ED COMMITTEE #1
March 21, 2016
Worksession

MEMORANDUM

March 17, 2016

TO: Education Committee

FROM: Essie McGuire, Senior Legislative Analyst

SUBJECT: **Worksession – Review of Council's Policy Regarding Reserve Levels for Montgomery College**

Today the Education Committee will review the Council's policy regarding reserve levels for Montgomery College. The following individuals will be present to discuss this issue with the Committee:

- Joseph Beach, Director, Department of Finance
- Janet Wormack, Senior Vice President for Administrative and Fiscal Services, Montgomery College
- Alex Espinosa, PSP Coordinator, Office of Management and Budget

Following FY16 operating budget discussions in which questions were raised about the appropriate budget level for the College reserve, the Education Committee asked Council staff to work with staff from the College and Executive branch to resolve policy issues regarding the College reserve. Staff met and worked together beginning last summer and have reached an overall consensus on an approach. **The purpose of today's worksession is for the Education Committee to review the consensus recommendation and confirm whether this approach should be implemented for the FY17 budget.**

Background

The College accrues fund balance consisting of unspent appropriation at the end of a fiscal year, as do the other County agencies. Some portion of these resources is typically allocated as a resource for the next year's budget. In addition, the College maintains a reserve consistent with Council Resolution 17-312, *Reserve and Selected Fiscal Policies*. This resolution, adopted in November 2011 and attached at circles 1-4, specifies reserve levels for County Government and the other County agencies. For the College, the resolution states that "The reserve in the Current fund should be 3.0%-5.0% of budgeted resources minus the annual contribution from the County" (circle 4).

For FY16, approximately $3.5 million would have been a reserve amount of 3.0% (the lowest reserve amount outlined in Resolution 17-312). In its FY16 budget request, the College's proposed fund balance assumption would have left a projected $4.6 million in reserve, consistent with the policy as described above.

In his March 15 transmittal, the Executive recommended that the College's FY16 budget include an appropriation of all available fund balance, which would have left a reserve amount of only $585,292. The Executive's recommendation was clearly inconsistent with the Council's November 2011 resolution. However, it was intended to provide additional resources for the College to use without additional new County funding.

The Council ultimately reappropriated $7.02 million of fund balance for the FY16 operating budget, which left a reserve of nearly $3 million, slightly under the 3% policy level due to fiscal constraints.

In brief, Council staff understands the main arguments in support of maintaining a separate reserve fund to be that:

- The College relies for approximately one-third of its revenue on tuition and fees that are not provided uniformly throughout the year and thus a reserve is necessary to assist with cash flow during the fiscal year.
- The College has bonds issued through its Foundation that require an independent reserve to guarantee.

In brief, Council staff understands the main arguments against maintaining a separate reserve fund to be that:

- The County's reserves provide sufficient assurance of support to the College for both the cash flow and bond guarantee issues.
- The College's annual fund balance tends to be higher than projected, which allows for a lower reserve amount to be budgeted without affecting the College's fiscal needs during the year.

As noted above, the Education Committee directed staff to work through the various policy issues and identify what amount of reserve is necessary to support the College's debt obligations and at the same time leverage the County's overall reserve levels.

Consensus Recommendation

College, Executive, and Council staff met and worked together beginning last summer to review the policy issues associated with the College's reserve. Finance sought advice from the County's financial adviser on the impact of debt issuance and reserve levels on the College and on the County. College leadership consulted with the College Foundation, which is responsible for the College's debt issuance processes. As a result of these efforts, the group recommends the following:

1. Maintain the Council's current 2011 fiscal policy which calls for a College reserve of between 3-5% of the Current Fund minus the County's contribution.

2. College, Executive, and Council staff will calculate annual fund balance and reserve amounts for the College consistent with the practice for other agencies. For example, for budgeting purposes, the FY17 beginning reserves will be based on the best estimate of the FY16 ending amount, rather than the FY15 actual year-end amount.

3. Future College financing options should be discussed between the College and the County Executive and County Council staff before beginning the financing process. County issuance of debt is to be considered as a first option given the County's greater financial capacity and reserves that should result in lower financing costs. From time to time the College may need to consider the need for additional financing. Certain types of these financings may involve obligations not appropriate for County Government issuance, such as certain refinancing, and other purposes; yet others may not be consistent with County Government debt strategies. All of these financings that benefit the College will require a set of approvals that include County Government and other approval processes. Nothing in this recommendation shall prohibit the College from participating in financings under its current practices that include the approvals already in place as stated above.

In staff's view, the current policy level of 3-5% reserve in the Current Fund will support the College's existing debt obligations and meet its cash flow requirements. The bond issuance approach going forward will alleviate the need to increase the College's reserve due to pressure from the rating agencies. Executive and College staff continue to work together to refine the details of this arrangement.

Council staff appreciates the efforts of College, Finance, and OMB leadership to collaborate in reaching this important policy consensus. Council staff recommends that the Committee confirm this approach for the FY17 operating budget, with the understanding that staff will continue to work on implementation details and next steps related to bond issuance in the future.

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Resolution No: 17-312
Introduced: November 29, 2011
Adopted: November 29, 2011

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Government Operations and Fiscal Policy Committee

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 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 adviser recommended that the County strengthen its policy on reserves and other fiscal policies to ensure budget flexibility and structural stability, and provided specific recommendations, which are reflected below.

7. On June 29, 2010 the Council approved Resolution No. 16-1415, *Reserve and Selected Fiscal Policies.* This Resolution established 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 10% of Adjusted Governmental Revenues (AGR), as defined in the Revenue Stabilization Fund law.

8. The County's reserve policy should be further clarified and strengthened. This resolution replaces the reserve policy established in Resolution No. 16-1415.

Action

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

1. *Structurally Balanced Budget*

   Montgomery County must have a goal of a structurally balanced budget. 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. *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. If the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures that are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or unfunded liabilities. Priority consideration should be given to unfunded liabilities for retiree health benefits (OPEB) and pension benefits prefunding.

3. *PAYGO*

   The County should allocate to the CIP each fiscal year as PAYGO at least 10% of the amount of general obligation bonds planned for issue that year.

4. *Fiscal Plan*

   The County should 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.

5. *County Government Reserve*

(a) **County Government Reserve.** The County Government Reserve has three components. The components of the budgeted reserve at the end of the next fiscal year are:

(i) **Reserve in the General Fund.** The County's goal is that this reserve will be the maximum permitted by §310 of the Charter, which is 5% of revenues in the General Fund in the previous fiscal year;

(ii) **Reserve in the Revenue Stabilization Fund (RSF).** This budgeted reserve at the end of the next fiscal year is the reserve at the beginning of the year, plus interest on the fund balance, plus a mandatory transfer from the General Fund, as defined in the Revenue Stabilization Fund law, plus a discretionary transfer if the Council approves one. The actual amount of the mandatory transfer is calculated in accordance with §20-68 of the Montgomery County Code; and

(iii) **Reserve in the other tax supported funds in County Government.** The budgeted reserve at the end of the next fiscal year for the following funds – Fire, Mass Transit, Recreation, Urban District, Noise Abatement, Economic Development, and Debt Service – and any other tax supported County Government fund established after adoption of this resolution, should be the minimum reserve possible (as close as possible to zero, but not negative), since the Council sets the property tax rate to the nearest one tenth of 1¢.

(b) **Calculation of budgeted reserve as a percent of Adjusted Governmental Revenues.** The target reserve as a percent of Adjusted Governmental Revenues is the sum of the reserves in the General Fund and the Revenue Stabilization Fund divided by Adjusted Governmental Revenues, as defined in the Revenue Stabilization Fund law. The reserves in the other tax supported funds in County Government are not included in this calculation.

(c) **Budgeted reserve as a percent of Adjusted Governmental Revenues.** To reach the County's goal of 10% of AGR in 2020, the annual minimum target goals are:

FY13	6.4%
FY14	6.9%
FY15	7.4%
FY16	7.9%
FY17	8.4%
FY18	8.9%
FY19	9.4%
FY20 and after	10.0%

The Council may make a discretionary transfer each year from the General Fund to the Revenue Stabilization Fund, if necessary, to reach the target goal for each year. The 10% goal for FY20 and after must be reflected in the Revenue Stabilization Fund law.

6. *Reserves in other agencies*

The reserves for the Montgomery County Public Schools (MCPS), the Maryland-National Capital Park and Planning Commission (M-NCPPC), and Montgomery College (MC) are not included in the target reserves for County Government. The County's reserve policies for these agencies are:

(a) **MCPS**. The Council should not budget any reserve for the MCPS Current Fund.

(b) **M-NCPPC**. The reserve in the Park Fund should be approximately 4.0% of budgeted resources. The reserve in the Administration Fund should be approximately 3.0% of budgeted resources. The reserve in the Advance Land Acquisition Debt Service Fund should be the minimum reserve possible, since the Council sets the property tax rate to the nearest one tenth of 1¢.

(c) **Montgomery College**. The reserve in the Current Fund should be 3.0% - 5.0% of budgeted resources minus the annual contribution from the County. The target reserve in the Emergency Plant Maintenance and Repair Fund – as stated in Resolution No. 11-2292, approved by the Council on October 16, 1990 – "may accumulate up to $1,000,000 in unappropriated fund balance, such goal to be attained over a period of years, as fiscal conditions permit."

7. *Reports to Council*

The Executive must report to the Council:

(a) the prior year reserve and the current year reserve projection as part of the annual November/December fiscal plan update;
(b) current and projected reserve balance in the Executive's annual Recommended Operating Budget;
(c) any material changes expected to have a permanent impact on ending reserve fund balance; and
(d) current and projected reserve balances in any proposed mid-year savings plan.

This is a correct copy of Council action.

Linda M. Lauer

Linda M. Lauer, Clerk of the Council