

SECTION 7: RESERVE AND LIQUIDITY POLICIES

7.1 Reserve Ratio

Objective:

Reserve funds are defined as unassigned and assigned fund balance as reflected annually in the GAAP financial statements. Managing these two funds is a critical component of the Town's credit evaluation, bond rating and perception of financial position.

Policy:

Standard and Poor Rating Service uses a metric that includes the sum of unassigned and assigned fund balance divided by total expenditures plus transfers out. In order to achieve the highest grade in this area a calculation of 15% or greater is required. The Town shall seek to maintain such a ratio at 15% or greater. For purposes of this policy, this will be called the reserve ratio.

Two statutory components of this GAAP reserve in Massachusetts are Free Cash and the Town's Stabilization Funds. Policies within these specific statutory areas directly impact the Town's GAAP reserves and therefore the Town's reserve ratio.

7.2 Free Cash

Objective:

To define appropriate uses of free cash and to assist in the accumulation of reserve funds in order to reduce risk in managing the Town's current and long-term needs as well as strengthen the Town's financial position and enhance its credit rating.

Policy:

Free Cash is the remaining, unrestricted funds from operations of the previous fiscal year including unexpended free cash from the previous year, actual receipts in excess of revenue estimates shown on the tax recapitulation sheet, and unspent amounts in budget line-items. Unpaid property taxes and certain deficits reduce the amount that can be certified as free cash. The calculation of free cash is based on the balance sheet as of June 30, which is submitted by the community's Director of Municipal Finance. Free cash is not available for appropriation until certified by the Director of Accounts.

Appropriate uses of free cash include: funding the Stabilization Funds; the OPEB Trust Fund; funding capital projects with an estimated cost between \$100,000 and \$500,000 for which long-term borrowing is authorized at terms of five or fewer years; funding extraordinary deficits that would otherwise be carried over to the following year; remaining in unreserved, undesignated fund balance until the sum of unappropriated free cash is equal to or greater than 5% of general fund expenditures. The purpose of maintaining an unappropriated amount of free cash is to provide for cash flow and to have funds available for emergency appropriations.

Exceptions to the free cash policy shall be made only under extraordinary circumstances and any such exception shall be explained to the voters in a statement written by the Board of Selectmen in the

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Annual Town Meeting or Special Town Meeting warrant, if applicable. The Town will not use free cash as a source to balance its annual operating budget.

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7.3 Stabilization Funds Policy

Objective:

To accumulate stabilization funds in order to reduce risk in managing the Town's current and long-term needs as well as strengthen the Town's financial position and enhance its credit rating.

Policy:

Stabilization Funds are designed to accumulate amounts for capital and other future spending purposes, although they may be appropriated for any lawful purpose (MGL Ch. 40 §5B). Communities may establish one or more stabilization funds for different purposes and may appropriate into them in any year an amount not to exceed 10% of the prior year's tax levy. Stabilization Funds earn interest on their outstanding balances and this interest becomes part of the funds. A two-thirds vote of town meeting is required to establish, amend the purpose of, or appropriate money into or from the Stabilization Funds. The Town has established two stabilization funds; a General Stabilization Fund and a Capital Stabilization Fund. The Town's General Stabilization Fund Balance goal is to meet or exceed 7% of annual general fund expenditures, while the Capital Stabilization Fund Balance goal is to meet or exceed 3% of annual general fund expenditures. Neither of these Stabilization funds will exceed 12% of general fund expenditures.

Appropriate uses of the Town's General Stabilization Fund include: an appropriation if the State Aid payments are reduced after the budget is voted by Town Meeting, an appropriation if net State Aid receipts are less than the average of the prior two fiscal years, an appropriation if local receipts are projected to be less than the average of the prior three fiscal years, or an appropriation in the event of a catastrophic or emergency event if the financial impact of the event is in excess of an amount which the Finance Committee Reserve Fund can fund.

Appropriate uses of the Town's Capital Stabilization Fund include: funding projects approved in the capital improvement plan or an appropriation in the event of a catastrophic or emergency event if the financial impact of the event is in excess of an amount which the Finance Committee Reserve Fund can cover.

There will not be any additional withdrawals from the Stabilization Fund until the amount withdrawn is replenished. Funding to replenish the Stabilization Fund shall come from Free Cash or from other available revenue. If Free Cash or available revenue is insufficient to replenish the Stabilization Fund in the immediately following fiscal year, the replenishment shall occur as soon as Free Cash or available revenue exists, and no further withdrawal shall occur until the fund has been replenished.

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7.4 Liquidity Policy

Objective:

To ensure that obligations will be met without adversely affecting either the daily operations or the financial condition of the Town. It is the responsibility of the Treasurer to manage the Town's cash and ensure that account balances are sufficient to cover municipal obligations in a timely manner. The objective of the cash flow forecast and liquidity policy is to help anticipate periods of low balances and to better manage any short-term borrowing, if any, needed to fill gaps. The policy will also reveal periods when account balances are positive and the potential to maximize investment income exists.

Policy:

The Town will regularly compute a liquidity measurement, which involves assessing the Town's cash inflows against its outflows and the liquidity value of its assets to identify the potential for future net funding shortfalls. Eligible liquid assets are defined as cash, bank bills and CDs issued by a bank and deposits at call, or convertible within 2 days.

This will require the measurement and forecast of the Town's prospective cash flows for assets, liabilities, off-balance sheet commitments and derivatives over a variety of time horizons, under normal conditions and stressed conditions.

The Town will develop a strategy and implement, as needed, for dealing with temporary and long-term liquidity disruptions as they arise (e.g. revenue anticipation notes, tax anticipation notes, modifying investment holdings, etc.)

A cash flow forecast will be developed after approval of the annual budget and before July 1 each year. At this time, the Treasurer can rely on the revenue projections that fund the budget and on the appropriations that were approved. By adjusting past patterns of monthly spending and collections to current year revenue projections and appropriations, a reasonable forecast of the Town's cash flow needs will emerge.

Procedures:

As a starting point, municipal and school payroll warrants together with vendor warrants can provide a very general perspective. Annual revenue amounts will be based on revenue projections which support the annual budget. The monthly forecast will be refined by accounting for anticipated deviations from the prior year, special circumstances, or other expectations in the coming fiscal year. At the end of each month through the course of the fiscal year, the cash flow projections will be replaced by actual monthly expenditures or receipts. If revenues are insufficient to cover costs and short-term borrowing is used to fill the gap, the note proceeds must be added to the forecast as revenue, and later payments of interest and principal will be inserted as expenditures.