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# TOWN OF SHERBORN, MA

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## Reserves Policy



FINAL

ADOPTED BY ADVISORY SEPTEMBER 8, 2021

ADOPTED BY SELECT BOARD OCTOBER 7, 2021

## **Background**

The Town of Sherborn (the “Town”) aims to adopt a Reserves Policy that, in conjunction with other established Town financial policies, serve as a guide for current and future officials and committees, and indicates to entities such as bond ratings agencies that the Town is run in an organized manner and worthy of the highest ratings. The Town aims to:

1. Form policies for financial reserves that are financially sound, protect our bond rating and are designed to protect taxpayers from unnecessary taxation.
2. Lay out these policies so that our financial planning process does not appear arbitrary.

Within these policies, we prioritize our uses of **Free Cash (FC)** towards best practices and away from such uses as funding recurring expenses.

## **Stabilization Funds**

The Town currently has a General Stabilization fund, a Special Education and an Elder Housing Stabilization fund. The general fund is simply a “rainy day” fund, and may be used for any purpose with approval of a 2/3 vote at Town Meeting.

The Town may also create other stabilization funds for specific additional purposes: for example, one or more stabilization funds to provide monies for specific future capital projects.

### **Stabilization Fund policies:**

1. *The General Stabilization Fund is targeted to be a minimum of 2% of the Town’s operating budget. When specific capital expenses or town liabilities are identified, either additional stabilization funds can be created, or the General Stabilization fund can be expanded to accommodate these anticipated expenditures. In addition to a targeted minimal percent, the Town strives to maintain a Stabilization Fund at a minimum of 2% of its Operating Budget and optimally at or around 3% of its operating budget.*
2. *The Town Finance Director and Treasurer will observe both the Town’s financial situation and the capital markets, and advising the options available to the Town to pay for capital projects from reserves or through borrowing.*

## **Free Cash (Undesignated Fund Balances)**

The Town will strive to avoid the application of Free Cash (FC”) to the Annual Town Meeting operating budget articles unless used to reconcile certain line item deficits late in the fiscal year. The availability of FC in subsequent years is always uncertain; routine use of FC for normal expenses disguises the true state of our financial situation.

FC may be used for supplemental appropriations, but not for filling deficits in the operating budget. These ‘supplementals’ are unexpected deficits in budget line items. Examples include the costs of snow removal due to heavy winters, police overtime when officers were out due to disability, expenses for Town counsel, etc.

When we use FC, we should give priority to meeting the Town's most urgent obligations, to maintaining sufficient reserves for emergencies and future needs, and to avoid borrowing.

**Proposal for FC usage policies:**

FC, once certified, is considered available for the purposes shown in **Table 1** below, based on how much FC is certified as a percentage of the current fiscal year's Operating Budget. FC is applied in priority order as listed in Table 1; e.g., supplemental appropriations are applied before transfers to stabilization, if any, which are considered before applications to capital projects, if any, etc.

The town strives to maintain Free Cash at 3-5% of the Operating Budget.

***Further Recommendations***

These policies are intended to allow exercise of judgment while acting as a firm reminder to the Advisory Committee, the Select Board, budget makers, and residents what Sherborn and other towns have learned about fiscal prudence. We want the Town to be operated as efficiently as possible while providing good services, and we want to avoid financial errors that can be very costly or that remove our discretion.

- **Planning** We should make plans for up to 25 years for the maintenance and replacement of our buildings and other property.
- **Potential liabilities.** We should formally monitor potential bad debts, legal settlements, etc., so that we can be prepared if the liabilities are realized.
- **Overlay reserves.** These are reserves set aside for tax abatements and tax exemptions, and after potential claims against the reserve are resolved, unused reserves come back into FC.

**Table 1. Step-by-step procedure for allocating Free Cash to various purposes in priority order**

|   | <b>Purpose</b>  | <b>Amount of Free Cash Applied</b>  | <b>Free Cash Balance</b>  |
|---|---|---|---|
|   |   |   | The initial FCB is the amount of FC certified by the DoR.       |
| 1 | <b>Supplemental Appropriations</b><br>Appropriate FC to fill extraordinary deficits in the current fiscal year that cannot be met from the Budgeted Reserve Fund or transfers from other budgets.       | Up to the smaller of the amount requested for Supplements or the remaining PFCB in excess of 3% of the Operating Budget.                            | The FCB is reduced by the amount of FC applied for Supplements. |
| 2 | <b>Replenishing General Stabilization to minimum</b><br>If the General Stabilization fund is below its policy target balance, apply the amount needed to bring it up to target.                         | Up to the smaller of the amount to replenish Stabilization or the remaining FCB in excess of 3% of the Operating Budget.                            | The FCB is reduced by the amount of FC applied in this step.    |
| 3 | <b>Small Capital Projects</b><br>Apply FC to a set of capital items that are small, and which the Town Treasurer has determined are more efficiently handled by application of FC than by borrowing.    | Up to the smaller of the request for capital projects or the remaining FCB in excess of 3% of the Operating Budget.                                 | ditto   |
| 4 | <b>Optional or Special Stabilization funding</b><br>Appropriate funds when the Town has committed to extra stabilization funding for specific future purposes, including additional OPEB Trust Funding. | Up to the smaller of the amount requested to bring stabilization to the desired level or the remaining FCB in excess of 3% of the Operating Budget. | ditto   |
| 5 | <b>Deferred Projects</b><br>Apply FC to non-recurring expenditures or special projects.   | Up to the smaller of the request for deferred projects or the remaining FCB in excess of 3% of the Operating Budget.                                | ditto   |

## **Examples –**

For these examples, assume the following unless specified otherwise:

1. The Operating Budget is \$25M: therefore 3% of the Operating Budget is \$750K.
2. The amount required for Supplemental Appropriations, net of other transfers, is \$200K.
3. General Stabilization is targeted to have a balance of \$500K (2% of \$25M), but the current balance is \$450K.
4. Capital Projects of \$200K have been approved by relevant Town Committees and identified for possible use of FC.
5. There is no special stabilization funding.

*All amounts in \$000.*

| Free Cash \$1000 (3%) |         |         |     |
|-----------------------|---------|---------|-----|
| Purpose               | Request | Applied | FCB |
|                       |         |         | 750 |
| Supplementals         | 200     | 200     | 550 |
| General Stabilization | 50      | 50      | 500 |
| Capital Projects      | 200     | 0       | 500 |
| Special Stabilization | 0       | 0       | 500 |
| Available / TBD       | 0       |         | 500 |

| Free Cash \$1,250 (5%) |         |         |       |
|------------------------|---------|---------|-------|
| Purpose                | Request | Applied | FCB   |
|                        |         |         | 1,250 |
| Supplementals          | 200     | 200     | 1,050 |
| General Stabilization  | 50      | 50      | 1,000 |
| Capital Projects       | 200     | 0       | 1,000 |
| Special Stabilization  | 0       | 0       | 1,000 |
| Available / TBD        | 300     |         | 1,000 |