



# ON THE BALLOT

A Report from the Bureau  
of Governmental Research

## NEW ORLEANS' SAVINGS FUND CHARTER AMENDMENT, NOVEMBER 18, 2017

### INTRODUCTION

On November 18, New Orleans voters will decide whether to establish the Savings Fund of the City of New Orleans in the City's home rule charter. The Savings Fund would set aside a portion of the City's general financial reserve and safeguard it for emergencies and other financial crises. The City Council could appropriate money from the Savings Fund by a two-thirds majority vote if the City faces an emergency that threatens lives or property, a serious economic downturn or a federal mandate.

The purpose of this report is to help voters make an informed choice on the proposed charter amendment. It explains the amendment and provides relevant background information. The report then provides an analysis grounded in BGR's mission of promoting the effective use of public resources. It concludes with BGR's position on the proposed amendment.

### OVERVIEW OF THE PROPOSITION

Currently, there are no restrictions on the City's use of its general financial reserve – also called its General Fund balance (Fund Balance).<sup>1</sup> By a simple majority vote, the City Council can make appropriations from the Fund Balance for any purpose. The proposed charter amendment would restrict how the council can use a portion of the Fund Balance. The restricted portion would be called the Savings Fund.

The charter amendment would require the council, through the annual budgeting process, to maintain the Savings Fund's balance at an amount equal to 5% of the City's average recurring General Fund expenditures for the previous five years.<sup>2</sup> If the Savings Fund were in place today, the amount would be approximately \$27 million.<sup>3</sup>

Use of the Savings Fund would require a two-step process. First, the City must face one or more of the following conditions:

- A council declaration by a two-thirds majority vote of an emergency due to an act of God, riot, war or a grave emergency that threatens widespread loss of life or grievous injury to health or property.
- A council determination by a two-thirds majority vote that a significant loss in City revenues due to an economic downturn of serious proportions has occurred or is occurring.
- A mandate by the United States Government that has been determined by the City Attorney to be in accordance with law.

City administrators stated that the last category would include costs to implement federal consent decrees, such as those underway at the New Orleans Police Department (NOPD) and the City's jail, and other federal court rulings.

If one or more of the conditions exists, the council can make an appropriation from the Savings Fund by a two-thirds majority vote (five of its seven members).

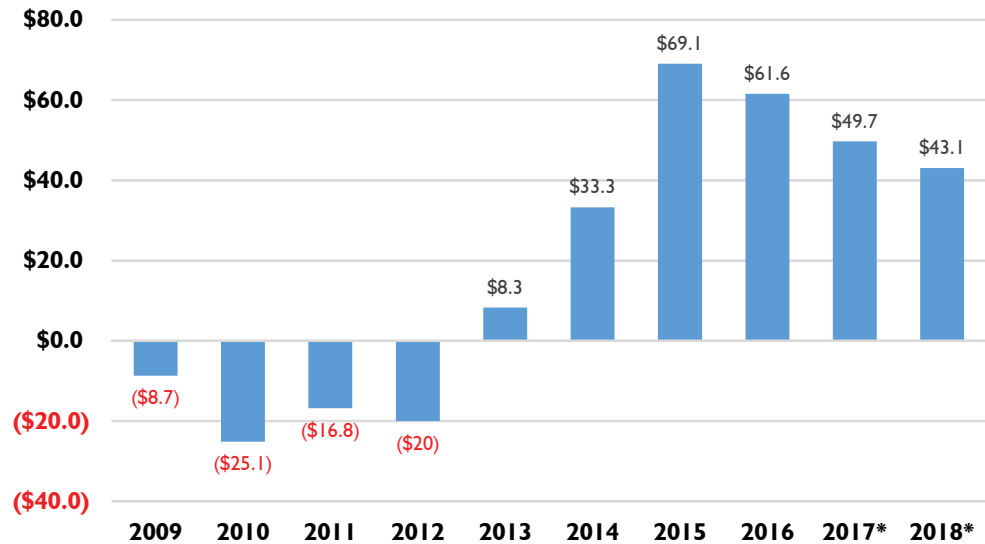
After making an appropriation, the council would have to fully replenish the Savings Fund in the following year's budget.<sup>4</sup> However, if the City meets one of the three conditions discussed above at the time the council adopts the budget, the City is relieved of that year's obligation to replenish the Savings Fund.

If voters approve the amendment, it would take effect January 1, 2018. The administration intends to request a \$27 million appropriation for the Savings Fund in its proposed 2018 budget. This is contingent upon voter

approval of the charter amendment and the council's approval of the budget. The charter requires the council to approve a budget by December 1, 2017.<sup>5</sup>

The portion of the Fund Balance not placed in the Savings Fund would remain available for council appropriation for any purpose by a simple majority vote. As of October, the City projected it would end 2017 with a Fund Balance of \$49.7 million. Assuming the City seeded the Savings Fund with \$27 million, the remainder available for any purpose would be about \$22.7 million.

CITY OF NEW ORLEANS YEAR-END FUND BALANCE, 2009 TO 2018 (\$ MILLIONS)



\*Projected

Source: Information provided by the City.

## BACKGROUND

A fundamental tenet of public finance is that government entities should maintain reserve funds to help cover unexpected costs during emergencies and economic downturns.<sup>6</sup> New Orleans has had no shortage of such incidents in recent years, including hurricanes, an oil spill and the recent drainage system failures. As recently as five years ago, the City had no reserves to respond to these types of incidents. In fact, in 2012, the City's General Fund had a deficit of \$20 million.

As the chart above shows, the Fund Balance has grown substantially since then. It was \$61.6 million at the end of 2016, but it has dropped this year largely as a result of an \$11.9 million emergency appropriation for the drainage system. The City projects a \$49.7 million Fund Balance at the end of 2017. That is 8.1% of recurring General Fund revenues.<sup>7</sup> This falls short of the City's goal of maintaining reserves equal to 10% of annual revenues.<sup>8</sup> The \$61.6 million year-end Fund Balance in 2016 was 10.5% of revenues for that year, meeting the City's goal.

In the 2017 adopted budget, the City "assigned" \$25

million of the Fund Balance to cover emergencies. However, "assigned" is an accounting term that means the City intends to use the money for that purpose.<sup>9</sup> There is no requirement that it actually do so. As noted above, the council, by a simple majority vote, could use the entire Fund Balance for any purpose.

If voters approve the charter amendment, the City would classify the Savings Fund as "restricted." This is the highest level of constraint for spendable reserves under governmental accounting standards.<sup>10</sup>

## ANALYSIS

City administrators said they designed the restrictions to safeguard a portion of the Fund Balance for when the City faces a critical financial need. They said the Savings Fund also will help maintain the City's improved financial position. Before the use of \$11.9 million of the Fund Balance to address the recent drainage crisis, the three major credit rating firms cited the City's improved Fund Balance as a positive development. Two of the firms upgraded the City's credit rating.<sup>11</sup>

According to government finance experts, there are three basic parameters that are important when establishing and evaluating reserve funds: 1) the size of the fund, 2) the circumstances under which the government may spend revenue from the fund and 3) the requirements for replenishing the fund after an appropriation. The remainder of BGR's analysis assesses how the proposed Savings Fund compares to best practices and norms for each of these parameters.

**Size of Reserves**

The Government Finance Officers Association (GFOA) recommends that government entities establish formal policies specifying the level of reserves they will maintain to mitigate the risks of revenue shortfalls and emergency expenditures. The proper reserve level varies depending on each government's circumstances. For example, GFOA notes that governments vulnerable to natural disasters, or dependent on a volatile revenue source, may need to maintain a higher level of reserves.<sup>12</sup> GFOA recommends that, at a minimum, general-purpose governments maintain a fund balance equal to two months of general fund operating revenues or expenditures. This amounts to 16.7% of annual revenues or expenditures. A survey of the center cities in the 30 largest metropolitan areas in the U.S. found that only half met this recommendation in 2014.<sup>13</sup>

The GFOA recommendation is significantly higher than the City's current goal of maintaining a Fund Balance equal to 10% of recurring annual revenues. Noting that the City had a significant deficit just five years ago, City administrators said the 10% Fund Balance target is an interim goal that they can increase if the City's financial position continues to improve. Similarly, the required appropriation for the Savings Fund – 5% of average recurring General Fund expenditures during the previous five years – is a minimum figure that the council can exceed if the City's financial position allows.

GFOA does not recommend what portion of the reserves, if any, should be set aside for emergencies. It provides examples of reserve fund policies for several governments that serve populations between 200,000 and 500,000 residents, a range that would include New Orleans. Fremont, Calif., maintains reserves equal to 12.5% of annual expenditures, including 2.5% for emergencies. Irvine, Calif., has a reserve fund equal to 15% of expenditures, with 3% for emergencies. Prince William County, Md., maintains reserves equal to 7.5% of revenues, including 1% for emergencies. Finally, Minneapolis maintains reserves equal to 15% of revenues, none of which is specifically for emergencies.

These wide variances provide little normative guidance concerning the portion of reserves to set aside for emer-

**CITY OF NEW ORLEANS FUND BALANCE OVERVIEW**

**Current situation**

- City's goal is to maintain a Fund Balance equal to 10% of annual recurring revenues
- City Council can use the Fund Balance for any purpose
- Appropriations from the Fund Balance require a simple majority vote

**Proposed charter amendment**

- Current Fund Balance goal of 10% of annual recurring revenues remains the same
- An amount equal to 5% of average annual recurring expenditures during the previous five years (roughly half of the Fund Balance goal) would be transferred from the Fund Balance into the new Savings Fund
- Savings Fund is restricted for emergencies, economic downturns and federal mandates
- Appropriations from the Savings Fund would require 2/3 council vote
- Council can make appropriations from the remaining Fund Balance for any purpose by simple majority vote

gencies. Based on City projections for 2018, the charter amendment would dedicate 63% of the City's Fund Balance to financial emergencies.<sup>14</sup> This is a much larger portion set aside for emergencies than in any of the cities the GFOA cites. However, New Orleans is susceptible to disasters, a factor that GFOA recommends taking into account when determining the appropriate size of reserve funds.

It is noteworthy that the initial proposed size of the Savings Fund (\$27 million) is in line with the portion of the Fund Balance that the City currently assigns for emergencies (\$25 million). As noted above, the council could increase both the size of the Savings Fund and the total Fund Balance as the City's financial position allows. While one might observe that the City has set the overall Fund Balance target too low relative to other cities' practices, it is a starting point toward a more sound fiscal practice.

### **Appropriation Conditions**

City administrators said they reviewed policies in other cities to establish the conditions that would trigger an appropriation from the Savings Fund. They also consulted the Pew Charitable Trusts (Pew), which has done extensive research on reserve fund best practices. Pew told BGR that governments should avoid being too permissive or too restrictive in the use of reserve funds. If the conditions for making an appropriation are too permissive, it increases the risk that non-emergency appropriations will deplete the fund. If the conditions are too restrictive, the government might not be able to access the funds when it needs to. Pew also stated that appropriations should ideally be tied to temporary or one-time events. In other words, reserves should generally not be used to fund recurring costs.

The first two conditions for appropriation in the proposed charter amendment – to provide funding during emergencies or economic downturns – align with best practices for the use of reserve funds. GFOA identifies these two purposes as among the primary reasons governments should maintain adequate reserves.<sup>15</sup> Both situations also involve temporary or one-time costs.

The third condition in the charter amendment – to com-

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ply with federal mandates – is not specifically mentioned in the GFOA position statement on best practices for use of reserve funds. However, the GFOA advises governments to take into account any unique local circumstances. As noted above, New Orleans is subject to two major federal consent decrees – one for the NOPD and the other for the City's jail. Compliance costs have been significant. The jail consent decree in particular has resulted in unexpected mid-year cost increases that are beyond the City's control. Thus, this condition, though locally tailored, does not seem to conflict with the GFOA recommended standards on use.

However, the federal mandate provision appears to be overly broad. It states only that the City must identify a lawful federal mandate to make an appropriation from the Savings Fund. It does not require the mandate to impose a significant financial burden, or any cost at all. A check on misuse still exists in the requirement for super-majority council approval of Savings Fund appropriations. Additionally, the public can assess in the course of this process whether council members are adhering to the amendment's intent.

Another potential problem is that the mere existence of any federal mandate could put the City in a perpetual state of meeting a condition to make appropriations from the Savings Fund. For example, the consent decrees have each been in place for several years, and neither has a firm end date. Some federal mandates, such as the minimum wage and Americans with Disabilities Act requirements, are perpetual. If the council allows these mandates to trigger a continuous authorization to tap the Savings Fund, it could undermine the goal of limiting the conditions under which appropriations are permissible. But, once again, the requirement of super-majority approval for appropriations offers a check on misuse.

There is a similar potential drawback concerning the longevity of the first two appropriation conditions. The proposed charter amendment lacks a mechanism for ending a council declaration of either an emergency or a significant economic downturn. The council could place a time limit on its initial declaration and extend it as needed. But there is no requirement in the proposed amendment that it do so. This increases the risk that a declaration could remain in place after the conditions that prompted it no longer exist.

City administrators said that, taken as a whole, the three appropriation conditions would prevent use of the Savings Fund to pay for mid-year policy decisions that require additional funding but are not tied to an emergency, economic downturn or federal mandate. They emphasized that the amendment would not prevent the use of the other Fund Balance revenues to implement such policy decisions. Thus, the City would retain some flexibility in how it uses its Fund Balance.

### Replenishing the Fund

Under the proposed charter amendment, the council would have to fully replenish the Savings Fund in the year after making an appropriation, unless the City continued to meet one of the three conditions. In that case, the council could wait until the year after the conditions are resolved. This replenishment requirement is somewhat stricter than the GFOA recommendation that governments generally should seek to replenish their reserve funds within one to three years of use.

Pew told BGR that one advantage to the City's proposed replenishment requirement is that the reserves will quickly recover when the council deems that the conditions no longer exist. The potential downside is that such "required balance" rules can be overly strict by mandating deposits before City revenues have actually recovered. Pew noted that in some cases, such

strict replenishment requirements have made governments reluctant to tap reserve funds.

While the replenishment provision in the proposed charter amendment is aggressive, the goal of quickly restoring the Savings Fund is appropriate. And there is built-in tolerance for persistent crises. As noted above, if the City remains under one of the conditions for making a Savings Fund appropriation, it does not have to replenish the fund.

However, the broad federal mandate provision, if loosely interpreted, could have an opposite effect, resulting in a lax approach to replenishment. For example, the council could cite one of the ongoing consent decrees as justification for not replenishing the fund after an appropriation, even if the appropriation was not related to the decree. The council could even cite one of the decrees as grounds for not making the initial appropriation to seed the fund. Such approaches would go against the intent of the charter amendment.

In summary, the proposed charter amendment would bring the force of law to the City's current policy of setting aside a portion of its reserves for fiscal emergencies. It is a step toward safeguarding recent improvements in the City's finances and ensuring a financial safety net for times of critical financial need.

The three conditions that would trigger an appropriation from the Savings Fund generally align with best practices for the use of emergency reserves. While the federal mandate condition is broadly worded, the required two-thirds majority vote by the council to make an appropriation offers a check on potential misuse of the Savings Fund.

The charter amendment provides for fast replenishment after an appropriation, thereby ensuring the Savings Fund continues to serve its purpose. The amendment also allows flexibility in replenishing the fund if the

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City remains under one of the appropriation conditions. Also, the council would maintain its current discretion in using the rest of the Fund Balance.

One drawback in the City's plan is that the total amount of the Fund Balance, including the proposed Savings Fund, falls short of best practice recommendations. Its projected year-end Fund Balance of \$49.7 million represents 8.1% of recurring General Fund revenues, less than half the GFOA recommended level. However, this is a limitation of the City's current finances, not a flaw in the amendment. If the City's financial position improves, the council could increase the size of the Savings Fund as well as the non-emergency Fund Balance to bring total reserves more in line with best practices.

Other flaws have to do with the amendment itself. A future city attorney could broadly interpret the federal mandate provision to leave the City in a perpetual state in which the council can tap the Savings Fund or avoid replenishing it after an appropriation. There also are no provisions to help ensure that a declaration of emergency or an economic downturn ends when conditions improve. The requirement that any appropriation from the Savings Fund would require a super-majority vote of the council mitigates the risk of misuse. Still, it is important that provisions and requirements added to the City's charter be clear and precise.

## **BGR POSITION**

**FOR.** The proposed charter amendment to establish the Savings Fund is a sensible approach to safeguarding recent improvements in the City's financial position. Setting aside a portion of the General Fund balance for fiscal emergencies will help make sure the money is available when the City needs it. The conditions for the use of the Savings Fund generally align with best practice recommendations. The proposal provides flexibility in replenishing the Savings Fund after an appropriation if the City remains in financial duress. It also allows the City Council to increase the size of the fund as the City's financial position allows.

However, the proposal has some flaws. The overly broad federal mandate provision could put the City in a perpetual state in which it could tap the Savings Fund and avoid replenishing it. Also, the lack of limitations on the duration of declarations of emergencies or economic downturns increases the risk that the declarations will persist after conditions have improved. Both scenarios could result in misuse of the fund. The requirement of a super-majority council vote for appropriations from the Savings Fund offers a check on misuse. Still, it is imperative that the council adhere to the amendment's clear intent and limit appropriations to times when the City faces a critical financial need.

**ENDNOTES**

- 1 The General Fund is the primary operating fund of City government. It accounts for the vast majority of the City's operating revenues. The Fund Balance is the difference between the General Fund's assets and its liabilities.
- 2 City of New Orleans, Ordinance Calendar No. 31,958, adopted August 10, 2017.
- 3 Information provided by the City. From 2012 to 2016, recurring General Fund expenditures averaged about \$540 million.
- 4 BGR notes that there is an apparent technical error in the wording of the replenishment provision. It states that the "percentage" the council must appropriate into the Savings Fund is the difference between the existing balance and 5% of the average recurring General Fund expenditures during the previous five years. It should say that this is the "amount" of the required appropriation. City administrators stated that the terms "percentage" and "amount" are synonymous in this context. BGR disagrees but does not deem this a significant issue in assessing the merits of the proposed amendment.
- 5 City of New Orleans Home Rule Charter, Sec. 3-115 (2).
- 6 Government Finance Officers Association, *Fund Balance Guidelines for the General Fund*, September 2015.
- 7 City of New Orleans, *2018 Revenue Budget*, September 2017, p. 12. As of July 31, 2017, the City projected recurring revenues of \$613.2 million for 2017.
- 8 City of New Orleans, *2018 Annual Operating Budget* (as proposed), p. 56.
- 9 Government Accounting Standards Board, *Summary of Statement No. 54: Fund Balance Reporting and Governmental Fund Type Definitions*, February 2009. GASB's accounting standards set forth a hierarchy of five fund balance classifications based primarily on the extent to which there are constraints on the government's use of the reserve. The most restrictive classification, *nonspendable*, is for funds that either are not in a spendable form, such as inventories, or that must remain intact because of legal or contractual constraints. The *restricted* category includes funds that can be spent only for purposes stipulated by the constitution, external resource providers or enabling legislation. The *committed* fund balance includes revenues that can be used only for purposes determined by a formal action of the government's highest level of decision-making authority. The *assigned* fund balance classification is for revenues the government intends to use for specific purposes but the revenues do not meet the criteria to be classified as restricted or committed. *Unassigned* fund balance is the residual classification that includes all spendable amounts not contained in the other classifications.
- 10 Ibid.
- 11 Fitch Ratings, *New Orleans, Louisiana: New Issue Report*, September 13, 2016. Moody's Investors Service, *Credit Opinion: New Orleans, LA*, September 7, 2016. Standard & Poor's Global Ratings, *New Orleans, Louisiana: General Obligation*, September 7, 2016. Fitch and Standard & Poor's upgraded the City's credit rating in the cited reports.
- 12 Government Finance Officers Association, *Fund Balance Guidelines*.
- 13 The Pew Charitable Trusts, *The Fiscal Landscape of Large U.S. Cities: Local governments still recovering long after Great Recession's end*, December 2016. <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/12/the-fiscal-landscape-of-large-us-cities>
- 14 The City projects it will end 2018 with a \$43 million Fund Balance. Of this amount, the Savings Fund would contain \$27 million, or 63%.
- 15 Government Finance Officers Association, *Fund Balance Guidelines*.

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