

# Fitch Ratings

everything you need **more than you expect**

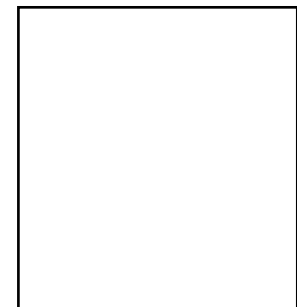
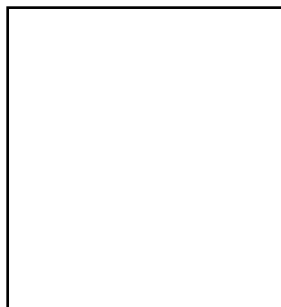
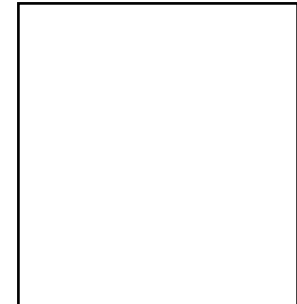


## Fund Balance Policies-Fitch Ratings Perspective

Nelsie L. Smith, Associate Director

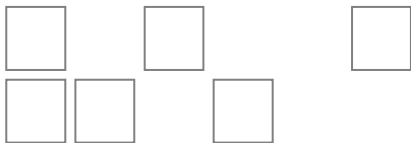
VGFOA Virginia Beach, VA

May 2, 2005



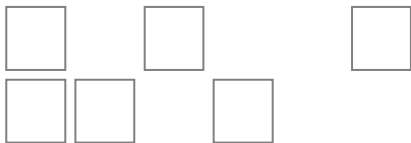
## Overview

- > “12 Habits of Highly Successful Finance Officers”
  - > Establishment and maintenance of reserves is a key element in credit analysis
- > “The Bottom Line: Local General Government Reserves and the Policies that Shape Them”
  - > Policies driving reserve levels can be just as important as the reserves themselves



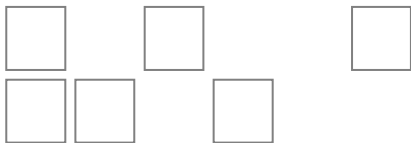
## Common Questions Raised

- > What level of fund balance is sufficient?
- > Do “I” have to store my reserves in the general fund?
- > What happens if we draw on our reserves and go below our policy?
- > Does a fund balance policy give the bonds a better chance at a higher rating/upgrade?
- > Does the fund balance policy have to be approved by the governing body to have any weight?
- > Can you provide a few examples of well-defined policies.



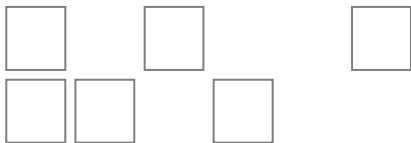
Best  
Practices-  
Fund  
Balance  
Policies

- > Reserve Floor
- > Reserve Drawdowns
- > Reserve Replenishment
- > Institutionalization
  
- > The higher the rating, the higher the expectation



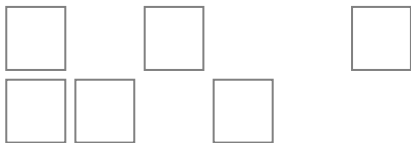
## Reserve Floor

- > Most common element in fund balance policies
- > Function of financial flexibility, level necessary depends on credit profile of entity
- > The level should be determined based on the variability/volatility of the revenue stream and working cash needs
- > Should be a level that the entity can maintain
- > Usually in the form of unreserved general fund balance, unless there are other tax-supported funds that have accumulated balances/reserves
- > Floor should be as a percentage of budget not monetary floor, unless reserving for a specific purpose in addition to other reserves



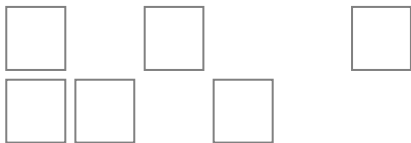
## Reserve Drawdowns

- > Included in stronger policies
- > Details the situations/expenditures acceptable for use of fund balance
- > Favorable uses:
  - > Nonrecurring expenditures
  - > One-time capital costs
  - > Emergency situations (economic/weather)
- > The above usually forces entity to take other budget balancing steps before raiding reserves



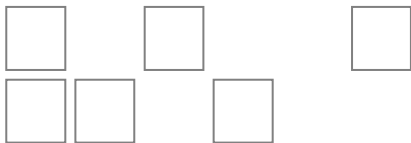
## Reserve Replenish- ment

- > Established mechanism to replenish reserves if they are drawn upon
- > Included in stronger policies, but less common
- > Typically seen in very high rated entities with low credit risk and high financial flexibility
- > Hard to adhere to because usually reserves are drawn upon during times of fiscal stress...why it is good to have other means of financial flexibility (pay-go)
- > Shows rebuilding of fund balance is priority to issuer



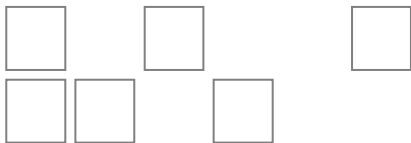
## Institution- alization

- > A policy that is adopted by the governing board is stronger than one that is practiced
- > Adherence to policy is most important
- > “A reserve policy is only as effective and creditworthy as the commitment of the management team to abide by its limits.”



## Examples

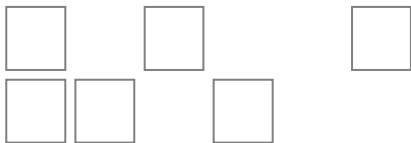
- > Howard County, MD (AAA)
  - > 7% of the latest audit of general fund expenditures at time of budget adoption, with any surplus going into the RSF
  - > Institutionalization (county charter)
  - > Drawdowns-only use surplus funds for one-time expenditures, debt reduction, or capital projects
  - > Highlight- reserve replenishment
    - > If budget stabilization account falls below the floor level for 2 consecutive fiscal years, the county will annually appropriate 25% of the difference in following fiscal year until minimum is achieved (if 25% is not feasible, lesser amount for longer period of time)



## Examples

- > Hillsborough County, FL (AA+)
  - > Floor-required to include in its budget a minimum reserve for cash balance of 5% of most recent available audited expenditures
  - > Highlight-If the surplus funds exceed the floor, the county must transfer a set percentage of surplus moneys to various other funds for renewal and replacement, self-insurance, and emergency reserves

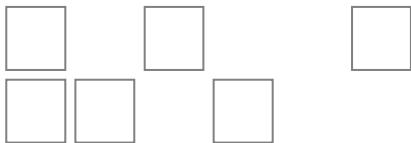
[www.hillsboroughcounty.org/mbd/adopted/fy0405/publications/exsummary.pdf](http://www.hillsboroughcounty.org/mbd/adopted/fy0405/publications/exsummary.pdf)



## Examples

- > Minneapolis, MN (AAA)
  - > Floor-10% general fund budget
  - > Highlight is drawdown- limiting use of reserves for nonrecurring expenditures unless available balances are in excess of the floor and plans are established to address any future operating budget shortfalls

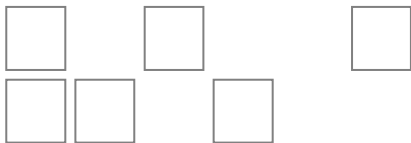
[www.ci.minneapolis.mn.us/city-budget/2005recommended/sec4FinPolicies/pdf](http://www.ci.minneapolis.mn.us/city-budget/2005recommended/sec4FinPolicies/pdf)



## Examples

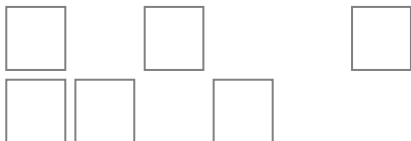
- > Forth Worth, TX (AA+)
  - > Floor-10% of current year's budget appropriation for operations
  - > Use of reserves-emergencies, nonrecurring expenditures, major capital purposes
  - > Reserve replenishment-less specific but states if reserve goes below minimum, the request to utilize fund balance to be accompanied by restoration recommendations
  - > Highlight is institutionalization-city ordinance approved by majority of council

<http://ci.fort-worth.tx.us/finance/policies/FMPS09-2004.pdf>



## Examples

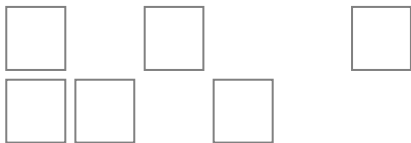
- > Los Angeles, CA (AA)
  - > Institutionalization-part of City Code
  - > Floor-4% of general fund budget in two reserves (reserve fund and liability claims account)
  - > Reserve Fund (2% of general fund budget) and broken apart for a contingency reserve (for unanticipated expenses or revenue shortfalls for approved programs) and an emergency reserve account for urgent economic necessity
  - > Highlight is use of drawdowns-contingency reserve requires a majority vote of city council and mayoral approval or super majority and mayoral veto and from emergency reserve a finding by the mayor and confirmation by the city council



[www.lacity.org/cao/Debt\\_Mgmt/Reserve%20Fund%20Policy.pdf](http://www.lacity.org/cao/Debt_Mgmt/Reserve%20Fund%20Policy.pdf)

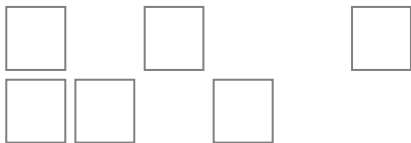
## Keys to Remember

- > If you have a policy, abide by it
- > If you have a practice in place and have historically adhered to it, why not adopt it?
- > Make the policy/reserves as transparent as possible



## Criteria Reports Available

- > Local Government General Obligation Rating Guidelines (June 10, 2004)
- > Water and Sewer Revenue Bond Rating Guidelines (Apr. 13, 2004)
- > Municipal Lease Rating Guidelines (Sep. 11, 2003)
- > The 12 Habits of Highly Successful Finance Officers (Nov. 21, 2002)
- > Sales Tax Revenue Bonds Rating Guidelines (Sep. 20, 2002)





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