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## CITY of NOVI CITY COUNCIL

**Agenda Item 1**  
**September 26, 2011**

**SUBJECT:** Approval of resolution to amend the City's Fund Balance/Reserve policy to include certain Special Revenue Funds and the Capital Replacement Reserve policy for the Enterprise Funds (in addition to the General Fund-Fund Balance policy).

**SUBMITTING DEPARTMENT:** Managers/Finance

**CITY MANAGER APPROVAL:**

**BACKGROUND INFORMATION:**

The City Council has an established fund balance range for its General Fund of between 18% and 22%. There is currently no similar policy or range for the City's Special Revenue Funds, which are funds restricted by the reason for which the funds were established (e.g., road funds). In addition to the restrictions on the use of these special funds, other aspects such as the timing of that use and the minimum balance in the fund (i.e., minimum for contingencies for road funds) must be determined on an annual basis through the budget process. As with the General Fund, that process includes discussions and input from the Leadership Team, as well as computations and projections by the Finance Department.

The Finance Department has prepared the attached information as a description of the procedures that have been used and will continue to be used during the annual budget preparation. The attached policy represents the past practice used for certain Special Revenue Funds and the Capital Replacement Reserve fund for each of the Enterprise Funds. It has been put in the form of a policy for consideration and adoption by City Council in order to give clear direction with regard to the Council's expectations as the budgets are established for these Special Revenue Funds, similar to the current policy for the General Fund. The policy will be useful in preparing the budget for 2012-13 and in the future.

The City has treated the General Fund millage as primarily operational and for certain capital outlay items. Novi has been reducing its debt millage in part by adopting a pay-as-you-go philosophy for larger capital improvement items. While generally, millages for operations are intended to be used for current activities (i.e. General Fund), so taxpayers paying the millage receive the benefit of those related services, the City's special millages for public safety, roads, library, parks and drains have also been used for larger capital improvements. For example, the City issued bonds to purchase park land in the 1990's, with the intent of using the special parks millage to pay for improvements and development as funds were available. Therefore, the fund balance range for the General Fund is the targeted range, and the fund balance range for the Special Revenue Funds is intended for operations to avoid transfers from the General Fund.

As with other financial policies, the fund balance policies should be adopted with the intention of being in place for long-term financial planning (greater than one year), unlike revenue and expenditures that are intended for the budget year being considered.

**RECOMMENDED ACTION:**

Approval of resolution to amend the City's Fund Balance/Reserve policy to include certain Special Revenue Funds and the Capital Replacement Reserve policy for the Enterprise Funds (in addition to the General Fund-Fund Balance policy).

	1	2	Y	N
<b>Mayor Landry</b>				
<b>Mayor Pro Tem Gatt</b>				
<b>Council Member Fischer</b>				
<b>Council Member Margolis</b>				

	1	2	Y	N
<b>Council Member Mutch</b>				
<b>Council Member Staudt</b>				
<b>Council Member Wrobel</b>				

## **RESOLUTION**

### **Approving the City of Novi Fund Balance/Reserve Policy for Certain Special Revenue Funds and Enterprise Funds**

WHEREAS, the City Council approved a financial policy resolution for the Fund Balance/Reserve policy for the General Fund on January 24, 2011, and seeks to amend this policy to include certain Special Revenue Funds and the Enterprise Funds, and

WHEREAS, the City Council has agreed to enhance the attached Fund Balance/Reserve Policy to reflect the prior practice used for certain Special Revenue Funds and the Enterprise Funds, and

WHEREAS, the City of Novi reserve policies are based on sound fiscal principles designed to maintain adequate fund balance levels which are an important component of the City's financial strength, and

WHEREAS, the City will seek to maintain a diversified and stable revenue system to shelter itself from short-run fluctuations in any one revenue source and will establish all user charges and fees at a level consistent with the cost of providing such services, and

NOW THEREFORE BE IT RESOLVED, that the City hereby adopts the attached Fund Balance/Reserve Policy for certain Special Revenue Funds and the Enterprise Funds.

### **CERTIFICATION**

I, Maryanne Cornelius, the duly appointed Clerk of the City of Novi, Oakland County, Michigan, hereby certify that the above is a true and complete copy of a resolution adopted by the City Council of the City of Novi at a regular meeting held on \_\_\_\_\_ at which time a quorum was present.

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Maryanne Cornelius  
City Clerk

**The following is the policy for inclusion in the City's  
Budget document and Comprehensive Annual  
Financial Report (where applicable)**

(The format and wording may be changed in the final documents. However the overriding principles and intent of the policy will remain intact.)

## **Fund Balance/Reserve Policies**

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- The City will establish a reserve to pay for expenditures as a result of unforeseen emergencies or for shortfalls caused by revenue declines. The City will seek to maintain a diversified and stable revenue system to shelter itself from short-run fluctuations in any one revenue source. The City will attempt to obtain additional revenue sources to insure a balanced budget.
- The City will follow an aggressive policy of collecting revenue.
- The City will establish all user charges and fees at a level considering the cost (operating, direct, indirect and capital) of providing the service.
- The City will establish reserves to comply with the terms and conditions of the debt instruments used to finance capital improvement projects.
- The City will review fund balance/reserves annually during the budget process.
- In the event the level of expenditures exceeds the estimated appropriations, the City will create a plan to replenish fund balance/reserves within three years by controlling operating expenditures, adjusting operations and/or dedicating excess or specific revenue sources.

### **General Fund**

For the General Fund, the reserve will be maintained at an amount that represents approximately 18-22 percent of the budgeted expenditures as adopted by City Council Resolution, January 24, 2011. Additional reserves can be designated for a specific purpose as identified by City Council during the budget process. Fund balance will be established to:

- Provide a fund or reserve to meet emergency expenditures;
- Provide cash to finance expenditures from the beginning of the budget year until general property taxes or other revenues are collected;
- Demonstrate financial stability and therefore preserve or enhance its bond rating, thereby lowering debt issuance costs;
- Accumulate sufficient assets to make designated purchases;
- Avoid short-term borrowing and associated interest costs.

As part of the budget process excess fund balance may be used to reduce liabilities or fund expenditures of the next fiscal period.

### **Special Revenue Funds**

Resources in a fund other than the general fund are either (1) required to be used for the purpose of the fund or (2) intended by the government to be used for that purpose. Special revenue funds report specific revenue sources that are limited to being used for a particular purpose.

### **Road Funds (Major, Local and Municipal Street)**

The City's fund balance for the road funds will be established within a minimum range of 10-20%, individually and collectively amongst the three funds, to cover extraordinary maintenance events (i.e. unusual winter maintenance events, emergency reconstruction, etc.), and contingencies for budgeted construction projects. In addition, the City may

establish a designation for capital projects in excess of \$1.5 million, to be completed in future years based on the capital improvement program.

#### **Police and Fire Fund**

The fund balance for the Police and Fire Fund will vary, based on future major fire equipment capital needs and operational costs for the Police and Fire departments. The City will look at both major fire equipment needs and operational expenditures for a 3-10 year period in the future. The revenue from the special voted property tax millage for this fund is transferred to the General Fund to support police and fire department expenditures based on the future outlook.

#### **Drain Funds (Drain Revenue and Drain Perpetual Maintenance)**

The Drain Revenue Fund reports the City's special property tax millage for the drain system. The Drain Perpetual Maintenance Fund revenue resources are from connection tap fees. The City's has a combination drain system, regional and site, resulting in the two types of revenue sources. The revenue from these funds is intended to cover the maintenance, construction and repairs of the drain system. The system includes basins and structures with other entities administered by Oakland County, with two of the larger systems being Caddell and Randolph.

The City's fund balance for the drain funds will vary as these funds are intended to be sufficient to cover current and future costs of the system given the limitation on the tap fee revenue source. In addition to annual maintenance, significant expenditures include construction and repair of large basins, lake dredging and shared systems. The City monitors and reviews future projects annually during the budget process, and reports the next six years projects in the Capital Improvement Program.

#### **Parks, Recreation and Cultural Services Fund**

The fund balance for the Parks, Recreation and Cultural Services Fund will be established within a minimum range of 12-22% of fund annual budgeted expenditures, since this fund is similar to the General Fund in terms of covering operations. This fund reports two major sources of revenue: special voted property tax millage and program revenue. The City may establish a designation for capital projects in excess of \$300,000; to be completed in future years based on the capital improvement program.

#### **Special Assessment Revolving Fund**

The fund balance for the Special Assessment Revolving Fund will be used primarily for capital road improvements, but may also be used for other capital infrastructure projects. The fund's resources are primarily from interest from special assessment construction and debt service funds relating to road construction projects. The fund balance is recommended to be at least \$1,000,000 until special assessment funds created prior to 2000 are closed, and at least \$500,000 until the 2003 Special Assessment District Limited Tax Bonds are paid in full, or collections are sufficient to cover the repayment of the bonds.

#### **Tree Fund**

The fund balance for the Tree Fund will be maintained at a minimum of \$500,000 for purposes of establishing a contingency or allowance in the event of some natural disaster impacting the City's tree inventory (e.g. severe storms, straight-winds; diseases; or infestations).

#### **Other Special Revenue Funds**

The fund balance for other special revenue funds (Forfeiture Funds and the Contributions and Donations Fund) will be used for appropriations based on the specific purpose of those funds.

## **Capital Replacement Reserve Policy – Enterprise Funds**

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The City has established Capital Replacement Reserve accounts in each of its three Enterprise Funds.

The key Capital Replacement Funding principle is that the money is collected and segregated, over a period of time, to cover the repair or replacement cost of existing common elements; that is, capital assets already in existence (for example, the replacement of an existing HVAC system, roof, parking area, etc.). Capital Replacement Funds are part of a long-term financial plan, which helps:

- Strengthen the community's fiscal health
- Increase the market value of units
- Provides stability to avoid large future assessments or rate increases

User charges and fees will be computed based on current year operating expenses, debt service requirements and annual contribution/replenishment of the capital replacement reserve.

The City will conduct a Capital Needs Assessment and Replacement Reserve Analysis for the Ice Arena and Meadowbrook Commons facilities every 5-7 years. The user charges and fees will include annual contribution/replenishment of the capital replacement reserve. Cash and investments for operations will be computed based on a minimum of two months expenditures.

The Capital Replacement Reserve for the Water & Sewer Fund is targeted at 10-25% of the current fair market value of water and sewer infrastructure assets. The City uses the overall national CPI to compute the fair market value of these assets. Cash and investment balances for operations will be computed based on a minimum of two months expenditures plus planned capital improvement projects of \$10 million or less for the year.