

# SACRAMENTO METROPOLITAN FIRE DISTRICT

## BOARD POLICY

POLICY TITLE:	<b>Reserve Funding Policy</b>	OVERSIGHT:	Administration		
POLICY NUMBER:	01.008.01	EFFECTIVE DATE:	08/08/2013	REVIEW DATE:	08/08/2013

### **BACKGROUND**

Best financial practices call for establishing a formal reserve policy. This Reserve Funding Policy will serve to formalize the current practices, establish the need for further reserves, set appropriate reserve level targets, and specify the process and procedures for reserve monitoring and use.

### **PURPOSE**

This policy establishes target reserve levels necessary for maintaining Metro Fire's credit worthiness and helps with both short-term and long-term planning. Reserves allow Metro Fire to adequately provide for loss of significant revenue sources i.e. tax receipts or Development Fees, infrastructure funding, local disasters, unfunded mandates, workers' compensation self-insurance claims, and debt obligation security.

A minimum reserve target level protects Metro Fire from reducing service levels when there are temporary revenue shortfalls or unpredicted one-time expenditures. Inevitably, there will be negative economic cycles and having these reserves buffers their impact. A maximum reserve target level is essential to ensure that only necessary reserve funds are accumulated.

The Reserve Funding Policy will also provide guidance for achieving target levels, use of reserves, and later replenishment of reserves.

### **SCOPE**

This Reserve Funding Policy will cover all funds and all types of reserves.

### **DEFINITIONS**

1. **Actuarial Present Value:** For Metro Fire, this is the amount presently required to fund the post-retirement medical benefits for retirees and their dependents in the future. It is determined by discounting the future payments by 7.25% interest rate and the probability of nonpayment.
2. **Annual Required Contribution (ARC):** A level of funding that if paid on an ongoing basis is projected to cover post-retirement medical costs for current employees and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

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3. **Assigned Fund Balance:** A classification of Fund Balance intended to be used by the government entity for specific purposes, however, does not meet the criteria to be classified as restricted or committed.
4. **Bond Indenture:** A bond indenture is a legal document issued to lenders and describes key terms such as the interest rate, maturity date, convertibility, pledge, promises, representations, covenants, and other terms of the bond offering.
5. **Bondholders:** Investors who lend money to the bond issuer in return for interest and future repayment.
6. **California Employer's Retiree Benefit Trust (CERBT):** CERBT is Metro Fire's trust fund managed by the California Public Employees' Retirement System (CalPERS).
  - a. CalPERS maintains a separate trust fund to benefit Metro Fire retirees. CERBT is accumulating and investing funds for post-retirement medical premiums.
  - b. Amounts cannot be removed from CERBT except to pay retiree premiums.
  - c. CERBT is a separate legal entity. As such, CERBT assets are only disclosed in Metro Fire's audited financial statements, and not included in Metro Fire's Governmental Fund balance sheet assets.
7. **Capital Facilities Fund:** A separate accounting for budgeting purposes used to track Development Fee collection and spending. The reserves in this fund are used for new capital needed to serve new development.
8. **Capital Improvement Program (CIP):** A multi-year plan that identifies needed capital projects and equipment, provides a planning schedule, and financing options.
9. **CIP Reserves:** Reserves accumulated for the purchase of new infrastructure. Funding is from Development Fees and General Fund transfers.
10. **Capital Replacement Reserves:** Reserves accumulated to fund replacement of existing infrastructure when the asset's useful life has ended.

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11. **Committed Fund Balance:** A classification of Fund Balance. Committed Fund Balance amounts can only be used for specific purposes as determined by a formal action of the Metro Fire Board of Directors.
12. **Compensated Absence Reserves:** Reserves accumulated to satisfy obligations due to employees to settle compensated absence amounts upon employee retirement, termination, or other times when employees are allowed to cash out a portion of their compensated absence balances.
13. **Debt Service Reserves:** Money generally from bond proceeds that is set aside for additional security to Bondholders. This is a Restricted Reserve and documentation of the requirement is in the Bond Indenture.
14. **Deferred Compensation Plan:** A retirement plan offered by Metro Fire under Internal Revenue Code 457. Metro Fire Employees voluntarily defer their compensation up to certain limits on a tax-deferred basis.
15. **Deferred Compensation Plan Committee (Committee):** A Committee that oversees the Deferred Compensation Plan. This Committee of employees and retirees is appointed by the Board of Directors.
16. **Development Fee:** A fee charged by Metro Fire to mitigate the costs associated with property acquisitions, site preparation, design, construction, and equipping of fire stations within Metro Fire's service areas. This fee serves to protect the health and safety of the general public and preserve lives and property, and is authorized by California Government Code Section 66000 et seq.
17. **Dry Period Funding:** Dry period funding is a borrowing from the County of Sacramento. Dry Period Funding is automatically activated should Metro Fire have a negative cash position from July through the last Monday in April. The County Treasurer will cover Metro Fire's negative cash up to 85% of anticipated tax collections. Metro Fire must have positive cash balances from the last Monday in April until fiscal year end.
18. **Fund Balance:** Governmental Fund balance sheet assets less liabilities, equals Fund Balance. Accountants distinguish up to five separate categories of Fund Balance, based on the extent to which the government is bound to honor specific purposes spending constraints.

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- a. These five categories are: Non-spendable Fund Balance, Restricted Fund Balance, Committed Fund Balance, Assigned Fund Balance, and Unassigned Fund Balance (all separately defined herein).
19. **Early Debt Extinguishment Reserves:** Reserves accumulated to retire the Pension Obligation Bonds at the earliest dates allowed under the Bond Indenture.
20. **Fiduciary Reserves:** Amounts set aside by the Committee on behalf of the Deferred Compensation Plan participants. The amounts pay the administrative expenses of the Committee.
21. **General Fund:** For budgeting purposes, Metro Fire records all transactions in the General Fund that are not specifically accounted for in any other fund. The other funds include the Capital Facilities Fund, the Leased Properties Fund, the Grant Fund, and the Simulator Fund.
22. **General Fund Operating Reserves:** These are Unassigned Reserves accounted for in the General Fund.
23. **Governmental Fund Financial Statements:** Governmental Fund Financial Statements report using the modified accrual basis of accounting and generally reports financial resources collected and used within 90 days of fiscal year end. Capital assets are expenditures when purchased.
24. **Government-Wide Financial Statements:** Government-Wide Financial Statements are reported using the accrual basis of accounting. The Statement of Net Assets in the Government-Wide Financial Statements include all capital assets, and the Statement of Activities shows annual depreciation of the capital assets
25. **Grant Fund:** For budgeting purposes, Metro Fire records all grant related revenue and expenditures in the Grant Fund. On occasion large grants may be assigned their own fund. Currently a federal grant is being accounted for in the Simulator Fund.
26. **Labor Agreements:** All agreements with Local 522, along with resolutions and employment agreements passed by the Board of Directors covering exempt employees.
27. **Leased Properties Fund:** For budgeting purposes, Metro Fire records all transactions for surplus real property in the Leased Properties Fund. In

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addition, real property temporarily not in use is also recorded in this fund. Rent from these properties offsets non-operating expenditures such as utilities and special assessments.

28. **Non-spendable Fund Balance:** A classification of Fund Balance. Non-spendable Fund Balance amounts cannot be spent because they are not in spendable form or cannot be spent because legally or contractually are required to be maintained intact.
  - a. Examples of Non-Spendable Fund Balance are inventory and prepaid items.
29. **Operating Reserves:** General Fund reserves that are used for unexpected costs, revenue shortfalls, and smoothing cash flow prior to the receipt of expected revenue. In particular, cash flow is needed prior to the receipt of property taxes in January, May and June.
30. **Pension Obligation Bonds:** Bonds issued by Metro Fire in 2004 to pay down unfunded pension liabilities with CalPERS and the Sacramento County Employee Retirement System (SCERS).
31. **Reserve Analysis:** Comparing actual reserve levels to target reserve levels.
32. **Restricted Fund Balance:** A classification of Fund Balance. Restricted Fund Balance amounts can only be spent for specific purposes, which are stipulated outside the control of Metro Fire's Board of Directors by State law, granting entities, legal agreements, or enabling legislation, etc.
  - a. Restricted Fund Balance examples are grant funds, debt proceeds, Developer Fees, and special assessment fees.
33. **Self-Insurance Reserves:** Reserves accumulated for the payment of workers' compensation claims.
34. **Simulator Fund:** For budgeting purposes, all transactions related to the Homeland Security Grant Program CalEMA award for the development of disaster simulation.
35. **Unassigned Fund Balance:** A classification of Fund Balance. Any Fund Balance amounts not classified as Restricted Fund Balance, Committed Fund Balance, and Assigned Fund Balance.

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### POLICY

1. Unassigned Fund Balance
  - a. General Fund Operating Reserves will be used for unexpected costs or revenue shortfalls.
    - I. The minimum amount of General Fund Operating Reserves shall be 1.8 months of General Fund Operating Expenditures (15%). Metro Fire is able to operate with this minimum amount due to a County of Sacramento "Dry Period Funding" credit line used in anticipation of property tax receipts.
    - II. The maximum amount of General Fund Operating Reserves shall be 6 months General Operating Expenditures (50%) as reflected in the most current Metro Fire budget. This amount would allow Metro Fire the cash flow needed to operate without the County of Sacramento "Dry Period Funding" credit line.
2. Committed Fund Balance
  - a. Metro Fire is self-insured for most workers' compensation claims, and maintains excess coverage for extraordinary claims of \$3 million or more. This coverage amount may be adjusted each budget cycle.
    - I. To allow for future payment of workers' compensation claims, the minimum General Fund Self-insurance Reserves should equal the most recent short-term liability disclosed in Metro Fire's Audited Financial Statements.
    - II. The maximum General Fund Self-insurance Reserve should equal the most recent total liability of unpaid claims and expenses as reported in the most recent Audited Financial Statements.
  - b. Metro Fire has obligations to its employees for certain earned but unused compensated absences for sickness, vacation, paid time-off, and time off in lieu of overtime pay. Reserves should be accumulated to settle compensated absence amounts upon employee retirement, termination or other times when employees are allowed to cash out a portion of their compensated absence balances.
    - I. The minimum General Fund Compensated Absence Reserves should be the amount expected to be paid in the next 12 months.





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Fire's budget, Purchasing and Contract Policy, and Labor Agreements. Any other use requires authorization of the Board of Directors.

- b. The Board of Directors will authorize use of General Fund Capital Replacement, and CIP Reserves during the budget process. General Fund Capital Replacement and CIP Reserves are also available for unplanned (unbudgeted) capital replacement. Authorization for the use of Capital Replacement Reserves for unplanned capital replacement will be consistent with Metro Fire's Purchasing and Contract Policy.
- c. Early Debt Extinguishment and Debt Service Reserves use, is limited to the repayment of principal and interest of the related debt obligations.
- d. Use of the Fiduciary Reserves is under the authority of the Committee.
- e. CERBT Reserves will be used exclusively for the payment of retiree medical premiums and CERBT management fees.

### **PROCEDURES**

1. The Chief Financial Officer shall perform a Reserve Analysis to be submitted to the Board of Directors upon the occurrence of the following events:
  - a. Board of Directors' budget deliberations; or
  - b. When changes are made to the amount of Workers' Compensation self-insurance excess insurance coverage; or
  - c. When updated Post-Retirement Medical or Workers' Compensation actuarial valuations are issued; or
  - d. When a major change in conditions threatens the targeted reserve levels established within this policy.
2. If the Reserve Analysis indicates projected or actual reserve levels are not within the target levels outlined in this policy, the following shall be included with the analysis:
  - a. An explanation of why reserve levels are not at the targeted level, and;
  - b. A course of action to bring reserve levels within the minimum and maximum levels prescribed.

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### REFERENCES

1. Sacramento Metropolitan Fire District, Actuarial Valuation of Other Post-Employment Benefits as of July 1, 2012, issued by Bickmore, June 12, 2013.
2. Sacramento Metropolitan Fire District, Audited Financial Statements, June 30, 2012, dated December 20, 2012.
3. Sacramento Metropolitan Fire District, Actuarial Review of the Self-Insured Workers' Compensation Program, as of June 30, 2011 and June 30, 2012, Forecast for Program Years 2011-12 and 2012-13, issued by Bickmore Risk Services, October 12, 2011.
4. Sacramento Metropolitan Fire District, Pension Fund Bonds Early Payoff Policy, 156.01 effective June 12, 2008.
5. Sacramento Metropolitan Fire District, Purchasing and Contracting Policy, 110.01, adopted August 23, 2008.
6. Sacramento Metropolitan Fire District, Ordinance 2-05, An Ordinance Amending the Capital Fire Facilities Fee Schedule for new Construction and Development within the District.
7. Sacramento Metropolitan Fire District, Pension Funding Bonds Early Payoff Policy 156.01, adopted June 12, 2008.
8. [National Advisory Council on State and Local Budgeting, Recommended Practices 4.1.](#)
9. [Government Finance Officers Association of United States and Canada, Best Practice for Appropriate Level of Unrestricted Fund Balance in the General Fund.](#)
10. [Governmental Accounting Standards Board \(GASB\) Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, effective for fiscal years June 30, 2011 and later.](#)
11. [California Special District Association, Special District Reserve Guidelines, Second Edition.](#)
12. Moody's Investors Service, Rating Update, February 20, 2013.

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**APPENDIX**

1. Appendix 1 (link below), is a table of the various reserves covered in this memo showing various target reserve amounts as of June 30, 2013. This is a dynamic table that will be adjusted when obligations or resources available change over time.

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