



Financial Reserve Policies

PURPOSE

To help the Town stabilize finances and maintain operations during difficult economic periods, this policy establishes prudent practices for appropriating to and expending reserve funds. With well-planned sustainability, Essex can use its reserves to finance emergencies and other unforeseen needs, to hold money for specific future purposes, or in limited instances, to serve as revenue sources for the annual budget. Reserve balances and policies can also positively impact the Town's credit rating and consequently its long-term cost to fund major projects.

APPLICABILITY

This policy pertains to short and long-range budget decision making and applies to the Board of Selectmen, Town Administrator, and Finance Committee in those duties. It also applies to the related job duties of the Town Accountant, Board of Assessors, and Town Treasurer.

POLICY

The Town commits to building and maintaining its reserves so as to have budgetary flexibility for unexpected events and significant disruptions in revenue-expenditure patterns and to provide a source of available funds for future capital expense. The Town will strive to maintain overall general fund reserves in the level of ten to fifteen percent of the annual operating budget. Adherence to this policy will help the Town withstand periods of decreased revenues and control spending during periods of increased revenues. There are multiple types of reserves, including free cash, stabilization funds, retained earnings, and overlay surplus.

A. Free Cash

The Division of Local Services (DLS) defines free cash as "the remaining, unrestricted funds from operations of the previous fiscal year, including unexpected free cash from the previous year." DLS must certify free cash before the Town can appropriate it.

The Town shall set a year-to year goal of maintaining its free cash at five percent of the annual general fund budget. To achieve this, The Board of Selectmen will propose budgets with conservative revenue projections, and department heads will carefully manage their appropriations to produce excess income and turn backs. Further, budget decision makers will avoid fully depleting the Towns' free cash in any year, so that the succeeding year's calculation can begin with a positive balance. Moreover, as much as practicable, the Town will limit its use of free cash to funding one-time expenditures (such as capital projects, snow and ice deficits, or emergencies) and will appropriate any

excess above five percent of the annual budget to build reserves or to offset unfunded liabilities.

B. Stabilization Funds

A stabilization fund is a reserve account allowed by state law to set aside monies to be available for future spending purposes, including emergencies or capital expenditures, although it may be appropriated for any lawful purpose. Prior to adoption of this policy, Essex has established a general stabilization fund, a street light stabilization fund, a Conomo Point stabilization fund, a town/hall library stabilization (maintenance fund), a town buildings-capital improvements fund, a recreation capital improvements fund, and a vehicle and major equipment stabilization fund.

General Stabilization: The Town will endeavor to maintain a minimum balance of five percent of the current general fund operating budget in its general stabilization fund. The Town will annually appropriate a minimum of half a percent of the general fund operating revenues to the general stabilization fund until the target minimum balance is met. Withdrawals from general stabilization should only be used to mitigate emergencies or other unanticipated events that cannot be supported by current general fund appropriations. When possible, withdrawals of funds should be limited to the amount available above the five percent minimum reserve target level. If any necessary withdrawal drives the balance below the minimum level, the withdrawal should be limited to one-third of the general stabilization fund balance. Further, the Board of Selectmen, Town Administrator and Town Accountant will develop a detailed plan to replenish the fund to the minimum level within the next two fiscal years.

Special Purpose Stabilization Funds: Essex currently has a street light stabilization fund, a Conomo Point stabilization fund, a town/hall library stabilization (maintenance fund), a town buildings-capital improvements fund, a recreation capital improvements fund, and a vehicle and major equipment stabilization fund. The Town will annually review the need to appropriate to these funds, and any future special purpose stabilization funds, so that over time they achieve target balances sufficient to cover cash outlays for capital needs.

C. Retained Earnings

The Water and Sewer Departments finances are managed under enterprise funds. By accounting for their revenues and expenditures in separate funds from the general fund, the Town can effectively identify the true delivery costs-direct, indirect-and capital-and set user fees at a level sufficient to recover them. Under this accounting, the Town may reserve the Water and Sewer Departments Operation's generated surplus.

For the water and sewer enterprise funds, the Town will maintain a minimum reserve amount of twenty percent of the operation's total budget, but the reserve target may be significantly higher if major infrastructure debt and improvements are necessary. The reserve will be used to provide rate stabilization and to fund major capital projects. To maintain the target reserve level for the enterprise funds requires the Board of

Selectmen and the Water/Sewer Commissioners to annually review, and when necessary, adjust user rates.

D. Overlay Surplus

The overlay is a reserve the Town uses to offset uncollected property taxes and other unrealized revenue resulting from property tax abatements and exemptions.

At the conclusion of each fiscal year, the Board of Assessors will submit to the Town Administrator and the Town Accountant an update of the overlay reserve with data that includes, but is not limited to, the gross balance, potential abatement liabilities, and any transfers to surplus. If the balance exceeds the amount of potential liabilities, the Board of Selectmen may request that the Board of Assessors vote to declare those balances surplus and available for use in the Town's capital.

REFERENCES

M.G.L. c.40, § 5b

M.G.L. c.59, § 25

M.G.L. c.44, § 53f½

DLS Best Practices: Free Cash and Special Purpose Stabilization Funds

DLS Departmental Procedure Manual: Enterprise Funds

DLS Informational Guideline Releases 17-20: Stabilization Funds and 17-23: Overlay and Overlay Surplus

Government Finance Officers Association Best Practices: Fund Balance Guidelines for the General Fund and Working Capital Targets for Enterprise Funds

EFFECTIVE DATE

This policy was adopted by the Board of Selectmen on February 10, 2020.