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DATE: June 14, 2022

TO: Members of the Board of Supervisors

FROM: Sheryl Bratton, County Administrator

SUBJECT: General Fund Reserves

Sonoma County enters Fiscal Year 2022-23 with $53,938,008 in General Fund Reserves, which equals 9.2% of operating revenues. No use of reserves is recommended in Fiscal Year 2022-23. The CAO recommends that $5,475,000 million in FY 2021-22 Year End available fund balance be added to General Fund Reserves to increase the balance to 10.2% of General Fund sources.

Current General Fund Reserve Policies

County Financial Policies set a target for General Fund Reserves of two months operating expenses (16.7% of budget). During the Fiscal Year 2018-19 budget hearings, the Board adopted the establishment of a General Fund Reserve minimum funding level (one month's general fund revenues or 8.3%) and a Replenishment plan. The policy states:

- *The Board will maintain a minimum level of unassigned General Fund Reserve balance equal to 1/12 (8.3%) or 1 month of annual General Fund revenues.*

- *Replenishing General Fund Reserve- Anytime the Board authorizes drawdown of Reserves, staff will present a re-payment schedule which shall include the amount of state/federal reimbursements expected to be received.*

This policy was put in place to ensure the County would have capacity to deal with future emergencies and to maintain the County's credit rating.

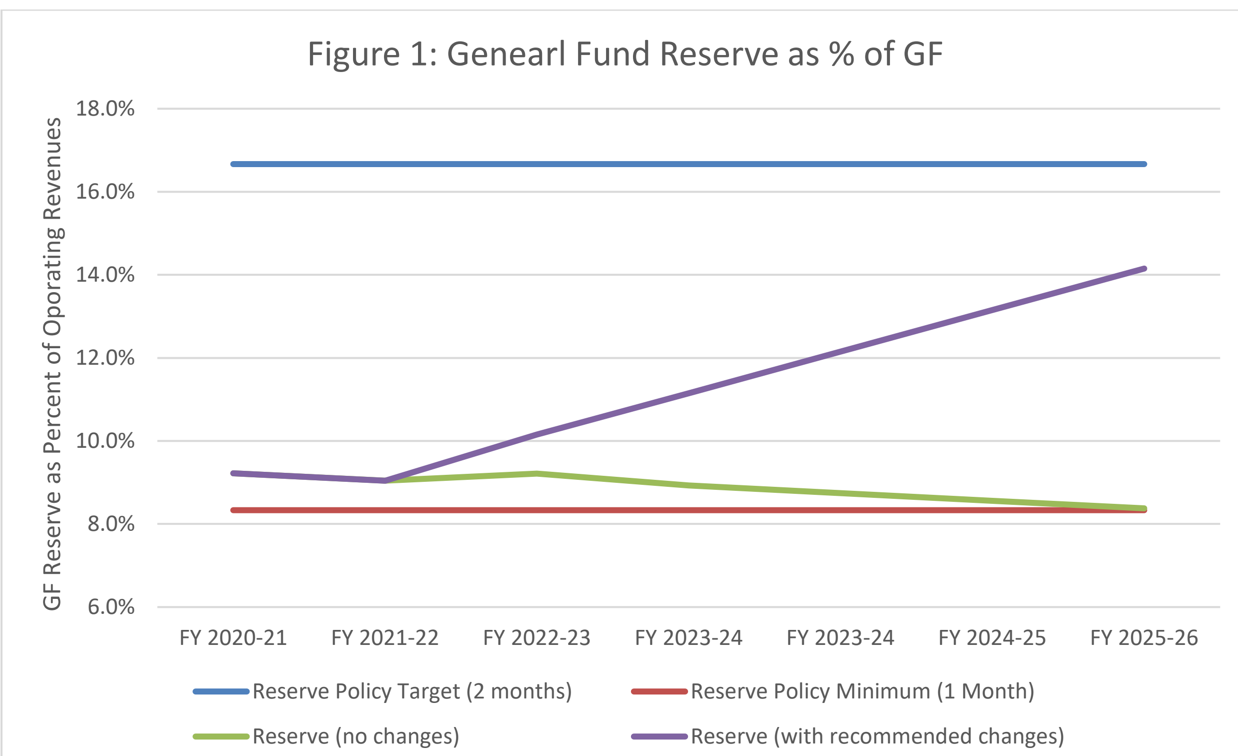
For purposes of the FY 2022-23 Budget, the targeted reserve amount of two months' general fund revenues equal $97.5 million, and one month is $48.8 million.

History and Projections

Prior to the 2017 wildfires, Sonoma County had been steadily increasing reserves toward the target of two-months of operating costs. At the start of FY2017-18, on the eve of the fires, reserves stood at $53.1 million, or 11.3% of FY2017-18 operating revenues. In the FY 2018-19 adopted budget the Board designated $8.5 million of the reserve balance for recovery and resiliency projects, with a focus on grant matches, as well as designating a $3.9 million FEMA audit reserve. This left reserves at $40.7 million, or 8.7% of operating revenues. Since then the Board has gradually added funds to ensure that the balance did not dip below the one-month minimum. At budget hearings in FY 2020-21, the Board dedicated $8.5 million in PG&E Settlement funds to replenish that $8.5 million that was drawn down following the 2017 Wildfires, bringing the total to $52.8 million or 9.2% of General Fund sources. In FY 2021-22 the Board directed staff to dedicate one-time funding to Probation until AB1869 backfill revenues were received, and then direct the funding to General Fund Reserves. This brought the Total to $53.9 million which keeps the fund at 9.2% of operating revenues. Because the reserve is calculated as a percent of operating revenues, it is a moving target that must be increased as revenues increase. Absent additional increases in balance, the Reserves will gradually decline toward the one-month minimum over the next several years.

Recommendations

The CAO recommends that the Board assign $5,475,000 in available one-time sources to the General Fund Reserves in order to increase the percentage of operating revenues from 9.2% to 10.2%. Further, in order to make progress toward the two-month reserve target, the CAO recommends that, the Board set aside year end fund balance totaling 1% of operating revenues each year until the reserve reaches the target of 16.7%. Figure 1 shows the estimated reserves under current policies and under CAO recommendations.



FEMA Audit Reserve Funds

In FY 2018-19, the Board created a Federal Emergency Management Agency (FEMA) Audit Reserve in response to the 2017 wildfires to ensure the County has adequate resources set aside to pay for any reimbursements disallowed by the Office of Inspector General (OIG). The OIG generally conducts its audits several years after claims are filed, and up to three years after the claim is closed out. Based on consultation with other jurisdictions that had been through major disasters, it was determined that a reserve equal to 20% of FEMA reimbursements received was prudent as significant levels of reimbursements were sometimes disallowed, often on technical matters. During the FY 2020-21 Budget Hearings the Board extended the policy to account for all outstanding claims from open disasters and approved an increase of $3.97 million to $8.42 million in order to account for 20% of outstanding claims from all currently open disasters, and in FY 2021-22 the Board increased the level to $10.6 million.

The Auditor-Controller-Treasurer-Tax Collector (ACTTC), CAO, and County Counsel staff periodically assess the reasonableness of the reserve balance and recommend an increase or decrease as necessary. Reserves will be calculated and maintained on a FEMA project by project basis based on FEMA funding that has been received. The ACTTC reviewed the current status of claims and determined that, in large part due to delays in FEMA reimbursements, no additional increase to the FEMA Audit Reserve is required during the FY 2022-23 Budget Hearings. If funding is received as anticipated during the course of FY 2022-23, additional funding will be recommended.

Currently the FEMA Reserve sits as an assignment within the General Fund reserves. This structure was determined to be appropriate when the Reserve was created, as it was anticipated to be established for a finite length of time, primarily on one disaster and as the original source was General Fund reserves. Since that time, it has become clear that the need for the FEMA Audit Reserve is likely to be permanent, with amounts adjusting up and down depending on the flow of funds and the completion of OIG audits. As such, staff will be moving the FEMA Audit Reserves to a separate fund as part of budget actions. This will make it easier to move funds in and out as needed without the restrictions that accompany General Fund Reserves under state law.