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**To:** Lemoore City Council Item 4F  
**From:** Jeff Brillz, City Manager  
**Date:** June 14, 2011  
**Subject:** Proposed Amendments – Strategic Financial Policy –  
Asset Replacement Program

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**Discussion:**

On December 5, 2000, the City adopted a Strategic Financial Policy (attached). The Policy established a number of important financial protections, including Reserve Levels, an Infrastructure/Facility Capital Fund, Reporting Requirements, Public Hearings prior to Debt Issuance, and Asset Replacement Accounts.

Asset Replacement Accounts were established primarily to avoid the need to finance vehicles and equipment by creating a dedicated savings account for those purposes. Since its implementation, the Asset Replacement Program has worked exactly as intended; the City has not needed to use lease/purchases or other financing mechanisms for what should be considered routine replacements, such as fire trucks, refuse vehicles, patrol cars, etc. In the 1990s, it was common for the City to use such instruments.

However, now that the program has been in place for more than a decade, we believe some minor amendments are in order. The first suggested amendment is simple, the Policy refers to tracking assets over \$1,000 and calculating depreciation on those assets. Many years ago, at the suggestion of our auditors, we switched the floor amount for tracking assets from \$1,000 to \$2,500. Changing this requirement from \$1,000 to \$2,500 is recommended.

The second item deals with the total amounts deposited annually per fund. Currently, it is equal to a given year's depreciation calculation. What we have noticed is that in some cases, the balances are growing beyond what is likely to be needed. The reason for that is that assets acquired through other funding sources, such as Redevelopment, grants, etc. are ultimately booked as City assets, and contribute to the depreciation schedule, causing it to rise over time, even though the City would not plan on using the Asset Replacement funds to replace such assets. In other cases, grants pay for what would be considered a replacement item, such as a grant-funded refuse truck, which causes the schedule to again rise.

Staff is proposing a modified contribution schedule to account for these rising balances. See the table below:

Fund	FY Ending Balance 100% of Depreciation	FY Ending Balance 75% of Depreciation	FY Ending Balance 50% of Depreciation	FY Ending Balance 25% of annual depreciation
General Fund	\$0 - 1,500,000	\$1,500,001 - 2,500,000	\$2,500,001 - 3,000,000	\$3,000,001 +
Water Fund	\$0 - 1,000,000	\$1,000,001 - 2,000,000	\$2,000,001 - 2,500,000	\$2,500,001 +
Refuse Fund	\$0 - 500,000	\$500,001 - 1,000,000	\$1,000,001 - 1,500,000	\$1,500,001 +
Sewer Fund	\$0 - 1,000,000	\$1,000,001 - 2,000,000	\$2,000,001 - 2,500,000	\$2,500,001 +
Fleet Fund	\$0 - 50,000	\$50,001 - 100,000	\$100,001 - 150,000	\$150,001 +

This revised contribution schedule will ensure that all of the funds continue to receive annual apportionments, but as the fund balances rise, the contributions amounts go down. This is a far more predictable way of dealing with the rising balances rather than simply electing, from time to time, to forgo contributions. Additionally, it allows the funds to be used for their original intent, without tying up resources unnecessarily.

On Tuesday June 7, the Council discussed these proposed changes, along with an evaluation of the impact they would have on the funds available in the Asset Replacement Accounts. Following the discussion, staff was directed to bring back the revisions in a proposed document, and to additionally add a requirement that the Council review the Policy at least every four years. Attached for your consideration is the proposed amended Policy, presented in strikethrough/underline format. If it is adopted, a clean copy of the Policy will be produced and used going forward.

**Budget Impact:**

The result of the proposed amendments will be reduced contributions into Asset Replacement Accounts as the balances rise. This will allow for more flexibility in uses of the available resources in each fund, but only as the balances rise to their second tier and above.

**Recommendation:**

That the Council, by motion, approve the proposed amendments to the Strategic Financial Policy.

# CITY OF LEMOORE

## STRATEGIC FINANCIAL POLICY

as Amended June 21, 2011

### **Purpose:**

This policy sets forth and memorializes the long term, strategic financial policies of the City of Lemoore and the Lemoore Redevelopment Agency. This policy is administrative in nature and may be amended as directed by the Lemoore City Council / Redevelopment Agency Board. The overall purpose of this policy is to specify and mandate those concepts that foster, preserve and protect the fiscal stability of the City / Agency.

### **Applicability:**

This policy is directive in nature and binds and affects the City Manager, Department Heads and all City employees. This policy and all financial planning shall be in consonance with the General Plan, and incorporate the principles of conservative, realistic revenue projections and expenditure recommendations, based on prudent growth and economic assumptions.

### **The Process:**

Budget planning begins midway in the fiscal year normally in early February, following audit completion and submission for the previous fiscal year, and a review of the first six months of actual expenditures and revenues for the current fiscal year. The preliminary City / RDA operating budgets are submitted annually no later than June for approval in early July. The City Manager shall schedule appropriate review session(s) and required public hearings.

### **Budget Controls:**

The approved annual operating budget is a planning and program execution tool. It consists of Council approved revenue estimates and expenditure recommendations to carry out the mission of the City.

- ◆ Departmental Budgets are established in the annual Budget and approved by the City Council, and then managed and controlled by the department heads under the overall supervision of the City Manager.

- ◆ Enterprise Funds (Utilities / Municipal Golf Course / LLMD) are also approved by the City Council, then operated as discrete cost / profit centers in accordance with State law and City ordinance.
- ◆ Redevelopment Agency operating / administrative funds are managed in this same manner, and will comply with State Health and Safety Code guidelines.

These operating budgets are controlled at department / enterprise activity level under the overall direction and responsibility of the City Manager. Cost element expenditures are shown in annual operating budgets to serve as Council approved appropriations, and provide internal budget monitoring controls. The City Council may transfer funds from reserves to departments or enterprise activities as deemed appropriate during the fiscal year.

## **2- Year Capital Program:**

The Capital projects planning document is prepared in even years for approval by the Council, and updated in odd years. Capital projects are funded by Impact Fees, operating accounts, grant proceeds, Redevelopment Funds, or bond proceeds.

## **Reserve Funding Levels:**

### ❖ General Fund:

The General Fund will maintain ending cash and receivable balance, including carryover, of at least 15% of the approved annual General Fund operations and maintenance budget. This level is a prudent minimum to maintain the City credit worthiness and reasonably provide for economic uncertainties, cash flow needs, contingencies or natural disasters.

### ❖ Utility Enterprise Funds:

The municipal utility enterprise fund balances shall maintain the following minimum reserves:

Water Fund: An amount equal to at least 25% of the approved annual operating budget. This reserve level is established to provide for prudent support for major, unanticipated or catastrophic fiscal requirements, while also complying with 1995 Bond requirements.

Refuse Fund: An amount equal to at least 15% of the approved annual operating budget. This reserve level is appropriate to support unanticipated fiscal requirements.

Sewer / Storm Drainage Fund: An amount equal to at least 20% of the approved annual operating budget. This reserve fund level is prudent to provide for unanticipated or catastrophic fiscal requirements, as well as to comply with 1995 Bond requirements.

Annually in December, staff will assess the fiscal health of the Utility Enterprise Funds and recommend fee adjustments (if any) appropriate to maintain proper reserve levels, taking into account any debt service requirements, capital project expenditures, and vehicle/equipment replacement plans. Such fee adjustment recommendations may be for increases or decreases.

### **City Infrastructure / Facility Capital Fund:**

The City Council has approved the concept of a long-term general Infrastructure / Facility Capital Fund. This fund will serve as a mandatory "savings account" to accrue discretionary funds for future capital projects, thereby avoiding the need for bonding or borrowing for future capital needs. This fund will be separate and distinct from Impact Fee accounts or Enterprise -- funded accounts and shall be annually funded by an amount equal to at least 5% of the combined sales and property tax revenues received by the City during the previous fiscal year. The specific amount to be funded will be included in the annual operation and maintenance budget and approval by Council. Potential uses might be expansion of current facilities, replacement of park equipment, or renovation of existing facilities.

**Asset Replacement Accounts:**

The City Council has decided to avoid, whenever possible, expensive lease / purchase arrangements for vehicles and equipment. This can be made possible by establishing asset replacement accounts for each City Utility Enterprise Fund and the General Fund. Each year, depreciation is calculated on a straight-line basis for several years, depending on the projected usable life of each piece of equipment or vehicle, for all items that cost \$2,500 or more. Depreciation schedules are determined at the time of purchase and have been examined each year during the City’s audit. Beginning with Fiscal Year 2010/11, the table below will be used to determine the annual contribution into each account, based on the estimated beginning balance of each Asset Replacement Account and the estimated annual depreciation expense:

<u>Fund</u>	<u>FY Est. Beginning Balance</u> <u>100% of Depreciation</u>	<u>FY Est. Beginning Balance</u> <u>75% of Depreciation</u>	<u>FY Est. Beginning Balance</u> <u>50% of Depreciation</u>	<u>FY Est. Beginning Balance</u> <u>25% of Depreciation</u>
<u>General Fund</u>	<u>\$0 - 1,500,000</u>	<u>\$1,500,001 - 2,500,000</u>	<u>\$2,500,001 - 3,000,000</u>	<u>\$3,000,001 +</u>
<u>Water Fund</u>	<u>\$0 - 1,000,000</u>	<u>\$1,000,001 - 2,000,000</u>	<u>\$2,000,001 - 2,500,000</u>	<u>\$2,500,001 +</u>
<u>Refuse Fund</u>	<u>\$0 - 500,000</u>	<u>\$500,001 - 1,000,000</u>	<u>\$1,000,001 - 1,500,000</u>	<u>\$1,500,001+</u>
<u>Sewer Fund</u>	<u>\$0 - 1,000,000</u>	<u>\$1,000,001 - 2,000,000</u>	<u>\$2,000,001 - 2,500,000</u>	<u>\$2,500,001 +</u>
<u>Fleet Fund</u>	<u>\$0 - 50,000</u>	<u>\$50,001 - 100,000</u>	<u>\$100,001 - 150,000</u>	<u>\$150,001 +</u>

Additionally, any proceeds from the sale of City vehicles and equipment will be placed into the appropriate asset replacement account.

Once established, all equipment and vehicle replacement purchases over \$2,500 will be made out of asset replacement accounts. No more than 50% of any asset replacement fund account balance may be spent during any given year.

These asset replacement funds will be separate and distinct from Impact Fee accounts.

**Debt Service Policy:**

The policy of the City of Lemoore and its Redevelopment Agency is to incur and service debt obligations in a conservative, prudent manner. Any new debt obligation, consisting of Certificates of Participation, lease purchase obligations, (excluding equipment purchases), issuance of Bonds or Tax Allocation Notes, shall be approved only after a noticed Public Hearing to allow citizen involvement.

A public information process, as deemed appropriate by the Council, will be implemented in each instance before the listed debt obligations are approved by the Council or Agency Board, and will include full disclosure of any planned or potential fee increases for services which may be required to service such debt obligations.

**Mandatory Reports:**

The Council requires the following reports, consistent with fiduciary responsibility, prudent decision making, and obligation to the citizens of Lemoore:

Monthly Expenditure Reports

Quarterly Investment Reports

Quarterly Revenue Reports

These reports will be prepared by the Finance Director and reviewed by the City Manager for timely presentation to the City Council.

At least once every four years, the City Council shall review the Strategic Financial Policy to determine if the policies contained herein remain relevant and prudent.