	<b>CITY OF PALM DESERT ADMINISTRATIVE PROCEDURES</b>	
	<i>Subject</i>	<b>Reserve Policy</b>
	<i>Policy No.</i>	<b>FIN - 003</b>
	<i>Date</i>	<b>Issued: September 27, 2018 Amended January 22, 2026</b>
	<i>Approved by</i>	<b>Resolution No. 2026- ____ authorizing a Reserve Policy</b>
	<i>Authored by</i>	<b>Finance Department</b>

## I. PURPOSE

To outline the policy and procedures for establishing reserves for long-term city infrastructure needs, economic uncertainties, economic development, emergency reserve, equipment replacement, productivity savings and innovation, pension and other ~~post-employment~~post-employment obligations.

This policy will also set guidelines and priorities for the distribution of excess revenue at the end of each fiscal year to assist in funding and replenishing the identified reserve categories as well as ensuring that funds for current operating needs are available. This Policy will help the City ensure stable service delivery.

## II. SCOPE

The City utilizes a variety of Government funds for reporting and budgeting revenues and expenditures of the City which are separated broadly by three fund types: governmental funds, proprietary funds and fiduciary funds. This policy will pertain only to governmental funds and proprietary funds since fiduciary funds are held in trust for others.

Governmental funds include the General Fund, Special Revenue funds, Debt Service funds and Capital Project funds. Proprietary funds include Enterprise funds and Internal Service funds.

To effectively utilize and maintain adequate reserves for both known and unknown contingencies, this policy establishes reserve categories based on the hierarchy of the City's needs and risks:

1. General Fund Operating Reserve
2. Contingency/Emergency Reserve
3. Facilities Maintenance Reserve
4. Capital Improvement Projects Reserve
5. Liability Reserve
6. Employment Benefits Reserve
7. Other Fund Stability Reserve
8. Equipment Replacement Reserve

9. Economic Development/Land Acquisition Reserve

**III. GENERAL DEFINITIONS**

- A. ACFR – Annual Comprehensive Financial Report – local government entity's main yearly financial reporting document, prepared in accordance with GAAP and governmental reporting standards (typically GASB)
- B. CJPIA – California Joint Powers Insurance Authority – a pooled insurance and risk management provider for California public agencies.

**III-IV. RESERVE CATEGORY DEFINITIONS** (in alphabetical order)

- a. Capital Improvement Projects Reserve – A reserve for major capital projects or improvements to the City's infrastructure including recreational facilities, undergrounding, roadways, storm drains, parks and gardens, buildings, and rights of way.
- b. Contingency/Emergency Reserve – A reserve to sustain General Fund operations, service delivery and budgetary stabilization in the event of an unexpected change in financial condition<sup>1</sup> or public emergency. This reserve is not intended to serve as an alternative funding source for new programs.
- c. Economic Development/Land Acquisition Reserve -- A reserve to facilitate economic development partnerships, incentives and property acquisitions to further the City's economic development goals.
- d. Employment Benefits Reserve – A reserve for accumulated compensated leave balances, pension discount rate changes, pension obligations and other post-employment benefits (OPEB), including unfunded pension liabilities.
- e. Equipment Replacement Reserve -- A reserve for the replacement of equipment not identified within the Facilities Maintenance Reserve, including vehicles, office furniture, information systems, printers, scanners, communication systems, etc.
- f. Facilities Maintenance Reserve – A reserve to maintain existing City buildings and infrastructure including recreational facilities, parks and gardens, and hiking trails.
- g. General Fund Operating Reserve – A reserve used to finance the daily operations of the City, such as public safety, streets maintenance, recreational parks, and special events.
- h. Liability Reserve – A reserve for costs not covered by the City's insurance programs including claim costs within the deductible amounts, certain types of settlements and judgments, or any claims awarded in excess of \$50 million. This reserve may also be used for deductibles, to pay any amount that may be

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<sup>1</sup> An unexpected change in financial condition could include things such as the economic crisis in 2008, a loss or delay of a major revenue source, a natural disaster, liabilities not covered by insurance, or change in the pension discount rate for the City's unfunded pension liability.

considered a liability to the City consistent with this category, or to pay any contribution or premium to the pool on behalf of the City.

- i. Other Fund Stability Reserve – A reserve for transfers to funds from the General Fund to cover expenses.

**IV-V. ACCOUNTING GUIDANCE**

The Government Finance Officers Association (GFOA) suggests that as a best practice, cities should consider their own unique circumstances in order to determine adequate reserves. This includes assessing the needs of the City as well as the uncertainties that could impact the City’s revenues and fund balance

Government Accounting Standards Board Statement (GASB) No. 54 defines five specific classifications of fund balance. The five classifications are intended to identify whether the specific components of fund balance are available for appropriation (or available to reserve) and are therefore “Spendable.” The classifications are also intended to identify the extent to which fund balance is constrained by special restrictions. The five classifications<sup>2</sup> of fund balance for governmental funds are as follows:

<u>CLASSIFICATIONS</u>	<u>NATURE OF RESTRICTION</u>
Non-spendable	Cannot be readily converted to cash
Restricted	Externally imposed restrictions
Committed	City Council imposed commitment
Assigned	City Manager assigned purpose/intent
Unassigned	Residual balance not otherwise restricted

<sup>2</sup> *Nonspendable Fund Balance* (inherently nonspendable) – Assets that cannot be converted to cash (i.e., prepaid items and inventories of supplies) and assets that will not be converted to cash soon enough to affect the current period. Examples of nonspendable fund balance are reserves for long term receivables and advances, prepaid assets, City’s financial assets which are not due to be received for an extended period, so are not available for appropriation during the budget year.

*Restricted Fund Balance* (externally enforceable limitations on use) – Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments and limitations imposed by law through constitutional provisions or enabling legislation. Examples of restricted fund balance are reserves for debt service, developer impact fee, capital bonds and grants.

*Committed Fund Balance* (self-imposed limitations on use set in place prior to the end of the fiscal year) – Limitation imposed at the highest level of decision making that requires formal action at the same level to remove (City Council). Examples of committed fund balance are the aquatic center, energy loan programs and the housing authority capital asset replacement.

*Assigned Fund Balance* (limitation resulting from intended use) – Intended use is established by highest level of decision making, then may be implemented by an official designated for that purpose (delegated by the City Council to the City Manager). Examples of assigned fund balance are the library fund, building maintenance fund, capital project reserve fund, and economic development fund.

*Unassigned Fund Balance* (residual net resources) – Excess of nonspendable, restricted, committed, and assigned total fund balance. Unassigned Fund Balance reserves are residual positive net resources in excess of what can properly be classified in one of the other four components. Unassigned General Fund Balance (unobligated general fund reserves) and can be used for any lawful purpose.

This Policy is focused only on the reserve designations that will be Committed, Assigned or identified in Unassigned. Non-spendable and Restricted classifications will be excluded because they are subject to requirements outside the City's control. The City will, however, consider restricted fund balance as spent first when both restricted and unrestricted fund balances are available.

## **V. RESERVE FUNDING POLICIES**

The primary goal of the Policy is to identify and reserve, adequate resources for operational liquidity, future needs and any uncertainties that might affect the City's fund balance. The Policy includes broad reserve categories that are meant to be as inclusive as possible, yet flexible enough to address needs or risks as they arise. Each reserve category may include multiple funds some of which may have a restricted fund balance component. At the discretion of the City Manager, monies held in reserve may be used in any year when the General Fund is not balanced in order to offset operating costs consistent with these reserve categories.

The identified reserve funding policies are as follows:

1. *General Fund Operating Reserve* – On June 30, the Finance Director shall set aside ~~twenty five~~ten percent (~~25~~10%) of the projected annual General Fund expenditures. Withdrawals are permitted following an economic contraction, defined as two consecutive quarters of declining "real Gross Domestic Product/GDP" (GDP adjusted for inflation). This reserve will be adjusted at the end of each fiscal year to the recommended level based on the next year's projected expenditures. This reserve will be classified in fund balance as ASSIGNED.
2. *Contingency/Emergency Reserve* – At the beginning of each fiscal year, the Finance Director shall reserve an amount equal to ~~twenty five~~ten percent (~~20~~15%)<sup>3</sup> of the projected annual General Fund revenues. Withdrawals are permitted if a severe emergency, such as a natural disaster accompanied by significant, unanticipated revenue loss or expenditure needs occur. Withdrawals would need to commence within 12 months of the triggering event and could continue until tax revenues exceed pre-contraction levels, if that is the case. This reserve will be adjusted at the beginning of each fiscal year to the recommended level based on that year's projected revenues. This reserve will be classified in fund balance as COMMITTED.
3. *Facilities Maintenance Reserve* – Upon the approval of this policy, the Finance Director is directed to commit the amount identified in the Capital Replacement Reserve Study, as the initial deposit, less amounts available from other funding sources to this reserve. The policy designated goal for funding this reserve, will be ~~between sixty and one hundred~~seventy percent (~~60-100~~70%) of the ~~'Fully Funded'~~annual calculated replacement value amount in the Capital Replacement Reserve Study. ~~The annual recommended funding amount identified in the Capital Replacement Reserve Study will be considered as part of the annual budget. The~~

<sup>3</sup> After the financial crisis in 2008 the fluctuation in the City's revenue was approximately twenty percent (20%) of the 2007-08 budget or \$11 million dollars. While the City also reduced its budget at that time to offset the reduction in revenues to the extent possible, the core services were still rising. It took approximately eight years to reestablish the revenue base to pre-2008 levels. Based on these actual events staff believes that 20% of the annual operating revenue would be prudent as a reserve, with a consideration to review from time to time as information becomes available to the City that might suggest the amount to be increased.

replacement value will be determined each by the total balance of facilities in the General Fixed Assets Fund 980. The minimum reserve will be calculated at 30%, with the maximum cumulative reserve balance not to exceed 110% of the annual calculated replacement value. Residual balances each year may be carried over up to the 110% ceiling. This reserve will be classified in fund balance as COMMITTED.

4. *Capital Improvement Projects Reserve* – At the financial closing of each fiscal year, the Finance Director shall set aside twenty percent (20%) of the total Capital Improvement Program projects for the next five years. The Finance Director will adjust this amount annually to the policy designated level plus any additional amounts so directed by the City Council under Section VI of this policy. This reserve will be classified in fund balance as both RESTRICTED and COMMITTED depending on the project funding. Unless otherwise specified, at such time as a project or any portion thereof has been awarded the amount will be allocated (committed) to the project and will not be available for other projects.
5. *Liability Reserve* -- The Finance Director shall commit at least the pooled retention requirement for both Liability and Workers' Compensation, which is currently \$4 million (\$2 million each). This amount may be adjusted annually in accordance with the minimum threshold requirements in CJPIA's Memorandum of Coverage. This reserve will be classified in fund balance as COMMITTED.
6. *Employment Benefits Reserve* – Internal Service Funds have been established for the purpose of reserving monies for compensated balances and Other Post-Employment Benefits (OPEB). On June 30 of each year, the Finance Director shall set aside one hundred percent (100%) of the compensable accrued unused vacation, sick leave, and compensatory time and the current year's OPEB requirements to the appropriate internal service funds. This amount will be COMMITTED. The Finance Director shall also set aside fifty percent (50%) of a one percent (1%) difference in the Public Employees Retirement System (PERS) discount rate. This amount will be COMMITTED in the General Fund.
7. *Other Fund Stability Reserve* ~~– Upon the approval of this policy, the Finance Director shall be directed to commit \$3.3 million to this reserve.~~ At the end of each fiscal year, the Finance Director shall adjust the amount to be the projected annual transfers to other funds. These funds may either be committed and transferred at the beginning of the Fiscal Year (and trued up at year-end) or is-a reserve will be classified in fund balance as COMMITTED.
8. *Equipment Replacement Reserve* – An Internal Service Fund has been established for the purpose of equipment replacement. At the financial closing of each fiscal year, the Finance Director shall adjust this reserve to be at least 100% of the total historical cost of equipment assets as noted in the GACFR and may

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include amounts set aside in excess of 100% for any approved one-time expenditures. This reserve will be classified in fund balance as COMMITTED.

9. Economic Development/Land Acquisition Community Investment Reserve — ~~Upon approval of this Policy, the Director of Finance shall deposit an additional \$4,000,000 as a reserve for land/property acquisitions. In addition, w~~ To ensure reinvestment in the community, a dedicated Economic/Community Investment Reserve will be created in an annual amount of \$5,000,000 supported by a structured, measurable allocation of limited fund balance. Any project utilizing these reserved funds would need to demonstrate a minimum expected ROI within five years that meets or exceeds the benchmark currently used for City investments, the Five-Year Treasury Bill rate to be viable investments paid from this reserve. Unused annual reserve amounts may accumulate for four years and then must be returned to fund balance as UNASSIGNED. As the City builds out, this amount may be adjusted and funds reallocated where needed with City Council approval. Additionally, within a reasonable amount of time from when the City receives its share of the proceeds of the former redevelopment agency's land sales, from the County of Riverside, the Finance Director shall commit the City's share to this reserve. This reserve will be classified in fund balance as COMMITTED.

9-10.

Productivity Savings/Innovation Reserve

This reserve concept is a modern, incentive-based approach to support innovation and operational efficiency across City departments. The reserve encourages continuous improvement and high performance by allowing General Fund managers to retain and reinvest productivity-related savings in long-term service enhancements. Eligible productivity savings would be separately tracked by the department or division that generated them. Requests for use of accumulated savings could be submitted to the City Manager at any point during the second half of the fiscal year. Any savings not utilized or requested would roll back into the General Fund balance at year-end. This reserve will be classified in fund balance as ASSIGNED.

## **VI. CITY COUNCIL DESIGNATION OF RESERVES AND MINIMUM THRESHOLD**

The City Council will take action to COMMIT fund balance and unless otherwise specified in this Policy, hereby designates the City Manager or his/her designee to ASSIGN fund balance when appropriate. The City Council may designate portions of General Fund unassigned or unobligated fund balance for any other municipal purpose that the City Council deems prudent or necessary. At no time will the City's cumulative Reserve Balance dip below 35% of annual revenue. This measure meets both bond rating requirements for Aaa rating and the suggested minimum of 16.7% of revenue, as suggested by GFOA's best practices without unanimous City Council approval.

## **VII. ANNUAL DISTRIBUTION OF EXCESS REVENUE**

The distribution of excess revenue at the end of each fiscal year will be according to the following guidelines and priorities. Excess revenue, for purposes of this Policy, is the difference between revenues and expenses in the General Fund at the end of a fiscal year after all required transfers are made to other funds.

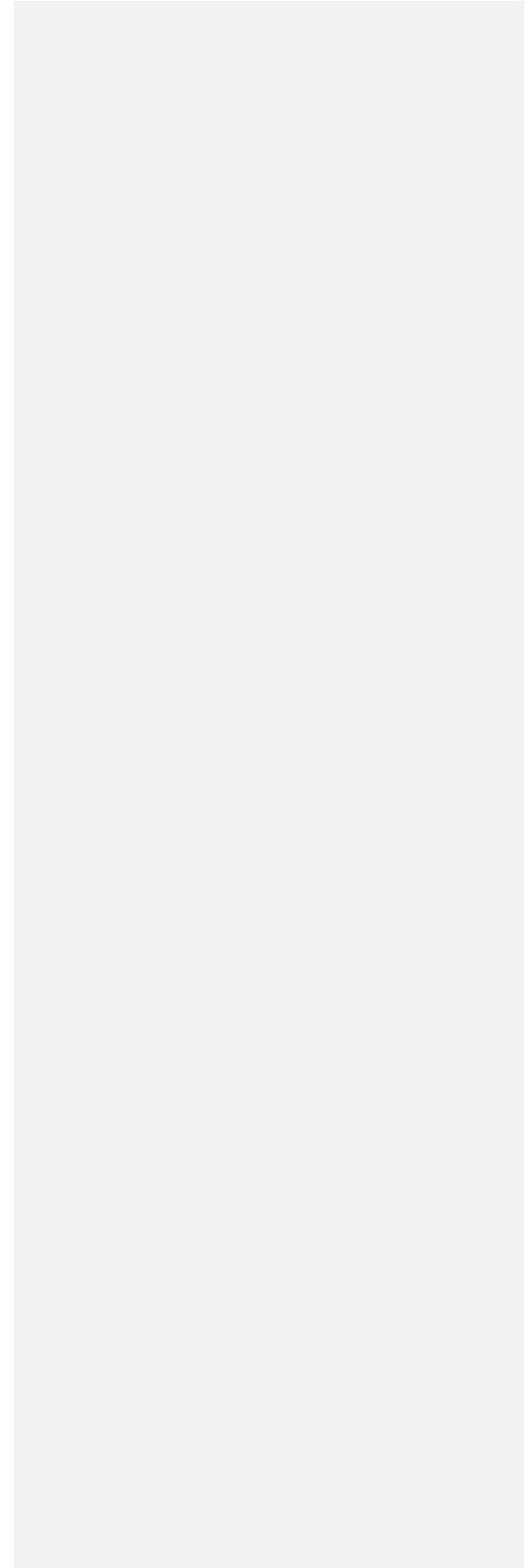
The priority for distributing or reserving excess revenue at year end is as follows:

1. All excess revenue shall first be used to replenish the General Fund Operating Reserve until it reaches the Policy designated level.
2. The amount necessary to reserve for continuing appropriations and encumbrances that are not funded by other methods, if any.
3. The amount necessary to fund an adequate reserve for potential liabilities, compensated absences, and other post-employment benefits to be paid during the next fiscal year that are not funded by other methods, if any.
4. The amount necessary to fund the Contingency/Emergency Reserve to maintain General Fund operations, service delivery and budgetary stabilization in the event of an unexpected change in financial condition<sup>4</sup> or public emergency. Or, if there is insufficient amounts available to fully fund the Contingency/Emergency Reserve, an amount necessary to temporarily reserve for any known and/or anticipated economic downturns during the next fiscal year that are expected to be more than three percent (3%) of the previous year's General Fund revenues.
5. Other considerations for the allocation of excess revenues will be at the discretion

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<sup>4</sup> An unexpected change in financial condition could include things such as the economic crisis in 2008, a loss or delay of a major revenue source, a natural disaster, liabilities not covered by insurance, or change in the pension discount rate for the City's unfunded pension liability.

of the City Manager after review of the City's outstanding obligations, approved goals, or level of reserves within each category.



### **VIII. REPLENISHMENT OF RESERVES**

After consideration of the use of excess revenue in Section VI., the City Manager will annually review the level of each approved reserve category, and after determining what is reasonably necessary and appropriate for the City's needs, may direct replenishment of critical reserves (General Fund Operating Reserve and Contingency/Emergency Reserve) from other reserves or may assign any remaining excess revenues accordingly.

If a transfer is required from one reserve to another, the City Manager shall notify the City Council at the next regularly scheduled City Council meeting of such transfer.

When reserves are used for any intended purpose, or as allowed under this policy, and a replenishment source is not identified at the time of use, the City Manager will advise the City Council during the annual budget process as to the status of reserves including any recommendations for replenishment.

### **IX. ~~COMPREHENSIVE~~ ANNUAL COMPREHENSIVE FINANCIAL REPORT**

In accordance with generally accepted accounting principles and practices, all classifications of General Fund fund balance will appear in the Notes to Financial Statements of the ~~CACFR~~ and be classified in accordance with GASB 54.