the Revenue Stabilization Fund.

By amending

Montgomery County Code  
Chapter 20, Finance  
Article XII  
Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72

By repealing

Montgomery County Code  
Chapter 20, Finance  
Article XII  
Section 20-67

|                              |  |
|------------------------------|--|
| <b>Boldface</b>              | <i>Heading or defined term.</i>                            |
| <u>Underlining</u>           | <i>Added to existing law by original bill.</i>             |
| [Single boldface brackets]   | <i>Deleted from existing law by original bill.</i>         |
| <u>Double underlining</u>    | <i>Added by amendment.</i>                                 |
| [[Double boldface brackets]] | <i>Deleted from existing law or the bill by amendment.</i> |
| * * *                        | <i>Existing law unaffected by bill.</i>                    |

*The County Council for Montgomery County, Maryland approves the following Act:*

1           **Sec. 1. Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72 are**  
 2 **amended and Section 20-67 is repealed as follows:**

3 **20-65.       Definitions.**

4           In this Article the following terms have the following meanings, unless the  
 5 context clearly indicates a different meaning:

6           [(a)] *Actual total revenues* means the combined total of income tax, real  
 7 property transfer tax, recordation tax, and investment income, as  
 8 reported in the County's annual financial report.

9           *Adjusted Governmental Revenues* means tax-supported County  
 10 *Governmental Funds revenues, plus revenues of the:*

- 11           (1) *County Grants Fund;*
- 12           (2) *County Capital Projects Fund;*
- 13           (3) *tax supported funds of the Montgomery County Public Schools,*  
 14 *not including the County's local contribution;*
- 15           (4) *tax supported funds of Montgomery College, not including the*  
 16 *County's local contribution; and*
- 17           (5) *tax supported funds of the Montgomery County portion of the*  
 18 *Maryland-National Capital Park and Planning Commission.*

19           [(b)] *Certified revenues* means revenues derived each fiscal year from the  
 20 income tax, real property transfer tax, recordation tax, and investment  
 21 income of the General Fund as certified by the Director on or before  
 22 June 15.]

23           [(c)] *Debt Service Fund* means the fund used to accumulate funds to pay  
 24 general long-term debt principal, interest and related costs.]

25           [(d)] *Director* means the Director of the Department of Finance.

26           [(e)] *Fund* means the Revenue Stabilization Fund created under this  
 27 Article.

28 [(f)] *General Fund* means the general operating fund of the County which  
 29 is used to account for all revenues and expenditures, except revenues  
 30 and expenditures required to be accounted for in another fund.

31 [(g)] *Income tax* means the County income tax imposed under state law.

32 [(h)] *Investment income of the General Fund* means income from the  
 33 investment of revenues that is reported in the General Fund.

34 [(i)] *Original projection* means the projection of total General Fund  
 35 revenues for the next fiscal year approved by the County Council in  
 36 the “Schedule of Revenue Estimates and Appropriations” resolution  
 37 or any similar resolution.

38 [(j)] *Real property transfer tax* means the tax imposed under Sections 51-  
 39 19 et. seq.

40 [(k)] *Recordation tax* means the tax imposed under Sections 12-101 et.  
 41 seq., Tax-Property Article, [Annotated Code of] Maryland Code.

42 [(l)] *Revised forecast* means any revised projection of total General Fund  
 43 revenues for the next fiscal year prepared by the Department of  
 44 Finance.

45 *Unrestricted General Fund Balance* means the residual portion of the  
 46 General Fund fund balance that has not been reserved, restricted, or  
 47 encumbered for later years’ expenditures.

48 **20-66. Revenue Stabilization Fund.**

49 (a) The Director may establish a Revenue Stabilization Fund to support  
 50 appropriations which have become unfunded.

51 (b) The Fund is continuing and non-lapsing.

52 (c) The Fund is in addition to any surplus that is accumulated under  
 53 Section 310 of the County Charter.

54 **20-67. [Fund sources and maximum size.] Reserved.**

55 [(a) The Fund must not exceed 10 percent of the average aggregate annual  
56 revenue derived from the income tax, real property transfer tax,  
57 recordation tax, and investment income of the General Fund in the 3  
58 preceding fiscal years.

59 (b) The Director must compute the maximum amount of the Fund  
60 annually and report that amount to the County Council not later than  
61 June 15.

62 (c) The Fund is in addition to any surplus that may be accumulated under  
63 Section 310 of the County Charter.]

64 **20-68. Mandatory contribution to Fund.**

65 [(a) Subject to the limit set in Section 20-67(a), the] The mandatory annual  
66 contribution to the Fund must equal the greater of:

67 (a) [50 percent of the product of the certified revenues estimated for the  
68 current fiscal year times the difference between:

69 (1) the annual percentage increase in the certified revenues  
70 projected for the next fiscal year, and

71 (2) the average annual percentage increase in the certified revenues  
72 collected in the 6 fiscal years immediately preceding the next  
73 fiscal year.] 50 percent of the amount by which actual total  
74 revenues from the income tax, real property transfer tax,  
75 recordation tax, and investment income of the General Fund for  
76 the next fiscal year exceed the original projections for these  
77 amounts; or

78 (b) an annual amount that does not exceed 0.5 percent of the Adjusted  
79 Governmental Revenues for the current year, but which does not

80 result in the sum of the current year-end projected Unrestricted  
 81 General Fund Balance and the Fund to exceed 10 percent of the  
 82 Adjusted Governmental Revenues.

83 [(b) A growth or decline in certified revenues which results from either an  
 84 increase or decrease in County tax rates must be:

- 85 (1) excluded from revenues projected for the next fiscal year, and  
 86 (2) phased in in the average annual percentage increase calculation  
 87 in the third, fourth, fifth and sixth years.

88 (c) If actual total revenues from the income tax, real property transfer tax,  
 89 recordation tax, and investment income of the General Fund for the  
 90 next fiscal year exceed the original projection, then 50 percent of the  
 91 excess must be transferred to the Fund if doing so will not result in the  
 92 10 percent limit in Section 20-67(a) being exceeded.]

93 **20-69. Discretionary contributions to Fund.**

94 The County Executive may recommend and the County Council may by  
 95 resolution approve additional contributions to the Fund [if doing so will not result  
 96 in the 10 percent limit in Section 20-67(a) being exceeded].

97 **20-70. Transfer of contributions.**

98 The Director must transfer the mandatory contributions required by Section  
 99 20-68 and any discretionary contributions under Section 20-69 from the General  
 100 [fund] Fund to the Fund at the end of each fiscal year.

101 **20-71. Interest.**

102 All interest earned on the Fund must be added to the Fund. [However, the  
 103 Director must transfer interest earned on the Fund when the Fund exceeds 50  
 104 percent of the maximum Fund size authorized by Section 20-67(a) to the Debt  
 105 Service Fund as an offset to the approved issuance of general obligation debt.]

106 **20-72. Use of Fund.**

107 (a) After holding a public hearing and seeking the recommendation of the  
108 Executive, and if the Council finds that reasonable reductions in  
109 expenditures are not sufficient to offset the shortfall in revenue, the  
110 Council may by resolution approved by the Executive transfer an  
111 amount from the Fund to compensate for no more than half of the  
112 difference between the original projection of total General [fund]  
113 Fund revenues for that fiscal year and a revised forecast of the  
114 General Fund revenues projected for the same fiscal year. If the  
115 Executive disapproves a resolution within 10 days after it is  
116 transmitted and the Council readopts it by a vote of 6  
117 Councilmembers, or if the Executive does not act within 10 days after  
118 it is transmitted, the resolution takes effect.

119 (b) However, a transfer must not be approved unless 2 of the following  
120 conditions are met:

121 (1) The Director estimates that total General Fund revenues will  
122 fall more than 2 percent below the original projected revenues.

123 (2) Resident employment in the County has declined for 6  
124 consecutive months compared to the same month in the  
125 previous year.

126 (3) The [local] most recent regional index of leading economic  
127 indicators, published by the Center for Regional Analysis,  
128 George Mason University, or a successor index determined by  
129 the Department of Finance, has declined for 3 consecutive  
130 months.

131 (c) The cumulative transfers from the Fund in any single fiscal year must  
132 not exceed half of the balance in the Fund at the start of that fiscal  
133 year.

134 (d) The funds transferred may only be used to support appropriations  
135 which have become unfunded.

136 (e) By an affirmative vote of 6 Councilmembers, the Council, after  
137 holding a public hearing and seeking the recommendation of the  
138 Executive, may transfer amounts from the Fund without regard to the  
139 limits and conditions in subsections (a)-(c).

140 *Approved:*

141

142

143 \_\_\_\_\_  
Nancy M. Floreen, President, County Council Date

144 *Approved:*

145

146

147 \_\_\_\_\_  
Isiah Leggett, County Executive Date

148 *This is a correct copy of Council action.*

149

150

151 \_\_\_\_\_  
Linda M. Lauer, Clerk of the Council Date

## LEGISLATIVE REQUEST REPORT

Bill 36-10

*Revenue Stabilization Fund - Amendments*

|   |   |
|---|---|
| <b>DESCRIPTION:</b>                       | The requested legislation removes the cap from the Revenue Stabilization Fund (RSF), retains interest earned in the RSF, and requires mandatory contributions to the RSF to achieve total reserves of 10%.            |
| <b>PROBLEM:</b>                           | The legislation would help ensure adequate reserve levels by increasing them to 10% over the next ten, or fewer, years.   |
| <b>GOALS AND OBJECTIVES:</b>              | This legislation, along with the accompanying "Reserve and Selected Fiscal Policies" Resolution is designed to strengthen the County's fiscal health, by improving budgetary flexibility and building reserve levels. |
| <b>COORDINATION:</b>                      | Department of Finance; Office of Management and Budget  |
| <b>FISCAL IMPACT:</b>                     | To be requested.  |
| <b>ECONOMIC IMPACT:</b>                   | To be requested.  |
| <b>EVALUATION:</b>                        | To be requested.  |
| <b>EXPERIENCE ELSEWHERE:</b>              | To be researched.   |
| <b>SOURCE OF INFORMATION:</b>             | Jennifer Barrett, Director, Department of Finance<br>Joseph Beach, Director, Office of Management and Budget<br>Kathleen Boucher, Assistant Chief Administrative Officer  |
| <b>APPLICATION WITHIN MUNICIPALITIES:</b> | N/A   |
| <b>PENALTIES:</b>                         | N/A   |



OFFICE OF THE COUNTY EXECUTIVE  
ROCKVILLE, MARYLAND 20850

Isiah Leggett  
*County Executive*

MEMORANDUM

May 21, 2010

TO: Nancy Floreen, President, County Council  
FROM: Isiah Leggett, County Executive  
SUBJECT: Reserve and Selected Fiscal Policies

In my April 22<sup>nd</sup> memorandum to the Council on Additional Budget Actions, I notified the Council of the need for revisions to the County's reserve policies. I made this recommendation in light of recent severe reductions in revenues, unanticipated expenditure pressures, and Moody's rating action putting the County on a negative watchlist. All three rating agencies included strong statements of concern regarding the County's reserves and budgetary structural balance in their most recent ratings.

As I indicated to you in April, I have asked for and received a careful review of the County's reserve policies by the County's Financial Advisor, PFM. As a result of that review, I am recommending a set of actions and policies which will set the County on a stronger fiscal path for FY11 and beyond. Attached to this memorandum you will find a resolution specifying these policies for Council's consideration and action, legislation to change the County's Revenue Stabilization Fund law, and a restructured balanced Fiscal Plan showing budgetary levels afforded within projected revenues and my plan for restoration of the County's key reserves to the recommended policy levels.

Specifically, the recommended reserve levels incorporate current and future risks, including:

- Potential for future State actions which may negatively affect the County's revenues and/or place additional expenditure requirements on the County.
- Numerous one-time actions taken to solve the FY10 and FY11 budget challenges.

### **Recommended Actions**

The attached charts (Attachments A and B) provide background on the current status of the County's most key fiscal policies, detailing the recommendations I made to you in April, and those that I am making today. In addition, I will soon be transmitting to you a report from the County's Financial Advisor, PFM, that provides further analysis and detail on the concerns of Moody's and the other Rating Agencies, and the fiscal circumstances that support the need for the recommended actions.

Specifically, I am recommending the following policies and actions, which are further detailed in the attachments:

1. For FY11, budget reserves at the current policy level of 6%, and within 10 years (by 2020), bring total reserves to 10%
2. Bring General Fund reserves to the charter maximum of 5%
3. Require mandatory contributions to the Revenue Stabilization Fund to a combined reserve level of 10%
4. Restore and maintain PAYGO at the policy level of 10% of general obligation bonds planned for issue
5. Budget expenditures for a fiscal year only up to the amount of recurring revenues for that fiscal year
6. Direct one-time revenues exceeding projections to the Revenue Stabilization Fund, PAYGO, Pension or Retiree's Health Benefit pre-funding, and one-time expenditures
7. Achieve a fiscal plan for future years that is structurally balanced – that matches expenditures to available revenues without any draw down of reserves or unanticipated revenues
8. Review budgeting practices for significant, known expenditures, and ensure adequacy of appropriations and possible carry-over provisions for unspent amounts

The combination of these actions is estimated to achieve structural budgetary balance and grow reserve levels to 10% by 2020 or sooner, enough to sustain the County through a variety of the pressures noted above. The reserve amounts I am recommending will also help ensure sufficient working capital through the County's usual fiscal cycle.

I very strongly recommend restoring General Fund reserves to the maximum allowed Charter level, and planning for a series of mandatory contributions to the Revenue Stabilization Fund to achieve a total reserve level of 10%. I recommend we strengthen our policies regarding a balanced budget and use of one-time revenues, and commit to return to our existing PAYGO policy. This set of actions will provide additional flexibility to the County in FY12 and beyond to respond to further adverse economic and fiscal conditions.

Nancy Floreen, Council President  
May 21, 2010  
Page 3

These actions are only the beginning of the work before us. I believe that together, we must steer the County back to structurally balanced budgets and return it to its fiscally conservative roots, restoring sufficiently strong reserve levels, to ensure that we do not return to the budget stresses we currently face. I believe the set of recommendations before you will ensure that outcome, and I urge your approval.

Enclosures

Attachment A – Reserve Policies – Overview  
Attachment B – Comparison of Fiscal Policies and Practices  
Resolution – Reserve and Selected Fiscal Policies  
Draft Bill - Revenue Stabilization Fund  
Restructured Balanced Fiscal Plan – FY11-16

cc: Duchy Trachtenberg, Chair, MFP Committee  
Timothy Firestine, Chief Administrative Officer  
Jennifer Barrett, Director of Finance  
Joseph Beach, Director, OMB  
Stephen Farber, Council Staff Director  
Kathleen Boucher, ACAO

**ATTACHMENT A**

**RESERVE POLICIES – OVERVIEW**

**1. CURRENT POLICIES**

Balanced Budget: expenditures not to exceed resources (including prior year ending fund balance)  
Reserves: 6% of combined all tax supported (including outside agencies) and revenue stabilization fund (RSF)  
RSF: mandatory contribution up to cap, investment earnings go to PAYGO  
PAYGO: 10% of planned GO Bond issues  
One Time Revenues: whenever possible give highest priority to capital assets or other non-recurring expenditures

**2. APRIL 22<sup>nd</sup> MEMORANDUM**

Balanced Budget: budgeted expenditures should match new revenues projected to occur in that fiscal year  
Reserves: 6% for FY11 and ramp up to 8% by end of FY13  
General Fund (GF) at Charter Limit – 5% of prior year GF revenues  
RSF: mandatory contributions to RSF to 3% (total of 8%), remove cap  
PAYGO: restore and maintain at 10% policy level  
One Time Revenues: direct in priority order to RSF, PAYGO, Retiree Health pre-funding, and one-time expenditures  
Fiscal Plan: achieve a fiscal plan display that is structurally balanced consistent with balanced budget policy

**3. RECOMMENDED – PFM MAY 2010**

Balanced Budget: expenditures not to exceed revenues  
Reserves: 6% for FY11, then ramp up combined General Fund and RSF balances over ten years to 10% of adjusted governmental revenues—  
RSF: mandatory contributions up to 10% reserve policy, remove cap, investment earnings retained in RSF  
PAYGO: 10% of planned GO Bond issues  
One Time Revenues: applied first to restoring reserves to policy levels or as required by law. If reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB

ATTACHMENT B

COMPARISON OF FISCAL POLICIES AND PRACTICES – CURRENT POLICY/PRACTICE vs. RECOMMENDED

|                                     | CURRENT POLICY/PRACTICE  | PFM and FINANCE RECOMMENDED POLICIES  |
|-------------------------------------|--|---|
| <b>Structurally Balanced Budget</b> | <p>Current Fiscal Policy:</p> <p><i>It is the fiscal policy of Montgomery County to balance the budget. A balanced budget has its funding sources (revenues, undesignated carryover, and other resources) equal to its funding uses (expenditures, reserves, and other allocations). No deficit may be planned or incurred.</i></p>  | <p>Recommended Policy:</p> <p><i>Montgomery County will have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.</i></p>  |
| <b>Reserves</b>                     | <p>Current Fiscal Policy:</p> <p><i>The County will maintain total reserves for tax supported funds that include both an operating margin reserve and the RSF. For tax supported funds, the budgeted total reserve of the operating margin and the RSF should be at least 6.0 percent of total resources (i.e., revenues, transfers, prior year undesignated and designated fund balance).</i></p> | <p>Recommended Policy:</p> <p><i>Montgomery County will have a goal over 10 years (by 2020) of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund to an amount equal to approximately 10% of Adjusted Governmental Fund revenues.</i></p> <p>Higher reserves are recommended in keeping with:</p> <ol style="list-style-type: none"> <li>1) revenue volatility</li> <li>2) expenditure volatility</li> <li>3) working capital needs</li> <li>4) more in line with other large AAA jurisdictions</li> </ol> |
| <b>General Fund Reserves</b>        | <p>Section 310 of Charter:</p> <p><i>With respect to the General Fund, any unappropriated surplus shall not exceed five percent of the General Fund revenue for the preceding fiscal year.</i></p>   | <p>Retain, but policy reserves above Charter limitation will be included in target for RSF.</p>   |

ATTACHMENT B (continued)

|  |   |   |
|--|---|---|
| <p><b>Revenue Stabilization Fund (RSF)</b></p> | <p>RSF is currently capped at 10% of average of prior 3 years specific revenue sources. Interest earned is transferred to PAYGO, and mandatory contributions are based on revenues exceeding estimates.<br/>(See County Code Ch 20 Article XII)</p> <p>If actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection, then 50 percent of the excess must be transferred to the Fund.</p> | <p>Remove cap, retain interest earned in RSF, and require mandatory contributions to achieve total reserves of 10% and when revenues exceed estimates:</p> <p><b>Mandatory annual contributions to the Fund must equal the greater of:</b></p> <p><b>50 percent of the amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection for these amounts.</b></p> <p><b>An annual amount not to exceed 0.5 percent of the Adjusted Governmental Revenues for the current year, but which does not result in the sum of the current year-end projected Unrestricted General Fund fund balance and the Revenue Stabilization Fund to exceed 10 percent of the Adjusted Governmental Revenues.</b></p> |
| <p><b>Use of One-time Revenues</b></p>         | <p>Current Fiscal Policy:</p> <p><b>Except for excess revenues which must go to the Revenue Stabilization Fund, the County will, whenever possible, give highest priority for the use of one-time revenues from any source to the funding of capital assets or other nonrecurring expenditures so as not to incur ongoing obligations for which revenues may not be adequate in future years.</b></p>   | <p>Recommended Policy:</p> <p><b>One-time revenues and revenues in excess of projections will be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB.</b></p>  |

ATTACHMENT B (continued)

|   |  |   |
|---|--|---|
| <p><b>PAYGO</b></p>                             | <p>Current CIP Fiscal Policy:</p> <p><i>It is the County's policy to allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.</i></p> | <p>Recommended Policy: (unchanged)</p> <p><i>The County will allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.</i></p>  |
| <p><b>Fiscal Plan</b></p>                       | <p>Shows Resources and Uses balanced in the budget year. To the extent uses exceed resources in future years, deficit amounts are displayed as Gaps to be closed in future budgets.</p>                                | <p>Recommended Policy:</p> <p><i>The County will adopt a fiscal plan that is structurally balanced, and that displays expenditures and other uses of resources within annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.</i></p> |
| <p><b>Adequacy of budget appropriations</b></p> | <p>Minimal levels are budgeted for certain known expenditures, not in line with actual experience.</p>   | <p>Budget at more realistic levels, possibly in a separate account where unused balance can carry over to next year.</p>  |

## County Executive's Recommended FY11-16 Public Services Program

(\$ in Millions)

|   | App.<br>FY10   | Est.<br>FY10   | % Chg.<br>FY10-11 | App.<br>FY11     | % Chg.<br>FY11-12 | Projected<br>FY12 | % Chg.<br>FY12-13 | Projected<br>FY13 | % Chg.<br>FY13-14 | Projected<br>FY14 | % Chg.<br>FY14-15 | Projected<br>FY15 | % Chg.<br>FY15-16 | Projected<br>FY16 |
|---|----------------|----------------|-------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Total Revenues</b>   | <b>5-21-09</b> | <b>5-27-10</b> | <b>Rec/Bud</b>    | <b>5-27-10</b>   |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 1 Property Tax (less PDs)   | 1,440.9        | 1,437.8        | 0.6%              | 1,450.1          | 2.7%              | 1,489.9           | 3.0%              | 1,534.9           | 3.1%              | 1,582.6           | 3.4%              | 1,635.9           | 2.4%              | 1,675.3           |
| 2 Income Tax  | 1,214.8        | 1,026.3        | -12.7%            | 1,060.7          | 6.6%              | 1,130.2           | 6.2%              | 1,200.8           | 5.3%              | 1,264.8           | 8.6%              | 1,373.6           | 7.9%              | 1,482.6           |
| 3 Transfer/Recard. Tax  | 123.4          | 114.8          | 13.4%             | 139.9            | 6.0%              | 148.3             | -2.2%             | 145.1             | 8.7%              | 157.8             | 7.5%              | 169.7             | 5.1%              | 178.3             |
| 4 Investment Income   | 5.9            | 1.3            | -38.2%            | 3.6              | 88.3%             | 6.9               | 95.1%             | 13.4              | 28.0%             | 17.1              | 16.8%             | 20.0              | 8.8%              | 21.7              |
| 5 Other Taxes   | 185.3          | 201.0          | 69.0%             | 313.2            | 2.8%              | 322.1             | -32.8%            | 216.4             | 2.9%              | 222.6             | 2.8%              | 228.9             | 2.7%              | 235.1             |
| 6 Other Revenues  | 834.6          | 832.6          | -2.8%             | 811.6            | -2.5%             | 791.7             | 0.7%              | 797.2             | 0.7%              | 803.1             | 0.8%              | 809.6             | 0.9%              | 816.6             |
| 7 <b>Total Revenues</b>   | <b>3,804.9</b> | <b>3,613.9</b> | <b>-0.7%</b>      | <b>3,779.2</b>   | <b>2.9%</b>       | <b>3,889.1</b>    | <b>0.5%</b>       | <b>3,907.8</b>    | <b>3.6%</b>       | <b>4,048.0</b>    | <b>4.7%</b>       | <b>4,237.6</b>    | <b>4.1%</b>       | <b>4,409.6</b>    |
| 8   |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 9 <b>Net Transfers In (Out)</b>   | <b>37.2</b>    | <b>62.1</b>    | <b>12.0%</b>      | <b>41.7</b>      | <b>-68.0%</b>     | <b>13.4</b>       | <b>2.4%</b>       | <b>13.7</b>       | <b>2.6%</b>       | <b>14.0</b>       | <b>2.8%</b>       | <b>14.4</b>       | <b>3.0%</b>       | <b>14.9</b>       |
| 10 <b>Total Revenues and Transfers Available</b>  | <b>3,842.2</b> | <b>3,676.0</b> | <b>-0.6%</b>      | <b>3,820.9</b>   | <b>2.1%</b>       | <b>3,902.4</b>    | <b>0.5%</b>       | <b>3,921.4</b>    | <b>3.6%</b>       | <b>4,062.0</b>    | <b>4.7%</b>       | <b>4,252.0</b>    | <b>4.1%</b>       | <b>4,424.4</b>    |
| 11  |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 12 <b>Non-Operating Budget Use of Revenues</b>  |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 13 Debt Service   | 251.5          | 243.8          | 5.0%              | 264.0            | 11.9%             | 295.3             | 11.3%             | 328.6             | 8.3%              | 356.1             | 6.3%              | 378.5             | 4.6%              | 396.1             |
| 14 PAYGO  | 1.3            | 0.3            | -100.0%           | -                | n/a               | 32.5              | 0.0%              | 32.5              | 0.0%              | 32.5              | 0.0%              | 32.5              | 0.0%              | 32.5              |
| 15 CIP Current Revenue  | 30.7           | 20.9           | -22.6%            | 23.8             | 72.1%             | 40.9              | 40.3%             | 57.4              | 41.0%             | 81.0              | 3.9%              | 84.2              | -24.7%            | 63.4              |
| 16 Montgomery College Reserves  | -              | -              | -                 | -                | -                 | 4.0               | 1.9%              | 4.0               | 1.8%              | 4.1               | 1.8%              | 4.2               | 1.9%              | 4.3               |
| 17 MNCPPC Reserves  | -              | -              | -                 | -                | -                 | 4.3               | 3.7%              | 4.5               | 3.5%              | 4.6               | 3.6%              | 4.8               | 2.6%              | 4.9               |
| 18 Contribution to General Fund Undesignated Reserves                                       | (39.3)         | (82.3)         | 372.2%            | 107.1            | -100.4%           | (0.4)             | 1498.5%           | 5.4               | -119.9%           | (1.1)             | 668.3%            | 6.1               | 39.3%             | 8.5               |
| 19 Contribution to Revenue Stabilization Reserves   | -              | (59.3)         | n/a               | 33.9             | -28.5%            | 24.3              | -16.0%            | 20.4              | 16.4%             | 23.7              | 44.9%             | 34.4              | -6.3%             | 32.2              |
| 20 Retiree Health Insurance Pre-Funding   | -              | -              | n/a               | -                | n/a               | 83.6              | 22.7%             | 102.6             | 18.6%             | 121.7             | 14.9%             | 139.8             | 5.0%              | 146.8             |
| 21 Set Aside for other uses (supplemental appropriations)                                   | 2.5            | 60.1           | -90.2%            | 0.3              | 8916.1%           | 22.5              | 0.0%              | 22.5              | 0.0%              | 22.5              | -11.3%            | 20.0              | 0.0%              | 20.0              |
| 22 <b>Total Other Uses of Resources</b>   | <b>246.7</b>   | <b>183.6</b>   | <b>73.9%</b>      | <b>429.1</b>     | <b>18.2%</b>      | <b>507.1</b>      | <b>14.0%</b>      | <b>578.0</b>      | <b>11.6%</b>      | <b>645.2</b>      | <b>9.2%</b>       | <b>704.4</b>      | <b>0.6%</b>       | <b>708.5</b>      |
| 23 <b>Available to Allocate to Agencies (Total Revenues+Net Transfers-Total Other Uses)</b> | <b>3,595.4</b> | <b>3,492.4</b> | <b>-5.7%</b>      | <b>3,391.8</b>   | <b>0.1%</b>       | <b>3,395.3</b>    | <b>-1.5%</b>      | <b>3,343.4</b>    | <b>2.2%</b>       | <b>3,416.9</b>    | <b>3.8%</b>       | <b>3,547.7</b>    | <b>4.7%</b>       | <b>3,715.9</b>    |
| 24  |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 25 <b>Agency Uses</b>   |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 26  |                |                |                   |                  |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| 27 Montgomery County Public Schools (MCPS)  | 2,020.1        | 1,989.9        | -5.0%             | 1,919.8          | 0.3%              | 1,926.240         | -1.3%             | 1,901.5           | 2.4%              | 1,947.9           | 4.1%              | 2,027.1           | 5.0%              | 2,127.9           |
| 28 Montgomery College (MC)  | 217.5          | 214.5          | -0.8%             | 215.8            | 1.0%              | 217.853           | -0.6%             | 216.5             | 3.1%              | 223.3             | 4.7%              | 233.8             | 5.6%              | 247.0             |
| 29 MNCPPC (w/o Debt Service)  | 106.6          | 103.2          | -13.1%            | 92.7             | -1.4%             | 91.331            | -3.2%             | 88.4              | 0.6%              | 88.9              | 2.2%              | 90.9              | 3.2%              | 93.8              |
| 28 MCG  | 1,251.2        | 1,184.8        | -7.0%             | 1,163.6          | -0.3%             | 1,159.870         | -2.0%             | 1,136.9           | 1.7%              | 1,156.8           | 3.4%              | 1,195.9           | 4.3%              | 1,247.3           |
| 29 <b>Subtotal Agency Uses</b>  | <b>3,595.4</b> | <b>3,492.4</b> | <b>-5.7%</b>      | <b>3,391.8</b>   | <b>0.1%</b>       | <b>3,395.3</b>    | <b>-1.5%</b>      | <b>3,343.4</b>    | <b>2.2%</b>       | <b>3,416.9</b>    | <b>3.8%</b>       | <b>3,547.7</b>    | <b>4.7%</b>       | <b>3,715.9</b>    |
| 30 <b>Total Uses</b>  | <b>3,842.2</b> | <b>3,676.0</b> | <b>-0.6%</b>      | <b>3,820.9</b>   | <b>2.1%</b>       | <b>3,902.4</b>    | <b>0.5%</b>       | <b>3,921.4</b>    | <b>3.6%</b>       | <b>4,062.0</b>    | <b>4.7%</b>       | <b>4,252.0</b>    | <b>4.1%</b>       | <b>4,424.4</b>    |
| 31 <b>(Gap)/Available</b>   | <b>0.000</b>   | <b>0.000</b>   |                   | <b>0.0000000</b> |                   | <b>0.000</b>      |

**Notes:**

1. FY12-16 property tax revenues are at the Charter Limit assuming a tax credit. All other tax revenues at current rates except as noted below.
2. Revenues reflect Energy Tax and Wireless Telephone Tax increases approved by the County Council on May 27, 2010. Energy Tax increase sunsets at the end of FY12.
3. PAYGO restored to policy level of 10% of planned GO Bond borrowing in FY12-16. See Row 14 above.
4. FY11 Revenues reflect one year redirection of Recordation Tax Premium (\$8 M.) and Recordation Tax for MCPS CIP and College IT (\$5 M.).
5. Retiree Health Insurance Pre-Funding assumed to resume at scheduled contribution levels in FY12. See Row 20 above.
6. Projected FY12-16 rate of growth of Agency Uses constrained to balance the fiscal plan in FY12-16.
7. FY11 Reserves reflect restoration of reserves to current 6% (of tax supported resources) policy level. FY10 and FY11 reserves (see Rows 34-42 below) include all County and Outside Agency tax supported reserves.
8. FY12-16 Unrestricted General Fund Reserves are reduced in certain years to reflect compliance with Section 310 of the County Charter on maximum size of the general fund balance (shall not exceed 5% of prior year general fund revenues). Outside Agency reserves are excluded from these amounts and are displayed separately (see Rows 29 and 30 above).
9. FY12-16 Reserves reflect proposed new reserve policy including increase in reserve levels and inclusion of capital projects and grant revenues as part of Adjusted Governmental Revenues.

**County Executive's Recommended FY11-16 Public Services Program**

(\$ in Millions)

|  | App.<br>FY10 | Est.<br>FY10  | % Chg.<br>FY10-11 | Rec.<br>FY11 | % Chg.<br>FY11-12 | Projected<br>FY12 | % Chg.<br>FY12-13 | Projected<br>FY13 | % Chg.<br>FY13-14 | Projected<br>FY14 | % Chg.<br>FY14-15 | Projected<br>FY15 | % Chg.<br>FY15-16 | Projected<br>FY16 |
|--|--------------|---------------|-------------------|--------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Beginning Reserves</b>  |              |               |                   |              |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Unrestricted General Fund  | 115.5        | 112.0         | -74.3%            | 29.7         | 360.4%            | 136.8             | -0.3%             | 136.4             | 3.9%              | 141.8             | -0.8%             | 140.7             | 4.3%              | 146.8             |
| Revenue Stabilization Fund   | 119.6        | 119.6         | -49.5%            | 60.4         | 56.2%             | 94.3              | 25.7%             | 118.6             | 17.2%             | 139.0             | 17.1%             | 162.7             | 21.1%             | 197.1             |
| <b>Total Reserves</b>  | <b>235.2</b> | <b>231.6</b>  | <b>-61.7%</b>     | <b>90.1</b>  | <b>156.5%</b>     | <b>231.1</b>      | <b>10.3%</b>      | <b>255.0</b>      | <b>10.1%</b>      | <b>280.7</b>      | <b>8.1%</b>       | <b>303.4</b>      | <b>13.3%</b>      | <b>343.9</b>      |
| <b>Additions to Reserves</b>   |              |               |                   |              |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Unrestricted General Fund  | -39.3        | -82.3         | 372.2%            | 107.1        | -100.4%           | -0.4              | 1498.5%           | 5.4               | -119.9%           | -1.1              | 668.3%            | 6.1               | 39.3%             | 8.5               |
| Revenue Stabilization Fund   | 0.0          | -59.3         | n/a               | 33.9         | -28.5%            | 24.3              | -16.0%            | 20.4              | 16.4%             | 23.7              | 44.9%             | 34.4              | -6.3%             | 32.2              |
| <b>Total Change in Reserves</b>  | <b>-39.3</b> | <b>-141.5</b> | <b>-458.4%</b>    | <b>141.0</b> | <b>-83.1%</b>     | <b>23.9</b>       | <b>7.9%</b>       | <b>25.8</b>       | <b>-12.1%</b>     | <b>22.6</b>       | <b>78.6%</b>      | <b>40.5</b>       | <b>0.5%</b>       | <b>40.7</b>       |
| <b>Ending Reserves</b>   |              |               |                   |              |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Unrestricted General Fund  | 76.2         | 29.7          | 79.5%             | 136.8        | -0.3%             | 136.4             | 3.9%              | 141.8             | -0.8%             | 140.7             | 4.3%              | 146.8             | 5.8%              | 155.3             |
| Revenue Stabilization Fund   | 119.6        | 60.4          | -21.2%            | 94.3         | 25.7%             | 118.6             | 17.2%             | 139.0             | 17.1%             | 162.7             | 21.1%             | 197.1             | 16.3%             | 229.2             |
| <b>Reserves as a % of Total Tax Supported Revenues Plus CIP &amp; Operating Grant Revenues</b> | <b>195.8</b> | <b>90.1</b>   | <b>18.0%</b>      | <b>231.1</b> | <b>10.3%</b>      | <b>255.0</b>      | <b>10.1%</b>      | <b>280.7</b>      | <b>8.1%</b>       | <b>303.4</b>      | <b>13.3%</b>      | <b>343.9</b>      | <b>11.8%</b>      | <b>384.5</b>      |
|  |              |               |                   | <b>6.0%</b>  |                   | <b>6.3%</b>       |                   | <b>6.9%</b>       |                   | <b>7.2%</b>       |                   | <b>7.8%</b>       |                   | <b>8.4%</b>       |
| <b>Retiree Health Insurance Pre-Funding</b>  |              |               |                   |              |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Montgomery County Public Schools (MCPS)  |              |               |                   | -            |                   | 53.2              |                   | 64.8              |                   | 76.4              |                   | 87.7              |                   | 92.1              |
| Montgomery College (MC)  |              |               |                   | -            |                   | 1.0               |                   | 1.2               |                   | 1.3               |                   | 1.4               |                   | 1.5               |
| MNCPCC (w/o Debt Service)  |              |               |                   | -            |                   | 4.4               |                   | 5.1               |                   | 5.6               |                   | 6.1               |                   | 6.4               |
| MCC  |              |               |                   | -            |                   | 25.0              |                   | 31.5              |                   | 38.4              |                   | 44.6              |                   | 46.8              |
| <b>Subtotal Retiree Health Insurance Pre-Funding</b>   |              |               |                   | -            | -                 | <b>83.6</b>       | -                 | <b>102.6</b>      | -                 | <b>121.7</b>      | -                 | <b>139.8</b>      | -                 | <b>146.8</b>      |

## FY11-16 Tax Supported Fiscal Plan Summary (Current 6% Reserve Policy)

| (\$ in Millions)   |                |                |                              |                |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
|--|----------------|----------------|------------------------------|----------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|  | App.<br>FY10   | Est.<br>FY10   | % Chg.<br>FY10-11<br>Rec/Bud | App.<br>FY11   | % Chg.<br>FY11-12 | Projected<br>FY12 | % Chg.<br>FY12-13 | Projected<br>FY13 | % Chg.<br>FY13-14 | Projected<br>FY14 | % Chg.<br>FY14-15 | Projected<br>FY15 | % Chg.<br>FY15-16 | Projected<br>FY16 |
| <b>Total Resources</b>   | <b>5-21-09</b> | <b>5-27-10</b> |                              | <b>5-27-10</b> |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Revenues   | 3,804.9        | 3,613.9        | -0.7%                        | 3,779.2        | 2.9%              | 3,889.1           | 0.5%              | 3,907.8           | 3.6%              | 4,048.0           | 4.7%              | 4,237.6           | 4.1%              | 4,409.6           |
| Beginning Reserves Undesignated  | 115.5          | 112.0          | -74.3%                       | 29.7           | 360.4%            | 136.8             | 8.2%              | 148.0             | 1.2%              | 149.8             | 5.7%              | 158.4             | 7.5%              | 170.3             |
| Beginning Reserves Designated  | -              | -              | 0.0%                         | -              | 0.0%              | -                 | 0.0%              | -                 | 0.0%              | -                 | 0.0%              | -                 | 0.0%              | -                 |
| Net Transfers In (Out)   | 37.2           | 62.1           | 12.0%                        | 41.7           | -68.0%            | 13.4              | 2.4%              | 13.7              | 2.6%              | 14.0              | 2.8%              | 14.4              | 3.0%              | 14.9              |
| <b>Total Resources Available</b>   | <b>3,957.7</b> | <b>3,788.0</b> | <b>-2.7%</b>                 | <b>3,850.6</b> | <b>4.9%</b>       | <b>4,039.2</b>    | <b>0.7%</b>       | <b>4,069.5</b>    | <b>3.5%</b>       | <b>4,211.9</b>    | <b>4.7%</b>       | <b>4,410.4</b>    | <b>4.2%</b>       | <b>4,594.7</b>    |
| <b>Less Other Uses of Resources (Capital, Debt Service, Reserve)</b>     | <b>362.2</b>   | <b>295.6</b>   | <b>26.7%</b>                 | <b>458.8</b>   | <b>17.6%</b>      | <b>539.3</b>      | <b>9.6%</b>       | <b>591.0</b>      | <b>10.1%</b>      | <b>650.5</b>      | <b>5.4%</b>       | <b>685.4</b>      | <b>1.1%</b>       | <b>693.3</b>      |
| <b>Available to Allocate to Agencies</b>                                 | <b>3,595.4</b> | <b>3,492.4</b> | <b>-5.7%</b>                 | <b>3,391.8</b> | <b>3.2%</b>       | <b>3,499.8</b>    | <b>-0.6%</b>      | <b>3,478.5</b>    | <b>2.4%</b>       | <b>3,561.4</b>    | <b>4.6%</b>       | <b>3,725.0</b>    | <b>4.7%</b>       | <b>3,901.5</b>    |
| <b>Agency Uses</b>   |                |                |                              |                |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Montgomery County Public Schools (MCPS)                                  | 2,020.1        | 1,989.9        | -5.0%                        | 1,919.8        | 0.9%              | 1,938.1           | -0.9%             | 1,920.0           | 2.1%              | 1,960.9           | 4.5%              | 2,048.4           | 5.0%              | 2,150.0           |
| Montgomery College (MC)  | 217.5          | 214.5          | -0.8%                        | 215.8          | 1.6%              | 219.2             | -0.3%             | 218.6             | 2.8%              | 224.7             | 5.1%              | 236.2             | 5.6%              | 249.5             |
| MNCPPC (w/o Debt Service)  | 106.6          | 103.2          | -13.1%                       | 92.7           | -0.8%             | 91.9              | -2.8%             | 89.3              | 0.2%              | 89.5              | 2.6%              | 91.9              | 3.1%              | 94.8              |
| MCG  | 1,251.2        | 1,184.8        | -7.0%                        | 1,163.6        | 0.3%              | 1,167.0           | -1.6%             | 1,148.0           | 1.4%              | 1,164.5           | 3.8%              | 1,208.6           | 4.3%              | 1,260.4           |
| <b>Subtotal Agency Uses</b>  | <b>3,595.4</b> | <b>3,492.4</b> | <b>-5.7%</b>                 | <b>3,391.8</b> | <b>0.7%</b>       | <b>3,416.2</b>    | <b>-1.2%</b>      | <b>3,375.9</b>    | <b>1.9%</b>       | <b>3,439.7</b>    | <b>4.2%</b>       | <b>3,585.2</b>    | <b>4.7%</b>       | <b>3,754.7</b>    |
| <b>Retiree Health Insurance Pre-Funding</b>                              |                |                |                              |                |                   |                   |                   |                   |                   |                   |                   |                   |                   |                   |
| Montgomery County Public Schools (MCPS)                                  | -              | -              | -                            | -              | -                 | 53.2              | -                 | 64.8              | -                 | 76.4              | -                 | 87.7              | -                 | 92.1              |
| Montgomery College (MC)  | -              | -              | -                            | -              | -                 | 1.0               | -                 | 1.2               | -                 | 1.3               | -                 | 1.4               | -                 | 1.5               |
| MNCPPC (w/o Debt Service)  | -              | -              | -                            | -              | -                 | 4.4               | -                 | 5.1               | -                 | 5.6               | -                 | 6.1               | -                 | 6.4               |
| MCG  | -              | -              | -                            | -              | -                 | 25.0              | -                 | 31.5              | -                 | 38.4              | -                 | 44.6              | -                 | 46.8              |
| <b>Subtotal Retiree Health Insurance Pre-Funding</b>                     | <b>-</b>       | <b>-</b>       | <b>-</b>                     | <b>-</b>       | <b>-</b>          | <b>83.6</b>       | <b>-</b>          | <b>102.6</b>      | <b>-</b>          | <b>121.7</b>      | <b>-</b>          | <b>139.8</b>      | <b>-</b>          | <b>146.8</b>      |
| <b>Subtotal Other Uses of Resources (Capital, Debt Service, Reserve)</b> | <b>362.2</b>   | <b>295.6</b>   | <b>26.7%</b>                 | <b>458.8</b>   | <b>17.6%</b>      | <b>539.3</b>      | <b>9.6%</b>       | <b>591.0</b>      | <b>10.1%</b>      | <b>650.5</b>      | <b>5.4%</b>       | <b>685.4</b>      | <b>1.1%</b>       | <b>693.3</b>      |
| <b>Total Uses</b>  | <b>3,957.7</b> | <b>3,788.0</b> | <b>-2.7%</b>                 | <b>3,850.6</b> | <b>4.9%</b>       | <b>4,039.2</b>    | <b>0.7%</b>       | <b>4,069.5</b>    | <b>3.5%</b>       | <b>4,211.9</b>    | <b>4.7%</b>       | <b>4,410.4</b>    | <b>4.2%</b>       | <b>4,594.7</b>    |
| <b>(Gap)/Available</b>   | <b>-</b>       | <b>-</b>       |                              | <b>-</b>       |                   | <b>-</b>          |                   | <b>-</b>          |                   | <b>-</b>          |                   | <b>-</b>          |                   | <b>-</b>          |

**Notes:**

1. FY12-16 property tax revenues are at the Charter Limit assuming a tax credit. All other tax revenues at current rates except as noted below.
2. Revenues reflect Energy Tax and Wireless Telephone Tax increases approved by the County Council on May 27, 2010. Energy Tax increase sunsets at the end of FY12.
3. PAYGO restored to policy level of 10% of planned GO Bond borrowing in FY12-16.
4. FY11 Revenues reflect one year redirection of Recordation Tax Premium (\$8 M.) and Recordation Tax for MCPS CIP and College IT (\$5 M.).
5. Retiree Health Insurance Pre-Funding assumed to resume at scheduled contribution levels in FY12.
6. Projected FY12-16 rate of growth of Agency Uses constrained to balance the fiscal plan in FY12-16.
7. Reserves are reflected at the current policy level of 6% of total resources in FY11-16.



Resolution No: \_\_\_\_\_  
Introduced: May 27, 2010  
Adopted: \_\_\_\_\_

**COUNTY COUNCIL  
FOR MONTGOMERY COUNTY, MARYLAND**

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By: Council President at the Request of the County Executive

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**SUBJECT:** Reserve and Selected Fiscal Policies

**Background**

1. Fiscal policy corresponds to the combined practices of government with respect to revenues, expenditures, debt management, and reserves.
2. Fiscal policies provide guidance for good public practice in the planning of expenditures, revenues, and funding arrangements for public services. They provide a framework within which budget, tax, and fee decisions should be made. Fiscal policies provide guidance toward a balance between program expenditure requirements and available sources of revenue to fund them.
3. As a best practice, governments must maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning. Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness.
4. In FY10, the County experienced an unprecedented \$265 million decline in income tax revenues, and weathered extraordinary expenditure requirements associated with the H1N1 flu virus and successive and historic winter blizzards. The costs of these events totaled in excess of \$60 million, only a portion of which was budgeted and planned for.
5. In a memorandum dated April 22, 2010, the County Executive recommended that the County Council restore reserves first to the current 6% policy level for FY11 and also to revise and strengthen policy levels in order to more appropriately position the County to weather economic cycles in the future, and to achieve structural balance in future budgets.
6. The County's financial advisor has recommended that the County strengthen its policy on reserves and other fiscal policies to ensure budget flexibility and structural stability, and has provided specific recommendations, which are reflected below.

**Action**

The County Council for Montgomery County, Maryland, approves the following policies regarding reserves and other fiscal matters:

1. Structurally Balanced Budget

*Montgomery County must have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.*

2. Reserves

*Montgomery County must have a goal of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund Balance to an amount equal to approximately 10% of Adjusted Governmental Fund revenues, representing tax-supported governmental and agency revenues, including operating grant and CIP revenues. This goal must be reflected in the Revenue Stabilization Fund law.*

3. Use of One-Time Revenues

*One-time revenues and revenues in excess of projections must be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or Retiree Health Benefits Pre-funding (OPEB).*

4. PAYGO

*The County must allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.*

5. Fiscal Plan

*The County must adopt a fiscal plan that is structurally balanced, and that limits expenditures and other uses of resources to annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.*

*This is a correct copy of Council action.*

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Linda M. Lauer, Clerk of the Council

|    | A  | B                | C                 | D                                |
|----|--|------------------|-------------------|----------------------------------|
| 1  | RESERVE, PROPOSED NEW POLICY, May 2010   |                  |                   |                                  |
| 2  | How is the target reserve calculated in the old 6% policy and in the new 10% policy?   |                  |                   |                                  |
| 3  |  |                  |                   |                                  |
| 4  |  | Old 6%<br>policy | New 10%<br>policy |                                  |
| 5  | Revenue in the 4 tax supported agencies  | 3,779.2          | 3,779.2           |                                  |
| 6  | Net transfers in   | 41.7             | NA                |                                  |
| 7  | Beginning total reserve  | 90.1             | NA                |                                  |
| 8  | County grants fund   | NA               | 113.0             |                                  |
| 9  | County capital projects fund   | NA               | 48.7              | Plug, using total minus other #s |
| 10 | Total resources (old)/Adjusted governmental revenues (new)   | 3,911.0          | 3,940.9           | Rating agency presentation, p8   |
| 11 | Less RSF at the beginning of the year  | (60.4)           | NA                |                                  |
| 12 | Net resources  | 3,850.6          | NA                |                                  |
| 13 | Target % reserve   | 6.0%             | 10.0%             | 6.0%                             |
| 14 | Target \$ reserve  | 231.0            | 394.1             | 236.5                            |
| 15 | Increase reserve in FY11 for new policy IF in effect in FY11.<br>This is the amount spending would have had to be reduced in<br>FY11 if new policy were in effect. |                  | 163.1             |                                  |
| 16 |  |                  |                   |                                  |
| 17 | Spending   | 3,680.0          | 3,516.9           | 3,674.5                          |
| 18 | Reduction in FY11 if new policy were in effect.  |                  | (163.1)           | (5.4)                            |
| 19 | To mitigate the impact of increasing the % reserve from 6% to 10%, the CE proposes to phase in the increase over   |                  |                   |                                  |
| 20 | the 9 year period FY12-20.   |                  |                   |                                  |

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|    | A  | B         | C               | D         | E               | F                 | G | H | I | J |
|----|--|-----------|-----------------|-----------|-----------------|-------------------|---|---|---|---|
| 1  | RESERVE, PROPOSED NEW POLICY, May 2010   |           |                 |           |                 |                   |   |   |   |   |
| 2  | What is the difference in spending permitted by the old 6% policy and the new 10% policy?                  |           |                 |           |                 |                   |   |   |   |   |
| 3  | Phase in the increase from 6% to 10% over the 9 year period FY12-21.                                       |           |                 |           |                 |                   |   |   |   |   |
| 4  | Agency spending excludes debt service, current revenue funding of the CIP,                                 |           |                 |           |                 |                   |   |   |   |   |
| 5  | prefunding of retiree health insurance.  |           |                 |           |                 |                   |   |   |   |   |
| 6  | Agency spending in old policy from FY12-16 is from the April 23, 2010 Revised Balanced Fiscal Plan FY11-16 |           |                 |           |                 |                   |   |   |   |   |
| 7  | Agency spending in new policy from FY12-16 is from undated OMB spreadsheet.                                |           |                 |           |                 |                   |   |   |   |   |
| 8  |  |           |                 |           |                 |                   |   |   |   |   |
| 9  |  |           |                 |           |                 |                   |   |   |   |   |
| 10 |  | Old       |                 | New       |                 |                   |   |   |   |   |
| 11 | FY   | % reserve | Agency Spending | % reserve | Agency Spending | Decrease spending |   |   |   |   |
| 12 | 11   | 6.0%      | 3,391.8         | 6.0%      | 3,391.8         | 0.0               |   |   |   |   |
| 13 | 12   | 6.0%      | 3,416.2         | 6.3%      | 3,395.3         | (20.9)            |   |   |   |   |
| 14 | 13   | 6.0%      | 3,364.3         | 6.9%      | 3,343.4         | (20.9)            |   |   |   |   |
| 15 | 14   | 6.0%      | 3,431.7         | 7.2%      | 3,416.9         | (14.8)            |   |   |   |   |
| 16 | 15   | 6.0%      | 3,567.6         | 7.8%      | 3,547.7         | (19.9)            |   |   |   |   |
| 17 | 16   | 6.0%      | 3,731.3         | 8.4%      | 3,715.9         | (15.4)            |   |   |   |   |

22



## BEST PRACTICE

### Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (BUDGET and CAAFR)

**Background.** Accountants employ the term *fund balance* to describe the net assets of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net assets of governmental funds calculated on a government's budgetary basis.<sup>1</sup> In both cases, fund balance is intended to serve as a measure of the financial resources available in a governmental fund.

Accountants distinguish up to five separate categories of fund balance, based on the extent to which the government is bound to honor constraints on the specific purposes for which amounts can be spent: *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.<sup>2</sup> The total of the last three categories, which include only resources without a constraint on spending or for which the constraint on spending is imposed by the government itself, is termed *unrestricted fund balance*.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance (i.e., the total of the amounts reported as committed, assigned, and unassigned fund balance) in the general fund.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unrestricted fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view high levels of fund balance as "excessive."

**Recommendation.** The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.<sup>3</sup> Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and

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<sup>1</sup> For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.

<sup>2</sup> These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which must be implemented for financial statements for periods ended June 30, 2011 and later.

<sup>3</sup> Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.

specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy.<sup>4</sup>

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that 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.<sup>5</sup> The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.<sup>6</sup> Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);<sup>7</sup>
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).

Furthermore, governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance rather than on unrestricted fund balance.

Naturally, any policy addressing desirable levels of unrestricted fund balance in the general fund should be in conformity with all applicable legal and regulatory constraints. In this case in particular, it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated by all interested parties.

Approved by the GFOA's Executive Board, October, 2009.

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<sup>4</sup> See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).

<sup>5</sup> In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.

<sup>6</sup> In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues or expenditures, that decision should be followed consistently from period to period.

<sup>7</sup> However, except as discussed in footnote 4, not to a level below the recommended minimum.