City of San Marcos Financial Policy

I. Purpose

The broad purpose of this policy is to enable the City to achieve and maintain a long-term stable and positive financial condition through the use of sound financial management practices. The watchwords used to epitomize the City's financial management include integrity, prudent stewardship, planning, accountability, full disclosure and communication.

The more specific purpose of this policy is to provide guidelines to the Director of Finance in planning and managing the City's daily financial affairs and in developing recommendations to the City Manager and City Council.

The City Council will annually review and approve this policy as part of the budget process.

The scope of this policy covers the operating budget, revenues, expenditures, capital improvements program, financial planning, accounting, auditing, financial reporting, treasury management, debt management, and financial condition and reserves, in order to:

A. Present fairly and with full disclosure the financial position and results of the financial operations of the City in conformity to generally accepted accounting principles (GAAP).

B. Determine and demonstrate compliance with finance-related legal and contractual issues in accordance with provisions of the City's Charter, the City's Code of Ordinances, the Texas Local Government Code and other pertinent legal documents and mandates.

II. Operating Budget

A. Preparation – Budgeting is an essential element of the financial planning, control, and evaluation process of municipal government. The budget is the City's annual financial operating plan. The budget includes all the operating departments of the governmental funds, special revenue funds, enterprise funds, and permanent funds of the City. The budget includes expenditures for personnel, contracted services, materials and supplies, other charges, operating transfers, social services, indirect costs, capital outlay and debt service. The budget is prepared by the City Manager and Director of Finance with the participation of all the City's Department Directors within the provisions of the City Charter, on a basis that is consistent with GAAP.

B. Multi-Year Planning – The Director of Finance will prepare a multi-year financial forecast of the General Fund. This forecast is an integral part of developing the adopted budget.

1. Adopted Budget – The City Manager presents a budget to the City Council. The budget provides a complete financial plan for the ensuing fiscal year, and shall contain a budget message explaining the budget, containing an outline of the adopted financial policies of the City for the ensuing fiscal year, setting forth the reasons for salient changes from the previous fiscal year in expenditure and revenue items, and explaining any major changes in financial policy.

a) The budget should include four basic segments for review and evaluation. These segments are: (1) actual revenue and expenditure amounts for the last completed fiscal year, (2) original revenue and expenditure amounts budgeted for the current fiscal year, (3) revenue and expenditure amounts estimated for the current fiscal year, and (4) revenue and expenditure amounts for the ensuing fiscal year.

b) The City Manager, not less than 30 days prior to the time the City Council makes its tax levy for the current fiscal year, shall file with the City Clerk the adopted budget.

2. Adoption – The City Council shall call and publicize a public hearing to allow for citizen participation. The City Council will subsequently adopt by Ordinance such budget, as it may have been amended, as the City's annual budget effective for the fiscal year beginning October 1st. The budget should be adopted by the City Council no later than the expiration of the fiscal year.

C. Balanced Budget – The operating budget will be balanced with current revenues, which may include beginning fund balances less required reserves as established by City Council, greater than or equal to current expenditures.

D. Planning – The budget process will be coordinated so as to identify major policy and financial issues for City Council consideration several months prior to the budget adoption date. This will allow adequate time for appropriate decisions and analysis of financial impacts.

E. Reporting – Financial reports will be made available to Department Directors to manage their budgets and to enable the Director of Finance to monitor the overall budget. The Director of Finance will present summary financial and budgetary reports to the City Council to disclose the overall budget and financial condition of the City. The financial and budgetary reports will include comparisons of actual to budget, actual to prior year, appropriate ratios, and graphs to ensure full disclosure and present meaningful information.

F. Control and Accountability – Department Directors will be responsible to ensure that their department budgets will not exceed budgeted amounts. Department Directors will be responsible to ensure revenues generated by activities of their departments meet budgeted amounts.

G. Contingent Appropriation – A provision shall be made in the budget for a contingent appropriation of no more than three percent of total expenditures to be used in case of emergencies or unforeseen circumstances. The contingent appropriation shall be under the control of and distributed by the City Manager after approval of the City Council. A detailed account of contingent appropriation expenditures shall be recorded and reported.

All expenditures of the contingent appropriation will be evaluated using the following criteria:

- Is the request of such an emergency nature that it must be made immediately?
- Why was the item not budgeted in the normal budget process?
- Why the transfer cannot be made within the division or department?

III. Revenue Policies

A. Characteristics – The City Finance Department will strive for the following optimum characteristics in its revenue system:

1. Simplicity – Where possible and without sacrificing accuracy, the revenue system will be kept in simple order to reduce compliance costs for the taxpayer or service recipient.

2. Certainty – There will be a thorough knowledge and understanding of revenue sources to increase the reliability of the revenue system. Consistent collection policies will be enacted to provide assurances that the revenue base will materialize according to budgets and plans.

3. Equity – Equity will be maintained in the revenue system structure; i.e., subsidization between entities, funds, services, utilities, and customer classes will be minimized or eliminated.

4. <u>Revenue Adequacy</u> – There will be a balance in the revenue system; i.e., the revenue base will have the characteristics of fairness and neutrality as it applies to cost of service, willingness to pay, and ability to pay.

5. <u>Administration</u> – The benefits of a revenue source should exceed the cost of levying and collecting that revenue. The cost of collection should be reviewed annually for cost effectiveness as a part of the indirect cost of service analysis. Where appropriate, the administrative processes of state, federal or local governmental collection agencies will be used in order to reduce administrative cost.

6. <u>Diversification and Stability</u> – A diversified revenue system with a stable source of income should be maintained. This will help avoid instabilities in similar revenue sources due to factors such as fluctuations in the economy and variations in the weather.

B. <u>Issues</u> – The following considerations and issues will guide the City Finance Department in its revenue policies concerning specific sources of funds:

1. <u>Cost/Benefit and Financial Impact Analysis for Tax and Fee Abatements</u> – A cost/benefit and financial impact analysis should be performed to assess tax or fee abatement economic development incentives.

2. <u>Accounts Receivable</u> – Accounts receivable procedures will target collection for a maximum of 30 days from service. Accounts past due more than 120 days may be sent to a collection agency. The Director of Finance is authorized to write-off non-collectible accounts that are delinquent for more than 180 days.

3. <u>Non-Recurring Revenues</u> – One-time or non-recurring revenues should not be used to finance current ongoing operations. Non-recurring revenues should be used only for non-recurring expenditures and not be used for budget balancing purposes.

4. <u>Deferrals or Short-Term Loans</u> – Deferrals or short-term loans will not be used for budget balancing purposes.

5. <u>Property Tax Revenues</u> – All real and business personal property located within the City is valued at 100% of the fair market value for any given year based on the current appraisal supplied to the City by the Hays Central Tax Appraisal District (HCTAD). A visual reappraisal and reassessment of all real and business personal property will be done every third year. The HCTAD reappraises real

and business personal property every year as a standard practice.

Conservatism will be used to estimate property tax revenues. The Hays Central Tax Assessor Collector will furnish an estimated property tax collection rate to the Director of Finance. The Finance Department will endeavor with the Tax Assessor Collector to collect one hundred percent (100%) of property taxes levied in each fiscal year.

6. Interest Income – Interest earned from investment of available monies, whether pooled or not, will be distributed to the funds in accordance with the equity balance of the fund from which monies were provided to be invested.

7. User Fees and Service Charges – For services associated with a user fee or service charge, the direct and indirect costs of that service will be offset by a user fee where possible. Department Directors will annually review user fees and service charges to ensure that the costs of services are recouped through user fees and service charges. The City Council will determine how much of the cost of a service should be recovered by fees and service charges.

8. Indirect Cost Allocation – All City funds will include transfers to and receive credits from other funds for general and administrative costs incurred. The most predominant fund that receives credits from other funds is the General Fund. The General Fund receives credits for bearing such costs as administration, legal counsel, finance, personnel, data processing, engineering and other costs. An independent third party will conduct an indirect cost allocation study annually to determine the credits received.

9. Enterprise Fund Rates – The Director of Finance and the Department Directors of each Enterprise Fund will review rates annually to ensure sufficient coverage of operating expenses, meet the legal restrictions of all applicable bond covenants, and provide for an adequate level of working capital.

10. Franchise Fees – The Electric Fund and Water and Wastewater Utility Fund will include franchise fees as a component of utility rates. A 8% Water and Wastewater Utility and a 8% Electric Utility Fund franchise fee is levied on gross sales. The City will aim to keep these franchise fees similar to those charged to investor-owned utility franchises operating within the City.

11. Intergovernmental Revenues (Federal/State/Local) – All potential

grants will be examined for matching requirements and the source of the matching requirements. These revenue sources will be expended only for intended purpose of grant aid. It must be clearly understood that operational requirements set up as a result of a grant or aid could be discontinued once the term and conditions of the project have terminated.

12. Revenue Monitoring – Revenues received will be compared to budgeted revenues by the Director of Finance and variances will be investigated. This process will be summarized in the appropriate financial report and reported to the City Manager and City Council on a quarterly basis.

IV. Budgetary Sales Tax Estimation

A. The estimated percentage increase in sales tax revenue for the ensuing fiscal year budget will not exceed the actual percentage increase of the most recently completed fiscal year in which a sales tax increase was realized.

B. The following example illustrates the limitation set by this policy.

Fiscal Year 1 Actual	Fiscal Year 2 Actual	Percentage Increase
$10,000,000	$10,500,000	5.0 %

Fiscal Year 3 Estimated	Fiscal Year 4 Budget	Percentage Increase
$11,550,000	$12,127,500	5.0 %

In the example above, the Fiscal Year 4 Adopted Budget is limited to a 5.0% increase, which is the actual percentage increase of the most recently completed fiscal year (Fiscal Year 2).

C. This policy ensures that the ensuing fiscal year budget contains a sales tax revenue estimate based on actual completed fiscal years only.

V. Budgetary Sales Tax Revenue Shortfall Contingency Plan

A. To proactively manage sales tax volatility and ensure consistent service delivery, the City will limit sales tax revenues budgeted for operations to 98.5% of the total estimated sales tax revenues for the fiscal year. This will be applied following the limitation in Section IV. Budgetary Sales Tax Estimation.

B. The City will establish a plan to address economic situations that cause sales tax revenue to be significantly less than the adopted budget sales tax revenue. The plan is comprised of the following components:

Indicators – Serve as warnings that potential budgetary sales tax revenue shortfalls are increasing in probability. Staff will monitor state and national economic indicators to identify recessionary or inflationary trends that could negatively impact consumer spending. Staff will develop a monthly report that compares the current month's sales tax revenue to the same month of the previous year. The report will show sales tax revenue by month for the last ten fiscal years.

Phases – Serve to classify and communicate the severity of the estimated budgetary sales tax revenue shortfall. Identify the actions to be taken at the given phase.

Actions – Preplanned steps to be taken in order to prudently address and counteract the estimated budgetary sales tax revenue shortfall.

C. The actions listed in phases 1 through 3 below are short-term in nature. In the event the underlying economic situation is expected to last for consecutive years, more permanent actions, such as phases 4 and 5, will be taken.

D. Staff will apprise City Council at the regular City Council meeting immediately following any action taken through this plan. Information such as underlying economic condition, economic indicators, estimated budgetary sales tax revenue shortfall, actions taken and expected duration will be presented to City Council.

E. The City Council may appropriate fund balance as needed to cover any estimated budgetary sales tax revenue shortfall. Appropriation of fund balance must be carefully weighted and long-term budgetary impacts must be considered in conjunction with the projected length of the economic downturn.

F. Actions taken through this plan must always consider the impact on revenue generation. Actions taken should reduce expenses well in excess of resulting revenue losses.

G. These are only guidelines of possible actions that may be taken in the event of sales tax revenue decreases. In the event of a catastrophic event, necessary measures will be taken by the City Manager that are in the best interest of the City.

H. The following is a summary of phase classifications and the corresponding actions to be taken. Revenue will be monitored on a quarterly basis, with action being taken in the month following the completed quarter that experiences the shortfall. Actions are cumulative, so each level will include all actions set forth in prior levels.

1. **ALERT:** The estimated annual sales tax revenue is 1.5% less than the adopted sales tax revenue budget.
    a. Freeze newly created positions.
    b. Implement a time delay for hiring vacant positions.

2. **MINOR:** The estimated annual sales tax revenue is 2.5% less than the sales tax revenue adopted budget.
    a. Suspend funding of Capital Maintenance accounts.
    b. Suspend capital outlay purchases.
    c. Reduce the number of temporary workers.

3. **MODERATE:** The estimated annual sales tax revenue is 3.5% less than the sales tax revenue adopted budget.
    a. Implement a managed hiring program for vacant positions.
    b. Reduce travel and training budgets.
    c. Reduce office supply budgets.
    d. Scrutinize professional services expenses.
    e. Implement a salary freeze and suspend mid-year merit increases if possible.

4. **MAJOR:** The estimated annual sales tax revenue is 4.5% less than the adopted sales tax revenue budget.
    a. Scrutinize repairs and maintenance expense. Perform only critical maintenance and make only critical repairs.
    b. Freeze all external printing and publication expenses, except for legally required notices.
    c. Reduce overtime budgets.
    d. Prepare a Reduction in Force Plan.
    e. Defer payments to City-owned utilities for electricity, street lighting, water and wastewater services.

5. **CRISIS:** The estimated annual sales tax revenue is 5% less than the adopted sales tax revenue budget.
    a. Service level reductions, elimination of specific programs, reduction-in-force and other cost reduction strategies will be considered.
    b. Reduce departmental budgets by a fixed percentage or dollar amount.
    c. Departments will prioritize service levels and programs according to City Council goals and objectives.
    d. Consider four-day work weeks to reduce personnel costs.
    e. Reduce external program funding – social service agencies.

VI. Expenditure Policies

A. <u>Appropriations</u> – The point of budgetary control is at the department level budget for all funds. Following formal adoption, the budget is amended or adjusted as necessary.

1. Amendment-. An amendment involves increasing the total expenditures of the funds over the original adopted budget or changes to the total approved FTE count. The budget is amended through a submission made by a Department Director to the City Manager. The Department Director prepares a budget amendment detailing the reason, line items and amounts to be affected, which is approved by the City Finance Department after verification of available dollars. The amendment is given to the City Manager or their designee for review for overall appropriate objectives and purposes. The amendment request is submitted to the City Council for formal adoption by ordinance.
2. Adjustment-An adjustment involves moving expenses between line items, departments or funds, but does not increase total expenditures over the adopted budget. The budget is adjusted through a submission made by the Department Director. If the budget adjustment requires a transfer between funds, or involves the use of contingent appropriations, the adjustment is submitted to City Council for approval by a motion. If the budget adjustment requires a transfer between departments, it must be approved by the City Manager or their designee. All other adjustments may be approved by the City Finance Director.

B. Encumbrance Accounting System – An encumbrance accounting system will be used to alert Department Directors when their maximum budget limits have been reached. Encumbrances are expenditure estimates and will reduce budgeted appropriations in the same manner as an actual expenditure. Once the actual expenditure amount is paid or the encumbrance lapses, the encumbrance will be deleted. Department Directors should use the encumbrance accounting system for all purchases.

C. Personnel Savings – No recognized or significant personnel savings in any Department will be spent by the Department Director without the prior authorization of the City Manager. This control is used to realize personnel savings each year that will be recognized in the adopted budget as a reduction in the current fiscal year's personnel appropriations.

D. Capital Outlay-Any previously budgeted capital outlay funds not expended at year end may be moved to a cash funded Capital Improvements Projects account for expenditure in a subsequent fiscal year. These funds may be used for a capital outlay item or for other designated purpose.

E. Impact Fees Reserves-Funds may be used to support projects identified in the impact fee study, as adopted by City Council, for new growth projects. Authorization for use of impact fee funds will be provided by the City Manager or their designee.

F. Purchasing – All Department Directors will ensure their respective departments comply with the City's Purchasing Manual when purchasing goods or services.

G. Prompt Payment – All invoices approved for payment will be paid by the City Finance Department within thirty (30) calendar days of receipt in accordance with the provisions of State law.

The Director of Finance will establish and maintain payment procedures that will make use of advance payment discounts. Advanced payment discounts will be used in all instances except when the City will earn more interest income than the advance payment discount through investing the idle cash.

VII. Capital Improvements Program – Major Projects

A. Purpose – The Capital Improvements Program (CIP) is a multi-year financial planning tool used to identify and plan for major capital projects which address growth, transportation, public safety, and utility infrastructure issues in conjunction with goals and priorities as determined by City Council. A major capital project generally involves a significant expenditure of funds, beyond operation and maintenance costs, for the acquisition or construction of a needed facility or infrastructure. A major capital project should exceed $100,000 in cost. The CIP coincides with the adoption of the budget and uses a ten-year projection.

B. Preparation – The CIP will be prepared annually and on a project basis categorized by specific program; i.e., streets, drainage, public safety, public buildings, parks and recreation, water, wastewater and electric. The CIP should contain a comprehensive description of the project, funding sources, the timing of capital projects, and the impact on operations. The CIP will be prepared by the Engineering and Capital Improvements and reviewed by the City Manager with the involvement of responsible departments. The CIP will be submitted to the Planning and Zoning (P&Z) Commission for their review. After considerable deliberation including public workshops and hearings to gather citizen participation, the P&Z will approve a recommended CIP for City Council's approval. The City Council reviews the CIP for adherence to goals and priorities and approves the CIP for inclusion in the ensuing fiscal year budget. Capital projects within the first year of the CIP are approved for funding. Maintenance and operational costs related to capital projects are included in the ensuing fiscal year budget.

C. Funding Sources – Where applicable, assessments, impact fees, pro rata charges, or other fees should be used to fund capital projects which have a primary benefit to specific, identifiable property owners.

Recognizing that long-term debt is usually a more expensive financing method, alternative-financing sources will be explored before debt is issued. When debt is issued, it will be used to acquire major assets with expected lives that equal or exceed the average life of the debt issue. The exceptions to this requirement are the traditional costs of issuing the debt, capitalized labor for design and construction of capital projects, and small component parts which are attached to major equipment purchases such as fire trucks. The types of debt issued are listed in Section VIII of this policy.

D. Timing and Expenditure Control – The Director of Finance will work with Department Directors during the fiscal year to schedule the timing of capital projects to ensure funds availability. All capital projects must be funded and appropriated. The Finance Department must certify the availability of resources before any capital project contract is presented to the City Council for approval.

E. Reporting – Financial reports will be made available to Department Directors to manage their capital projects budgets and to enable the Director of Finance to monitor the overall capital projects budget.

VIII. Financial Planning, Accounting, Auditing and Reporting

A. Financial Planning – The Director of Finance provides recommendations for short-term and long-term strategic financial planning to efficiently and effectively use the City's financial resources. This financial planning is achieved in accordance with the goals and priorities of the City Council, the City Manager, and in compliance with applicable laws and Generally Accepted Accounting Principles (GAAP).

B. Accounting System – The Director of Finance is responsible for the development, maintenance and administration of the City's accounting system. Compliance with GAAP and applicable federal, state and local laws and regulations will be maintained. This responsibility also includes the implementation and maintenance of internal accounting controls for the City's financial resources. Functions of the accounting system include payroll, accounts payable, general ledger, grants, capital projects, fixed assets, accounts receivable, self-insurance, utility billing and collections.

C. Financial Auditing –

1. Qualifications of the Auditor – In conformance with the City's Charter and according to the provisions of Texas Local Government Code, the City will be financially audited annually by

an outside independent auditing firm. The auditing firm must demonstrate that it has the breadth and depth of staff to conduct the City's financial audit in accordance with generally accepted auditing standards and contractual requirements. The auditing firm must hold a license under the Civil Statutes of Texas and be capable of demonstrating that it has sufficient staff which will enable it to conduct the City's financial audit. The auditing firm will complete its financial audit within 150 days of the City's fiscal year end. The auditing firm will submit its Management Letter to the City Council within 30 days of the completion of its financial audit. The Management Letter will state the auditing firm’s findings of non-compliance and recommendations for compliance.

The Director of Finance shall respond within 60 days in writing to the City Manager and City Council regarding the auditing firm’s Management Letter, addressing the findings of non-compliance contained therein.

2. Responsibility of Auditing Firm to City Council – The auditing firm is retained by and is accountable directly to the City Council and will have access to direct communication with the City Council if the City staff is unresponsive to the auditing firm’s recommendations or if the auditing firm considers such communication necessary to fulfill its legal and professional responsibilities.

D. Financial Reporting –

1. External Reporting – The City Finance Department will prepare the necessary transmittal letter, financial summaries and tables, notes and miscellaneous financial information contained within the annual comprehensive financial report (ACFR). The auditing firm will audit this financial information for compliance with GAAP. The audited ACFR will be submitted to the City Council for their review and will be made available to the public for inspection.

2. Internal Reporting – The City Finance Department will prepare internal financial reports, sufficient to plan, monitor, and control the City's financial affairs. The City Finance Department will strive for excellence in its financial reporting. The following qualitative characteristics of accounting information will be incorporated in all reports that are prepared:

Definitions of Qualitative Characteristics of Accounting Information:

- **Bias –** Bias in measurement is the tendency of a measure to fall more often on one side than the other of what it represents instead of being equally likely to fall on either side. Bias in accounting measures means a tendency to be consistently too high or too low. Financial reporting will strive to eliminate bias in accounting measures.

- **Comparability –** The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.
- **Completeness –** The inclusion in reported information of everything material that is necessary for faithful representation.
- **Conservatism –** A prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in financial situations are adequately considered.
- **Consistency –** Conformity from period to period with unchanging policies and procedures.
- **Feedback Value –** The quality of information that enables users to confirm or correct prior expectations.
- **Materiality –** The magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.
- **Neutrality –** Absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior.
- **Predictive Value –** The quality of information that helps users to increase the likelihood of correctly forecasting the outcome of past or present events.
- **Relevance –** The capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations.
- **Reliability –** The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to present.
- **Representational Faithfulness –** Correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity).
- **Timeliness –** Having information available to a decision-maker before it loses its capacity to influence decisions.
- **Understandability –** The quality of information that enables users to perceive its significance.
- **Verifiability –** The ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias.

IX. Treasury Management

A. Investments – The Director of Finance, or designee shall promptly deposit all City funds with the City's depository bank in accordance with the provisions of the current depository bank agreement. The Director of

Finance, or designee will then promptly invest all funds in any negotiable instrument that the City Council has authorized under the provisions of the State of Texas Public Funds Investment Act and in accordance with the City Council approved Investment Policy.

B. Cash – The City's cash flow will be managed to maximize the cash available to invest. Such cash management will entail the centralization of cash collection centers such as utility bills, building and related permits and licenses, parks and recreation, and other collection offices where appropriate and feasible.

Idle cash position will be determined daily to maximize interest income. The underlying theme will be that idle cash will be invested with the intent to 1) safeguard assets, 2) maintain liquidity, and 3) maximize return.

The City Finance Department will use appropriate check-signing technology to sign all checks with the signatures of the City Manager and Director of Finance. Internal controls will be established to secure the technology and to prevent its misuse.

The City Manager, Assistant City Manager, and Director of Finance are authorized signatories on all City depository bank accounts. Any withdrawal, transfer or payment of City funds requires a minimum of two signatures.

X. Debt Management

A. Policy Statement – The City Council recognizes the primary purpose of major capital projects is to support provision of services to its residents. Using debt financing to meet the major capital project needs of the community must be evaluated according to two tests - efficiency and equity. The test of efficiency equates to the highest rate of return for a given investment of resources. The test of equity requires a determination of who should pay for the cost of major capital projects. In meeting the demand for major capital projects, the City will strive to balance the load between debt financing and "pay as you go" financing methods. The City Council realizes failure to meet the demands of growth may inhibit its continued economic viability, but also realizes that the amount of debt incurred may have a negative financial impact. The City will achieve an appropriate balance between service demands and the amount of debt incurred. The aforementioned tests and methods of financing will assist the City Council, City Manager and Director of Finance in achieving this appropriate balance.

B. Types of Debt –

1. General Obligation Bonds (GO's) – General obligation bonds will be

issued to fund major capital projects of the general government, are not to be used to fund operating needs of the City and are backed by the full faith and credit of the City as well as the ad valorem taxing authority of the City as prescribed by law. The term of a bond issue will not exceed the useful life of the major capital projects funded by the bond issue and will generally be limited to no more than twenty years. GO's must be authorized by a vote of the citizens of the City.

2. Revenue Bonds (RB's) – Revenue bonds may be issued to fund major capital projects necessary for the continuation or expansion of a service which produces a revenue sufficient enough to obtain investment grade ratings and credit enhancement and for which the major capital project may reasonably be expected to provide for a revenue stream to fund the annual debt service requirements. The term of a bond issue will not exceed the useful life of the major capital projects funded by the bond issue and will generally be limited to no more than twenty years. RB's do not need a vote of the citizens of the City.

3. Certificates of Obligation (CO's) and Limited Tax Notes (Notes) – Certificates of obligations may be issued to fund major capital projects, which are not otherwise covered under either General Obligation Bonds or Revenue Bonds. Notes will be used in order to fund capital requirements which the useful life does not exceed seven (7) years as authorized by State law. Debt service for CO's or Notes may be either from general revenues or backed by a specific revenue stream or streams or by a combination of both. The term of the CO's will not exceed the useful life of the major capital projects funded by the certificate issuances and will generally be limited to no more than twenty years. Neither CO's nor Notes require a vote of the citizens of the City.

4. Method of Sale – The Director of Finance will use a competitive bidding process in the sale of bonds unless the nature of the issue or market conditions warrant a negotiated sale. In situations where a competitive bidding process is not elected, the Director of Finance will publicly present the reasons why and will participate with the City's Financial Advisor in the selection of the underwriter or direct purchaser.

C. Analysis of Financing Alternatives – The Director of Finance will explore alternatives to the issuance of debt for major capital projects. These alternatives will include, but are limited to: 1) grants-in-aid, 2) use of fund balance or working capital, 3) use of current revenues, 4) contributions from developers and others, 5) leases, and 6) impact fees.

D. Conditions for Using Debt – Debt financing of major capital projects will be done only when the following conditions exist:

- When non-continuous projects (those not requiring continuous annual appropriations) are desired;
- When it can be determined that future users will receive a benefit from the major capital project;
- When it is necessary to provide basic services to residents and taxpayers (for example, purchase of water rights);
- When total debt, including that issued by overlapping governmental entities, does not constitute an unreasonable burden to the residents and taxpayers.

E. Costs and Fees – All costs and fees related to debt issuance will be paid out of debt proceeds.

F. Debt Limitations – The City maintains the following limitations in relation to debt issuance:

- An Ad Valorem tax rate of $1.20 per $100 of assessed value is the maximum municipal tax rate that may be levied for all General Fund tax supported expenditures and debt service.
- Debt payments made solely from ad valorem tax revenue should not exceed 20% of combined General Fund and Debt Service Fund expenditures.
- The debt component of the tax rate should be 30% or less of the total tax rate.
- Total outstanding debt should not exceed 5% of the current year's taxable assessed valuation.
- Debt service coverage ratios:
    - Electric Utility Fund: Maintain the higher of the legal minimum debt service ratio or 1.2, with a goal of 1.4.
    - Water/Wastewater Utility Fund: Maintain the higher of the legal minimum debt service ratio or 1.2, with a goal of 1.4.

G. Arbitrage Rebate Compliance – The City Finance Department will maintain a system of record keeping and reporting to comply with arbitrage rebate compliance requirements of the Federal tax code.

H. Sound Financing of Debt – When the City utilizes debt financing, it will ensure that the debt is soundly financed by:

- Conservatively projecting the revenue sources that will be used to pay the debt;
- Financing the major capital project over a period not greater than the

useful life of the major capital project;

- Maintaining a debt service coverage ratio which ensures that combined debt service requirements will not exceed revenues pledged for the payment of debt; and
- To the extent possible, the City will aim to repay at least 25% of the principal amount of its general obligation debt within five years and at least 50% within 10 years. The City may choose to structure debt repayment so as to wrap-around existing debt obligations or to achieve other financial planning goals.

I. <u>Credit Enhancement</u> – The City should seek credit enhancement (letters of credit, bond insurance, surety bonds, etc.) when such credit enhancement proves cost effective. Credit enhancement may be used to improve or establish a credit rating on a debt obligation even if such credit enhancement is not cost effective if the use of such credit enhancement meets the financial planning goals.

J. <u>Financing Methods</u> – The City maintains the following guidelines in relation to methods of financing used to issue debt:

- Where it is efficient and cost effective, the City will use revenue or other self-supporting bonds in lieu of tax supported/pledged debt instruments.
- When appropriate, the City will issue non-obligation debt, for example, Industrial Development Revenue bonds, to promote community stability and economic growth.

K. <u>Refunding</u> – Periodic reviews of all outstanding debt will be undertaken to determine refunding opportunities. Refunding will be considered if and when there is a net economic benefit of the refunding or the refunding is essential in order to modernize covenants, which impinge on prudent and sound financial management.

L. <u>Full and Complete Disclosure</u> – The City of San Marcos is committed to full and complete financial disclosure, and to cooperating with credit rating agencies, institutional and individual investors, City departments, other levels of government, and the general public to share clear, comprehensible and accurate financial information. Official statements accompanying debt issues, annual comprehensive financial reports, and continuous disclosure statements will meet, at a minimum, the standards articulated by the Municipal Standards Rulemaking Board, the National Federation of Municipal Analysts, the Government Accounting Standards Board (GASB), and the Securities Exchange Commission (SEC). The City will abide by the provisions of the SEC concerning primary and secondary market disclosure and will work with Bond Counsel and its Financial Advisor to assist with meeting the requirements. The City Finance Department will be responsible for ongoing disclosure to nationally recognized municipal securities information repositories (NRMSIRs). Updates of budget, debt and financial information will be provided to credit rating agencies and investors when new debt is issued.

M. Post Bond Issuance Federal Tax Compliance – The City has issued or will issue from time to time bonds, notes or other tax-exempt obligations (collectively, the "Bonds"). The City is required by the terms of Section 103 and 141 through 150 of the Internal Revenue Code of 1986, as amended ("Code"), and the U.S. Treasury Regulations promulgated thereunder ("Regulations"), to preserve the tax-exempt status of its Bonds subsequent to their issuance. Further, the Code and the Regulations impose record retention requirements on the City with respect to its Bonds.

N. Credit Rating – The City of San Marcos seeks to maintain the highest possible credit ratings for all categories of debt that can be achieved without compromising the delivery of basic City services.

O. Elections – State law regulates which securities may be issued only after a vote of the electors of the City and approved by a majority of those voting on the issue.

1. Election Required –
    - Securities payable in whole or in part from ad valorem taxes of the City except issues such as tax increment securities, certificates of obligation, and limited tax notes.

2. Election Not Required –

    - Short-term notes (12 months or less) issued in anticipation of the collection of taxes and other revenues.
    - Securities issued for the acquisition of water rights or capital improvements for water and wastewater treatment.
    - Securities payable solely from revenue other than ad valorem taxes of the City.
    - Refunding securities issued to refund and pay outstanding securities.
    - Tax increment securities payable from ad valorem tax revenue derived from increased valuation for assessment of taxable property within a plan of development or other similar area as defined by applicable State Statutes.
    - Certificates of obligation.
    - Limited Tax Notes.
    - Securities for the construction or improvement of public streets and/or rights-of-way in order to relieve congestion or for public safety matters.

XI. Financial Conditions, Reserves, and Stability Ratios

A. Operational Coverage – The City's Enterprise Funds will comply with all bond covenants and maintain an operational coverage of at least 120%, such that current operating revenues will exceed current operating expenses.

B. Fund Balances/ Working Capital –

1. The General Fund's fund balance should be at least 25% of the General Fund's annual operating expenditures. This percentage is the equivalent of three months operational expenditures. As a goal, the City will strive to achieve 30% fund balance.

2. The Water and Wastewater Utility Fund working capital should be maintained at 150 days of recurring operating expenses. Ending fund balances above 150 days of recurring operating expenses will be used to cash fund future Capital Improvement projects and/or other non-recurring expenditures.

3. The Electric Utility Fund working capital should be maintained at the equivalent of 150 days of recurring operating expenses with a goal of 180 days. Ending fund balances above the 150 days of recurring operating expenses will be used to cash fund future Capital Improvement projectsand/or other non-recurring expenditures.

4. Reserves will be used for emergencies or unforeseen expenditures, except when balances can be reduced because their levels exceed guideline minimums as stated below.

C. Capital and Debt Service Funds –

1. Monies in the Capital Improvement Program Funds should be used within twenty-four months of receipt or within a reasonable time according to construction schedules. Interest income and unspent monies from bond issuances can be used to fund similar projects as outlined by bond covenants. Any remaining monies will be used to pay the bond issuance.

2. Revenues in the Debt Service Fund are based on property tax revenues and interest income. Reserves in the Debt Service Fund are designed to provide funding between the date of issuance of new debt and the time that property tax levies are adjusted to reflect the additional debt. Article 10, Section 10.02 of the City Charter requires that the City maintain a reserve balance of two percent of all outstanding general obligation debt.

D. Ratios/Trend Analysis – Ratios and significant balances will be incorporated into financial reports. This information will provide users with meaningful data to identify major trends of the City's finances through analytical procedures. We have selected the following ratios/balances as key indicators:

Fund Balance FB	**Assets Less Liabilities** AL (Acceptable Level) > 25% of Expenditures
Working Capital CA - CL	**Current Assets Less Current Liabilities** AL > 25% of Expenses
Current Ratio CA / CL	**Current Assets Divided By Current Liabilities** AL > 1.00
Quick Ratio CA / CL	**"Liquid" Current Assets Divided By Current Liquid Liabilities** AL > 1.00
Debt Ratio CL + LTL / TA	**Current Liabilities Plus Long-Term Liabilities Divided By Total Assets** AL < 1.00
Enterprise Operational Coverage OR / OE	**Operating Revenue Divided By Operating Expense** AL > 1.20

Our goal is to develop minimum/maximum levels for the ratios/balances above through analyzing the City's historical trends and anticipated future trends. We will also analyze and compare the City to other municipalities to develop these acceptable levels.

XII. Internal Controls

A. Written Procedures – Wherever possible, the Director of Finance will establish and maintain written procedures for all functions involving cash handling and/or accounting throughout the City. These procedures will embrace the general concepts of fiscal responsibility set forth in this policy statement.

C. Department Directors' Responsibilities – Each Department Director is responsible to ensure that good internal controls are followed throughout their Department, that all City Finance Department directives or internal control recommendations are implemented, and that all independent auditor recommendations are addressed.

XIII. Personnel and Training

A. Adequate Personnel – Personnel levels will be adequate for the City Finance Department to operate effectively. Overtime will be used only to address temporary or seasonal demands that require excessive hours. Workload allocation alternatives will be explored before increasing personnel.

B. Training – The City Finance Department will support the continuing education efforts of all personnel. Personnel will be held accountable for communicating, teaching, and sharing with other personnel members all information and training materials acquired from seminars, conferences, and related education efforts.

C. Awards, Credentials, Recognition – The City Finance Department will support efforts and involvement which result in meeting standards and receiving exemplary recitations on behalf of any of the City's fiscal policies, practices, processes, products, or personnel. Certifications may include Certified Government Finance Officer, Certified Public Accountant, Management Accountant, Certified - Internal Auditor, and Certified Cash Manager.

The City Finance Department will strive to maintain a high level of excellence in its policies and procedures. The ACFR and budget will be presented annually to the Governmental Finance Officers Association for evaluation and consideration for the Certificate of Achievement for Excellence in Financial Reporting and the Distinguished Budget Presentation Award.