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MEMORANDUM

To: Kurt Triplett, City Manager

From: Tracey Dunlap, Director of Finance and Administration

Date: September 22, 2011

Subject: REVIEW OF RESERVE POLICIES AND RECOMMENDATIONS

RECOMMENDATION:
City Council receives a report on the City's reserve policies, recommended revisions and replenishment strategy, and the process for implementing any changes.

BACKGROUND DISCUSSION:

Introduction

In 1998, the City Council approved recommendations establishing policies regarding reserves and fund balance levels that were reflected in the 1999 budget process. In 2003, the City Council revisited the reserve policies, resulting in the reserve structure and replenishment policies that are still in place today (with a few minor modifications). Several factors necessitated a detailed review of the reserve policies in 2011:

- The annexation of the Juanita, Finn Hill, and Kingsgate neighborhoods on June 1, 2011 dramatically changed the size and dynamics of the City's budget. If the current policies were applied, adding the new neighborhoods would increase the required reserve replenishment to meet targets by $3 million (from $6 million to over $9 million). A re-evaluation of the reserve needs will help determine whether this magnitude of increase is really required.
- The economic downturn that began in 2008 resulted in the planned use of over $4 million dollars in reserves to help smooth the transition to lower revenue and service levels. All of these uses were consistent with the City's reserve policies, but now that revenues appear to be stabilizing and the 2011-2012 budget was balanced without the use of reserves, the discussion of the process for replenishing those uses needs to be a priority.
- With over ten years of history since the current reserves were established, it is an opportune time to evaluate how the current policies and targets have met their intended purposes.

One of the action items assigned to the Finance Subcommittee from the 2011-2012 budget process was the evaluation of the reserve target policies in light of annexation. At a series of five meetings, the Subcommittee reviewed the current reserve targets and replenishment policies, historical trends, and staff recommendations. The Subcommittee supports the recommendations summarized in this memorandum for full Council consideration. If approved by the City Council, these policies will be incorporated into the 2013-2014 budget development process that will begin in 2012.

Importance of Reserves

Maintaining reserves is a best practice in government financial management (and in the private sector as well). The Government Finance Officers Association (GFOA) has published best practice guidelines that are provided as Attachment A. These guidelines provide a broad context for developing specific reserve policies addressing each jurisdiction's unique circumstances.

In the introduction to the City's "Fiscal Policies" section in the budget document, it states that:

> *"The stewardship of public funds is one of the greatest responsibilities given to the officials and managers of the City of Kirkland. Therefore, the establishment and maintenance of wise fiscal policies enables city officials to protect public interests and ensure public trust."*

The "Reserve and Fund Balance Policies" are adopted as part of the fiscal policies in the budget and are prefaced by the following discussion (see Attachment B for the full text of the reserve section):

> *"Adequate fund balance and reserve levels are a necessary component of the City's overall financial management strategy and a key factor in external agencies' measurement of the City's financial strength.*
>
> *Maintenance of fund balance for each accounting fund assures adequate resources for cash flow and to mitigate short-term effects of revenue shortages. City and state regulations have been established to allow the City of Kirkland to create and maintain specific reserve funds. Prudent use of reserve funds enables the City to defray future costs, take advantage of matching funds, and beneficial (but limited) opportunities. Reserve funds provide the City with the ability to exercise flexible financial planning in developing future capital projects. Reserve funds are necessary to enable the City to deal with unforeseen emergencies or changes in condition."*

To summarize the message of these passages as they relate to this discussion, reserves are an integral part of the City's financial planning strategy and provide a tangible external measure of financial strength. Reserves also provide flexibility for dealing with unforeseen events in a planned manner, rather than having to take hasty action when circumstances change. This flexibility is best illustrated by the planned use of $4 million in reserves during the recent economic downturn. In the absence of these funds, expenditures (and service levels) would need to have been cut deeper and sooner. For example, to save that amount in the 2009-2010 budget through reductions in staffing would have meant an additional 20 jobs cut at the beginning of 2009 for the biennium (or as many as 40 positions if the savings were required to be realized in one year).

The results of the City's recent credit rating assessment illustrate the importance of reserves from an external viewpoint. Standard & Poor's uses an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality, one of which is reserve and liquidity policies (see Attachment C). To receive a "strong" rating requires that: "A formal operating reserve policy is well defined. Reserve levels are clearly linked to the government's cash flow needs and the historic volatility of revenues and expenditures throughout economic cycles. Management has historically adhered to it." In re-affirming Kirkland's AAA long-term rating with a stable outlook (their highest rating), two of the key factors cited were maintenance of **very strong available reserves** and **strong financial policies and practices** (Attachment D). The City's strong credit rating has resulted in the ability to issue bonds at historically low interest rates.

General Purpose Reserves

The General Purpose Reserves are funded from general revenues and may be used for any general government function within the policies set by the City Council. The General Purpose reserves that are specifically called out in the *Fiscal Policies* are:

- Contingency Reserve Fund (accounted for in Fund 152)
- General Operating Reserve (accounted for in the General Fund)
- Revenue Stabilization Reserve (accounted for in the General Fund)
- General Capital Contingency (accounted for in the Capital Fund 310)

Two other General Purpose reserves accounted for in the General Fund are identified in the *Fund Balance and Reserves* section of the budget (Attachment E):

- Council Special Projects Reserve
- Building and Property Reserve

Note that most of the Finance Subcommittee review focused on the General Purpose Reserves because these are set by City Council policy, several were tapped during the recent economic downturn, and the targets are most impacted by annexation. An overview of other reserves maintained by the City can be found at the end of this memorandum.

Current Policies and Historical Analysis

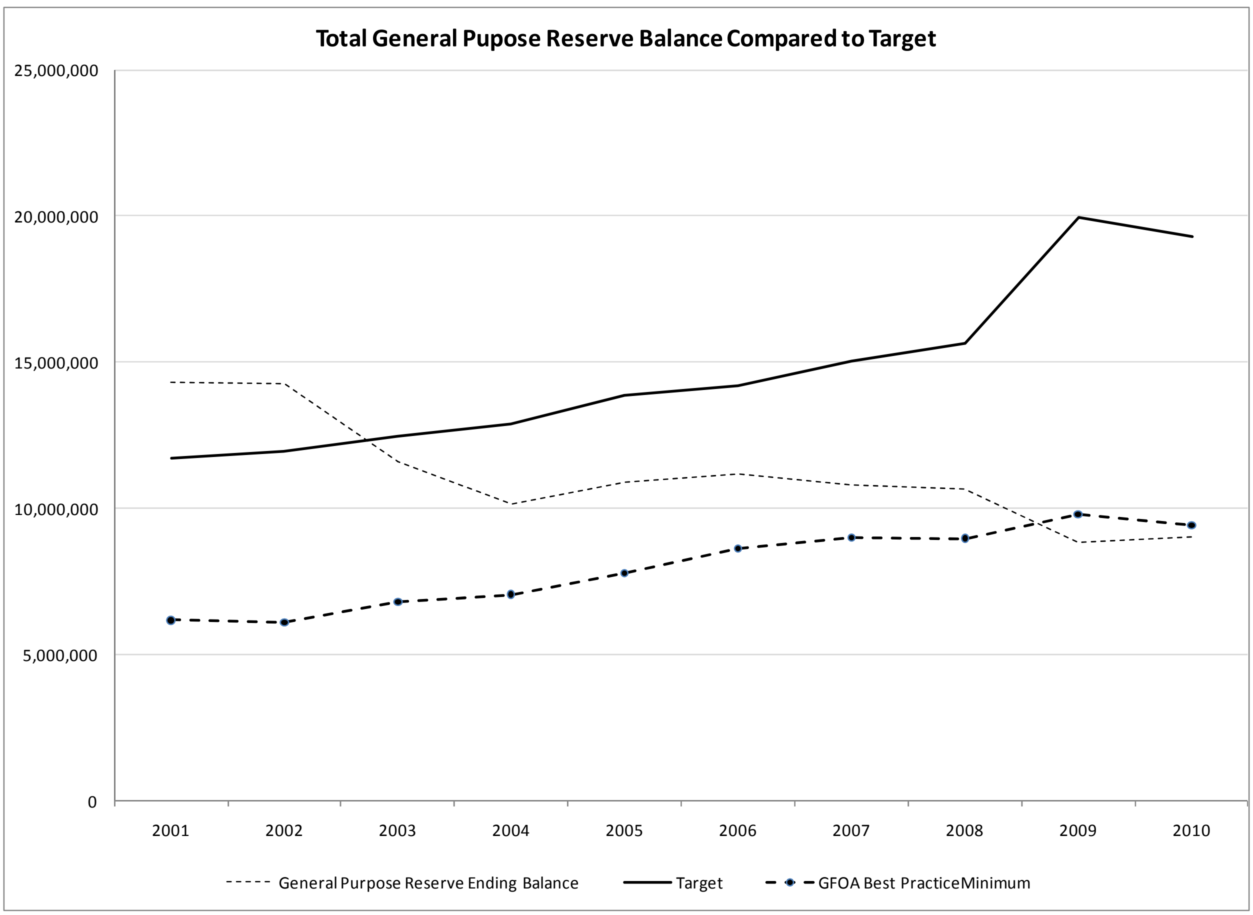
Attachment F summarizes the current policies and estimated balances related to the General Purpose Reserves. Based on the current policies, the budgeted 2012 reserve balances are under target by almost $6 million without annexation and over $9 million when annexation is taken into consideration, as summarized in the table below.

Current Policy				(Under)/Over Target Current	
Item	2011-12 Target (w/o Annexation)	2011-12 Target (with Annexation)	2012 Estimated Ending Balance	w/o Annexation	with Annexation
Contingency	4,016,232	6,081,788	2,246,510	(1,769,722)	(3,835,278)
General Capital Contingency	6,766,320	6,766,320	4,437,370	(2,328,950)	(2,328,950)
General Operating Reserve (Rainy Day)	3,473,324	4,127,496	2,806,513	(666,811)	(1,320,983)
Revenue Stabilization Reserve	1,954,123	2,279,251	731,431	(1,222,692)	(1,547,820)
Council Special Projects	250,000	250,000	251,534	1,534	1,534
Subtotal	16,459,999	19,504,855	10,473,358	(5,986,641)	(9,031,496)
Building and Property Reserve	N/A	N/A	1,972,213	N/A	N/A
Total	16,459,999	19,504,855	12,445,571	(5,986,641)	(9,031,496)

To evaluate whether the reserve targets should be modified, the 10-year history of the reserve balances, uses, and additions was analyzed and the ending balances were evaluated in relation to targets. Attachment G contains the historical analysis, which shows:

- The reserve balances were at or above target levels in the early years after the policies were established (2001-2002) and close to the target level (93%) at the time of the last reserve review in 2003.
- Reserves were maintained between 70-80% of target during the period of economic expansion between 2004 and 2007.
- Balances were used to help cushion the decline during the economic recession and ended 2010 at 47% of target; the 2011-2012 was built assuming that the City will begin replenishing reserves over time.

The graph that follows shows the status of year-end balances versus the target and the GFOA Best Practice recommended minimum of no less than two months of general fund operating revenues or expenditures (refer to Attachment A) for the 10-year period.



The growth in the target over the past few years is due to two primary factors: increases in the 6-year CIP (such as the Public Safety Facility), which is the basis for the current Capital Contingency target, and pre-annexation costs beginning in 2009. During the economic downturn, the ending balances were drawn down so that they are slightly below the recommended GFOA minimum in the last biennium and a replenishment plan to get them back toward the target is discussed below.

Recommendations for Changes to Reserve Targets

Based on the review, the following changes to the reserve policies are recommended:

- The **Contingency Fund** target is currently set at the maximum balance set by RCW ($0.375 per 1,000 AV). It is important to note that the statute establishes a maximum balance, but no minimum target. Over the past ten years, the balance has remained in the range of $1.8 million to $2.5 million, averaging about 73% of target. The average annual use of the reserve during the same period is about $250,000. Staff recommends that **the target be 80% of the statutory maximum** to recognize historical trends.

- The **General Capital Contingency** target has grown as the CIP has grown, however, the uses of the Contingency have averaged about $700,000 per year, with the highest use occurring in 2001 at $1.6 million. The current target is $7.8 million (10% of the 2011-2016 CIP), while the estimated 2012 ending balance is $4.4 million. The balance has ranged from $2.1 million to $4.5 million during the 10 year period. Staff recommends that **the target be based on 10% of the 2-year CIP budget** (currently 2011-2012), which equates to a target of $4.6 million for the existing CIP. This change recognizes that each project budget contains approximately a 10% contingency and that the CIP is looked at annually (on a comprehensive basis every two years with an update in the off years), allowing for adjustments and re-prioritization as needed.

- Staff recommends no changes to current policies regarding the following reserves:
  - Rainy Day Reserve (current target)
  - Revenue Stabilization Reserve (current target)
  - Council Special Projects (current target)
  - Building and Property (no target).

The staff recommendations are summarized in Attachment H. The following table summarizes the revised targets and required replenishment to meet those targets.

Item	Current 2011-12 Target (with Annexation)	Recommended 2011-12 Target (with Annexation)	2012 Estimated Ending Balance	Recommended (Under)/Over Target
Contingency	6,081,788	4,865,430	2,246,510	(2,618,920)
General Capital Contingency	6,766,320	4,631,904	4,437,370	(194,534)
General Operating Reserve (Rainy Day)	4,127,496	4,127,496	2,806,513	(1,320,983)
Revenue Stabilization Reserve	2,279,251	2,279,251	731,431	(1,547,820)
Council Special Projects	250,000	250,000	251,534	1,534
Subtotal	19,504,855	16,154,081	10,473,358	(5,680,723)
Building and Property Reserve	N/A	N/A	1,972,213	N/A
Total	19,504,855	16,154,081	12,445,571	(5,680,723)

Replenishment Strategy

Current Replenishment Needs

Attachment H shows the recommended reserve targets and the projected balance at the end of 2012, identifying that the replenishment to 100% of the revised target is $5,680,723. Note that the estimated year-end 2012 balance that is the basis of the replenishment calculations already takes into account the budgeted replenishment in the 2011-2012 operating budget of $800,000.

One of the proposed performance measures for *Financial Sustainability* is to maintain general purpose reserve balances to be at or above 80% of the reserve balance targets, requiring a replenishment of at least $4,544,578 to achieve. The initial objective should be to aggressively prioritize the replenishments to meet this 80% goal within a targeted period of time, with further replenishment to 100% of target occurring as resources are available.

On-going Policy Considerations

Generally, reserve replenishments occur in two ways during periods of economic recovery:

- Planned - A specific amount is included in the adopted budget, and/or
- Unplanned - Ending fund balances are higher than budgeted, either due to higher than budgeted revenues or under-expenditures.

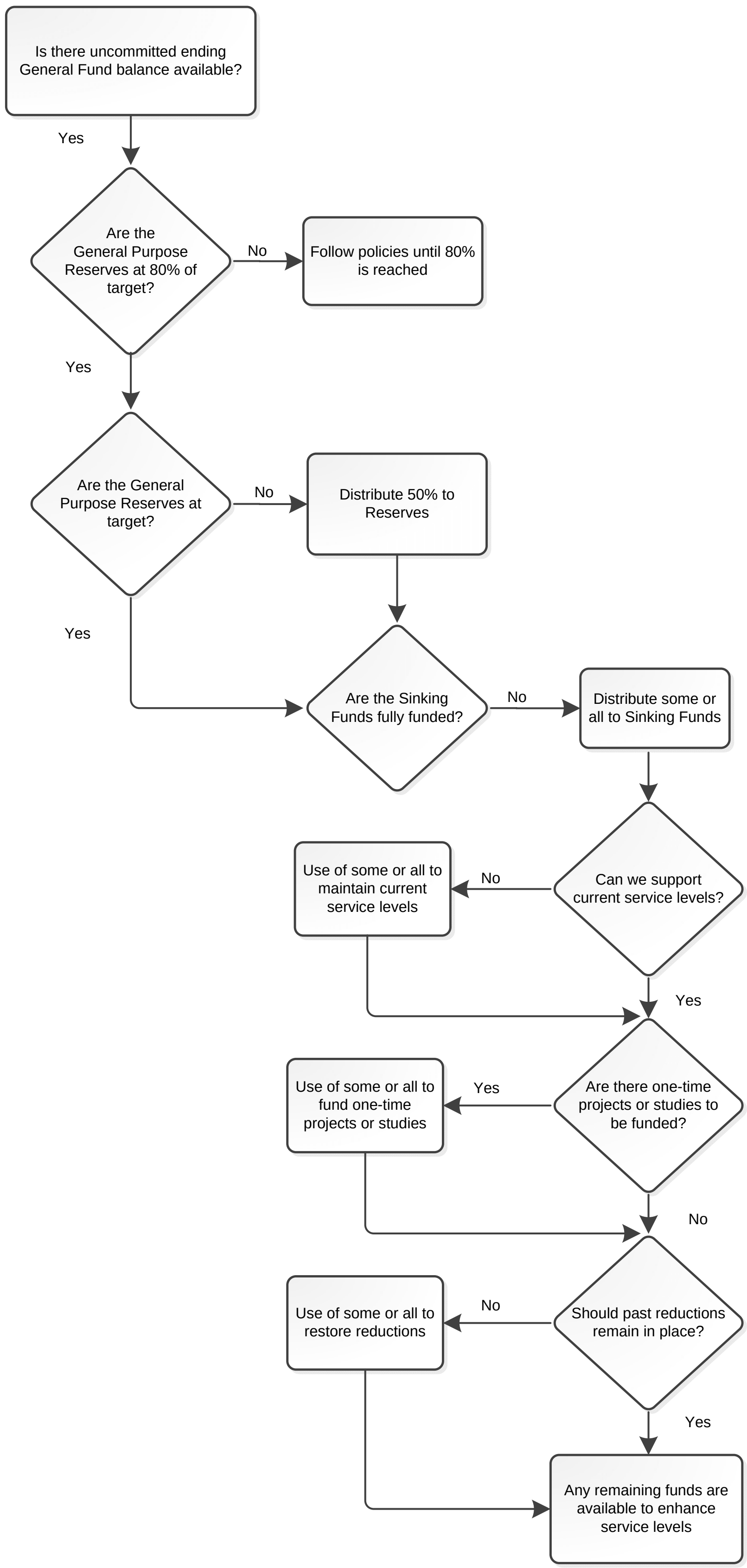
Planned amounts are included as part of the adopted budget. **The recommendation is that planned replenishments toward the 80% target should be set at 1% of the General Fund adopted budget.** Unplanned amounts available at the end of each biennium (if any) could help replenish to target faster. An alternative approach would be to use some or all of those unplanned funds in place of planned (budgeted) amounts in the following biennium to the extent it meets or exceeds the 1% budgeted amount. Staff is proposing that a high percentage (up to all) uncommitted funds available at the end of a biennium should be used for reserve replenishment until reserves meet 80% of target.

By adopting this approach, once reserves reach 80% of target, funds could be freed up to meet other one time or on-going needs. Additional funds could be used to fund a variety of needs, potentially based on the following process:

- Set a specific percentage of available cash toward reserves until they are at target (City Manager recommends 50%), with the remainder available for one or more of the following needs, depending on the nature of the funds available (one-time or on-going) and in this suggested order of priority:
    - Fund liabilities related to sinking funds for public safety and information technology equipment,
    - Maintain current service levels,
    - Fund one-time projects or studies,
    - Increase funding for capital purposes,
    - Restore previous program service reductions,
    - Potential program/service enhancements.

A flowchart of the proposed decision-making process is contained in the exhibit on the following page.

Decision Making Process if Reserves are Greater Than 80% of Target



In terms of priority for replenishing the individual reserves, the following should be considered:

- If the Council Special Projects reserve is below target, replenish to target at the start of each biennium.
- If unplanned funds are available because planned reserve uses did not occur, those funds should be returned to the source reserve.
- To the extent cash is from volatile revenues above budgeted amounts, those funds should be applied to revenue stabilization reserve first.

Other factors may include:

- The source of uncommitted funds should be taken into consideration (for example, interest earnings over budget could be applied to the capital contingency, since they are one of the designated sources for this reserve).
- The degree to which an individual reserve is below target (for example, the reserve that is furthest from its target level on a percentage basis might receive a larger share of the funds).

The approach described above assumes that the decision on how replenishments are allocated to specific reserves will be based on where available funds came from and on each reserve's status at the time the decision is made.

Staff also recommends that the replenishment policy include a mechanism whereby Council could take action to suspend replenishment policies if it was found that special conditions existed warranting such action.

<u>Current Replenishment Recommendations</u>

As part of the mid-biennial budget adjustments, staff is planning to propose that up to $500,000 of the unencumbered funds from year end 2010 ($618,374), be used for reserve replenishment. In addition, the budget contemplates an initial reimbursement of pre-annexation costs from the state sales tax credit of $342,000, which is also recommended as reserve replenishment during the biennium. The total recommended additional replenishment is $842,000.

Given the magnitude of the need and the impact of annexation, staff recommends budgeting the remaining replenishment over time beginning in 2013. If the replenishment need is based on 80% of target (to meet the performance measure objective) and the planned replenishment is set at 1% of the General Fund budget, the annual replenishment amount would be about $750,000 per year starting in 2013. At this rate, reserves would reach 80% of target by 2017. The following table illustrates these figures.

Difference Between Estimated Ending Balance and Target for Reserves with Target

2012 Total Estimated Ending Balance of Reserves with Target	10,473,358
Total General Purpose Reserve Target	16,154,081
Difference Between Estimated Ending Balance and Target (100%)	(5,680,723)
80% of Difference	(4,544,578)

Reserve Replenishment Scenario

	80% of Target
Required Reserve Replenishment @ 80% of Target	4,544,578
Potential Additional Replenishments in 2011-2012	
Uncommitted 2010 Ending Fund Balance	500,000
Pre-Annexation Cost Reimbursement	341,947
Other Unplanned	-
Subtotal Potential Replenishments in 2011-2012	841,947
Future Reserve Replenishment Required	**3,702,631**
Potential Annual Reserve Replenishment Amount at 1% of Target- Starting 2013	750,000
Year Reserve Replenished (with no unplanned additions)	2017

An additional short-term policy recommendation is that any reimbursement of pre-effective date annexation costs that occurs through the annexation state sales tax credit over the replenishment period be used to accelerate the reserve replenishment or to smooth the transition once the 10-year sales tax credit expires.

Other Reserves

Description

In addition to the General Purpose Reserves, there are several reserves that are set aside by Council-directed policy, to meet legal restrictions, or to designate funds for special purposes. These other reserves fall in four broad categories:

- **Special Purpose reserves** reflect both restricted and dedicated revenue for specific purpose, as well as general revenue set aside for specific purposes. These reserves are identified in the *Fund Balance and Reserves* section of the budget document (refer to Attachment E) and, for the most part, do not have target balances because they are accounts that hold funds received for specific purposes. The exception is the Litigation Reserve, which has a target balance of $50,000.

- **Capital Reserves** provide the City the ability to respond to unexpected changes in costs and accumulate funds for future projects. The General Capital Contingency was discussed under General Purpose Reserves because it is funded from general revenues. The other reserves in this category are restricted by statute (Real Estate Excise Taxes [REET], Impact Fees) or for specific purposes (Street Improvement). The REET reserve has a target balance and staff is recommending a modification to that target, as discussed below.

- **Utility reserves** are funded from utility rates and provide the utilities with the ability to respond to unexpected costs and accumulate funds for future replacement projects. The utility reserve policies are set as part of each utility's rate study and adopted with those rates. Utility reserves may only be used for utility purposes.

- **Internal Service funds** are fully funded by charges to operating departments. They provide for the accumulation of funds for replacement of equipment, as well as the ability to respond to unexpected costs. The City has four internal service funds: Information Technology, Facilities Maintenance, Equipment Rental, and Health Benefits. The balances in each fund are based on specific analyses of the funds purpose and needs, as described in Attachment E. These analyses are updated each biennial budget cycle and reviewed periodically to ensure that balances are consistent with the City's expected needs.

<u>Recommendation for Changes</u>

The Real Estate Excise Tax (REET) is accounted for in two accounts within the **Excise Tax Capital Improvement Fund** – one for the first quarter percent (REET 1) and one for the second quarter percent (REET 2), which has been dedicated historically to transportation projects. The fiscal policies anticipate that a portion of these funds will be available to leverage external funding when the opportunity arises (grant match reserve). The reserve would be maintained through excise tax revenue received over and above the annual allocation to the CIP.

In practice, the target has been set at one year of planned use in the CIP (for both REET 1 and 2) plus the budgeted external funding in the 6-year CIP for REET 2 only. For the 2011-2012 biennium, this results in a target of $1 million in REET 1 and $11.5 million in REET 2 due to the level of external funding, for a total of $12.5 million, which is not a realistic target given current trends. In reality, if external funding is not received as planned, the City does not proceed with the project in most cases and the project is revisited during the next CIP update process. The actual use of the REET 2 reserve over the past 6 years (2005-2010) has averaged $2.1 million annually (with individual years varying between $1.9 and 2.3 million). Staff recommends setting the **additional REET 2 set aside at the annual average use based on the 6-year rolling average** to ensure some funds are available for grant match and other unexpected needs, but resulting in a more realistic target and freeing up some of the balance for emerging needs. This recommendation would result in a target of $1 million for REET 1 and $3.1 million for REET 2, for a total target of $4.1 million.

Further recommendations related to the Internal Service funds may emerge from the evaluation of establishing sinking funds for Public Safety and Information Technology equipment replacement (in addition to the existing reserves for vehicles and personal computers). That review will be undertaken by the Finance Subcommittee over the next several months.

Summary of Recommendations

The proposed changes to the current reserve policies are:

- Set the target balance for the **Contingency Fund** at 80% of the statutory maximum.
- Modify the target balance for the **General Capital Contingency** to be based on 10% of the 2-year CIP budget (rather than the 6-year CIP).

- Change the **Excise Tax Capital Improvement** balance target to one year of planned use in the CIP (for both REET 1 and 2) plus a grant match reserve based on the annual use of REET 2 based on a 6-year rolling average.
- Establish reserve replenishment policies during times of economic recovery that include:
    - Planned replenishments toward the 80% target set at 1% of the General Fund adopted budget.
    - Make unplanned amounts available at the end of each biennium to help replenish to target faster or some or all of those funds in place of planned (budgeted) amounts in the following biennium. Staff is proposing that a high percentage (up to all) uncommitted funds available at the end of a biennium should be used for reserve replenishment until reserves meet 80% of target.
    - Once reserves reach 80% of target, funds could be freed up to meet other one-time or on-going needs. City Manager recommends 50% of available cash be put toward reserves until they are at 100% of target, with the remainder available for allocation to a hierarchy of needs.
    - Broad guidance on how replenishments are allocated to specific reserves.
    - A mechanism whereby Council could take action to suspend replenishment policies if it was found that special conditions existed warranting such action.

As part of the mid-biennial budget adjustments, staff will also propose that up to $500,000 of the unencumbered funds from year end 2010 ($618,374), be used for reserve replenishment. In addition, the budget contemplates an initial reimbursement of pre-annexation costs from the state sales tax credit of $342,000, which is also recommended as reserve replenishment.

Next Steps

After the October 4 Study Session, staff will incorporate Council feedback and draft a resolution adopting the revised policies. The intent would be for this resolution to be in place before the 2013-2014 budget process gets underway in 2012, so that it can be incorporated into development of that budget.

BEST PRACTICE

<u>Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (BUDGET and CAAFR)</u>

<u>Background.</u> Accountants employ the term *fund balance* to describe the net assets of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net assets of governmental funds calculated on a government's budgetary basis.[1] In both cases, fund balance is intended to serve as a measure of the financial resources available in a governmental fund.

Accountants distinguish up to five separate categories of fund balance, based on the extent to which the government is bound to honor constraints on the specific purposes for which amounts can be spent: *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.[2] The total of the last three categories, which include only resources without a constraint on spending or for which the constraint on spending is imposed by the government itself, is termed *unrestricted fund balance*.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance (i.e., the total of the amounts reported as committed, assigned, and unassigned fund balance) in the general fund.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unrestricted fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view high levels of fund balance as "excessive."

<u>Recommendation</u>. The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.[3] Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and

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[1] For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.
[2] These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which must be implemented for financial statements for periods ended June 30, 2011 and later.
[3] Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.

specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy. [4]

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.[5] The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.[6] Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);[7]
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).

Furthermore, governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance rather than on unrestricted fund balance.

Naturally, any policy addressing desirable levels of unrestricted fund balance in the general fund should be in conformity with all applicable legal and regulatory constraints. In this case in particular, it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated by all interested parties.

Approved by the GFOA's Executive Board, October, 2009.

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[4] See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).

[5] In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.

[6] In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues or expenditures, that decision should be followed consistently from period to period.

[7] However, except as discussed in footnote 4, not to a level below the recommended minimum.

BEST PRACTICE

Replenishing Fund Balance in the General Fund (2011) (Budget and CAAFR) (new)

Background. It is essential that governments maintain adequate levels of fund balance to mitigate risks and provide a back-up for revenue shortfalls.

The adequacy of unrestricted fund balance[1] in the general fund should be assessed based upon a government's specific circumstances. Nevertheless, the GFOA recommends, at a minimum, that general-purpose governments, regardless of size, incorporate in its financial policies that unrestricted fund balance in their general fund be no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

If fund balance falls below a government's policy level, then it is important to have a solid plan to replenish fund balance levels. Rating agencies consider the government's fund balance policy, history of use of fund balance, and policy and practice of replenishment of fund balance when assigning ratings. Thus, a well developed and transparent strategy to replenish fund balance may reduce the cost of borrowing. However, it can be challenging to build fund balances back up to the recommended levels because of other financial needs and various political considerations.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments adopt a formal fund balance policy that defines the appropriate level of fund balance target levels. Also, management should consider specifying the purposes for which various portions of the fund balances are intended. For example, one portion of the fund balance may be for working capital, one for budgetary stabilization, and one for responding to extreme events. This additional transparency helps decision makers understand the reason for maintaining the target levels described in the fund balance policy.

Governments should also consider providing broad guidance in their financial policies for how resources will be directed to fund balance replenishment. For example, a policy may define the revenue sources that would typically be looked to for replenishment of fund balance. This might include non-recurring revenues, budget surpluses, and excess resources in other funds (if legally permissible and if there is defensible rationale). Year-end surpluses are an especially appropriate source for replenishing fund balance.

Finally, a government should consider including in its financial policy a statement that establishes the broad strategic intent of replenishing fund balances as soon as economic conditions allow. This emphasizes fund balance replenishment as a financial management priority.

Governments are subject to a number of factors that could require the use of fund balances. It is therefore incumbent on jurisdictions to minimize the use of fund balance, except in very specific circumstances. Replenishment should take place in a prompt fashion with amounts that have been used to ensure that the jurisdiction is properly prepared for contingencies. With the foundation of a financial policy in place, governments should use their long-term financial planning and budget processes to develop a more detailed strategy for using and replenishing fund balance. With these criteria in mind, the government should develop a replenishment strategy and timeline for replenishing fund balances as soon as possible, and that is still appropriate to prevailing budgetary and economic conditions and that considers the following:

[1] Unrestricted fund balance comprises the committed, assigned, and unassigned fund balance categories.

1. The policy should define the time period within which and contingencies for which fund balances will be used. This gives the public a sense for how fund balance is being used as a “bridge” to ensure stable cash flow and provide service continuity.
2. The policy should describe how the government’s expenditure levels will be adjusted to match any new economic realities that are behind the use of fund balance as a financing bridge.
3. The policy should describe the time period over which the components of fund balance will be replenished and the means by which they will be replenished. Frequently, a key part of the replenishment plan will be to control operating expenditures and use budget surpluses to replenish fund balance. The replenishment plan might also specify any particular revenue source that will aid in the replenishment of fund balances. For example, if the government has a volatile sales tax yield, it might specify that yields that are significantly above average would be used to replenish fund balances.

Generally, governments should seek to replenish their fund balances within one to three years of use. However, when developing the specifics of the replenishment plan, governments should consider a number of factors that influence the rate and time period over which fund balances will be replenished. Factors influencing the replenishment time horizon include:

1. *The budgetary reasons behind the fund balance targets.* The government should consider special conditions that may have caused it to set its fund balance target levels higher than the GFOA-recommended minimum level. For example, if targets are higher because the community has very volatile cash flows, then the government would want to build the fund balances back up more quickly compared to governments with more stable cash flows.
2. *Recovering from an extreme event.* An extreme event, such as a natural disaster, that has required the government to use a portion of its fund balance, may make it infeasible to replenish the fund balance as quickly as normal, depending upon the severity of the event.
3. *Political continuity.* Replenishing fund balance takes political will, and that will is often strengthened by the memory of the financial challenge that caused the use of fund balances in the first place. If the governing board and/or management are already committed to a particular financial policy, the replenishment strategy should be as consistent as possible with that policy in order to maximize political support.
4. *Financial planning time horizons.* Fund balances should typically be replenished within the time horizon covered by the organization’s long-term financial plan. This puts the entire replenishment plan in context and shows the public and decision makers the expected positive outcome of the replenishment strategy.
5. *Long-term forecasts and economic conditions.* Expectations for poor economic conditions may delay the point at which fund balances can be replenished. However, in its replenishment plan the government should be sure to set a benchmark (e.g., after fund balances have dropped to a certain point below desired target levels) for when use of fund balance is no longer acceptable as a source of funds.
6. *Milestones for gradual replenishment.* A replenishment plan will likely be more successful if it establishes replenishment milestones at various time intervals. This is especially important if replenishment is expected to take place over multiple years (e.g., if you are starting from 75% of your target, set a goal to reach 80 percent of target in one year, 90 percent in two years, and 100 percent in three years).
7. *External financing expectations.* A replenishment plan that is not consistent with credit rating agency expectations may increase the government’s cost of borrowing. It is important that the logic used by the government to develop the replenishment plan be communicated in an effective fashion to external lenders.

References.

- GFOA Best Practice Appropriate Level of Unrestricted Fund Balance in the General Fund, 2009.
- For a fuller explanation of the concept of "bridging" in financial distress, please visit GFOA's financial recovery website at www.gfoa.org/financialrecovery.

Approved by the GFOA’s Executive Board, February, 2011.

CITY OF KIRKLAND

FISCAL POLICIES

BACKGROUND AND PURPOSE

The stewardship of public funds is one of the greatest responsibilities given to the officials and managers of the City of Kirkland. Therefore, the establishment and maintenance of wise fiscal policies enables city officials to protect public interests and ensure public trust.

This document incorporates past financial practices in defining the current policies to be used by the City to meet its obligations and operate in a financially prudent manner. These policies have been established to provide general fiscal guidelines and are intended to provide sound direction in the management of the City's financial affairs.

[Excerpt below applies to this discussion - the full text can be found in the budget document starting on page 21.]

RESERVE AND FUND BALANCE POLICIES

Adequate fund balance and reserve levels are a necessary component of the City's overall financial management strategy and a key factor in external agencies' measurement of the City's financial strength.

Maintenance of fund balance for each accounting fund assures adequate resources for cash flow and to mitigate short-term effects of revenue shortages.

City and state regulations have been established to allow the City of Kirkland to create and maintain specific reserve funds. Prudent use of reserve funds enables the City to defray future costs, take advantage of matching funds, and beneficial (but limited) opportunities. Reserve funds provide the City with the ability to exercise flexible financial planning in developing future capital projects. Reserve funds are necessary to enable the City to deal with unforeseen emergencies or changes in condition.

- The City will establish minimum fund balance targets for each fund based on the cash flow requirements of the fund. The City will include all fund balances in the biennial budget.
- The minimum fund balance will be attained and maintained through expenditure management, revenue management and/or contributions from the General Fund.
- All expenditures drawn from reserve accounts shall require prior Council approval unless previously authorized by the City Council for expenditure in the biennial budget.
- A Contingency Reserve Fund shall be maintained in accordance with RCW 35A.33.145 to meet any municipal expense, the necessity or extent of which could not have been reasonably foreseen at the time of adopting the biennial budget. The target balance will be consistent with state law at $0.375 per $1,000 of assessed valuation. Annual contributions to the Contingency Fund will be budgeted from interest income and General Fund resources.
- The City will maintain a General Operating Reserve at an amount equivalent to five percent of the tax-supported general government budgets (General Fund, Street Operating Fund and Parks Maintenance Fund) for the second year of the biennium. The General Operating Reserve is available to address unforeseen revenue shortfalls or expenditure needs that occur during the current biennium. Annual contributions will be budgeted from General Fund resources as available to attain and maintain an established reserve level.
- The City will maintain a Revenue Stabilization Reserve to address temporary revenue losses due to economic cycles or other time-limited causes. The Revenue Stabilization Reserve will be maintained at ten percent of selected General Fund revenue sources which, in the judgment of

the Director of Finance and Administration, are subject to volatility. The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end General Fund resources in excess of those needed to maintain the fund balance at the target level.

- The City will maintain a General Capital Contingency to address unforeseen project expenditures or external revenue shortfalls in an amount equivalent to ten percent of the funded six-year CIP, less proprietary fund projects. Contributions will be made from General Fund resources as they are available.
- The City Manager may authorize the use of capital funding reserves up to an aggregate total of $100,000 per year in increments not to exceed $25,000. The City Manager will provide regular reports to the City Council at a regular Council meeting if this authorization is used. Capital funding reserves include: General Capital Contingency, Street Improvement Reserve, REET Reserves, Impact Fee Reserves, Water/Sewer Capital Contingency, Water/Sewer Construction Reserve, Surface Water Capital Contingency, and Surface Water Construction Reserve.
- The City will maintain a Capital Improvement Project Grant Match Reserve as a means of assuring the availability of cash resources to leverage external funding when the opportunity arises. The reserve will be maintained in the Real Estate Excise Tax Capital Reserve Fund and maintained through excise tax revenue received over and above the annual allocation to the Capital Improvement Plan.
- The City will maintain fully funded reserves for the replacement of vehicles and personal computers. Contributions will be made through assessments to the using funds and maintained on a per asset basis.
- Additional reserve accounts may be created by Council to account for monies for future known expenditures, special projects, or other specific purposes.
- All reserves will be presented in the biennial budget.

STANDARD &POOR'S

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June 27, 2006

Criteria | Governments | U.S. Public Finance:
Financial Management Assessment

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Criteria | Governments | U.S. Public Finance:

Financial Management Assessment

*(**Editor's Note:** This criteria article originally was published on June 27, 2006. We're republishing it following our periodic review completed on Dec. 15, 2010.)*

The rigor of a government's financial management practices is an important factor in Standard & Poor's Ratings Services analysis of that government's creditworthiness. Managerial decisions, policies, and practices apply directly to the government's financial position and operations, debt burden, and other key credit factors. A government's ability to implement timely and sound financial and operational decisions in response to economic and fiscal demands is a primary determinant of near-term changes in credit quality. Standard & Poor's will now offer a more transparent assessment of a government's financial practices as an integral part of our general obligation and appropriation credit rating process.

Assessing Financial Practices

Major elements of governmental financial management include economic analysis, revenue forecasting, risk management, accounting practices, financial strategies, cash and liquidity administration, and debt management. All of these elements have an impact on a government's bottom line, and, as a result, on its credit quality. If a government is unable or unwilling to employ its authority in a timely manner to address events that impact its budget and financial condition, its credit rating can be adversely affected.

Many finance directors and other local government officials take pride in the managerial policies, practices, and structures they have established to ensure efficiency and quality of service, and to promote innovation and security. While credit ratings incorporate financial management as one of many factors, the impact of financial management on the rating may not be readily apparent because other factors may counterbalance, or even outweigh it. Examples of such factors include local economic conditions, debt levels, and statutory limitations. By focusing special attention on the assessment of financial practices, Standard & Poor's will more fully recognize governments' efforts in this important area. In fact, the vast majority of downgrades in recent years can be attributed to financial practices, or lack thereof. (For further information on this trend, see the report, "GO Credit Ratings Are At A Crossroad As Downgrades Increase," RatingsDirect, June 12, 2006).

Analytical Framework

Standard & Poor's has established an analytical methodology that evaluates established and ongoing management practices and policies in the seven areas most likely to affect credit quality. These areas are:

- Revenue and expenditure assumptions
- Budget amendments and updates
- Long term financial planning
- Long term capital planning
- Investment management policies
- Debt management policies

- Reserve and liquidity policies

The evaluation of each area focuses on best practices and policies that are credit-important in most governments rather than policies that address issues that are fairly unusual or unique to the government. The nature of the policies and practices considered are those that governments may use in some manner regardless of the size or type of government. Issuers that rank well in the evaluation should be those whose policies help reduce the likelihood of credit deterioration, or enable them to benefit more from changing conditions, whether they are economic, budgetary, statutory, or personnel related.

Users of the FMA, however, should also realize its limitations. By focusing on a government's policies and practices, the FMA is not an evaluation of the competency or aptitude of individual finance professionals; nor is it an evaluation of a finance department's ability to handle unique challenges. Moreover, the nature of the entity's governing body, the effectiveness of its governance practices, and issues of public policy pursued by the government are beyond the scope of this analysis.

Although Standard & Poor's considers in its analysis any material information that provides relevant context or influences financial management, it is important to note that this assessment of financial practices is based primarily on the existence and implementation of management practices, and not necessarily the results achieved by such practices. Results—both positive and negative—are assumed to manifest themselves in other visible ways. The purpose of the focus on policies and practices is to evaluate the potential for credit quality to move away from those currently indicated by results.

The following tables detail each of the seven financial practice areas examined by Standard & Poor's.

Table 1

Revenue And Expenditure Assumptions	
Are the organization's financial assumptions and projections realistic and well grounded from both long-term and recent trend perspectives?	
Strong	Formal historic trend analysis is performed and updated annually for both revenue and spending; regular effort is made to determine whether revenues or expenditures will deviate from their long-term trends over the next couple of years; evidence of independent revenue forecasting exists(when possible).
Standard	Optimistic assumptions exist that, while supportable, add risk; assumptions are based on recent performance, but little evidence of questioning or validating assumptions exists.
Vulnerable	Assumptions neglect likely shortfalls, expenditure pressures or other pending issues; assumptions exist which enjoy no prudent validation.

Table 2

Budget Amendments And Updates	
Are there procedures for reviewing and amending the budget based on updated information and actual performance to ensure fiscal targets are met?	
Strong	At least quarterly budget surveillance is maintained to identify problem areas and enable timely budget adjustments; management exhibits ability and willingness to address necessary intra-year revenue and expenditure changes to meet fiscal targets.
Standard	Semiannual budget reviews exist; management identifies variances between budget and actual performance.
Vulnerable	No formal process exists for regular review and timely updating of budget during the year.

Table 3

Long-Term Financial Planning

Does management have a long-term financial plan that allows them to identify future revenues and expenditures as well as address upcoming issues that might affect these?	
Strong	A multi-year financial plan exists where future issues are identified and possible solutions are identified, if not implemented; revenue and expenditure decisions are made primarily from a long-term perspective. Structural balance is a clear goal.
Standard	Multi-year projections are done informally; multi-year projections are done, but without discussion of pending issues, so that issues are not addressed; some one-shot actions exist, but the long-term consequences of these actions are acknowledged and communicated.
Vulnerable	No long-term financial planning exists; operational planning is done on a year-to-year (or budget-to-budget) basis; one-shot budget fixes are used with little attention to long-term consequences.

Table 4

Long-Term Capital Planning

Has the organization created a long-term capital improvement program?	
Strong	A five-year rolling CIP with funding identified for all years exists and is linked to the operating budget and long-term revenue and financing strategies.
Standard	A five-year CIP is done, but is generally limited to projects to be funded from the current budget plus a four-year wish list; some funding for out-year projects is identified, but not all.
Vulnerable	No five-year CIP exists; capital planning is done as needs arise.

Table 5

Investment Management Policies

Has the organization established policies pertaining to investments, such as the selection of financial institutions for services and transactions; risk assessment; investment objectives; investment maturities and volatility; portfolio diversification; safekeeping and custody; and investment performance reporting, benchmarking, and disclosure?	
Strong	Investment policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning.
Standard	Informal or non-published policies exist; policies are widely communicated and followed.
Vulnerable	Absence of informal or non-published policies

Table 6

Debt Management Policies

Has the organization established policies pertaining to the issuance of debt, such as projects that may or may not be funded with debt (including economic development projects); maturity and debt service structure; use of security and pledges, credit enhancement, and derivatives; and debt refunding guidelines?	
Strong	Debt policies exist and are well defined; strong reporting and monitoring mechanisms exist and are functioning. If swaps are allowed, a formal swap management plan that follows S&P's guidelines (see the DDP) has been adopted.
Standard	Basic policies exist; policies are widely communicated and followed. If swaps are allowed there is a swap management plan in place, but it does not follow S&P's guidelines.
Vulnerable	Absence of basic policies or clear evidence that basic policies are followed. Swaps are allowed but there is no swap management plan in place, and/or there is no local (non-FA) knowledge about the swap.

Table 7

Reserve And Liquidity Policies	
Has the organization established a formalized operating reserve policy, which takes into account the government's cash flow/operating requirements and the historic volatility of revenues and expenditures through economic cycles?	
Strong	A formal operating reserve policy is well defined. Reserve levels are clearly linked to the government's cash flow needs and the historic volatility of revenues and expenditures throughout economic cycles. Management has historically adhered to it.
Standard	A less defined policy exists, which has no actual basis but has been historically adhered to it.
Vulnerable	Absence of basic policies or, if they exist, are not followed.

Assessment Methodology

Standard & Poor's evaluates and assigns each of the seven areas a qualitative ranking, based on the above framework. In determining the overall assessment, the revenue and expenditure assumptions, budget amendments and updates are given a relatively higher importance; long-term financial planning and liquidity policies are given an average importance; and capital planning, debt policies, and investment policies receive relatively less weight. The difference in degrees of importance is limited, however, so that each factor's contribution to the assessment is meaningful.

Overall assessments are communicated using the following terminology: The term "good", in addition to the terms "strong", "standard", and "vulnerable", is used to further differentiate governments with a mix of strong and standard practices.

"Strong"

A Financial Management Assessment of 'strong' indicates that practices are strong, well embedded, and likely sustainable. The government maintains most best practices deemed critical to supporting credit quality and these are well embedded in the government's daily operations and practices. Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel.

"Good"

A Financial Management Assessment of 'good' indicates that practices are deemed currently good, but not comprehensive. The government maintains many best practices deemed as critical to supporting credit quality, particularly within the finance department. These practices, however, may not be institutionalized or formalized in policy, may lack detail or long-term elements, or may have little recognition by decision makers outside of the finance department.

"Standard"

A Financial Management Assessment of 'standard' indicates that the finance department maintains adequate policies in most, but not all key areas. These policies often lack formal detail and institutionalization, and may not include best practices.

"Vulnerable"

A Financial Management Assessment of 'vulnerable' indicates that the government lacks policies in many of the areas deemed most critical to supporting credit quality. The 'vulnerable' designation suggests a high degree of uncertainty regarding a government's ability to effectively adapt to changing conditions that could threaten its long-term financial position.

Analytical Process And Supporting Documentation

To perform its analysis of local government financial practices, Standard & Poor's will rely on documentation provided by the government and discussions with the organization's management. Relevant documents include, but are not limited to, audited financial statements and accompanying notes, budget documents, financial plans, management policy statements, procedure manuals, and periodic reports. Discussions provide an important opportunity for management to elaborate on the factors listed above, as well as answer specific questions, so as to enable Standard & Poor's analysts to assess the factors as thoroughly as possible.

STANDARD &POOR'S

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August 15, 2011

Summary:
Kirkland, Washington; General Obligation

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Summary:

Kirkland, Washington; General Obligation

Credit Profile		
US$4.14 mil GO Bnds ser 2011 due 12/01/2021		
Long Term Rating	AAA/Stable	New
Kirkland Ultd Tax		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' long-term rating to Kirkland, Wash.'s series 2011 limited-tax general obligation (GO) refunding bonds. In addition, Standard & Poor's affirmed its 'AAA' long-term rating and underlying rating (SPUR) on the city's previously issued GO debt. The outlook on all ratings is stable.

The ratings reflect our view of the city's:

- Economic base in the Seattle region that shows strong-to-extremely-strong wealth and income indicators,
- Maintenance of very strong available reserves,
- Strong financial policies and practices, and
- Low debt burden relative to market value.

The bonds are secured by the city's full faith and credit, including the obligation to levy property taxes subject to a statutory tax limit of $3.10 per $1,000 of assessed value (AV) for operations and non-voted debt. The levy rate is currently $1.30. Property tax revenue growth is additionally limited to 1% per year plus new construction without a voted override.

We understand that the city will use bond proceeds to refund its series 1999 limited-tax GO bonds and a portion of its series 2001 limited-tax GO refunding bonds.

The city serves an established suburban area 12 miles northeast of Seattle, along the jobs-rich Interstate 405 corridor and near the main Microsoft campus. Its income and wealth indicators are very-strong-to-extremely strong in our view, with a median household effective buying income of 151% of the U.S. level and a per capita market value of $225,093. The city's preliminary June 2011 unemployment rate of 8.2% was below the region's 9.3% rate and nation's 9.2% rate, but the number of employed residents in the city remains below the December 2007 peak.

On July 1, 2011, the city annexed three largely residential unincorporated neighborhoods on its northern border that it will fully phase-in for 2012 for property tax purposes. This new area increased the city's population to 80,505 from 49,020 and its AV by 42% based on 2011 figures. During its current biennium, the city will receive a portion of county-allocated taxes attributable to the second half of 2011 and a state sales tax credit during a 10-year transition period budgeted at an annualized 4% of general fund expenditures. The city does not have material taxpayer concentration, in our view, and we do not expect any significant change as a result of the annexation.

Similar to many other cities in the region, the city's total AV has declined concurrently with housing market stress after a period of substantial growth. Since its 2009 peak, AV declined by what we consider a significant 9.6%

average annual rate to $10.8 billion for 2011. Including the annexation area, the city's total AV stands at $15.3 billion for 2011. We understand that the city is levying property taxes for operations at the maximum level permitted under state law, which, without a public vote, generally limits local governments to property tax revenue growth of 1% per year, excepting new construction. However, at $1.30 per $1,000 of AV, the city's levy rate stands at 42% of the statutory levy rate cap, and we believe that if the city allows its levy rate to rise, it could experience substantial further AV declines without realizing a loss in property tax revenues. Voters last approved a "levy lid lift" (a property tax limit override) in 2002 for parks maintenance and operations.

This property tax structure notwithstanding, the city's general fund has shown the effects of the current economic trough, but has a financial position that we consider very strong. We calculate the city's available balances, consisting of the general fund and five reserves outside of the general fund, at $16.5 million, or 29% of general fund expenditures, at the end of 2010, down from 43% in 2007. We understand that the city responded to its budgetary challenges by reducing expenditures and increasing its utility taxes in 2008, fully drawing on its reserve for economically driven revenue declines in 2009, and negotiating compensation reductions with its bargaining units in 2010. A positive revenue sign has been sales tax performance, which increased 4.5% governmentwide in 2010.

We calculate based on the city's budget and discussions with management that the city's available balances will contract further through the city's biennial period ending 2012 to a still very strong 23% of annual expenditures. This reflects a reserve position that is stronger in absolute terms but weaker in relative percentage terms as spending increases to serve the annexed area. We understand that the city reduced comparable positions by 16 in 2011 for its pre-annexation service area, but that the annexation allowed it to retain 13 of these jobs. Management reports that general fund sales taxes increased by 4.6% for the first quarter of 2011 for the pre-annexation area of the city and believes that a state sales tax amnesty program this year may net additional one-time and ongoing revenues.

We consider the city's management practices to be "strong" under our Financial Management Assessment (FMA) methodology. An FMA of "strong" indicates our view that practices are strong, well embedded, and likely sustainable.

Combined direct and overlapping debt levels after this issuance represent 2.6% of market value, which we consider low, and $5,905 per capita, which we consider high, but the city's wealth and income profile mitigates our concern regarding the latter ratio. We believe that the market value ratio could rise and population ratio drop in 2012, when the annexation area is included in the city's ratios, due to the annexation area's primarily residential land use pattern. Management reports that the city's $35.3 million series 2010 GO bonds represent the city's planned GO borrowing through 2016, but that the city is considering a smaller GO issuance in the next two years after it incorporates the annexation area into its operations and identifies new capital needs, if any.

The city makes its full contributions to the state-managed Public Employees Retirement System pension plans in which its employees participate. Management calculates its other postemployment benefits (OPEB) actuarially accrued liability, which is attributable to a benefits plan closed to new employees, at $10.1 million at the end of 2010. The city's most recent annual pay-as-you-go OPEB payment was $493,000 compared with a $948,200 actuarially calculated annually required contribution rate to retire the liability.

Outlook

The stable outlook reflects our view that the city's strong financial management policies and practices have positioned it well to handle the transition and ongoing costs associated with its service area expansion. Notwithstanding recent positive sales tax performance and the projections of net growth in available reserves in absolute terms following the annexation, we view the changes to the city's operations as a management challenge that is compounded by the revenue effects of a weak economic recovery. Accordingly, although our outlook incorporates the possibility that the city's reserves could stagnate in 2011 and 2012 due to transition costs associated with the annexation, we could lower the rating if we believe that the city is having difficulty restoring its operations to balance and its available reserves erode significantly.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008
- State And Local Government Ratings Are Not Directly Constrained By That Of The U.S. Sovereign, Aug. 8, 2011

Ratings Detail (As Of August 15, 2011)		
Kirkland ltd tax GO bnds		
Long Term Rating	AAA/Stable	Affirmed
Kirkland unltd tax GO bnds ser 2003 dtd 01/15/2003 due 12/01/2003-2016 2018 2020 2022		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
Kirkland unltd tax GO rfdg bnds ser 2001 dtd 07/01/2001 due 12/01/2001-2012		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

CITY OF KIRKLAND

FUND BALANCE AND RESERVES

Reserves and fund balance are two important indicators of the City's fiscal health. Reserves represent "savings accounts" that are held to meet unforeseen budgetary needs ("general purpose reserves"). Some specialized reserves are dedicated by purpose and are held until an appropriate expenditure is needed ("special purpose reserves"). Fund balance includes both reserves and working capital. Working capital is needed within each fund to meet its cash flow needs.

The charts following this narrative summarize the changes in fund balance across all funds and the estimated balance in each reserve at the end of 2010. An analysis of the changes in fund balance is included with each section of the budget (i.e. General Government Operating, Water/Sewer Utility, etc.) in addition to the summary provided here. The analysis shows the 2012 delineation between reserved fund balance and working capital. The following narrative highlights the major reserve policy components as they are incorporated in the 2011-2012 Budget.

FUND BALANCE

Each fund begins the year with a beginning fund balance which may be comprised of: capital reserves, operating reserves, and unreserved working capital. As the year progresses the expenditures made from the fund and revenues received will change the fund balance. A minimum amount of fund balance should be maintained in each operating fund to meet cash flow needs and, if needed, as a means of meeting commitments when a revenue shortfall occurs. A reduction in fund balance during the biennium (unless it is planned) can be seen as a sign of fiscal stress – revenues are not adequate to meet expenses. Fund balance in excess of the amount needed for minimum cash flow purposes can be used to fund one-time expenses or to replenish or enhance reserves. Budgeted fund balances recognize all cash resources estimated to be available as of the end of the biennium.

GENERAL PURPOSE RESERVES

General purpose reserves are available to meet a wide variety of contingencies. They are funded by excess general purpose revenues, which have no restrictions on the public purpose for which they are spent. The utility funds have a companion set of reserves distinct from those in the General Government category.

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each biennium, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the second year of the prior biennium budget and the second year of the current biennium budget would be added or subtracted utilizing interest income and year-end fund balance in the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end fund balance in the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual {biennial} budget." State law sets the maximum balance in the fund at $0.375 per $1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

General Capital Contingency

This reserve is available to fund general capital projects when the scope or cost of the project exceeds the budgeted amount. The target established by fiscal policy is ten percent of the funded six-year Capital Improvement Program (CIP) less utility projects. Funding is received from the General Fund year-end transfer and interest income. Use of the General Capital Contingency is secured through a request to Council. Typically, this reserve has covered changes in project scope or unanticipated costs that arose out of the bid process or unavoidable change orders. Council granted limited administrative authority to the City Manager to fund small project overruns (e.g. up to $100,000 per year each for the general and utility capital reserves with up to $25,000 for any single project).

Building and Property Reserve

This reserve is used for property purchases, building improvements and other property-related transactions. It has also been used as a general purpose reserve to fund Council-approved unanticipated expenditures.

Council Special Project Reserve

This reserve is available to the City Council to fund special one-time projects that were unforeseen at the time the budget was prepared. When the reserve is used, it is replenished from the General Fund year-end fund balance.

SPECIAL PURPOSE RESERVES

Special purpose reserves are dedicated either by Council policy or by state or local laws that govern their use. Following are descriptions of a few of the larger and more important special purpose reserves.

Excise Tax Capital Improvement Reserve

There are two reserves in the Real Estate Excise Tax Capital Improvement Fund – one for the first quarter percent real estate excise tax (REET 1) and one for the second quarter percent real estate excise tax (REET 2). These cash balances must be kept separate due to the dedication of REET 2 to transportation capital projects. The REET 1 reserve is used primarily as a general CIP grant match reserve and/or for significant project scope changes. The target should be reviewed periodically against potential grants.

Equipment Rental Fund

The Equipment Rental Fund is one of four internal service funds. There are two capital reserves maintained in this fund. One relates to the replacement of vehicles and the other is for the replacement of 800 MHz radios. Vehicle replacement rates, based on the estimated useful life, the replacement cost of each vehicle, and the related cash flow requirements are assessed monthly to each user department. The radio replacement reserve was funded previously via the year-end transfer from the General Fund; however, future funding is still to be determined, but may come from radio replacement rates which will be assessed in the year after a radio is replaced.

Information Technology Fund

The Information Technology Fund is the second internal service fund. There are two reserves within this fund. The Personal Computer (PC) replacement reserve in this fund is for the replacement of personal computers. PC replacement rates, based on the estimated useful life and replacement cost of each type of PC, are assessed monthly to each user department. The Technology Major Systems Replacement Reserve was initiated by Council in 2003 by reallocating a portion of the General Capital

Contingency. The reserve will be used to fund projected major system replacements that cannot be covered through the current CIP funding allocations. An initial amount of $1 million was reallocated from the General Capital Contingency to start the reserve which may be funded in future years by replacement charges to department users.

Facilities Maintenance Fund

The third internal service fund is the Facilities Maintenance Fund which accounts for the costs of maintaining and repairing City buildings. Revenue to the fund is derived primarily from user charges to other funds. Two types of reserves are budgeted in this fund – an operating reserve and a sinking fund reserve. The operating reserve is set at $550,000 and is used to pay for major, unanticipated repairs. It is replenished, if necessary, from the General Fund year-end transfer.

The sinking fund reserve is used to pay for each City facility's twenty-year life cycle costs related to the repair or replacement of major architectural, mechanical, and electrical components. A facilities sinking fund charge is assessed to each operating fund and is in addition to the annual facilities rental charge, which covers the basic annual maintenance costs for each facility. The reserve is the source of funding for planned repair and replacement projects.

Health Benefits Fund

The Health Benefit Fund was established in the 2011-12 biennium to account for programs providing employee medical health coverage under the City's new medical self-insurance program. Medical premiums received by the fund are used to play claims for employees participating in the self-insured health care program, as well as "stop loss" coverage insurance and administrative and other program costs. A portion of the premiums will be set aside in a reserve to maintain the viability of the fund based on actuarial estimates.

Attachment E

CITY OF KIRKLAND
CHANGE IN FUND BALANCE (Beginning 2009 to Ending 2012)
SUMMARY OF ALL FUNDS

	General Government		Utility			
	Operating Funds	Non-Operating Funds	Water/ Sewer Utility	Surface Water Utility	Solid Waste Utility	All Funds
2009 Actual Beginning Fund Balance	**22,258,092**	**56,111,187**	**15,716,068**	**9,761,132**	**1,338,548**	**105,185,027**
Reserved	*9,968,025*	*32,157,537*	*10,881,270*	*4,773,445*	-	*57,780,277*
Unreserved Working Capital	*12,189,194*	*11,355,557*	*4,834,798*	*4,987,687*	1,338,548	*34,705,784*
Plus: 2009-10 Estimated Revenues	148,333,625	45,497,645	48,452,303	14,590,028	17,109,170	**273,982,771**
Less: 2009-10 Estimated Expenditures	149,564,569	61,357,713	51,588,868	15,837,257	16,496,130	**294,844,537**
Fund Structure Changes	9,784,710	10,744,807	-	-	-	**20,529,517**
Less: 2009-10 Amount Avail. for Year-End Transfer	-	-	-	-	-	**-**
2009-10 Estimated Ending Fund Balance	**30,811,858**	**29,506,312**	**12,579,503**	**8,513,903**	**1,951,588**	**83,363,164**
Less: Funding for Carryovers to 2011	1,019,516	-	2,879,480	409,350	555,951	**4,864,297**
Less: Funding for 2011-12 Service Packages	1,222,590	-	-	-	-	**1,222,590**
2011 Budgeted Beginning Fund Balance	**28,569,752**	**29,506,312**	**9,700,023**	**8,104,553**	**1,395,637**	**77,276,277**
Plus: 2011-12 Budgeted Revenues	185,982,056	67,992,963	50,731,089	19,165,877	29,462,954	**353,334,939**
Less: 2011-12 Budgeted Expenditures	184,056,113	76,921,181	49,195,740	20,003,107	28,795,279	**358,971,420**
2012 Budgeted Ending Fund Balance	**31,718,285**	**20,578,094**	**13,038,811**	**7,267,323**	**2,063,312**	**74,665,825**
Reserved	*25,124,878*	*17,546,308*	*10,245,806*	*6,013,580*	-	*58,930,572*
Unreserved Working Capital	*6,593,407*	*3,031,786*	*2,793,005*	*1,253,743*	*2,063,312*	*15,735,253*
Change in Fund Balance: Beginning 2009 to Ending 2012	**9,532,504**	**(23,674,324)**	**(2,677,257)**	**(2,493,809)**	**724,764**	**(18,588,122)**

Notes:
Change in Fund Balance depicts the effects of the current and coming year's financial transactions on available resources. A minimum level of fund balance must be maintained in each fund to assure adequate cash flow. In all cases, fund balance is at or above the minimum level. A negative change in fund balance is not necessarily a reflection of a problem. Rather, it typically reflects the use of accumulated resources for planned expenditures (e.g. use of bond proceeds for capital projects). The significant decline in non-operating funds is partially due to a change in accounting standards, which consolidated some of these funds into general government operating funds.

Greater detail regarding the change in fund balances can be found in the following sections: General Government Operating Funds, General Government Non-Operating

CITY OF KIRKLAND
ESTIMATED FUND BALANCE / RESERVES
2011-2012 BUDGET WITH TARGETS

General Purpose Reserves

Fund/Reserve	2012 Est. Ending Bal	Current Target	Restriction Type	Allowable Uses	Source of Funds
Contingency	2,246,510	4,016,232	Legal	Reserve for unforeseen expenditures	Interest income and year-end transfer from General Fund
General Capital Contingency	4,437,370	6,766,320	Policy	Reserve for unforeseen changes in project cost or scope	Year-end transfer from General Fund
General Government Operating					
General Operating Reserve (Rainy Day Reserve)	2,806,513	4,127,496	Policy	Reserve for unforeseen revenue losses and other temporary events	Interest income and other General Fund revenue
Revenue Stabilization Reserve	731,431	2,279,251	Policy	Revenue Stabilization Reserve to smooth revenue receipts through economic cycles	General Fund revenue
Building and Property Reserve	1,972,213	N/A	Legal	Reserve for building improvements and property related transactions	Street vacations, property sale proceeds and other General Fund revenue
Council Special Projects	251,534	250,000	Policy	Reserve for unanticipated Council special projects	General Fund revenue
Total General Purpose Reserves	**12,445,571**				

Restricted Fund Balance

Fund/Reserve	2012 Est. Ending Bal	Current Target	Restriction Type	Allowable Uses	Source of Funds
Excise Tax Capital Improvement					
REET 1	1,081,284	1,035,000	Legal	Parks projects, Park debt service, & Transportation projects	1st quarter percent Real Estate Excise Tax (REET 1)
REET 2	4,965,034	11,484,000	Legal	Transportation projects and CIP Transp. grant match	2nd quarter percent Real Estate Excise Tax (REET 2)
Equipment Rental					
Vehicle Reserve	7,400,451	7,400,451	Policy	Vehicle replacement reserve	User charges to other funds
Radio Reserve	-	TBD*	Policy	Radio replacement reserve	User charges to other funds
Information Technology					
PC Replacement Reserve	321,376	321,376	Policy	PC equipment replacement reserve	User charges to other funds
Major Systems Replacement Reserve	84,900	TBD*	Policy	Reserve for replacement of major technology systems	Initial funding from General Capital Contingency; future funding from user charges to other funds
Facilities Maintenance					
Operating Reserve	550,000	550,000	Policy	Reserve for maintenance and repair of City buildings	Year-end transfer from General Fund
Sinking Fund	2,050,023	2,050,023	Policy	20 year Facilities Life Cycle costs	User charges to other funds
Impact Fees					
Roads	869,392	N/A	Legal	Transportation capacity projects	Road impact fees and interest income
Parks	12,681	N/A	Legal	Park capacity projects	Park impact fees and interest income
Bond Reserve	537,700	N/A	Legal	Park projects identified with Park bond issue	Park bond funds reserved for future park projects
Cemetery Improvement	592,393	N/A	Legal	Reserve for cemetery improvements and debt service	75% of cemetery lot sales

*To Be Determined (TBD) - the targets for these reserves are under review.

Attachment E

CITY OF KIRKLAND
ESTIMATED FUND BALANCE / RESERVES
2011-2012 BUDGET WITH TARGETS

Restricted Fund Balance (Continued)

Fund/Reserve	2012 Est. Ending Bal	Current Target	Restriction Type	Allowable Uses	Source of Funds
Off-Street Parking	10,777	N/A	Legal	Reserve for parking improvements in the Central Business Dist.	Fees collected in lieu of parking
Tour Dock	75,315	N/A	Legal	Dock repairs	Tour dock fees
Street Improvement	1,215,693	N/A	Legal	Street improvements	Gas tax, sales tax and transfers from the surface water utility
Firefighter's Pension					
Pension Benefits	834,305	834,305	Legal	Pre-LEOFF 1 firefighters' pension benefits	Fire insurance premium tax
Long-Term Care Benefits	898,666	733,902	Legal	Pre-LEOFF 1 firefighters' long-term care benefits	Fire insurance premium tax
General Government Operating					
Litigation Reserve	50,000	50,000	Policy	Anticipated litigation expense for outside counsel	General Fund revenue
Labor Relations Reserve	69,565	N/A	Policy	Anticipated labor negotiation expenses	General Fund revenue
Police Equipment Reserve	-	N/A	Legal	Narcotics investigations	Seized property
LEOFF 1 Police Reserve	618,079	1,249,616	Policy	Police long-term care benefits	General Fund revenue
Facilities Expansion Reserve	800,000	N/A	Policy	Public Safety building	Interest income and year-end transfer from General Fund
Development Services Reserve	776,821	N/A	Policy	Revenue and staffing stabilization through economic cycles	Development services revenues
Tree Ordinance	19,117	N/A	Legal	Replacement trees program	Tree planting fee-in-lieu and tree removal fines
Donation Accounts	122,680	N/A	Legal	Purpose donation was given	Donations
Revolving Accounts	565,985	N/A	Policy	Purpose which the fee or reimbursement was collected	Fees and reimbursements
Total Restricted Fund Balance	**24,522,237**				

Water/Sewer Utility

Fund/Reserve	2012 Est. Ending Bal	Current Target	Restriction Type	Allowable Uses	Source of Funds
Operating Fund					
W/S General Operating Reserve	1,979,380	1,979,380	Legal	Rate stabilization reserve	Utility rates
Non-Operating Funds					
Debt Service Reserve	508,717	508,717	Legal	Reserve for debt service	Utility rates
Water/Sewer CIP Contingency	1,793,630	1,793,630	Legal	Reserve for unanticipated changes in Water/Sewer CIP project cost or scope	Available cash transfers and connection fees
Construction Reserve	5,964,079	N/A	Policy	Utility capital projects	Connection fees and interest
Total Water/Sewer Utility	**10,245,806**				

CITY OF KIRKLAND
ESTIMATED FUND BALANCE / RESERVES
2011-2012 BUDGET WITH TARGETS

Surface Water Utility

Fund/Reserve	2012 Est. Ending Bal	Current Target	Restriction Type	Allowable Uses	Source of Funds
Operating Fund					
Surface Water General Operating Reserve	412,875	412,875	Legal	Available fund balance for operating reserve	Surface Water fees
Non-Operating Funds					
Surface Water CIP Contingency	758,400	758,400	Legal	Reserve for unanticipated changes in Surface Water CIP project cost or scope	Available cash transfers
Surface Water Capital Reserve Transportation Project Related	2,447,053	N/A	Policy	Surface Water capital projects	Interest income & depreciation transfers
Surface Water Capital Reserve Surface Water Project Related	2,395,252	N/A	Policy	Surface Water capital projects	Interest income & depreciation transfers
Total Surface Water Utility	**6,013,580**				

TOTAL ALL FUNDS	**53,227,194**

Attachment F

Current General Purpose Reserves Policies

Current Policies						(Under)/Over Target	
Item	Description	Policy and Replenishments	2011-12 Target (w/o Annexation)	2011-12 Target (with Annexation)	2012 Estimated Ending Balance	w/o Annexation	with Annexation
Contingency	The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual {biennial} budget."	State law sets the maximum balance in the fund at $.375 per $1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). Annual contributions to the Contingency Fund will be budgeted from interest income and General Fund resources if required.	The maximum amount would be 0.375 per 1,000 of 2011 Assessed Valuation of 10,709,950,883 =	The maximum amount would be 0.375 per 1,000 of 2011 Assessed Valuation of 16,218,101,434 =			
			4,016,232	**6,081,788**	**2,246,510**	**(1,769,722)**	**(3,835,278)**
General Capital Contingency	This reserve is available to fund general capital projects when the scope or cost of the project exceeds the budgeted amount. Funding is received from the General Fund year-end transfer and interest income. Use of the General Capital Contingency is secured through a request to Council. Typically, this reserve has covered changes in project scope or unanticipated costs that arose out of the bid process or unavoidable change orders.	The target established by fiscal policy is ten percent of the funded six-year Capital Improvement Program (CIP) less utility projects. Council granted limited administrative authority to the City Manager to fund small project overruns (e.g. up to $100,000 per year each for the general and utility capital reserves with up to $25,000 for any single project). Replenishments will be made from General Fund resources as they are available.	10% of the 2011-2016 Funded CIP less Utility Projects, Equipment Rental, and Transporation projects funded by Surface Water 67,663,199=	10% of the 2011-2016 Funded CIP less Utility Projects, Equipment Rental, and Transporation projects funded by Surface Water 67,663,199=			
			6,766,320	**6,766,320**	**4,437,370**	**(2,328,950)**	**(2,328,950)**
General Operating Reserve (Rainy Day Reserve)	This reserve is to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.	For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each biennium, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the second year of the prior biennium budget and the second year of the current biennium budget would be added or subtracted utilizing interest income and year-end fund balance in the General Fund.	5% of the Operating Budget (second year of the biennium only) less Utility and Internal Service Funds 69,465,478 =	5% of the Operating Budget (second year of the biennium only) less Utility and Internal Service Funds 82,549,913 =			
			3,473,324	**4,127,496**	**2,806,513**	**(666,811)**	**(1,320,983)**
Revenue Stabilization Reserve	The Revenue Stabilization Reserve was approved by Council in 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue).	Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (primarily sales tax and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end fund balance in the General Fund.	10% of Selected General Fund Revenue Sources 19,541,226 =	10% of Selected General Fund Revenue Sources 22,792,507 =			
			1,954,123	**2,279,251**	**731,431**	**(1,222,692)**	**(1,547,820)**
Council Special Projects	This reserve is available to the City Council to fund special one-time projects that were unforeseen at the time the budget was prepared. When the reserve is used, it is replenished from the General Fund year-end fund balance.	Replenishment from year-end fund balance in the General Fund.	**250,000**	**250,000**	**251,534**	**1,534**	**1,534**
		Subtotal	**16,459,999**	**19,504,855**	**10,473,358**	**(5,986,641)**	**(9,031,496)**
Building and Property Reserve	This reserve is used for property purchases, building improvements and other property-related transactions. It has also been used as a general purpose reserve to fund Council-approved unanticipated expenditures.	Funding sources include: Street vacations, property sale proceeds and year-end transfer from General Fund. Current balance planned for use toward annexation facilities projects.	**N/A**	**N/A**	**1,972,213**	**N/A**	**N/A**
		Total	**16,459,999**	**19,504,855**	**12,445,571**	**(5,986,641)**	**(9,031,496)**

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Attachment G

10-Year History of General Purpose Reserves with Percentage of Target

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	10 Year Average
Contingency											
Beginning Balance	2,247,561	2,490,257	2,490,257	2,523,257	2,357,321	2,291,028	2,815,790	2,463,851	2,328,060	1,846,045	2,385,343
Uses	(481,490)	-		(165,936)	(66,293)	(336,036)	(365,936)	(250,339)	(482,015)	(125,822)	(252,652)
Additions	724,186	-	33,000	-	-	860,798	13,997	114,548	-	331,647	207,818
Ending Balance	2,490,257	2,490,257	2,523,257	2,357,321	2,291,028	2,815,790	2,463,851	2,328,060	1,846,045	2,051,870	2,365,774
Target	2,236,603	2,522,990	2,665,606	2,783,854	2,952,183	3,285,172	3,698,456	4,277,723	4,915,571	4,242,600	3,358,076
Ending Balance as % of Target	**111%**	**99%**	**95%**	**85%**	**78%**	**86%**	**67%**	**54%**	**38%**	**48%**	**76%**
General Capital Contingency											
Beginning Balance	4,372,150	4,505,274	4,425,274	4,209,340	2,979,056	3,737,337	3,518,137	3,312,834	3,269,834	2,178,047	3,650,728
Uses	(1,633,000)	(80,000)	(1,025,000)	(1,608,350)	(1,110,000)	(219,200)	(205,303)	(43,000)	(1,091,787)	(71,803)	(708,744)
Additions	1,766,124	-	809,066	378,066	1,868,281	-	-	-	-	-	482,154
Ending Balance	4,505,274	4,425,274	4,209,340	2,979,056	3,737,337	3,518,137	3,312,834	3,269,834	2,178,047	2,106,244	3,424,138
Target	4,227,714	3,968,149	4,304,899	5,708,260	5,900,568	5,900,568	5,822,280	5,822,280	9,032,430	9,032,430	6,198,918
Ending Balance as % of Target	**107%**	**112%**	**98%**	**52%**	**63%**	**60%**	**57%**	**56%**	**24%**	**23%**	**65%**
General Operating Reserve (Rainy Day Reserve)											
Beginning Balance	4,228,836	4,228,836	4,228,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	3,167,636
Uses			(2,320,000)		-	-	-	-	-	-	(331,429)
Additions			804,000		-	-	-	-	-	-	114,857
Ending Balance	4,228,836	4,228,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	2,712,836	3,016,036
Target	5,005,545	5,186,247	5,231,717	2,381,091	2,676,890	2,676,890	3,134,779	3,134,779	3,567,649	3,567,649	3,625,824
Ending Balance as % of Target	**84%**	**82%**	**52%**	**114%**	**101%**	**101%**	**87%**	**87%**	**76%**	**76%**	**86%**
Revenue Stabilization Reserve											
Beginning Balance	N/A	N/A	1,500,000	1,500,000	1,493,480	1,493,480	2,082,380	2,082,380	2,082,380	-	1,529,263
Uses			-	(6,520)	-	6,520	-	-	(2,082,380)	-	(260,298)
Additions			-	-	-	582,380	-	-	-	-	72,798
Ending Balance			1,500,000	1,493,480	1,493,480	2,082,380	2,082,380	2,082,380	-	-	1,341,763
Target				1,743,568	2,082,380	2,082,380	2,143,422	2,143,422	2,188,803	2,188,803	2,053,447
Ending Balance as % of Target				**86%**	**72%**	**100%**	**97%**	**97%**	**0%**	**0%**	**65%**
Council Special Projects											
Beginning Balance	260,420	259,299	257,560	306,760	271,920	267,160	309,960	276,960	271,960	167,684	264,968
Uses	(161,121)	(1,739)	(70,800)	(77,000)	(96,200)	-	(33,000)	(5,000)	(104,276)	(46,150)	(59,529)
Additions	160,000	-	120,000	42,160	91,440	42,800	-	-	-	80,000	53,640
Ending Balance	259,299	257,560	306,760	271,920	267,160	309,960	276,960	271,960	167,684	201,534	259,080
Target	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000
Ending Balance as % of Target	**104%**	**103%**	**123%**	**109%**	**107%**	**124%**	**111%**	**109%**	**67%**	**81%**	**104%**
Building and Property Reserve											
Beginning Balance	3,780,276	2,830,928	2,855,882	1,851,946	1,827,882	1,901,022	1,842,970	2,059,669	2,059,669	1,934,669	2,294,491
Uses	(3,891,685)	(167,609)	(1,010,996)	(24,064)	-	(217,363)	(10,000)	-	(125,000)	-	(544,672)
Additions	2,942,337	192,563	7,060		73,140	159,311	226,699	-	-	-	400,123
Ending Balance	2,830,928	2,855,882	1,851,946	1,827,882	1,901,022	1,842,970	2,059,669	2,059,669	1,934,669	1,934,669	2,109,931
Ending Balance as % of Target	**104%**	**7%**	**0%**	**0%**	**4%**	**9%**	**11%**	**0%**	**0%**	**0%**	**13%**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	10 Year Average
Total General Purpose Reserves											
Beginning Balance	14,889,243	14,314,594	14,257,809	11,604,139	10,149,015	10,909,383	11,199,693	10,826,150	10,642,359	8,839,281	11,763,167
Uses	(6,167,296)	(249,348)	(4,426,796)	(1,875,350)	(1,272,493)	(772,599)	(614,239)	(298,339)	(3,885,458)	(243,775)	(1,980,569)
Additions	5,592,647	192,563	969,126	420,226	2,032,861	1,062,909	240,696	114,548	-	411,647	1,103,722
Ending Balance	14,314,594	14,257,809	11,604,139	10,149,015	10,909,383	11,199,693	10,826,150	10,642,359	8,839,281	9,007,153	11,174,958
Target	11,719,862	11,927,386	12,452,222	12,866,773	13,862,021	14,195,010	15,048,937	15,628,204	19,954,453	19,281,482	
Ending Balance as % of Target	**122%**	**120%**	**93%**	**79%**	**79%**	**79%**	**72%**	**68%**	**44%**	**47%**	**80%**
Ending Balance as % of GF Revenues	**38.62%**	**38.99%**	**28.49%**	**23.98%**	**23.38%**	**21.62%**	**20.01%**	**19.77%**	**15.01%**	**15.92%**	**25%**

General Purpose Reserves with Staff Recommendations

Current Policies			Preliminary Staff Recommendations				
Item	**Description**	**Policy and Replenishments**	**Staff Recommended Policy**	**2011-12 Target (with Annexation)**	**2012 Estimated Ending Balance**	**(Under)/Over Target**	**Ending Balance as % of Target**
Contingency (Fund 152)	The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual {biennial} budget."	State law sets the maximum balance in the fund at $0.375 per $1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). Annual contributions to the Contingency Fund will be budgeted from interest income and General Fund resources if required.	Target calculation set at 80% of statutory maximum	The maximum amount would be $0.375 per $1,000 of 2011 Assessed Valuation of 16,218,104,434, the target would be 80% of the maximum =			
				4,865,430	**2,246,510**	**(2,618,920)**	**46.2%**
General Capital Contingency (Fund 310)	This reserve is available to fund general capital projects when the scope or cost of the project exceeds the budgeted amount. Funding is received from the General Fund year-end transfer and interest income. Use of the General Capital Contingency is secured through a request to Council. Typically, this reserve has covered changes in project scope or unanticipated costs that arose out of the bid process or unavoidable change orders.	The target established by fiscal policy is ten percent of the funded six-year Capital Improvement Program (CIP) less utility projects. Council granted limited administrative authority to the City Manager to fund small project overruns (e.g. up to $100,000 per year each for the general and utility capital reserves with up to $25,000 for any single project). Replenishments will be made from General Fund resources as they are available.	10% of the biennial (2011-2012) Funded CIP less Utility Projects, Equipment Rental, and Transportation projects funded by Surface Water	10% of the 2011-2012 Funded CIP less Utility Projects, Equipment Rental, and Transportation projects funded by Surface Water 46,319,040 =			
				4,631,904	**4,437,370**	**(194,534)**	**95.8%**
General Operating Reserve (Rainy Day Reserve)	This reserve is to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.	For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each biennium, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the second year of the prior biennium budget and the second year of the current biennium budget would be added or subtracted utilizing interest income and year-end fund balance in the General Fund.	No change	5% of the Operating Budget (second year of the biennium only) less Utility and Internal Service Funds 82,549,913 =			
				4,127,496	**2,806,513**	**(1,320,983)**	**68.0%**
Revenue Stabilization Reserve	The Revenue Stabilization Reserve was approved by Council in 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue).	Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (primarily sales tax and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end fund balance in the General Fund.	No change	10% of Selected General Fund Revenue Sources 22,792,507 =			
				2,279,251	**731,431**	**(1,547,820)**	**32.1%**
Council Special Projects	This reserve is available to the City Council to fund special one-time projects that were unforeseen at the time the budget was prepared. When the reserve is used, it is replenished from the General Fund year-end fund balance.	Replenishment from year-end fund balance in the General Fund.	No change	**250,000**	**251,534**	**1,534**	**100.6%**
		Subtotal		**16,154,081**	**10,473,358**	**(5,680,723)**	**64.8%**
Building and Property Reserve	This reserve is used for property purchases, building improvements and other property-related transactions. It has also been used as a general purpose reserve to fund Council-approved unanticipated expenditures.	Funding sources include: Street vacations, property sale proceeds and year-end transfer from General Fund. Current balance planned for use toward annexation facilities projects.	No change	**N/A**	**1,972,213**	**N/A**	**N/A**
		Total		**16,154,081**	**12,445,571**	**(5,680,723)**	**77.0%**