COUNTY OF SACRAMENTO
CALIFORNIA

For the Agenda of:
September 14, 2006

To: Board of Supervisors

From: Office of Budget and Debt Management

Subject: Report Back: Additional Explanation/Justification For Increase To Cash Flow Reserve In General Fund

Contact: Linda Foster-Hall (874-2453)

Overview
It is a best practice for government entities to maintain a prudent level of financial resources to protect against reducing service levels or raising fees because of temporary revenue shortfalls or unpredicted one-time expenditures.

Fiscal Impact
The increase recommended in the County Executive's Fiscal Year 2006-07 Final Budget would increase the Reserves for Cash Flow to 1.51% of recommended final budget expenditure levels.

BACKGROUND:

It is recommended by the National Advisory Council on State and Local Budgeting Practices that government entities maintain a prudent level of financial resources to protect against reducing service levels because of temporary revenues shortfalls or unpredicted one-time expenditures. While reserve funds are called many names including unreserved or undesignated fund balances, these funds are essentially a savings account that should be used with discretion to address:

1. Temporary cash flow shortages;
2. Emergencies and unanticipated economic downturns
3. One-time opportunities
4. To partially fund long term liabilities; and
5. To meet statutory requirements or covenants.

The Government Finance Officer's Association further recommends that the level of reserves in the General Fund be no less than five to 15.0 percent of general fund operating expenditures or revenues which ever is less volatile.

DISCUSSION:

As a best practice, the county should maintain reserve balances at a level that would allow the county to weather an economic downturn without dramatically reducing the level of critical county services. Then as the financial condition improves, there should be a process to increase reserves back to an acceptable level.

Additionally, in recent discussions with Moody's and Standard & Poor's, both were concerned about the level of the County's reserves. Specifically Moody's indicated in their most recent ratings of the County's debt, that for a county of our size and when compared to other California counties with similar credit, cash reserves (as a percentage of expenditures) held by the county fell well below the norm of 15% or greater. Both also commented on their concerns regarding the County's continued General Fund structural imbalance between expenditures and revenues, and the lack of sufficient reserves to "cushion" the difficult steps that will be necessary over a few years to resolve the imbalance by reducing expenditure growth to be in line with available revenues.

After the conclusion of Fiscal Year 2005-06, because of an unusually large fund balance caused primarily by one-time revenues/improvements, the county has an opportunity to increase the level of General Fund reserves with one-time resources. Conversely, it would not be prudent to increase expenditures beyond sustainable levels with these resources. The most appropriate use of these funds would be to increase reserves to a level that is more suitable for a county with an expenditure base of $2.14 billion.

Reserves and Cash Levels

When the reserves are maintained, they provide the General Fund with operating cash. This has become increasingly more important as the County has moved to a modified accrual basis of budgeting/accounting. Under this method, the County counts revenues in our budget when earned during the fiscal year but not received until the following fiscal year. Because most of our budgeted expenses are actually paid before fiscal year-end, the gap between revenues actually received and expenses paid often exceeds $30-40 million even though the budget is balanced because of this cash-flow timing issue. At the end of a fiscal year, the cash balance of the General Fund is usually less than the total reserve balance. As such, if not for the reserves, the General Fund would be in a cash deficit position (overdrawn) and would be unable to meet payroll and other commitments. This situation is well illustrated in the following Table:

Fiscal Year 2005-06 was the first time since the early 1990's that the county had a positive cash position at year end. An analysis of the various cash transactions for Fiscal Year 2005-06 reveled that the majority of the $29.4 million is the result of the rapid growth in property tax related transactions that occurred throughout the fiscal year and more specifically in July 2005.

Year	General Fund Reserves	General Fund Cash Balance	Cash Balance W/out Reserves
1993	48.40	55.00	6.60
1994	64.90	43.40	(21.50)
1995	54.00	23.20	(30.80)
1996	39.10	22.30	(16.80)
1997	34.60	12.00	(22.60)
1998	39.60	27.90	(11.70)
1999	33.30	(0.30)	(33.60)
2000	41.60	22.90	(18.70)
2001	50.60	25.70	(24.90)
2002	48.80	7.80	(41.00)
2003	36.80	29.90	(6.90)
2004	46.50	10.60	(35.90)
2005	41.80	27.70	(14.10)
2006	82.30	111.70	29.40

In the Fiscal Year 2002-03 budget hearings, the Board was presented with a comprehensive report on the use of County's reserves. This report has been attached (See Attachment I) as additional information regarding the use of General Fund Reserves as operating cash. This report also included a list that defined the reserves as they existed at that time. Attachment II of this report is an updated version of this list and gives a full description of the General Fund's current recommended reserves.

Measures/Evaluation:

Currently the level of reserves for cash flow before the recommended increase is equal to 0.70% of the level of expenditures identified in the recommended final budget. The recommended increase of $17.42 million would increase this level to 1.51%. If all general fund reserves are incorporated into this calculation, the level increases from approximately 4.25% to 5.90%.

FINANCIAL ANALYSIS:

The increase recommended in the County Executive's Fiscal Year 2006-07 Final Budget would increase the Reserves for Cash Flow to 1.51% of recommended final budget expenditure levels. This increase would also increase the total level of reserves from approximately 4.25% to a total of approximately 5.90% of the recommended final budget expenditure levels.

Respectfully submitted,	CONCUR:
GEOFFREY B. DAVEY Chief Financial/Operations Officer	TERRY SCHUTTEN County Executive

Attachment:

Attachment I – Fiscal Year 2002-03 Report Back on General Fund Reserves
Attachment II – Description of current recommended General Fund Reserves

ATTACHMENT I

COUNTY OF SACRAMENTO

Inter-Office Correspondence

Date: August 16, 2002

To: Members, Board of Supervisors

From: Geoffrey B. Davey
Chief Financial Officer

Subject: Final Budget Report-Back on General Fund Reserves

During the August 6, 2002 Budget Workshop, Members of the Board requested a report on General Fund Reserves, reserve levels, and the discretionary or mandated nature of each reserve account. This report back includes:

- A general description of reserves and their role in the budget process
- A brief history of reserve levels in the General Fund
- A discussion of the county's year end cash position and the relationship to reserves
- A discussion of the use of reserves in the context of the county's multiyear budget problem
- An identification of other unallocated funds in the budget

As attachments to this report may be found:

- An explanation of where reserves are found in the budget document
- A description of each individual General Fund Reserve Account
- A summary of insurance reserves for other counties

SUMMARY

Reserves are essentially off-budget savings accounts. The reserves serve several purposes:

1. To provide operating cash allowing modified-accrual for budgeting/accounting;
2. To provide a set aside against future budget funding gaps;
3. To partially fund long term liabilities; and
4. To meet statutory requirements or covenants.

At the end of 2001-02 Fiscal Year (Fiscal Year), General Fund Reserves totaled $48.8 million. In the Adopted Fiscal Year 2002-03 Proposed Budget, the reserves were reduced by $10.1 million to $37.7 million in order to reduce our projected budget shortfall. There are currently 11 separate General Fund Reserves. Seven of these reserves, totaling $ 10.7 million are mandated or restricted. The remaining four reserves, totaling $28.3 million, are discretionary.

The discretionary reserves include the General Reserve ($8.5 million), the Future Realignment Costs Reserve ($2.0 million), the Reserve for Long Term Liabilities ($17.2 million), and the Reserve for Mather Community Center ($0.3 million).

Reductions to (withdrawals from) discretionary reserves may be used to avoid making budget reductions by in effect transferring funds from the County's savings to our operational fund (budget). The Adopted Fiscal Year 2002-03 Proposed Budget includes use of $10.1 million of the General Reserve for this purpose.

Any use of reserves to avoid making budget reductions should be considered in light of the impact on cash balances and a longer-term view of the county's fiscal position. Given the extremely narrow cash position of the General Fund at the end of a fiscal year and the likelihood the County is facing a multi-year budget problem, we strongly caution against further use of reserves in the 2002-03 budget process.

DISCUSSION

As stated previously, the reserves in the General Fund are essentially off-budget savings accounts. Unlike appropriations, which expire at the end of a fiscal year, reserves stay in existence at the end of a fiscal year, and only change with specific acts of the Board of Supervisors. In general there are three types of General Fund reserves: (1) budgetary reserves, (2) liability reserves, and (3) restricted reserves. In addition, by their existence, reserves provide operating cash under the county's modified accrual basis of accounting where high levels of revenue are recognized at the conclusion of a fiscal year well in advance of the receipt of cash.

Reserves in the Budget

Reserves enter the annual budget equation only when they are changed. A reduction to reserves creates financing. An increase to reserves is part of the annual budgetary requirement and consumes financing. Practically speaking, a reserve reduction is like a transfer from a savings account to a checking account; more funds are made available for spending. A reserve increase is like a transfer from a checking account to a savings account; less funds are available for spending.

The use of reserves is a one-time or short-term financing source. The Adopted Fiscal Year 2002-03 Proposed Budget includes the use of $10.1 million of the General Reserve. Budget and service reductions are avoided, but there is a multi-year impact. In the following fiscal year, 2003-04, the first $10.0 million in revenue growth will be consumed by replacing the prior year's transfer from reserves, before any expenditure and other revenue changes are considered.

History of Overall Reserve Levels

The following table gives a ten year history of total (discretionary and restricted) reserve levels for the General Fund. The reserve level is at the start of each fiscal year given along with the overall change from the prior year. Amounts are in millions:

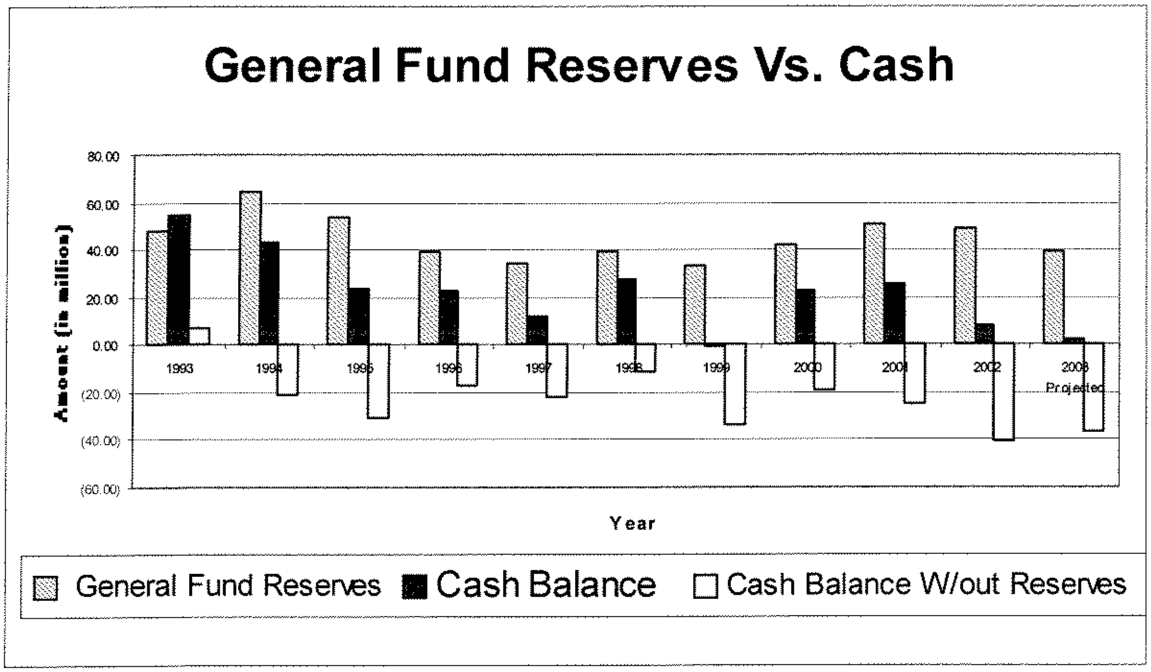
Year	General Fund Reserves	Change from Prior Year
1993	$ 48.4	
1994	64.8	$ 16.4
1995	53.9	(10.9)
1996	39.1	(14.8)
1997	34.5	(4.6)
1998	39.6	5.1
1999	33.3	(6.3)
2000	41.6	8.3
2001	50.5	8.9
2002	48.8	(1.7)
2003	38.7	(10.1)

Overall reserves have ranged from a high of $64.8 million at the start of 1993-94 to a low of $33.3 million at the start of 1998-99. In 1993-94 the refinancing of the main jail and the commencement of the Teeter Plan enabled the Board of place over $24.0 million in a Reserve for Fiscal Stability. This reserve was then used over a three-year period to offset budget reductions. In 1999-2000 and 2000-01, tobacco litigation settlement revenue received before the bond sale were used to build up the General Reserve from approximately $3.5 million to $18.5 million.

It is important to note that over this decade, significant reserve increases came only when large one-time amounts of financing were available.

Reserves and Cash Levels

When the reserves are maintained, they provide the General Fund with operating cash. This has become increasingly more important as the County has moved to a modified accrual basis of budgeting/accounting. Under this method, the County counts revenues in our budget that are earned during the fiscal year but not received until the following fiscal year. Because most of our budgeted expenses are actually paid before fiscal year-end, the gap between revenues actually received and expenses paid often exceeds $30.0 to $40.0 million even though the budget is balanced because of this cash-flow timing issue. At the end of a fiscal year, the cash balance of the General Fund is usually less than the total reserve balance. As such, if not for the reserves, the General Fund would be in a cash deficit position (overdrawn) and would be unable to meet payroll and other commitments. This situation is well illustrated in the following graph:



During Fiscal Year 1993-94, the larger portion of the cumulative ERAF shift occurred and the County lost nearly one-half of its property taxes, which was partially back-filled with Proposition 172 sales tax. Property taxes are not accrued, but Proposition 172 sales taxes are, in addition to Bradley-Burns sales taxes, vehicle license fees and Realignment revenues. For the last nine years since the ERAF shift, our General Fund cash balances at year's end have been less than reserve balances. In effect, our operating cash at year end is due to the reserve balances only. Along with having budget authority to spend, the County must also have cash to support the spending. The annual cash flow borrowing covers the county's maximum cash deficit in the Fall and early Winter each year, but the terms of the borrowing require the County to set aside cash at the end of a fiscal year to repay the notes. We rely upon our reserves to provide the cash support to bridge one fiscal year to another.

The 2001-02 Fiscal Year which just closed is a good example. The budgetary fund balance is approximately $48.0 million, but the actual cash balance was less than $10.0 million. The reserve balance was $48.8 million. The General Fund was in effect overdrawn by $38.8 million in cash terms. If the cash balance matched the available fund balance and the reserves, then the cash balance would have been approximately $100.0 million rather than one-tenth that amount.

Significant depletion of reserve could place the County in a very difficult cash position at the end of a fiscal year and could lead to a disastrous bond covenant default.

The Reserve for Long Term Liabilities really serves as a cash flow reserve rather than an insurance program reserve. For this reason, with the Fiscal Year 2002-03 Final Recommended Budget (as revised), we intend to recommend that $15.0 million of this reserve be reclassified as a Reserve for Cash Flow. The remaining balance of this reserve, $2.2 million, will be placed in the General Reserve.

Current Budget Problems and the Use of Reserves

We strongly caution against further use of reserves to avoid making budget reductions in the 2002-03 budget process. The use of $10.1 million is already included in the Proposed Budget. Reserves are one-time or short-term financing sources only. Using reserves to support on-going operations cannot be sustained. At some point the reserves will be depleted and ongoing reductions must replace them. Typically, use of reserves as a budgetary financing source only postpones the inevitable.

The County is now in the second year of a multi-year budget problem. The root cause of the problem is that on-going costs are increasing more than on-going revenues. Revenue growth is slowing due to the economy and the shrinking unincorporated area, while caseload driven costs and payroll costs are increasing. Improvements in the local and statewide economy, which would help solve this problem, are not on the immediate horizon. It is already anticipated that the County will face severe budget difficulties in Fiscal Year 2003-04. This could be compounded by the incorporation of Rancho Cordova and the state's extraordinarily difficult budget situation.

The use of additional one-time financing in the current year will just push our budget problem off into the coming fiscal year when the General Fund will not be in a position to absorb the problem. For Fiscal Year 2003-04, the first $10.1 million in general revenue growth will be needed to just offset the use of the General Reserve in the current year. Increased use of reserves will require even more of the next year's financing growth just to stay even. But with increasing costs, staying even will not maintain service levels.

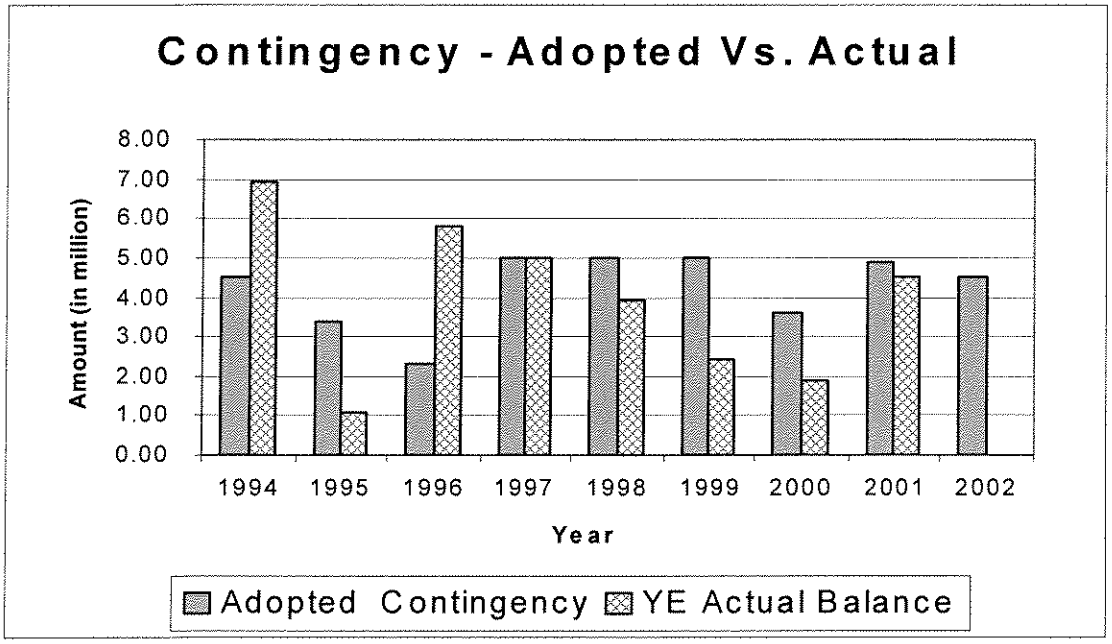
The Unallocated Funds: The Contingency Appropriation and Insurance Fund Reserves

Along with the General Fund Reserves, there are other unallocated funds over which the Board of Supervisors exercises discretion. There is the annual contingency appropriation in the budget, and there are reserves in the Workers Compensation and Liability Insurance Funds.

Contingency

The contingency in the General Fund is an appropriation in the operating budget. The appropriation is made for unforeseen events or circumstances. The contingency appropriation does not carry forward from year to year; rather, it expires at the end of a fiscal year as do other annual appropriations. The contingency may not be directly expended during the year. To use the contingency during the year, the County typically shifts this appropriation to other operating accounts with a 4/5ths vote being required. In some years, the appropriation is used to cover revenue shortfalls (as was the case in Fiscal Year 2001-02). The County Executive has typically recommended that a $5.0 million contingency be included in the General Fund Budget at the start of any fiscal year.

The following table gives a recent history of the contingency included in the annual General Fund Budget and the contingency balance at the end of the fiscal year:



Over the nine year period, the contingency remain unchanged in one year, was increased in two years, and was used in the remaining six years. In Fiscal Year 2001-02 the entire $4.5 million contingency was used to write down sales tax and Proposition 172 Public Safety Sales Tax revenue estimates.

It is important to note that Boards of Supervisors have used the contingency appropriation to restore some budget reductions doing budget hearings, and the County Executive has recommended a contingency less than $5.0 million in some years. However, the contingency actually included in the Adopted Final Budget has been as low as $2.3 million, but has never exceeded $5.0 million.

Insurance Fund Reserves

Along with the Reserve for Long Term Liabilities in the General Fund, there are separate reserves in the Workers Compensation and Liability Insurance Funds. The Workers Compensation Fund has a reserve of $6.5 million and the Liability Fund has a reserve of $4.0 million. These reserves have been used in recent years to avoid significant allocated cost increases due to higher than anticipated claims payments. In Fiscal Year 2000-01, liability claims exceeded the budget by over $4 million and nearly all the reserve was used to fund settlements and judgements. In Fiscal Year 2001-02 the reserve was restored to $4.0 million. During Fiscal Year 2001-02, the workers compensation payments and treatment costs exceeded the budget by over $2.0 million, and a portion of the reserve was used to cover this overage. Given recent state legislation increasing workers compensation benefits and the recent claims experience, we anticipate further use of the reserve in this fund during Fiscal Year 2002-03. The existence of the reserve allowed avoidance of increasing charges to county departments in the budget.

CONCLUSION

In the budget for the General Fund and the insurance funds there are reserves and contingencies over which the Board of Supervisors has discretion. The reserves and contingency may be reduced to avoid the need to make budget reductions. The Adopted Proposed Budget for 2002-03 already includes use of $10.1 million of the General Reserve.

We strongly caution against further significant use of reserves due to the narrow cash position in the General Fund at the end of a fiscal year and due to the multi-year nature of the county's current budget problems.

GEOFFREY B. DAVEY
Chief Financial Officer

GBD/RTF:

Cc: Elected Officials
Agency Administrators
Department Heads
County Executive's Analysts

Attachment One

Reserves in the Budget Documents

Reserve levels and changes to reserves are included in the annual budget document. The status of and changes to reserves are displayed in the Summary Schedules found in the front part of the budget document.

Schedule 1 displays the overall balancing of the General Fund and other governmental funds. Increases in reserves are displayed and accounted as part of the requirement, and reductions in reserves are part of financing.

Schedule 2 is an analysis of the fund balance. This schedule shows the overall fund balance, that portion which is reserved, that portion which funds encumbrances from the prior year, and the remaining portion which is available for financing the new year's requirement.

Schedule 3 (attached) gives the balance for each separate reserve account and any increases or decreases included in the annual budget.

Description of General Fund Reserves ($ 38,708,439)

The reserves of the General Fund consist of a series of separate reserve accounts. Some of the reserves are restricted and some are discretionary. Following is a brief description of each reserve account. The balance of each reserve account, as of the Adopted Proposed Budget, is also given.

General Reserve ($ 8,485,041)

The General Reserve is the county's "rainy day" fund. The primary intent of this reserve is to provide additional funding in lean budget years. Since the 1999-2000 Fiscal Year this reserve has been increased from $3.6 million to $18.5 million. The Adopted Proposed Budget for 2002-03 includes us of $10 million of this reserve to avoid budget reduction in the General Fund.

Future EMD Costs ($ 495,082)

This reserve was created to hold excess revenues collected by the Environmental Management Department (EMD) and provide for rate/fee stabilization. This department's activities are entirely fee supported, and these fees may only be used to support EMD's services and operations. At the conclusion of a fiscal year, and EMD carryover is placed in this reserve. Should EMD face a shortfall, this reserve could be used rather than immediately increasing fees. This reserve is restricted in that it may only be used to support EMD services.

Future Realignment Costs ($ 2,000,000)

This reserve was created in the Fiscal Year 1999-2000 Fiscal Year with excess realignment revenue from the prior year. Realignment revenue consists of state-collected sales taxes and vehicle license fees and may only be used to support certain human services such as mental health, public health, IHSS, and some human assistance programs. At the conclusion of Fiscal Year 1998-99, actual realignment revenue was $2.0 million higher than the net cost of realignment funded programs. This $2.0 million was placed in the newly established reserve in the Fiscal Year 1999-2000 budget process and has not been used since. This reserve is restricted in that it may only be used to support realignment funding eligible programs. This reserve could be considered a sub-set of the General Reserve.

Imprest Cash ($ 393,630)

This reserve represents the various petty cash holding of general fund departments. This reserve shows the budgetary impact of the petty cash furnished to departments so that change may be made and for other operational reasons. When more petty cash is furnished, then the additional budgetary requirement is reflected through an increase to this reserve. When petty cash is recalled or reduced, then the financing is reflected through reducing the reserve. This is a restricted, technical reserve. However, the reserve could be reduced and financing made available

Long Term Liabilities ($ 17,193,460)

This reserve represents funds set aside against long term liabilities of the County. These liabilities are in the forms of workers compensation claims, liability and property claims, and employee leave balances. The identified liabilities far exceed this reserve. This is a discretionary reserve.

The County is self-insured, as opposed to being uninsured. For liability claims and settlements up to $2 million, payments are made from the Liability or Workers Compensation Fund. For claims between $2 million and $27 million per occurrence, the County has insurance through the CSAC Excess Insurance Authority. For judgements and settlements above $27 million the County is self-insured.

The financing for these funds comes from charges to county departments included in the County Executive's annual budget instructions.

The Reserve for Long Term Liabilities really serves as a cash flow reserve rather than an insurance program reserve. For this reason, with the Final Recommended Budget, we intend to recommend that $15 million of this reserve be reclassified as a Reserve for Cash Flow. The remaining balance of this reserve, $2.2 million, will be placed in the General Reserve.

Mather Community Center ($ 600,000)

This is a discretionary reserve. The Board of Supervisors has been setting aside funds generated at Mather for a Mather Community Center. The funds being reserved must be expended on Mather development projects, but there is no external requirement for the County to construct and fund a Mather Community Center.

Reserve for Special Deposits – Travel ($ 100,000)

This reserve is similar to the Reserve for Imprest Cash. Certain county departments have emergency travel funds for out-of-county criminal investigations and extraditions. When the cash is made available to departments, this reserve in increased. If departments were to return the cash, then the reserve would be reduced and financing for other activities made available.

TRANS Interest ($ 1,163,000)

The annual cash flow notes (tax revenue anticipation notes or TRANS) are issued for a 15 or 13 month period. Thus some of the interest earnings and expense fall to the year after the borrowing. The current year interest costs are covered with an appropriation in the budget and the out year amount is placed in reserve. The level of the reserve is determined by the interest rate, the note principal, and the number of months the debt extends into the out year. The following year the reserve is released and funds the partial year interest payment. Each year a reserve is created and the prior year reserve liquidated.

Teeter Plan Reserves

There are reserves which are integral parts of the Teeter Plan method of tax apportionment. Under the Teeter Plan, the County "buys" all delinquent current secured property taxes at the end of a fiscal year. Property tax revenues are allocated to those jurisdictions receiving property taxes as if there were no delinquencies. This supplemental payment is made in August each year. Funding for these advances is provided by a five-year loan from the Treasury Pool. There is a new load each year. As the delinquent taxes, penalties, and interest are paid, funds necessary to pay the annual debt service to the Treasury Pool are set aside. Any addition revenue is allocated to the General Fund. Since the Treasury Pool interest rate (of 6% to 2%) is much less than the 18 % simple interest assessed against delinquent taxes, the County makes a profit from the Teeter Plan.

After five years, an annual note is repaid, both principal and interest. At this point there are still taxes associated with that note still outstanding. At the point the Treasury Pool is repaid, the County "owns" the delinquent taxes and all interest and penalties (5 years of interest at 18 % per year plus a one-time 10 % penalty). As these longer term delinquent taxes are paid, the County receives all of the principal, interest, and penalties.

There are three restricted reserves which are part of the overall Teeter Plan. Two of the reserves are required by either state law or debt covenants, and the third is an accounting mechanism.

<u>Loan Buyout ($ 3,020,388)</u>

Over the course of a five year note associated with one year's delinquent taxes, not all of those delinquencies will be paid. Some amount will still be outstanding at the time the final note payment is made. The terms of the note with the Treasury Pool require this amount be placed in reserve. This reserve varies in size with the level of long term delinquent taxes.

<u>Tax Loss Reserve ($ 3,757,838)</u>

State law requires that counties participating in the Teeter Plan have a tax loss reserve equal to 25 percent of delinquent taxes. This reserve is sized on an annual basis.

<u>Teeter Delinquencies ($ 1,500,000)</u>

After the final payment on a five year note is made, the County "owes" any taxes, interest, and penalty associated with that note. The principal amount has been purchased with cash through the repayment of the note, and the interest and penalties are allocated to the County when paid. This reserve represents the long-term delinquent taxes. When the taxes are repaid the financing is recognized through a release from this reserve. The reserve is increased at the time of the final note payment. Thus there are increases and releases for this reserve each year. The interest and penalties are allocated to the General Fund as revenue.

Attachment II

Description of Recommended General Fund Reserves ($ 126,067,785)

The reserves of the General Fund consist of a series of separate reserve accounts. Some of the reserves are restricted and some are discretionary. Following is a brief description of each reserve account. The balance of each reserve account, as of the Final Recommended Budget, is also given.

General Reserve ($ 10,799,813)

The General Reserve is the county's "rainy day" fund. The primary intent of this reserve is to provide additional funding in lean budget years. Since the 1999-2000 Fiscal Year this reserve has been increased from $3.6 million to $10.8 million.

General Reserve – Department Savings ($ 11,872,241)

This reserve represents the increase in carryover between Proposed and Final Budget for various General Fund departments. As consistent with policy established by the Board in February 2003, these funds will be reserved as a financing source for Fiscal Year 2007-08 and will be earmarked for the specific departments who earned them.

Reserve for Cash Flow ($ 32,421,527)

This reserve was specifically created in Fiscal Year 2002-03 to function as an operating cash reserve. These funds have become increasingly important as the County has moved to a modified accrual basis of budgeting/accounting. Under this method, the County counts revenues in the budget when earned during the fiscal year but in many cases those funds are not received until the following fiscal year. Because most of the budgeted expenses are actually paid before fiscal year-end, the gap between revenues actually received and expenses paid often exceeds $30-40 million even though the budget is balanced because of this cash-flow timing issue. At the end of a fiscal year, the cash balance of the General Fund is usually less than the total reserve balance. As such, if not for these reserves, the General Fund would be in a cash deficit position (overdrawn) and would be unable to meet payroll and other commitments.

Imprest Cash ($ 254,755)

This reserve represents the various petty cash holding of general fund departments. This reserve shows the budgetary impact of the petty cash furnished to departments so that change may be made and for other operational reasons. When more petty cash is furnished, then the additional budgetary requirement is reflected through an increase to this reserve. When petty cash is recalled or reduced, then the financing is reflected through reducing the reserve. This is a restricted, technical reserve. However, the reserve could be reduced and financing made available.

Reserve for the Department of Revenue Recovery Management Accounting and Collection System ($ 512,908)

This reserve is for the Department of Revenue Recovery (DRR) to purchase its Management Accounting and Collection System. The reserve amount reflects DRR's carryover for Fiscal Year 2005-06.

Reserve for Assistance Payments ($ 6,991,548)

This reserve was established in Fiscal Year 2005-06 for "Future Human Assistance Costs." Past experiences have shown that Human Assistance program costs tend to increase as revenue growth moderates. This reserve was established to mitigate against times of escalating Human Assistance program costs and little or no revenue growth.

Reserve for SAFCA ($ 5,000,000)

Pending Board approval, the Sacramento Area Flood Control Agency (SAFCA) has requested that the county's Director of Finance purchase $5.0 million in SAFCA Bond Anticipation Notes from the county's Pooled Investment Fund. This reserve will provide added protection against the default on the notes.

Reserve for Future Pension Obligation Bond ($ 45,979,859)

In Fiscal Year 2003-04 the State kept approximately $26.9 million in Vehicle License Fees that have been traditionally deposited annually into the County's General Fund and created a "loan" that was to be fully repaid in Fiscal Year 2006-07. This "loan" to the state was partially responsible for the county's financial difficulties during Fiscal Year 2003-04 and Fiscal Year 2004-05. At that time, the County sought to delay making otherwise necessary, difficult budget decisions through the refinancing of our bonded debt, in particular our Pension Obligation Bonds (POBs). This refinancing significantly reduced the county's POB debt service and postponed the pension funding increases required by the provision of the retroactive service credits given to county employees with the pension benefit enhancements in 2003. However, beginning in Fiscal Year 2006-07, the debt service will return to the levels that would otherwise have been in place for Fiscal Years 2004-05 and 2005-06, and increases steeply in the following two fiscal years. This structure was recommended since the State had indicated they would repay the "loan" in Fiscal Year 2006-07. However, the State repaid this debt a year early. Therefore, the Board authorized the establishment of this reserve in order to help mitigate the increasing debt service on the POBs. The increased level of this reserve will provide added ability to partially mitigate the increasing debt service levels during the anticipated shortfalls in the next few years.

Reserve for Health For All Loan ($ 111,462)

The State Budget was adopted late in 1998. As a result, Health For All, a Community-Based Organization, experienced cash flow issues. Health For All requested a loan from the County to mitigate this problem. The reserve amount reflects the principal balance that is still outstanding on the loan.

Reserve for Golf Fund Loan ($ 400,000)

In Fiscal Year 2005-06, the Board approved two loans from the General Fund to the Golf Fund to help mitigate the Golf Fund's negative cash and negative fund balance issues. The reserve amount reflects the portion of the loan that is not expected to be repaid until Fiscal Year 2007-08.

Reserve for Special Deposits – Travel ($ 100,000)

This reserve is similar to the Reserve for Imprest Cash. Certain county departments have emergency travel funds for out-of-county criminal investigations and extraditions. When the cash is made available to departments, this reserve is increased. If departments were to return the cash, then the reserve would be reduced and financing for other activities made available.

TRANS Interest ($ 765,000)

The annual cash flow notes (tax revenue anticipation notes or TRANS) are issued for a 15 or 13 month period. Thus some of the interest earnings and expense fall to the year after the borrowing. The current year interest costs are covered with an appropriation in the budget and the out year amount is placed in reserve. The level of the reserve is determined by the interest rate, the note principal, and the number of months the debt extends into the out year. The following year the reserve is released and funds the partial year interest payment. Each year a reserve is created and the prior year reserve liquidated.

Teeter Plan Reserves

There are reserves which are integral parts of the Teeter Plan method of tax apportionment. Under the Teeter Plan, the County "buys" all delinquent current secured property taxes at the end of a fiscal year. Property tax revenues are allocated to those jurisdictions receiving property taxes as if there were no delinquencies. This supplemental payment is made in August each year. Funding for these advances is provided by a five-year loan from the Treasury Pool. There is a new load each year. As the delinquent taxes, penalties, and interest are paid, funds necessary to pay the annual debt service to the Treasury Pool are set aside. Any addition revenue is allocated to the General Fund. Since the Treasury Pool interest rate (of 6% to 2%) is much less than the 18 % simple interest assessed against delinquent taxes, the County makes a profit from the Teeter Plan.

After five years, an annual note is repaid, both principal and interest. At this point there are still taxes associated with that note still outstanding. At the point the Treasury Pool is repaid, the County "owns" the delinquent taxes and all interest and penalties (5 years of interest at 18 % per year plus a one-time 10 % penalty). As these longer term delinquent taxes are paid, the County receives all of the principal, interest, and penalties.

There are three restricted reserves which are part of the overall Teeter Plan. Two of the reserves are required by either state law or debt covenants, and the third is an accounting mechanism.

<u>Loan Buyout ($ 2,471,299)</u>

Over the course of a five year note associated with one year's delinquent taxes, not all of those delinquencies will be paid. Some amount will still be outstanding at the time the final note payment is made. The terms of the note with the Treasury Pool require this amount be placed in reserve. This reserve varies in size with the level of long term delinquent taxes.

<u>Tax Loss Reserve ($ 6,832,647)</u>

State law requires that counties participating in the Teeter Plan have a tax loss reserve equal to 25 percent of delinquent taxes. This reserve is sized on an annual basis.

<u>Teeter Delinquencies ($ 1,554,726)</u>

After the final payment on a five year note is made, the County "owes" any taxes, interest, and penalty associated with that note. The principal amount has been purchased with cash through the repayment of the note, and the interest and penalties are allocated to the County when paid. This reserve represents the long-term delinquent taxes. When the taxes are repaid the financing is recognized through a release from this reserve. The reserve is increased at the time of the final note payment. Thus there are increases and releases for this reserve each year. The interest and penalties are allocated to the General Fund as revenue.