MMA Fiscal Policy Committee
Best Practice Recommendation: Municipal Reserves

BEST PRACTICE: Adopt, as a set policy or practice, adequate funding of municipal reserve accounts to mitigate budget risks from extraordinary and unforeseen events and maintain fiscal stability over time. This could include the adoption of reserve funding targets of 5 percent or more, based on the size of the municipal budget and consideration of spending and revenues risks. This could also include the identification of specific year-end fund balances or revenues from other sources to contribute to reserve accounts. A good policy or practice could also include rules for the use or draw down of reserves and for replenishment of depleted accounts.

It is widely recognized that those state and local governments that have established and funded reserve and stabilization accounts at sufficient levels have been well-served, because reserves allow states and localities to sustain services in times of economic and fiscal distress and limit the risk from extraordinary and unforeseen occurrences. Sound policies and practices, along with adequate levels of reserves, can also have a positive impact on credit ratings and can reduce the cost of borrowing and capital project spending.

The Division of Local Services advises that a good reserve policy will establish target balances for the local stabilization fund and other reserves and "develop a schedule of annual appropriations … designed to reach and sustain target balances gradually over time."

A Best Practice adopted by the Government Finance Officers Association (GFOA) Executive Board recommends that "governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund." The GFOA suggests that the balance be maintained at no less than two months of general operating fund revenues or expenditures, although the amount of the balance and the measurement depend on the specific circumstances of the municipality. The GFOA also recommends that the purpose of various parts of the fund balance be specified, including, for example, "a portion for working capital, one for budgetary stabilization, and one for responding to extreme events."

References from the Government Finance Officers Association (GFOA):
www.gfoa.org/appropriate-level-unrestricted-fund-balance-general-fund
www.gfoa.org/adopting-financial-policies-0