

Town of Colchester

Fund Balance Policy

Approved by Selectboard – April 9, 2024

I. Background

The Town of Colchester maintains various funds. Except for the General Fund all have stated purposes for use of the resources therein. Funds are created to provide separate accounting of revenues, expenses, and ongoing valuation of resources. For example, the Wastewater Fund exists for the operation and maintenance of the Town's wastewater system on the Route 7 and Route 15 corridors and inner Malletts Bay. The Town also maintains a Recreation Program Fund, a Rescue Fund, and a Stormwater Fund. These funds have their own revenues, expenses, assets, and liabilities which are reported within, but also independently of, the Town's overall financials. Funds have balances, tracking of assets vs. liabilities over time. The balance of special purpose funds (those other than the General Fund) is for the benefit of the purpose of those funds.

The property tax-funded General Fund benefits the Town generally and its fund balance represents the cumulative surplus or deficit of budgets since the fund began. The General Fund is not dedicated to a specific purpose therefore, it is important to describe the purpose of any balance therein.

This policy establishes goals and provides guidance concerning the desired level of fund balance maintained by the Town. Maintenance of a fund balance will mitigate financial risk that can occur from unforeseen revenue fluctuations in tax collections and unanticipated expenditures due to disasters or unexpected and unusual public safety expenses. It will reduce the cost of borrowing, and can provide tax rate stabilization.

II. Purpose

In private business or personal finance, it is ideal to have enough money available for unexpected expenses; for times of decreased revenue; or to pay bills as they come in.

For example, a homeowner may need to buy a new roof or replace a septic system, or be out of work due to illness or injury for an extended period of time. Saving for such contingencies is preferable to going into debt.

Savings are achieved in personal finance by earning more than you spend. In business, earning more than you spend, on an accounting basis, results in net income. Net income can be distributed to owners or kept by the business as retained earnings. Retained earnings may be reinvested in the business, kept for future reinvestment or be used to cover unplanned expenses or a lack of revenue.

Like a private business, the Town is an ongoing enterprise. The Town's annual General Fund operating budget may result in a surplus (annual revenues exceed expenses) or deficit (annual expenses exceed revenues) in any given year. The sum of the operating surpluses and deficits for all years is called the General Fund balance.

Maintenance of a fund balance is essential to the preservation of the financial integrity of the Town and is fiscally advantageous for both the Town and the taxpayers. As with individual or business finance; in a given year the Town may experience a lack of revenue or expenses beyond those planned.

Insufficient revenue can stem from lack of collections in a specific year or over time during extended financial duress. The Town is required to pay the Colchester School District the State Education Taxes that the Town bills and collects on behalf of the State of Vermont, regardless of whether or not the Town Collects the taxes from the taxpayers, The average tax collection vs. budgeted tax collections from FY18 to FY23 was 98.8% (\$147,443 less than budgeted)., Tax payments could be more significantly affected by a rise in unemployment, a recession, extended local emergency, or other community wide form of financial duress.

Expenses might exceed budget due to a disaster or weather event requiring significant public works expenditures, or a significant ongoing police investigation. Although the Town is often eligible for federal and state disaster aid, there is often a matching amount required. It can take years to even determine whether expenditures under a declared disaster are eligible for aid. The fund balance could be used to provide the required match of 7.5% to 25% to federal aid, and to pay for numerous costs that are not reimbursable even under a declared federal disaster.

The Town does not budget for these exceptional situations. Just as with individual or private business finance, we have a tool, the fund balance, to provide funding necessary to address unexpected decreases in revenue or unbudgeted expenses.

Cash flow, or working capital, is important. It helps avoid borrowing to pay bills that come due before revenue comes in. Colchester's first property tax installment of the fiscal year is due August 15. Therefore, the Town has one-and-a-half months of expenses to cover before the first tax bill is due.

Reducing cost of borrowing is a way to save money over time. Bonds for debt issued on behalf of the Town of Colchester are generally rated Aa2 by Moody's. This is the eighth of ten "investment grade" rankings for bonds, which are designated from AAA (highest) to Baa3 (lowest). The interest rate difference from an Aa2 bond (top 8 of 10 investment grades) to a Baa3 bond (bottom 3 of 10 investment grades) is about 0.7%. These investment grades do not include "speculate grades" Ba1 through C, otherwise known as junk bonds. As of June 30, 2023, the Town has \$1.6 million in outstanding general fund debt to be paid off in 5 years and the voters have authorized up to \$6.9 million in general fund debt for the recreation center. On the amount of current and approved future debt the difference in borrowing costs between Aa2 and Baa3 is about 28% or approximately \$410,000. Having a healthy fund balance is one of the many measures taken when going to market for bonds.

Stabilization of Tax Rate, is another use for a fund balance, especially when the tax rate, like ours is based on growth in value of property through investment and development. In the last five years (ending in FY23) net municipal liability (operating and capital expenses funded by property taxes) has grown by 3.7% annually. Yet, the property tax rate, per hundred dollars of property valuation, has increased an average of 2% annually over this five-year period. This was due to increased property value and investment of 6% over this same period.

Should the rate of growth decrease, which is possible because we have a limited supply of developable land, and service needs increase in cost, it would be advantageous to be able to mute the effect of the increase in any given year by applying a portion of the fund balance to the operating budget. This would moderate the impact of a tax increase in any given year.

III. Definitions

Fund balance is a measurement of available financial resources and is the difference between total assets and total liabilities.

GASB Statement 54 distinguishes fund balance classified based on the relative strength of the constraints that control the purposes for which specified amounts can be spent. Beginning with the most restrictive constraints, fund balance amounts will be reported in the following categories:

- 1) **Nonspendable fund balance** – amounts that are not in a spendable form (e.g., inventory such as gasoline in tanks, or prepaid expenses such as insurance).
- 2) **Restricted fund balance** – amounts that can be spent only for the specific purposes stipulated by parties external to the Town of Colchester (e.g., grants or donations).
- 3) **Committed fund balance** – amounts that can be used only for a specific purpose determined by a vote of the voters, including votes on budgets that include commitment of a fund balance. Commitments can be uncommitted by vote or by expiration of the authorization (e.g., the budget year has concluded).
- 4) **Assigned fund balance** – amounts *intended* to be used by the government for specific purposes. Intent can be expressed by the Selectboard.
- 5) **Unassigned fund balance** – includes all amounts not contained in other classifications and is the residual classification of the General Fund only. Unassigned amounts are available for any legal purpose.

IV. Policy

Annual Review of Fund Balance The fund balance shall be reviewed annually by the Selectboard after receipt and presentation of the audit by the auditor. Due to the timing of this review, changes to the fund balance as it relates to minimum and maximum unassigned fund balance shall be addressed in the next capital planning or general fund budget process that begins after this review.

Minimum Unassigned Fund Balance It is the goal of the Town to achieve and maintain an unassigned fund balance in the General Fund at fiscal year-end that is not less than 13% of the prior year's operating expenditures, which shall include for this purpose the operating budget and bond payments.

This formula does not include: a) funding of voter approved capital plans, since they are internal commitments that can be revisited in times of significant economic duress, or b) Legislatively required payments to the School District, regardless of whether or not taxes are actually collected.

If the unassigned fund balance at fiscal year-end falls below the goal, the Town shall develop a restoration plan to achieve and maintain the minimum fund balance.

Maximum Unassigned Fund Balance It is the goal of the Town to achieve and maintain an unassigned fund balance in the General Fund at fiscal year-end that does not exceed 17% of the prior year's operating expenditures, which shall include for this purpose the operating budget and bond payments.

This formula does not include: a) funding of voter approved capital plans, since they are internal commitments that can be revisited in times of significant economic duress, or b) Legislatively required payments to the School District, regardless of whether or not taxes are actually collected.

If the unassigned fund balance at fiscal year-end exceeds this goal, the Town shall develop a plan to achieve and maintain the minimum fund balance. The plan should take into consideration the operating and capital needs of the Town.

The plan shall consider carefully the use of the fund balance so as not to cause tax spikes. For example: If a) the budgeted general fund increase was \$450,000 (3%) over the prior year and there was no increase in grand list value and b) \$450,000 of the fund balance was used to eliminate the tax increase altogether. Then the following year: 1) there is again no grand list growth, and another similar budget increase and 2) no fund balance is applied to the budget, then, the resulting tax increase would be 6%. It would be more advantageous (and palatable to taxpayers) to apply the \$450,000 over the course of several years to avoid a spike when the fund balance is not used. The Town could reduce the fund balance by spending it on capital projects. This would be done by both a) having a project approved through the Selectboard held public hearing process which authorizes capital projects and b) funding the projects through a transfer from the general fund to a capital project fund through the voter approval of the general fund budget.



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**COLCHESTER SELECTBOARD
SIGNATURE PAGE:**

The Colchester Selectboard approves to adopt the Fund Balance Policy.

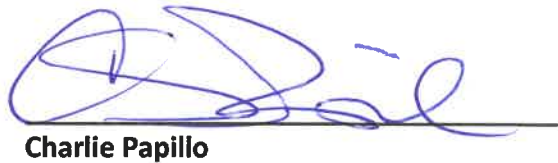
Signed this 9th day of April 2024.

COLCHESTER SELECTBOARD:


Pam Loranger, Chair


Tom Mulcahy


Jacki Murphy


Charlie Papillo


Maureen P. Dakin