CITIZENS FINANCE ADVISORY COMMITTEE

Presentation to Princeton Council

Surplus Policy Recommendations

January 27, 2014

- **Objective**: Establish (1) a policy for the level of Current Fund Balance (Surplus) to maintain and (2) policies to manage our finances to maintain that level of Surplus
- **Fund Balances** are the accumulation of prior years' revenues in excess of appropriations
- It is critical to maintain an adequate Current Fund Balance for 'rainy day' purposes
  - Emergency appropriations (Sandy, Consolidation)
  - Statutory year-end reserves for receivables, etc.

Recommendations:

1. Establish a target range for Current Fund Balance (Surplus)

   Available Fund Balance is to be maintained at 15 – 20% of Budgeted Appropriations

   (Available FB = Total FB – Appropriated FB)

2. Establish an accurate forecast of surplus (beginning-of-year and end-of-year) as part of the budget process
3. Monitor & manage the Current Fund budget to keep the surplus within the target range
4. Insist on transparency in budget reserves and contingencies; close out unutilized reserves and contingencies (before introduction of budget?) (by end of budget year?). Budget using conservative reserves consistent with our AAA-rating.

Why adopt this policy

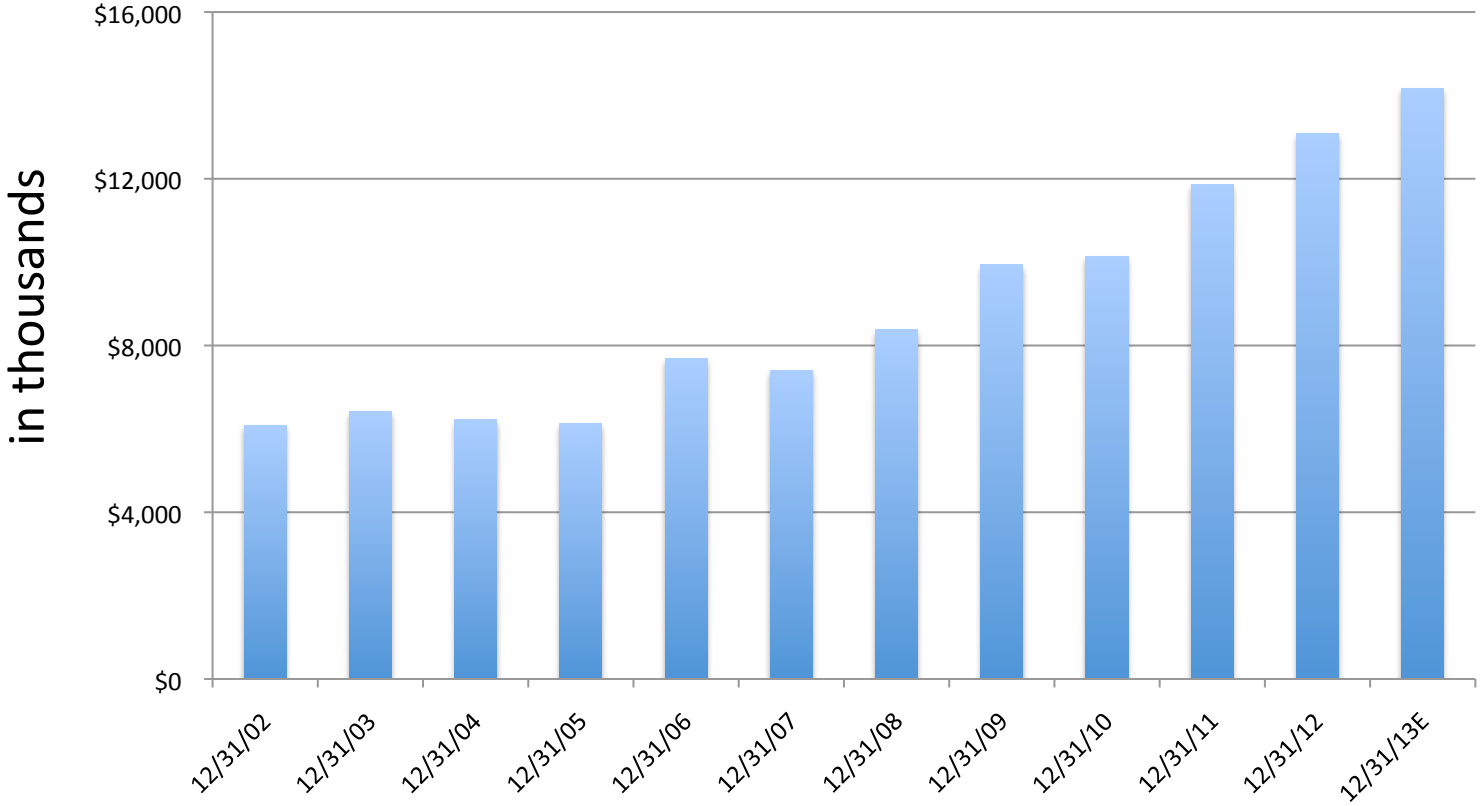
- Ratings agencies ascribe much importance to maintaining a strong surplus
  - S&P
  - Moody's
  - Increased emphasis being placed on written policies
- State-mandated budget process does not focus on entire fiscal picture
  - Managing for long-term results requires greater diligence
  - State-mandated caps limit short-term flexibility
- Failure to manage all elements of budget can lead to poor short-term decisions
  - Inappropriate tax rates
  - Inappropriate spending decisions
  - Loss of future flexibility

Benchmarks vs Other AAA—Rated NJ Municipalities

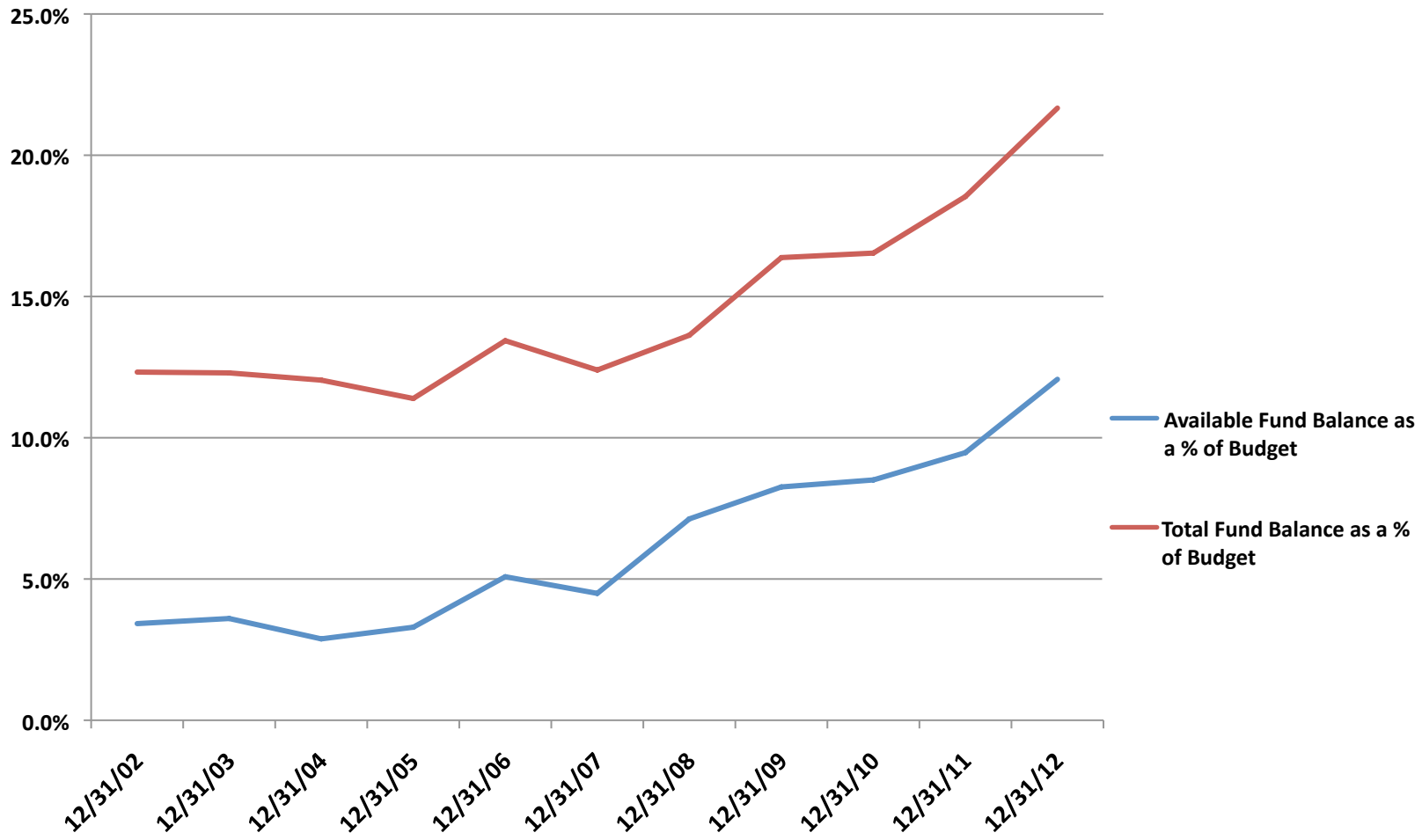
	% of Appropriations	
	Total Fund Balance	Available Fund Balance
Princeton	20%	11%
Mahwah Twp	17%	6%
Randolph Twp	26%	17%
Ridgewood Village	9%	3%
Summit	17%	4%
West Windsor	19%	7%

Current Fund Balance Trend

Princeton's Current Fund Balance is healthy and growing

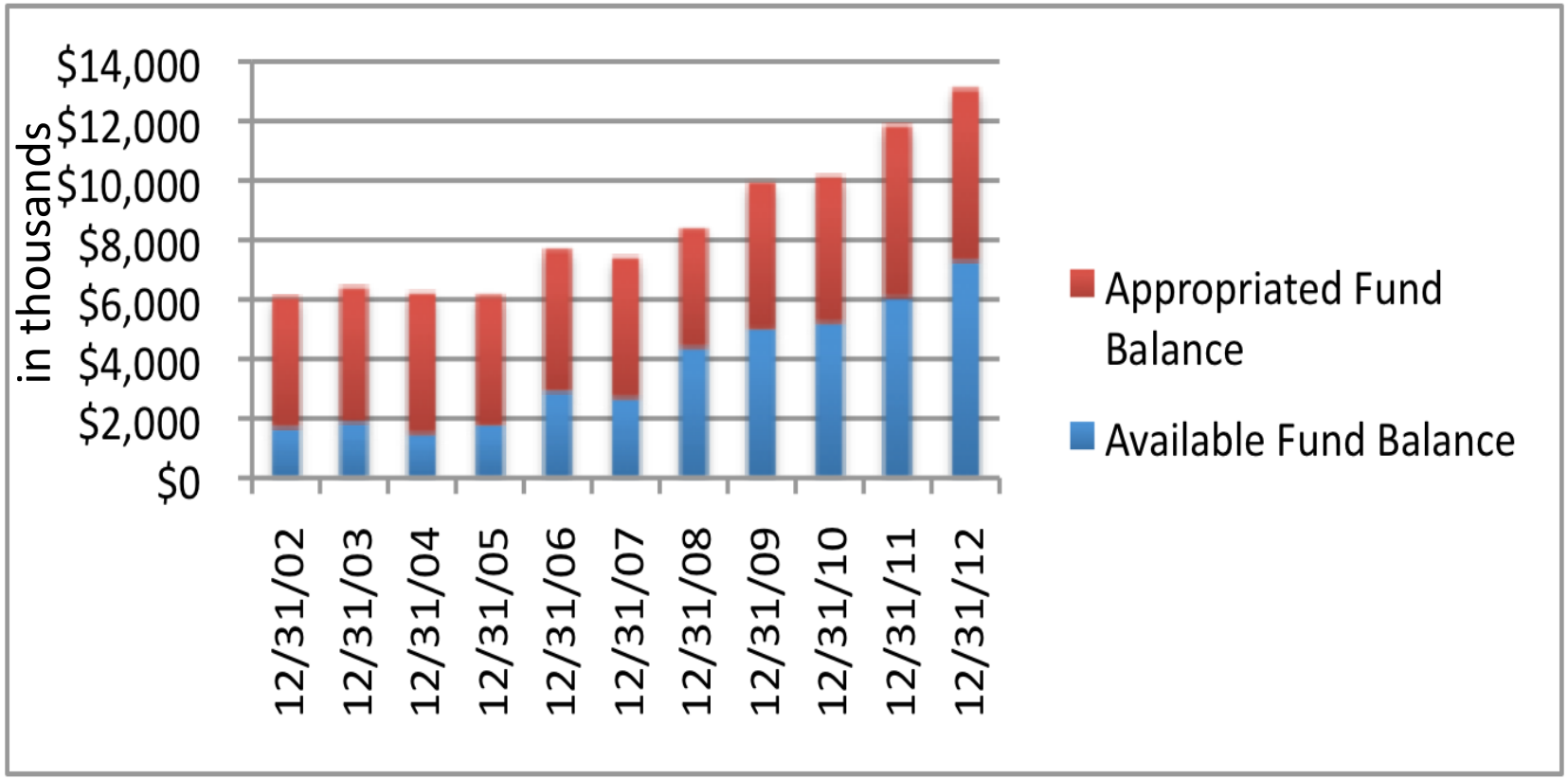


Current Fund Balance Trend



Current Fund Balance Trend

- Fund Bal. – Appropriated Fund Bal. = Available Fund Bal.
- Princeton appropriates but does not use a significant portion of its Fund Balance



What impacts surplus?

- A very preliminary 2013 estimate:

	($ in thousands)		
	Budget	**Actual**	**Difference**
Appropriated fund balance	$ 5,800.0	$ 5,800.0	
Current taxes	30,514.0	28,858.1	(1,655.9)
collection rate	*100.0%*	*98.8%*	
Delinquent taxes	1,553.0	1,695.3	142.3
Other budgeted revs	22,551.4	22,210.8	(340.6)
Non-anticipated revs		785.5	785.5
Lapsed approp reserves		4,457.7	4,457.7
Total Revenues	**60,418.5**	**63,807.4**	**3,388.9**
Appropriations*	**60,418.5**	**56,935.2**	**3,483.3**
	$ -	**$ 6,872.2**	**$ 6,872.2**

** Difference is Reserve for Uncollected Taxes, where a 97.5% collection rate is assumed*

Beginning Fund Balance	**$ 13,092.0**	**$ 13,092.0**
Appropriated Fund Balance	(5,800.0)	(5,800.0)
Other impacts to FB	**-**	**6,872.2**
Ending Fund Balance	**$ 7,292.0**	**$ 14,164.2**

Our budget factors in large contingencies

- Sources of variance to Budget:

	($ in thousands)
Uncollected taxes	$ 1,827.4
Up to Cap reserve	3,004.3
Other approp variances	1,453.4
Non-anticipated revs	785.5
Other revenue variances	(198.3)
	$ 6,872.3
memo: Fund Bal Appropriated	$ 5,800.0

We can improve Surplus ratios simply by reducing our budget for contingencies

- 2 versions of 2013 Budgeted Appropriations:

	($ in thousands)	
	Budget	Alternative
Core budget	$ 56,213.1	$ 56,213.1
Contingencies budgeted for uncoll taxes & up-to-cap	4,205.4	3,430.0
Total budgeted appropriations	60,418.5	59,643.10
Fund balance appropriated	$ 5,800.0	$ 3,800.0
Remaining (available) fund balance	7,292.0	9,292.0
Avail FB as a % of Approps	12.1%	15.6%
Total FB as a % of Approp	21.7%	22.0%

How to manage for a surplus target as part of the budget process (process is iterative)

1. Close out prior year to determine starting Fund Balance
2. Develop core budget (budget before contingencies)
3. Establish appropriate contingencies
4. Create forecast for current year (misc revenues not anticipated, tax collection rates, other variances to budget)
5. Establish use/(source) for Current Fund surplus/(deficit)
6. Determine correct Fund Balance to appropriate as Revenue (Surplus Anticipated)
7. Re-forecast current year's ending Fund Balance

Possible actions when Fund Balance deviates from Policy Targets

- Evaluate whether deviation is long-term-structural
  - Yes: Expect to change tax rates and/or spending, and…
  - No…
- Positive deviations:
  - Increase portion of capital spending financed from Current Fund (reduce borrowing for capital projects)
  - Temporarily reduce the tax rate
  - Fund one-time expenditures
- Negative deviations:
  - Minimize spending from Current Fund
  - Temporarily fund from other sources
    - Taxes
    - Other funds

Caution!

- Be careful not to fool ourselves in managing Fund Balance
  - 2% tax cap and 3½% spending cap demand that budgets (and taxes) be managed for the long-term
  - Negative trends may be very difficult to correct
  - Bond ratings may be impacted
- Insist on following policy steps to ensure Fund Balance is maintained within parameters

Recommendations:

1. Establish a target range for Current Fund Balance (Surplus)

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2. Establish an accurate forecast of surplus (beginning-of-year and end-of-year) as part of the budget process
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Difference between "close out reserves and contingencies (before introduction of budget) (by end of budget year)"

By end of Budget Year:

We should be able to identify budgeted contingencies that were not used during the year and close them out prior to year – end through Council resolution

This would accelerate realization of Lapsed Appropriation Reserve—and increase Surplus—by roughly $3 – 4 million (presently hidden in financial statements), a one-time gain to Surplus

Pros: Higher Fund Balance

Cons: Failure to create & adopt resolution prior to year-end will have a significant negative impact on Surplus

Difference between "close out reserves and contingencies (before introduction of budget) (by end of budget year)" (continued)

Before Introduction of Budget:

We know with certainty what our Revenues from Lapsed Appropriation Reserves will be when creating our forecast of Surplus for the year

We keep in mind that we have this "hidden" Surplus (~5% of Appropriations) in our financial statements when viewing the 15 – 20% Surplus range

Pros: No risk of inaction at year-end

Cons: Roughly $3 – 4 million of Surplus is hidden and not available

No decision needs to be made at this moment

Conclusions

- Recommend adoption of the Current Fund Balance (Surplus) policies
- More discussion on establishment of adequate budget contingencies, Fund Balance to appropriate, etc. will take place in conjunction with 2014 budget discussion
- Our Fund Balances are in excellent shape
  - Current Fund
  - Capital Fund (more on this next time)
- Next steps:
  - Review long-term capital spending plan (& associated debt service & bonding needs)
  - Integrate plan into 2014 Budget
  - Create long-term projections to help guide budget process