

The Metropolitan Government of Nashville and Davidson County, Tennessee

FUND BALANCE RESERVE POLICIES

Adopted [], 2023

Introduction

The Metropolitan Government of Nashville and Davidson County (the "Metropolitan Government" or "Metro") recognizes that Fund Balance Reserve Policies are a recommended 'Best Practice' by the Government Finance Officers Association.

Fund Balance Reserve Policies tailored to the needs of the Metropolitan Government: (1) demonstrate a commitment to long-term financial planning; (2) improve the quality of budgetary decisions; and (3) promote long-term fiscal health and equitable outcomes for Metro residents.

These policies govern the maintenance of adequate levels of Unrestricted Fund Balance in each governmental fund, which is essential to mitigate current and future risks (e.g. revenue shortfalls/declines or unexpected expenditures), to ensure continuity of government services, and to ensure stable tax rates.

Adherence to Fund Balance Reserve Policies signals to the citizens of the community, the rating agencies, and the capital markets that the Metropolitan Government is well-managed, is able to meet its obligations in a timely manner, and has the resources necessary to accommodate unforeseen circumstances.

Goals & Objectives of the Fund Balance Reserve Policies

The Goals of these policies are as follows:

To provide the Metropolitan Government with guidelines to ensure that there is adequate Unrestricted Fund Balance or in each of Metro's governmental funds to meet annual operating cash flow needs, to provide funds for unforeseen circumstances, and to promote long-term fiscal health and equitable outcomes for Metro residents. In addition, these policies help to ensure that the Metropolitan Government satisfy certain clear objective standards in establishing and maintaining adequate levels of Reserves.

The objectives of these policies are as follows:

- a. To document responsibility for the oversight and management of Metro's Fund Balance Reserves;
- b. To define the types of fund balance that will comprise Metro's Fund Balance Reserves;
- c. To define the criteria for establishing and maintaining Metro's Fund Balance Reserves;
- d. To define the criteria for use of the Metro's Funds Balance Reserves;
- e. To protect and enhance the Metropolitan Government's credit ratings; and
- f. To promote equity for all Metro residents.

Fund Balance

Fund Balance is the term used to describe the net position of governmental funds calculated in accordance with Generally Accepted Accounting Principles (“GAAP”) and represents the measure of the financial resources available in Metro’s governmental funds. GAAP financial statements may have up to five separate fund balance categories depending on the type and source of constraints placed on how resources can be spent. The Fund Balance categories in order of most constraining to least constraining are as follows:

- Nonspendable Fund Balance;
- Restricted Fund Balance;
- Committed Fund Balance;
- Assigned Fund Balance; and
- Unassigned Fund Balance

The total of the amounts comprising the Committed, Assigned, and Unassigned Fund Balance is typically referred to as Unrestricted Fund Balance.

The adequacy of Unrestricted Fund Balance should take into account Metro’s unique circumstances, which include governmental fund structure comprised of separate budgeting and accounting for Metro’s governmental funds. The Fund Balance Reserve Policies discussed in this document shall apply to the following governmental funds of the Metropolitan Government:

- General Fund of the General Services District (the “GSD Fund”)
- General Fund of the Urban Services District (the “USD Fund”)
- General Purpose School Fund
- GSD General Purposes Debt Service Fund
- GSD School Purposes Debt Service Fund
- USD General Purposes Debt Service Fund

The Unrestricted Fund Balance that pertains to the GSD Fund, the USD Fund, and General Purpose School Fund shall be referred to as the Operating Reserve. Such reserve shall be comprised of Unassigned Fund Balance and Committed Fund Balance that is committed due to the specific type of fund in which it is held. Fund Balance that is committed or assigned to be spent on specific budgeted purposes shall not count toward meeting the policy target levels.

The Unrestricted Fund Balance that pertains to the GSD General Purposes Debt Service Fund, GSD School Purposes Debt Service Fund, and the USD General Purposes Debt Service Fund shall be referred to as the Debt Service Fund Balance. Such reserves shall be comprised of Unassigned Fund Balance and Committed Fund Balance that is committed due to the specific type of fund in which it is held (as defined under “Operating Reserve” and “Debt Service Fund Balance” sections below). Fund balance that is committed or assigned to be spent on specific budgeted purposes shall not count toward meeting the policy target levels.

The Operating Reserve and Debt Service Fund Balance shall be collectively referred to as “Fund Balance Reserves” or “Reserves”.

Operating Reserve

The Operating Reserve shall have a Minimum Target of 17.0% in each governmental fund (which amount is approximately two months of the Metropolitan Government's Budgeted Operating Expenditures). Or, if so determined by the Finance Director, an amount no greater than 3.0% above the Minimum Target that is sufficient to minimize, if not avoid, the need for annual cash flow Tax Anticipation Note ("TAN") borrowings.

For the purposes of Minimum Target calculation for the Operating Reserve, Budgeted Operating Expenditures includes the expenditures and transfers out of the GSD Fund, USD Fund, and General Purpose School Fund included in the adopted budget.

30% of the Operating Reserve is designated as an Operating Budget Stabilization Reserve.

Use of the Operating Reserve

The Metropolitan Government may incorporate the use of the Operating Reserve through its annual budget ordinance as adopted by the Metropolitan Council or through supplemental appropriations legislation as adopted by the Metropolitan Council in a given fiscal year pursuant to meeting the criteria below.

1. For Budget Stabilization

In the event of an economic downturn, the Operating Budget Stabilization Reserve is designated for use as Bridge Funding necessary to offset revenue declines during a recession. For purposes of this policy, declines in Local Revenue Sources shall guide the Metropolitan Council's assessment in using the Operating Budget Stabilization Reserve when, during the budget process, it is projected that Local Revenue Sources in the next fiscal year's budget will decline.

In addition, one or more of the following conditions must occur based on data as reported by Federal Reserve Economic Data of the St. Louis Fed (www.fred.stlouisfed.org) or successor national economic database in conjunction with a decline in Local Revenue Sources:

- a. The National Gross Domestic Product has declined in the two most recent quarters with available data.
- b. Local housing prices as estimated by the year-over-year change in the All-Transactions House Price Index for Nashville-Davidson-Murfreesboro-Franklin, TN MSA have decreased by more than 10% in the prior 24 months;
- c. Year-over-year change in the unemployment rate for Nashville-Davidson-Murfreesboro-Franklin, TN MSA is in excess of 2.0% at any time in the prior 12 months; or
- d. Year-over-year Employment in the Nashville-Davidson-Murfreesboro-Franklin, TN MSA has declined by at least 2.0% at any time in the prior 12 months.

2. For Unforeseen Circumstances in a Fiscal Year

Use of the Operating Reserve, other than the Operating Budget Stabilization Reserve, may only be used to address one-time Unusual, Unanticipated, and Unforeseen Expenditures or Unanticipated/Unexpected Revenue Declines only after all other reserves or budgeted contingency funds have been exhausted.

Any proposed uses of the Operating Reserve which will decrease the Operating Reserve below the Minimum Target shall include a justification presented to the Metropolitan Council and shall require approval from a majority of Council Members.

Debt Service Fund Balance

The Debt Service Fund Balance shall have a Minimum Target of 50% of the Budgeted Debt Service in each governmental fund. Or, if determined by the Finance Director, an amount no greater than 3.0% above the Minimum Target that is sufficient to minimize, if not avoid, the need for annual cash flow Tax Anticipation Note ("TAN") borrowings.

Use of Debt Service Fund Balance

The Metropolitan Government may incorporate the use of the Debt Service Fund Balance through its annual budget ordinance as adopted by the Metropolitan Council or through emergency legislation as adopted by the Metropolitan Council in a given fiscal year pursuant to meeting the criteria below.

The Debt Service Fund Balance may only be used to address one-time Unusual, Unanticipated, and Unforeseen Expenditures or Unanticipated/Unexpected Revenue Declines only after all other reserves or budgeted contingency funds have been exhausted.

Any proposed uses of the Debt Service Fund Balance which will decrease the Debt Service Fund Balance below the Minimum Target shall include a justification presented to the Metropolitan Council and shall require approval from a majority of Council Members.

Replenishment of Fund Balance Reserves

Upon the use of any Fund Balance Reserves that causes such Reserves to fall below the Minimum Target levels, the Metropolitan Council must approve and adopt a plan to restore amounts used within 36 months. If restoration of the Reserves cannot be accomplished within such period without severe hardship to the Metropolitan Government, then the Metropolitan Council will establish a different time period.

Annual Review

During the annual budget process, the Metropolitan Government will review the estimated Fund Balance Reserve levels of the current fiscal year in relation to the proposed budget under consideration for adoption. Any addition to the Fund Balance Reserves, if necessary, to maintain compliance with policy target levels and/or replenish any amounts used shall be incorporated into the proposed budget under consideration for adoption. In addition, Metro shall also review the Fund Balance Reserve policy target levels and increase such levels as may be necessary in order to further the goals of this policy.

Application of Surpluses for the Replenishment of Fund Balance Reserves

Up to 100% of each year's Calculated Surplus in the General Fund shall be allocated to the replenishment of Fund Balances during the Annual Review in connection with the annual budget adoption process.

Each year's Calculated Surplus shall be allocated based on the following prioritization:

1. First, a minimum of 50% to the Operating Reserve, or any amount in excess of 50% (up to 100%) as deemed necessary by the Metropolitan Council to sufficiently fund the Operating Reserve in compliance with policy target levels. If the Debt Service Fund Balance is at its target level, then up to full 100% may be applied to the Operating Reserve as needed. In the event that the Debt Service Fund Balance is not at its target level and there is not a surplus in the Debt Service Funds, then the Metropolitan Council may appropriate surplus funds from the Operating Reserve to the Debt Service Funds in order to satisfy the target level.
2. Second, if the Operating Reserve is at its target level, then a minimum of 50% to the Debt Service Fund Balance, or any amount in excess of 50% (up to 100%) as deemed necessary by the Metropolitan Council to sufficiently fund the Debt Service Fund Balance in compliance with policy target levels. If the Operating Reserve is at its target level, then up to the full 100% may be applied to the Debt Service Fund Balance as needed.
3. Third, upon the allocation of Calculated Surplus per items one and two above, any remaining balance to be allocated for any of the following **One-Time** purposes:
 - a. Capital expenditures;
 - b. Debt reduction; and/or
 - c. The establishment of other reserves to enhance the Metropolitan Government's financial position/wherewithal.

Prior to the allocation of any remaining fund balance for the above-referenced One-Time purposes, each proposed allocation will be submitted for an equity analysis utilizing tools developed by the Office of Diversity, Equity and Inclusion.

Glossary of Terms

Annual Review – the review of estimated Fund Balance Reserves for the most recently completed fiscal year versus the proposed budget under consideration for adoption for the subsequent fiscal year undertaken during Metro’s budget development process.

Assigned Fund Balance – the classification of Fund Balance that includes amounts that are intended to be used by Metro for specific purposes, but do not meet the criteria to be classified as restricted or committed.

Bridge Funding – a one-time revenue supplement for a fiscal year that is used to offset a short-term or temporary decline in one or more Local Revenue Sources and which cannot be relied upon as a recurring revenue stream from year-to-year or in subsequent budget years.

Budgeted Debt Service – debt service budget for the Debt Service Funds.

Budgeted Operating Expenditures – operating expenditure budget for the General Fund and GSD General Purpose School Funds.

Calculated Surplus – excess of Revenues over expenditures as determined by the Metro based on the most recently completed fiscal year.

Committed Fund Balance – the classification for fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal legislative action of the Metropolitan Council

Debt Service Fund(s) – the GSD General Purposes Debt Service Fund, GSD School Purposes Debt Service Fund, and USD General Purposes Debt Service Fund.

Debt Service Fund Balance – the Unrestricted Fund Balance that pertains to the GSD General Purposes Debt Service Fund, GSD School Purposes Debt Service Fund, and the USD General Purposes Debt Service Fund and is comprised of Unassigned Fund Balance and Committed Fund Balance in each governmental fund that is committed due to the specific type of fund in which it is held.

Equity – fair practices to ensure everyone has access to the same opportunities while acknowledging and addressing past and present structural inequalities.

Fund Balance – Amounts calculated in accordance with Generally Accepted Accounting Principles (“GAAP”) and represents the measure of the financial resources available in Metro’s governmental funds.

Fund Balance Reserves (or “Reserves”) – the Operating Reserve and Debt Service Fund Balance amounts held in each governmental fund to be maintained as set forth by policy.

General Fund – the General Services District (the “GSD Fund”) and Urban Services District funds (the “USD Fund”)

Local Revenue Sources – Property taxes (real and personal), public utility taxes, and the local option sales tax that are collected in the General Fund and Debt Service Funds.

Minimum Target – for each governmental fund, the ratio of Operating Reserve versus Budgeted Operating Expenditures with respect to the Operating Reserve or the ratio of Debt Service Fund Balance versus Budgeted Debt Service with respect to the Debt Service Fund Balance.

Nonspendable Fund Balance – consists of assets that are inherently nonspendable in the current period either because of their form or because they must be maintained intact, including prepaid items, inventories, long-term portions of loans receivable, financial assets held for resale, and principal of endowments.

Operating Budget Stabilization Reserve – a 30% subset of the Operating Reserve that is designated for use as Bridge Funding necessary to offset revenue declines during a recession (in the event of an economic downturn).

Operating Reserve – the Unrestricted Fund Balance that pertains to the General Fund and General Purpose School Fund and is comprised of Unassigned Fund Balance and Committed Fund Balance in each governmental fund that is committed due to the specific type of fund in which it is held. Committed and Assigned Fund Balance for specific budgeted or spending purposes shall not count toward meeting the policy target levels.

Public Utility Taxes – Public utility property tax revenue, which may also include Payment in Lieu of Tax (“PILOT”) payments.

Restricted Fund Balance – the classification for fund balance that includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

Tax Anticipation Note or “TAN” – short-term borrowing that is either internally funded or externally sourced from a bank that is used to provide cash flow of operations within a fiscal year and that is repaid prior to Metro’s June 30 fiscal year end.

Unanticipated/Unexpected Revenue Declines – one-time unbudgeted declines in revenue due to events beyond the Metropolitan Government’s control, such as the COVID-19 Pandemic, or other broad economic-related impacts that are unforeseen and unexpected in a given year.

Unassigned Fund Balance – the residual classification for the government’s general fund and includes all spendable amounts not contained in the other classifications. Such amounts are generally available to be spent on any governmental purpose.

Unrestricted Fund Balance – Committed Fund Balance, Assigned Fund Balance, and Unassigned Fund Balance where the only constraint on spending, if any, is imposed by the Metro Government itself.

Unusual, Unanticipated, and Unforeseen Expenditures (or “One-Time Emergencies”) – one-time non-recurring losses resulting from events beyond the Metropolitan Government’s control for which funding is necessary to keep essential infrastructure/facilities in continued service or maintain continued delivery of essential services.