

SUBJECT:	CAPITAL ASSET RENEWAL AND REPLACEMENT RESERVES POLICY	POLICY NUMBER	EFFECTIVE DATE
		200-XX	06-28-2022

PURPOSE:

The purpose of the Capital Asset Renewal and Replacement Reserves Policy (the Policy) is to ensure adequate funding for the renewal and replacement of the City’s capital assets to protect the public investment and achieve the assets’ maximum useful life. The Policy is intended to promote proactive financial management by increasing awareness of the ongoing need for capital replacement and encouraging long-term capital planning.

POLICY:

Definitions

For the purpose of this Policy, capital assets includes roads (arterial and local), storm drainage facilities, buildings and structures, parks and medians, equipment and vehicles, and technology. Water and sewer infrastructure are excluded from this Policy, as both enterprises have established their respective capital replacement component within their corresponding rate structures.

Capital Renewal – a capital program which entails a wide range of repairs and replacement of such components, including roofing, heating and cooling systems, structures etc.

Capital Repair – a repair expected to extend the service life of the asset or its systems.

Deferred Maintenance – the degree to which spending on routine repair and maintenance falls below what is required to achieve the asset’s intended service life.

Planned Maintenance – a process that improves or preserves the appearance and functionality of an asset, is performed at planned intervals and is normally funded by the operating budget.

Preventative Maintenance – a process that is performed on an asset to support continuing operation at its optimum efficiency, and is normally funded by the operating budget.

Funding Strategies

To operate and maintain the City’s capital assets in a most efficient and cost effective manner, an assessment of each category of the asset shall be conducted periodically, to assess the remaining life of the asset and identify repairs or replacement needs for the next five years. Accordingly, a Repair and Replacement fund for each major asset type

shall be established, either through internal service charges, or setting aside funds as reserves in the General Fund.

- Roads (Arterial and Local)

Funding sources for the repairs and replacement of the City's Road assets include but not limited to the following:

- Measure M2
- Gas Tax
- Senate Bill 1, Road Maintenance and Accountability Act (RMRA)
- Traffic Impact Mitigation fees
- Community Development Block Grant (CDBG)
- General Fund

In Fiscal Year 2021-22, the City established a Pavement Management Acceleration Program, with initial funding of \$17.5 million. The program was created to address the deferred maintenance of our local arterial and residential streets. Additional routine contribution to the Pavement Management Acceleration Program shall be determined from the General Fund's positive operating results and/or existing reserves during each budget cycle, unless other funding sources become available. Once the City's overall weighted average Pavement Condition Index (PCI) is restored to 75 (the condition category of "Good"), the Pavement Management Acceleration Program shall be re-evaluated, and residual funds from the program shall be repurposed for other projects during the biennial budget process.

Major repair and replacement projects shall be identified during the budget process and included in the City's five-year Capital Improvement Plan. Funds shall be set aside from all available sources accordingly, in the order from restricted (such as development impact fees) to unrestricted (General Fund).

- Storm Drainage Facilities

Funding sources for the repairs and replacement of the City's Storm Drainage facilities include but not limited to the following:

- Gas Tax
- Senate Bill 1, Road Maintenance and Accountability Act (RMRA)
- Drainage Facilities fees
- Community Development Block Grant (CDBG)
- General Fund

Major repair and replacement projects shall be identified during the budget process and included in the City's five-year Capital Improvement Plan. Funds shall be set aside from all available sources accordingly, in the order from restricted (such as development impact fees) to unrestricted (General Fund).

- Buildings and Structures

This Policy establishes a Buildings and Structures Rehabilitation Fund, an internal service fund, to provide for the accumulation and distribution of funds for various building and structure repairs and rehabilitation projects. Sources for this funds is the internal service charges identified during the budget process. To determine the internal service charges, current condition and average annual cost to maintain the various building and structures shall be evaluated. Costs will be allocated systematically among all internal users of such facility.

The annual contribution to the Buildings and Structures Rehabilitation Fund include: internal service charges, investment earnings, and proceeds from the sale of surplus assets.

- Parks and Medians

Funding sources for the repairs and replacement of the City's parks and medians include but not limited to the following:

- Development impact fees
- In-Lieu Park Fees (Quimby)
- Citywide Park fees
- Community Development Block Grant (CDBG)
- Grant funds
- General Fund

Development impact fees and grants are the primary funding sources for new construction, and the rehabilitation of parks and other outdoor public spaces when additional features or capacity is increased. Funds should be set aside from all available sources for planned repairs and replacement.

- Equipment and Vehicles

The Fleet Management Fund is used to pay for the replacement and ongoing maintenance of City-owned fleet equipment. Equipment replacement will be determined based on age, actual and projected vehicle maintenance costs, and operational needs. The goal is to maximize the useful life of each vehicle, while minimizing lifetime fleet costs. The annual contribution to the Fleet Management Fund include: internal service charges, investment earnings, and proceeds from the sale of surplus equipment.

The fleet internal service charges are determined during the budget process, based on the allocation of vehicle expenses to user departments.

- Technology

The Information Systems Fund (ISF) is used to pay for the replacement and ongoing maintenance and operations of City owned technology assets. Funding sources for

the ISF include: internal service charges, investment earnings, and any proceeds from the sale of surplus ISF assets.

In addition to the ISF, the City also maintains two other internal service funds in the Technology asset category, they are Telephone System and Communication Replacement (also known as 800 MHz) funds.

The internal service charges for the ISF, Telephone System and Communication Replacement are determined during the budget process, based on each department's usage.

Implementation

The method of estimating an appropriate amount of capital assets renewal and replacement reserves vary based on the type of the asset or its funding mechanism. Regardless, each method requires planning for future asset rehabilitation and replacement over a given period, forecasting the annual amount needed over the life of the asset, as well as estimating the amount that will be needed each year over a specific planning horizon.

The annual amount needed for renewal and replacement over the long-term can be estimated based on an asset management plan, the value of assets from the fixed asset register, the annual depreciation expense, the average cost of maintaining such asset over the past years, or the combination of several alternatives. The method of determination of such amount for the specific asset type should be consistent once established. The calculation will be performed during the budget process or year-end closing, based on the methodology.

For the assets that requires setting aside reserves in the General Fund, the amount can be determined based on the following:

- A percentage of the General Fund revenues in excess of expenditures at the end of the year;
- A percentage of one-time revenue during the year; or
- Proceeds from sale of surplus assets.

New Infrastructure Assets

Prior to acquiring or constructing a new capital asset, an estimate of the full cost to operate, maintain, and replace the asset through its life cycle is to be developed. A plan for meeting these costs is to be identified, and funding availability in the applicable Renewal and Replacement Reserves fund is to be determined.

Uses of Reserves

Funds accumulated in the Capital Asset Renewal and Replacement Reserves accounts may only be used for capital assets renewal and replacement, including:

- Cost to bring a new asset into service or full capacity
- Cost of capital renewal and capital repairs

- Cost of planned and preventative maintenance
- Cost to enhance the value of an asset

Use of the funds on non-capital asset related expenditures are not allowed, such as the purchase of inventory items, and services on non-City owned assets. Additionally, funds accumulated in the Capital Asset Renewal and Replacement Reserves accounts shall not be used to acquire or construct new infrastructure assets, unless approved by the City Manager.

Periodic review and assessment of funding levels in each capital asset renewal and replacement reserves account shall be performed. If determined any reserve account is funded above the operational needs, excess funding shall be redistributed through the budget process with Council approval.

Responsibilities

City Council:

1. Approve the Policy to establish Capital Asset Renewal and Replacement reserves.
2. Approve necessary budgetary items to implement and fund the Capital Asset Renewal and Replacement reserves.

City Manager:

1. Review status reports on the Capital Asset Renewal and Replacement reserve accounts and make recommendations to City Council relative to funding contributions as necessary.
2. Review and recommend to City Council the budget for capital asset replacement costs and internal service charges to fund for certain reserves.

Director of Finance:

1. Develop and implement the Capital Asset Renewal and Replacement Reserves Policy.
2. Establish necessary reserve accounts for each major asset type.
3. Review the charge/collect/transfer of funds to achieve targeted reserves amount over a desired period of time through budget development.
4. Coordinate the development of capital improvement plan budget, and participate in evaluating potential acquisition and/or construction of new capital assets.
5. Coordinate the review and assessment of the funding levels of each capital asset renewal and replacement reserves account.
6. Review replacement schedules, recommend adjustments and redistribute expenses based on expected shortfalls/surpluses.
7. Prepare periodic reports on funding status of each type of capital asset's reserve fund.
8. Ensure the proper use of the funds accumulated in the Capital Asset Renewal and Replacement Reserve accounts.

Directors of all City departments involved in the management of City Assets:

1. Maintain capital asset information and assist the Finance Department in formulating budget allocation for asset renewal and replacement costs.
2. Conduct periodic assessment of City assets and determine repairs and replacement needs.
3. Develop replacement schedules for City assets.
4. Recommend funding priorities.
5. Identify and recommend new funding sources for asset renewal and replacement.
6. Evaluate potential acquisition and/or construction of new capital assets, including develop an estimate of the full cost to operate, maintain, and replace the asset through its life cycle, identify funding sources, and determine the level of corresponding Renewal and Replacement Reserves funds.