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Date: October 13, 2010

To: COG Board of Directors

From: David Robertson, Executive Director

Subject: FY 2011 General Reserve Expenditure
and Proposed FY 2011 – FY 2016 Capital Repair/Replacement Plan

Purpose

The Metropolitan Washington Council of Governments (COG) Board of Directors is asked to approve a FY 2011 General Reserve reprogramming and expenditure not to exceed \$200,000 to support audiovisual system replacement and the installation of additional fire safety equipment. I will make this request at the COG Board's October 13, 2010 meeting. In addition, I will propose that the COG Board approve a long-term policy to support additional infrastructure repair and replacement expense as part of a Capital Repair/Replacement Plan that will be incorporated annually into the Fiscal Year Work Program and Budget, beginning FY 2012 at the COG Board's January 2011 meeting.

Background

COG is a co-owner along with ICMA and ICMA-RC of the building located at 777 North Capitol Street NE, Washington DC and has occupied approximately 56,000 square feet of office and meeting space since the building was first occupied in 1990.

Not unlike a new home, COG's offices required little significant expenditure for capital repair or replacement in the first 20 years, with the exception of the HVAC and power supply replacement in its information technology server room in 2008. COG is now finding that it must fund several costly capital repair and replacement actions to maintain its office space, support its members, and provide a safe work environment for staff, members and guests.

Staff has prepared a multi-year, FY 2011 through FY 2016 Capital Repair/Replacement Plan that identifies several items and estimated costs. Because of the urgency of audiovisual replacement in the Board Room and fire safety systems in COG offices and sublease space, the COG Board of Directors is asked to approve a reprogramming of FY 2011 General Reserve at the COG Board of Director's October 13, 2010 meeting. I will further recommend COG Board of Directors approval of the FY 2011 to FY 2016 Capital Repair/Replacement Plan and a funding policy as part of Budget and Finance Committee discussion and COG Board of Directors action on the FY 2012 Work Program and Budget in January 2011.

*Adjunct member

COG Funding Sources

COG has three principal funding sources, only one of which the Chief Financial Officer and I believe is appropriate for funding Capital Repair/Replacement Plan expenses.

1. Fiscal Year Operating Budget: Approximately 12 percent of COG's operating budget comes from member assessments (which have been frozen since FY 2009). The other approximately 88 percent comes from a variety of federal, state and foundation grants and contracts. More than half of member assessments are used to provide matching funds for grant revenue.
2. Indirect Cost Allocation Plan: Like most not-for-profit organizations, COG has an indirect costs allocation plan that funds ongoing and routine expenses, for example, management and administration staff, employee benefits, and indirect costs such as rent, audit expense, etc.
3. Reserve Funds: COG's principal source of unrestricted funds is generated by building and interest income. This is shown in the Fiscal Year Work Program and Budget as Capital/Contingency Reserve. In recent years, a portion has been allocated to priority programs or approved for matching funds for unanticipated grants. Unallocated Capital/Contingency Reserve is added to the General Reserve at the end of the Fiscal Year following the audit.

Grant funds may not be used to support capital repair and replacement expense. Also, COG's indirect cost allocation plan is better suited to annual expenses and any large one-time capital expenses would result in periodic spikes in the rate and make COG uncompetitive for grants.

Because building and interest income are the principal revenue source for the Fiscal Year Capital/Contingency Reserve, and if unspent, have overtime built up COG's General Reserve, the Chief Financial Officer and I concluded that this is the most appropriate source to fund the Capital Repair/Replacement Plan.

Total COG reserves are approximately \$9.8 million as of the end of FY 2010 (unaudited) or 37.8 percent of the adopted work program budget. The COG approved reserve fund target is 40 percent of adopted work program budget. COG is on track to fully fund its reserve in several years, absent any significant change in the size of the budget or COG Board of Directors action obligating a large portion of the reserve.

Capital/Contingency Reserve

Beginning FY 2012, I will recommend that approximately one-third of budgeted Capital/Contingency Reserve (approximately \$250,000) be allocated as part of the Fiscal Year budget process to support annual expenses associated with the Capital Repair/Replacement Plan. This will leave two-thirds for allocation by the COG Board for priority program expenses, grant match, or held as unallocated. Unallocated and unspent Capital/Contingency Reserve funds, following COG's Fiscal Year audit, will add to its General Reserve, unless otherwise directed by the COG Board.

FY 2011 Proposed Action

While the recommendation described above will provide a policy and process for allocating sufficient revenue to meet forecasted Capital Repair/Replacement Plan expenses beginning FY 2012, COG has an immediate need to support audiovisual and fire safety expenses in FY 2011.

The table below shows that COG has \$335,000 unallocated FY 2011 Capital/Contingency Reserve. I considered, but do not recommend that the requested audiovisual and fire

safety expenses (not to exceed \$200,000) come from FY 2011 Capital/Contingency Reserve, because it would significantly deplete this balance and leave the COG Board with little flexibility should other priorities or grant opportunities occur in the remainder of the Fiscal Year.

<i>Additions</i>	<i>FY 2011 (Forecast)</i>
Building Income	550,000
Interest Income	295,000
Total Capital/Contingency Reserve	\$845,000
<i>Subtractions</i>	
Allocated FY 2011 WPB	330,000
Approved DTP/FHwA Grant Match	80,000
Approved HUD Grant Match *	100,000
FY 2011 Unallocated	\$335,000
*Grant application pending with HUD	

The audiovisual and fire safety expenses are costs that are not expected to reoccur (essentially one-time for fire safety and with a projected life of 10 to 15 years for audiovisual), and the use of General Reserve funds to support these costs is consistent with the COG Board adopted policy governing reserve funds.

The use of General Reserve funds to support audiovisual and fire safety expenses in FY 2011 will result in a negligible reduction in the \$9.8 million balance as of June 30, 2010 (unaudited). If the COG Board approves no further use of unallocated Capital/Contingency Reserve, the projected \$335,000 will be added to the COG reserve as of June 30, 2011.

Lastly, I considered but do not recommend that the audiovisual and fire safety expenses be funded by reprogramming COG membership assessment revenue included in the FY 2011 program budget. More than half of membership assessment revenue is used for required grant match, so a reduction in this area would have very significant and negative program and staffing impacts and would result in reduced eligibility for grant funds. The remaining membership assessment revenue has been approved by the COG Board to support programs that have consistently been deemed of high priority, such as public safety. Eliminating several priority programs and associated staff for what is largely a one-time capital expense, is unwise in my view.

Conclusion

These are very difficult fiscal times for COG and its member governments and funding partners and warrants thoughtful budget action by management and the COG Board of Directors. Building and interest income has enabled COG to slowly build a reserve fund that provides it with a level of financial security not often found in voluntary, not-for-profit organizations. The COG Board adopted a reserve fund policy that has successfully guided use of its resources. I believe it is necessary to undertake the audiovisual and fire safety work immediately and further believe it is appropriate and consistent with adopted reserve fund policy to essentially use building and interest income to maintain COG's investment in its capital asset at 777 North Capitol Street, both in FY 2011 and in the long-term as part of a multi-year Capital Repair/Replacement Plan.

As always, I thank the COG Board for its support and guidance concerning the sound fiscal management of this organization.