



**CITY OF NOVI CITY COUNCIL
OCTOBER 28, 2024**

SUBJECT: Approval of resolution to amend the City's Fund Balance/Reserve Policy.

SUBMITTING DEPARTMENT: Finance

KEY HIGHLIGHTS:

- The proposed amendment is to the General Fund fund balance policy only
- The last amendment to the policy was on September 26, 2011
- The proposed amendment is to bring the targeted fund balance in line with actual historical fund balance and to reflect the current financial condition of the City (28-30%)

BACKGROUND INFORMATION:

“Fund balance” is an accounting term that means the total accumulation of operating surpluses and deficits since the beginning of a local government’s existence. “Fund balance” is not synonymous with unrestricted cash. A common misconception is that fund balance is a cash account, associated with or correlated to a government’s bank account balance. But unlike a personal bank account, a general fund balance is a measure of equity between revenues and expenditures. Government fund accounting is unique to the public sector and requires separate self-balancing accounting entries to track each fund’s revenues and expenditures. Fund balance is a government’s total assets less total liabilities.

In September 2011 the City Council amended its policy regarding the level in which the City’s fund balance should maintained which was between 18-22%. Since that time the overall revenues and expenditures have significantly increased. Also, during the past 13 years since the last amendment, bond rating agencies have placed a higher emphasis on larger fund

Savings in Month	Equivalent	FB as % of expenses	
<i>est. 3 months</i>		25% or below	Action Required (1)
		26%	
		27%	
		28%	
		29%	Target Range
		30%	
		31%	
<i>est. 4 months</i>		32%	
		33% or greater	Action Required (2)

balance reserves when determining their ratings. As a result, the proposed amendment to the policy moves the target range to between 28-30% and sets specific requirements on how to address variances from the target (+/- 3% of target). The following is a summary of the components of the reserve:

1. If fund balance is expected to fall to 25% or lower the following corrective action is required:

The City will immediately create a plan such that fund balance is >25% within three years by:

- a. controlling operating expenditures, adjusting operations and/or dedicating excess or specific revenue sources
 - b. adjusting operations and capital projects and/or
 - c. dedicating excess or specific revenue sources
 - d. any other means as recommended by staff and approved by City Council
2. If fund balance is expected to be 33% or greater, the following action is required: The City Council shall discuss elevated fund balance level, and shall consider:
 - a. moving a portion of fund balance from unassigned to assigned
 - b. lowering taxes
 - c. appropriating funds over the next three fiscal years to one time/capital projects and/or
 - d. articulating reason for elevated balance (saving for pension paydown, anticipated economic downturn, etc.)
 - e. other option as council deems appropriate

Attached is a red-lined version of the current policy and the proposed changes.

RECOMMENDED ACTION: Approval of resolution to amend the City's Fund Balance/Reserve Policy.

RESOLUTION

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

WHEREAS, the City Council approved a financial policy resolution for the Fund Balance/Reserve policy on September 26, 2011, and seeks to amend this policy to reflect the current financial position of the City, and

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

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

NOW THEREFORE BE IT RESOLVED that the City hereby adopts the attached Fund Balance/Reserve Policy.

CERTIFICATION

I hereby certify that the above is a true and complete copy of a resolution adopted by the City Council of the City of Novi at a regular meeting held on October 28, 2024.

Cortney Hanson
City Clerk

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

Amended October 28, 2024

Fund Balance/Reserve Policies

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

General Fund

For the General Fund, the reserve will be maintained at a ~~minimum of approximately target range of 18-22~~ 28-30% percent of ~~the~~ budgeted annual expenditures. ~~as adopted by City Council Resolution, January 24, 2011 and amended on September 26, 2011.~~ In the event that circumstances arise causing the fund balance to fall below ~~18%-25%~~, the City Council will ~~immediately discuss a corrective action—a plan will be put in place~~ to replenish the balance. ~~during the subsequent budget year.~~ If fund balance is projected to be above 33%, City Council will immediately discuss the purpose of the additional fund balance and consider if adjustments need to be made to the balance. ~~Additional reserves can be designated for a specific purpose as identified by City Council during the budget process.~~ Fund balance will be established to:

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

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

Special Revenue Funds

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

Road Funds (Major, Local and Municipal Street)

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

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

Police and Fire Fund

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

Drain Funds (Drain Revenue and Drain Perpetual Maintenance)

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

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

Parks, Recreation and Cultural Services Fund

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

Special Assessment Revolving Fund

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

Tree Fund

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

Other Special Revenue Funds

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

Capital Replacement Reserve Policy – Enterprise Funds

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

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

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

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

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

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