

## MEMORANDUM

**To:** Lawson Wijesooriya, Chief of Staff, City of Richmond, Virginia  
Sabrina Joy-Hogg, Interim Chief Administrative Officer, City of Richmond, Virginia

**From:** David Rose, Senior Vice President and Manager of Public Finance

**Date:** April 21, 2025

**RE:** Fund Balance Reserve Levels and Their Implications for the City of Richmond

**CC:** Roland Kooch, Senior Vice President, Davenport & Company LLC  
Sheila White, Director of Finance  
Michael Nguyen, Deputy Director of Finance – Chief Investment and Debt Officer  
Meiling Qu, Debt and Investment Manager

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### Background

Following the city of Richmond's (the "City") Council Budget Work Session of Monday April 14th, you have asked us to provide a response to the question(s) posed by Council Member(s) concerning the above.

Specifically, during the presentation by interim CAO Sabrina Joy-Hogg, several references were made concerning the City's self-imposed Downturn Reserve Fund Policy, consisting of the City's Unassigned Fund Balance/Contingency Reserve, (the "Fund Balance Policy") which has now been increased to 20% of Budgeted General Fund Operating Expenses.

To that end, we have outlined below the purposes for the City's Fund Balance Policy as well as the economic cost/benefit of meeting this Policy from the City's perspective.

### Why Establish/Maintain an Unassigned Fund Balance Policy

Local governments like the city of Richmond have regular ongoing outlays during the course of a fiscal year that do not match up with annual revenues. Said another way, while cities must meet payroll monthly, if not bi-monthly, among other expenditures; typically revenues in the form primarily of tax receipts often come in once or twice a year. As such, this cash flow imbalance inevitably requires a local government to have a pool of money to take care of these ebbs and flows in cash flow lest they need to borrow to meet payroll. As a result, it is generally assumed that a minimum of two months of revenues (16.7% rounded) is recommended under "best practices."

In addition, there are other reasons that a local government should have ample reserves.

For example, in the event of a catastrophic occurrence. One Councilmember referenced FEMA in regard to the possibility that it may be defunded under the current Federal administration. Nevertheless, even under previous Administration(s), at best, FEMA reimbursement to the city in the event of a qualifying event could take upwards of three to four years.

Having a solid, substantial Unassigned Fund Balance allows a local government to avoid borrowing money in order to make necessary emergency improvements and then be reimbursed from FEMA down the road. I would point out that FEMA does not typically pay interest cost in the event a local government wants and or needs to borrow monies until reimbursement occurs.

Generally speaking, there is a misperception that Unassigned Fund Balance dollars are "costing" the local residents and other taxpayers money. To the contrary, last year alone, the Unassigned Fund Balance monies in the City's accounts provided an excess of \$13 million dollars of interest income, all of which, went back into the General Fund, to help defray annual operating expenditures. In other words, \$13+ million was the equivalent of nearly 3.5 pennies of funding on the real estate rate.

### **Why do the Rating Agencies Matter?**

There are effectively three national credit rating agencies that monitor and evaluate local governments. They are Fitch, S&P and Moody's. Richmond is rated by all three of these agencies. As discussed last week, all three rating agencies view Richmond as being a very strong credit worthy institution.

Fitch has assigned a AAA to Richmond - the highest possible. They cite the City's strong Unassigned Fund Balance and note any "erosion" of this could leave to a downgrade. Similarly, Moody's and Standard and Poor's have Richmond ranked one notch below AAA with a similar commentary. To the extent that the City reduces its Fund Balance Policy, it would be lessening one of the critical strengths of the City, in turn, making it difficult to keep improving to AAA.

This begs the question... Why does this matter?

As per City Council's request, Davenport has attempted to answer that question from the perspective of how strong credit ratings are important to Richmond residents (i.e tax payers) as opposed to any importance to Wall Street investors.

First, the higher a local government credit rating, the lower the average annual debt service paid will be. Specifically, given Richmond's credit rating mix, when Richmond last borrowed funds, it borrowed at what was effectively a few basis points below AAA levels. An across-the-board loss of one notch would increase the City's borrowing costs by roughly 25-basis points. This in turn translates to nearly \$35 Million of extra interest cost on the City's planned CIP general obligation bond financings.

Second, to the extent the City's credit ratings were downgraded similarly because the City had either reduced its Fund Balance Policy level and/or not satisfied its self-imposed policy amounts then the City could realize the above reference financial hit.

In 2024, the city of Richmond established an enhanced Fund Balance Policy of 20% of Budgeted General Fund Operating Expenditures. This new bar will require the City to set aside approximately \$30 million of additional one-time funds in order to meet and maintain compliance with this enhanced 20% policy target.

However, there is another component to the City either reducing its Fund Balance Policy level or not meeting its policy target. The financial implications would be as follows - In the current interest rate environment, every \$10 million of funds either added to the Unassigned Fund Balance or removed from the Unassigned Fund Balance translates into roughly \$500,000 of annual cost and/or benefit.

In other words, to the extent the City added \$30 million of additional funds per its policy, it could assume that these funds would then result in approximately \$1.5 million of increased interest earnings that would benefit the general fund in the next Fiscal Year. Conversely, to the extent the City were to use \$30 million of available funds to pay for a crucial project, the cash the implications of this would be the loss of approximately \$1.5 million

in interest earnings in the general fund during the next Fiscal Year. These interest earnings directly impact the general fund and help to offset the tax burden to Richmond tax payers.

Moreover, invested Unassigned Fund Balance generates interest earnings and works in unison with the City's use of debt financing. One of the reasons the City utilizes the "Debt Markets" to fund major capital projects is because Richmond can borrow monies on a "tax-exempt basis" at the lowest AAA cost of funds. This ability is due to the City's excellent credit rating coupled with its status as a local government that is not for profit.

The City can actually obtain fixed rate, long term monies at or below the interest rate at which it can invest its money. Simply stated, last year the City was able to raise approximately \$150 million for the stadium at an all in cost below 4%. Conversely, money sitting in the Unassigned Fund Balance, earned on average well in excess of 5%.

While this is not always the case, it is another example of why strategic investment and debt management actually helps the City's overall finances. This in turn puts a reduced level of stress on City taxpayers be they individuals and/or commercial businesses.

Lastly, there are several other reasons why strong fund balance reserve policies - and adherence to those policies - are important.

Beyond the ability to earn additional interest income as outlined above, the national credit rating agencies view this financial metric (Unassigned Fund Balance levels) as perhaps it's single most important factor in obtaining a strong credit rating. We have identified above the avoided and/or additional costs of the loss of one notch in credit rating but there is more to the overall story.

***Specifically, businesses that are either seeking to relocate and/or expand, in a local government like Richmond see the actual credit rating(s) and the trajectory either upward, downward, or stable, as a signal to the economic development community that a local government is either fiscally strong and sound or is weakening. The latter of which can have a negative implication on businesses looking to invest and/or reinvest in a local government.***

Unfortunately, there is no way for us to quantify this per se. Finally, having a strong Unassigned Fund Balance typically in excess of a two-month minimum policy provides extra comfort in the event of a FEMA style event or other unexpected need for one-time monies.

In closing, the continued adherence to the City's updated Fund Balance Policy is the best way to ensure that Richmond does not trigger a credit rating downgrade. Moreover, lessening of the City's Fund Balance Policy by roughly \$30-\$60 million could result in a loss of interest earnings to the general fund in the amount of upwards of \$5 million annually. This is the equivalent of more than one cent in lost real estate tax revenues. This economic loss coupled with the multi-million-dollar annual increase(s) in debt service costs by virtue of a reduced credit rating(s) would be a significant financial blow to Richmond taxpayers.

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