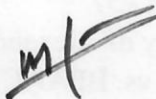


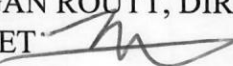
City of Alexandria, Virginia

MEMORANDUM

Date: SEPTEMBER 9, 2019

TO: THE HONORABLE MAYOR AND THE MEMBERS OF THE CITY COUNCIL

THROUGH: MARK JINKS, CITY MANAGER 

FROM: MORGAN ROUTT, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET 

SUBJECT: SUBMISSION OF BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC) FY 2021 MEMO #1 – CITY OF ALEXANDRIA UNCOMMITTED/UNASSIGNED FUND BALANCE TARGET

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During the FY 2020 Budget Development Process, Mayor Wilson submitted the following question as part of the Budget Questions & Answer Process:

*“Unassigned/uncommitted fund balance has now increased from 9% of General Fund Revenues at the end of FY 2017, to 10.28% at the end of FY 2018 to a projection of 10.57% at the end of FY 2019. Our target remains 5.5%. Is staff’s position that this is an appropriate level for this fund balance? If so, does staff believe the target ratio should be adjusted?”*

Staff’s April 18 response to Council is provided as Attachment 1. Subsequent to the staff response, City Council asked the Budget and Fiscal Affairs Advisory Committee (BFAAC) to review the current City target for the Uncommitted/Unassigned Fund Balance and to make a recommendation as to the appropriate level of the target. BFAAC worked throughout the spring and summer to review relevant materials, interview staff, and develop a recommendation for an appropriate target.

BFAAC worked collaboratively with City staff and solicited input and review from the Department of Finance and Office of Management and Budget on their recommendation memo. BFAAC approved their final memo and recommendation at their August 15, 2019 meeting. City staff reviewed this final recommendation and agree with BFAAC’s findings.

The proposed changes are to increase the Spendable General Fund Balance<sup>1</sup> as a Percentage of General Fund Revenue limit from 10.0% to a 15.0% limit, and to eliminate the Uncommitted/Unassigned<sup>2</sup> General Fund Balance as a Percentage of General Fund Revenue

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<sup>1</sup> Formerly known as Unreserved.

<sup>2</sup> Formerly known as Undesignated.

ratio. Additionally, BFAAC recommends the development of a replenishment policy that clearly delineates the use of fund balance and a timetable for replenishment.

Staff will be docketing these proposed changes to City financial policies to Council for consideration this fall along with a likely to be proposed amendment to ACPS fund balance policy.

**ATTACHMENTS:**

1. FY 2020 Budget Question #57
2. BFAAC Memo #01 – City of Alexandria Uncommitted/Unassigned Fund Balance Target
3. Table of Current Policies vs. BFAAC Recommendation

**CC:** Laura Triggs, Deputy City Manager  
Kendel Taylor, Director, Department of Finance  
Chair & Members of Budget and Fiscal Affairs Advisory Committee (BFAAC)

**City of Alexandria, Virginia  
FY 2020 Proposed Operating Budget & CIP  
Budget Questions & Answers**

**April 8, 2019**

**Question:**

Operating Budget (Page 9.7): Unassigned/uncommitted fund balance has now increased from 9% of General Fund Revenues at the end of FY 2017, to 10.28% at the end of FY 2018 to a projection of 10.57% at the end of FY 2019. Our target remains 5.5%. Is staff's position that this is an appropriate level for this fund balance? If so, does staff believe the target ratio should be adjusted? (Mayor Wilson)

**Response:**

The City's General Fund Balance includes different components: Spendable and Unspendable or Reserved. Within the Spendable portion there are three different levels: Spendable, Committed and Assigned. Unspendable Fund Balance is City reserves which cannot be used for any other purpose. Either the funds are already obligated for a specific purpose, such as encumbered for an authorized contract or the resources are not in a spendable form, such as inventory.

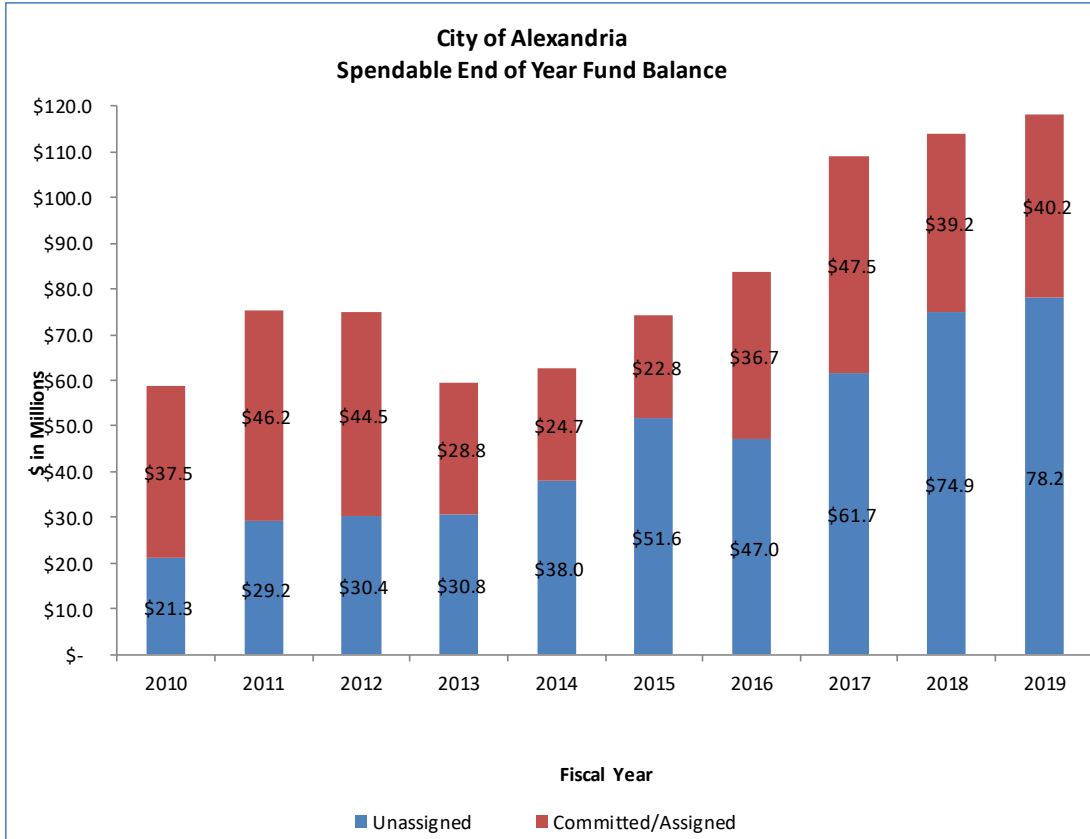
Spendable Fund Balance are resources that City Council can use to fund unforeseen, unbudgeted, one-time needs. Within Spendable Fund Balance, Committed and Assigned funds have been designated for a specific intended purpose, such as natural disasters, incomplete projects or future capital budgets. Although these are the stated intentions, Committed and Assigned fund balance can be used for any purpose, should circumstances change. The remaining Spendable Fund Balance has no designated purpose and is available for one-time uses.

Prior to issuing debt for capital projects, the City obtains ratings from rating agencies (Moody's and S&P), to provide would-be investors with an independent evaluation of the investment risk. One of the factors that contributes to this rating is the Spendable General Fund Balance as a percentage of General Fund Revenues, or more simply - how able is the city to withstand a sudden change in economic condition through reliance on reserves. One of the few negative comments the City received in its ratings analysis related to its low percent of reserves compared to other jurisdictions who hold the highest ratings (AAA/Aaa).

For the past 5 years, a deliberate effort has been in place to raise the Spendable Fund Balance ratio from 10.1 percent in 2013, when the Uncommitted/Unassigned ratio was 5.6 percent, to today's ratio of 16.4 percent, with an Uncommitted/Unassigned ratio of 10.28 percent. By returning surplus revenues and unspent budget authority to Fund Balance, the City has been able to address the concerns of the rating agencies and improve the overall Spendable Fund Balance ratio. Identifying the surplus funds as Uncommitted/Unassigned has helped achieve this goal while minimizing the volatility of identifying future spending designations, appropriating those designations and then replenishing Fund Balance each year. The chart below comes from the Statement of Estimated Fund Balance section beginning on page 9-1 of the FY 2020 Proposed Operating Budget.

The current 5.5% target provides City Council with the maximum flexibility to respond as needed to unexpected resource requirements, while maintaining an overall fund balance policy. It should be noted that City Council has several policies in place to ensure an appropriate level of fund balance, including

limitations on the number of years that fund balance can be used to offset spending and the number of votes required to use fund balance (a super majority). Staff does not recommend making any changes to the targets for Fund Balance at this time, but to monitor the situation for a few more years before considering raising the target percentage.



Estimate for FY 2019

Source: FY 2020 Proposed Operating Budget

## City of Alexandria, Virginia

## MEMORANDUM

Date: AUGUST 15, 2019

TO: THE HONORABLE MAYOR AND THE MEMBERS OF THE CITY COUNCIL

FROM: BUDGET AND FISCAL AFFAIRS ADVISORY COMMITTEE (BFAAC)

SUBJECT: MEMO #1 – CITY OF ALEXANDRIA UNCOMMITTED/UNASSIGNED FUND BALANCE TARGET

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The Mayor of the City of Alexandria asked BFAAC to review the 5.5% City target for the Uncommitted/Unassigned Fund balance and make a recommendation as to the appropriate level of the target.

**Background:** The City's fund balance target policy dates to 1987 with a major update in 1997, to provide targets for both unreserved fund balance, which is the City's total Spendable Fund Balance and Undesignated fund balance, which is a subset of Spendable fund balance and reflects fund balance that has not been committed or assigned for any specific purpose. Unreserved, or Spendable Fund Balance provides the greatest tool for comparison to other jurisdictions, since the use of fund balance designations varies by jurisdictions, which makes Undesignated fund balance a more volatile subset. The City's designation of commitments and assignments has varied significantly over the past 20 years, as it does in other jurisdictions. The policy established in 1987 also stipulates that general fund balance should not be relied upon to finance current operations, and limits use of fund balance for ongoing operations to not more than two years. However, the policy does not provide for a clear replenishment strategy in the event fund balance is used.

The actual City of Alexandria Unassigned/Uncommitted Fund Balance for 2017 is 9% of General Fund Revenues. The forecast for 2018 is 10.28% and 2019 is 10.57%.<sup>1</sup> The Unassigned/ Uncommitted Fund Balance is part of a larger Spendable Fund Balance, which has a City target of 10% of General Fund Revenues. The Spendable Fund Balance as a percent of General Fund Revenues are as follows: 2017 actual -- 15.96%; 2018 forecast -- 16.43%; 2019 forecast -- 16.0%. The City has recently determined that the Spendable Fund Balance is the most useful benchmark regarding the City's ability to respond to uncertainties.

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<sup>1</sup> <https://www.alexandriava.gov/uploadedFiles/budget/info/budget2020/Section%2009%20-%20Fund%20Balance.pdf>; page 7.

The following table shows the dollars associated with the targets and the current percentages for FY 2017-2019.

Fund Type	2017		2018		2019	
	Percent	Dollars	Percent	Dollars	Percent	Dollars
Uncommitted/Unassigned	9%	\$61.6M	10.28%	\$73.8M	10.57%	\$78.7M
	5.50%	\$37.6M	5.50%	\$39.5M	5.50%	\$40.7M
Spendable	15.96%	\$120M	16.43%	\$129M	16.0%	\$129.4M
	10.0%	\$68.4M	10.0%	\$71.8M	10.0%	\$74.0M

The Spendable Fund Balance and the Unassigned/Uncommitted Fund Balance are related since if the Unassigned/Uncommitted Fund Balance is reduced (used for one-time expenditures as dictated by policy), the Spendable Fund Balance would be reduced as well. However, reducing the Unassigned/Uncommitted Fund Balance to the target does not necessarily meet the Spendable Fund Balance Target. For example, reducing the:

- a. 2017 Unassigned/Uncommitted Fund Balance from 9.0% to 5.5% of the General Fund Revenues
  - i. Spendable Fund Balance becomes 14.04%.
- b. 2018 forecast Unassigned/Uncommitted Fund Balance from 10.28% to 5.5%
  - i. Spendable Fund Balance becomes 13.19%; and
- c. 2019 forecast Unassigned/Uncommitted Fund Balance from 10.57% to 5.5%
  - i. Spendable Fund balance becomes 12.42%.

Negative economic conditions in FY 2013 and FY 2014 caused the City of Alexandria to spend down the Fund Balances. Since FY 2015, the City of Alexandria has worked hard to grow the Spendable Fund Balance from 10.1% in 2013 to the current 15.96% in 2017. The corresponding Unassigned/Uncommitted Fund Balance has grown from 5.6% in 2013.

**Ratings Agencies:** Ratings agencies, Moody's and S&P Global, look at the Spendable Fund Balance as part of their credit analysis. An important part of these analysis is the tax base stability, which is strong in the City. Comments from the ratings agencies regarding City of Alexandria's balances are as follows.

- a. Moody's – Dated July 12, 2018: Rating: AAA  
*Alexandria's financial position will likely remain stable, given a trend of operating surpluses and improving cash and reserve levels, and tax base growth. Fiscal 2017 ended with a sizeable \$25.3 million surplus due primarily to a tax rate increase, bringing total general fund balance to just over \$120 million, or 17.6% of revenues, which is satisfactory but below the national median for the Aaa rating category of 47.8%. Available general fund balance (total less nonspendable and restricted amounts) represented 16.0% of revenues, which also falls below the national Aaa median of 43.8%.*

*Positively, unaudited results for fiscal 2018 show a \$8.7 million surplus in the general fund, further increasing fund balance levels. The fiscal 2019 budget represents a 2.8% increase from the previous year's budget and is balanced without appropriation of general fund balance. Given that Alexandria's available*

*reserves are below the US Aaa median, the city's current level of financial flexibility is a key consideration in the rating going forward. Any draws on reserves reducing available fund balance below historical levels would diminish financial flexibility and could result in a weaker credit profile.*

- i. Moody's credit rating methodology includes a review of the Spendable Fund Balance level, making up 10% of the 30% factor for Finances. The other Moody's factors are Economy/Tax Base at 30%; Management at 20%; and Debt/Pensions at 20%.<sup>2</sup>
- ii. The Moody's analysis indicates that the median Spendable Fund Balance is 43.8% for AAA rates governments.<sup>3</sup> However, the Moody's ratings methodology requiring larger balances are not factors that apply to the City of Alexandria, specifically:
  1. If budgeted revenues are economically sensitive and therefore not easily forecasted or
  2. To offset risk associated with tax base concentration, unsettled labor contracts, atypical natural disaster risk, and pending litigation.

b. S&P Global Ratings July 13, 2018: Rating: AAA

*The city has a history of maintaining what we consider strong available general fund balances after including committed reserves available for operational expenses following board approval. We understand management expects uncommitted reserves to be stable at fiscal year-end 2018, despite ongoing growth and capital needs. The formal general fund balance policy calls for reserves equal to a minimum 10% of general fund revenue. Historically, Alexandria has maintained reserves at or above this threshold. With performance likely to remain stable, we anticipate the city's reserves will remain at least strong.*

- i. S&P Global credit rating methodology review of the Spendable Fund Balance is 10% in the S&P assessment as the Budgetary Flexibility factor. The other S&P factors are: Institutional Framework 10%; Economy, 30%; Management, 20%; Liquidity, Budget Performance, and Debt and Contingent Liabilities are all set at 10% each of the total score.<sup>4</sup>
- ii. The S&P rating considers the Spendable Fund Balance 10% target to meet the requirements for a AAA rating, making no further comment on it.<sup>5</sup>
- iii. The rating methodology notes that the option to use fund balance in the near term can provide fiscal flexibility although fund balance drawdowns

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<sup>2</sup> Moody's US Local Government General Obligation Debt, Rating Methodology, January 2014. <https://www.leg.state.nv.us/App/InterimCommittee/REL/Document/2857>

<sup>3</sup> Moody's US Local Government General Obligation Debt, Rating Methodology, January 2014.

<sup>4</sup> S&P Global Ratings. U.S. Local Governments General Obligation Ratings: Methodology and Assumptions. Sept 12, 2013

<sup>5</sup> S&P Global Ratings. U.S. Local Governments General Obligation Ratings: Methodology and Assumptions. Sept 12, 2013

may impair future fiscal flexibility. Likewise, increasing fund balances can enhance fiscal flexibility.

- c. Neither ratings agencies' written reports make comments on the target or actual levels of the Uncommitted/Unassigned Fund Balance.

**Budget Question #57:** In the Budget Question #57 response during the FY 2019 budget process, the City Staff recommended the target remain at 5.5% noting that it provides the City "maximum flexibility to respond as needed to unexpected resource requirements, while maintaining an overall fund balance policy." At that time, the staff indicated the need to monitor the fund balance changes over the next several years and then determine if the target should be changed<sup>6</sup>. Since that time, Staff has determined that an update to fund balance policy is warranted.

Much has changed since the City last updated the Fund Balance policy. While the City has targets for both the Spendable and Unassigned/Uncommitted Fund balance, the City has worked hard to build those balances beyond the current targets. It seems that the time has come to establish a target that the City deems appropriate for use in case of an economic downturn or natural disaster. Further, a replenishment policy would be useful to provide guidance to the City as to the timeframe for meeting the targets if the Fund Balances are used in the future. Replenishment would then be an important part of the budget development process to budget the revenues required for replenishment. Finally, the Unassigned/Uncommitted Fund Balance Target is no longer a useful target for identifying a Fund Balance the City can use in an economic downturn or natural disaster. As mentioned above, even the ratings agencies don't review such fund balance targets.

**Recommendation:** To ensure the City of Alexandria has a clear policy for Fund Balance targets, BFAAC recommends the following policy changes:

- a) The City establish a target of 15 percent for the Spendable Fund Balance as a percent of the General Fund Revenues. This is near the current projected 16.27% for FY 2019. This will allow a robust, but reasonable target that the City can achieve and then enhance budget planning for any funding projected above that target to be utilized for City requirements;
- b) Delete the target for the Unassigned/Uncommitted Fund Balance since it is no longer a relevant benchmark to determining fund balance availability; and
- c) Develop a replenishment policy that will clearly delineate the use of the Fund and a timetable for replenishment. It is important that the City utilize the Fund when necessary and a replenishment policy then helps the City with guidance to building the Fund back to the target, including the timeframe required to meet the target.

Making these changes will provide the City with the confidence to use the Spendable Fund Balance when an unusual event occurs. Further, the Spendable Fund Balance is a more

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<sup>6</sup> City of Alexandria FY 2020 Proposed Operating Budget and CIP Budget Questions and Answers, Budget Question #57.



meaningful measure of fund availability for such events. The replenishment policy will provide the needed guidance as to when the City is to again meet the targets and can then be incorporated into the annual budget process. Finally, this policy will ensure the City and Council have revenue flexibility to consider additional spending on needed priorities while also having the appropriate level of "rainy day" fund for emergency requirements that might arise.

Attachment #3 - Table of Current Policies vs. BFAAC Recommendation

	Current Policies		BFAAC Recommendation	
	Limit	Target	Limit	Target
Spendable General Fund Balance as a Percentage of General Fund Revenue (Previously known as Unreserved)	10.0%	N/A	Not Defined	15.0%
Uncommitted/Unassigned General Fund Balance as a Percentage of General Fund Revenue (Previously known as Undesignated)	4.0%	5.5%	<i>DELETE AS MEASURE</i>	
Net Assets as a Percentage of General Revenues [1]	4.0%	5.5%	4.0%	5.5%

Notes:

[1] Measure not addressed in BFAAC report.