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## Coates' Canons Blog: Capital Reserve Funds Revisited

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Article: <https://canons.sog.unc.edu/capital-reserve-funds-revisited/>

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In a recent **post**, I discussed two ways through which a local government may save money over time to fund capital projects. The first is through fund balance and the second is by establishing a capital reserve fund. I received several follow-up questions about capital reserve funds that may be of interest to local government officials, including the following:

1. In establishing a capital reserve fund, does a local government have to list each specific project for which it is accumulating funds or may it list more general expenditure categories?
2. May a local government use a capital reserve fund to accumulate money to provide a grant or loan to a private entity to fund a private capital project?
3. May moneys held in a capital reserve fund be invested? If so, what are the available investment options? And, must the investment returns be allocated to the capital reserve fund?
4. May a local government establish a trust fund to accumulate moneys over time to finance future government expenses?

Each is addressed below.

***1. In establishing a capital reserve fund, does a local government have to list each specific project for which it is accumulating funds or may it list more general expenditure categories?***

A local government must list the specific purpose(s) for which it is accumulating moneys in a capital reserve fund. It may amend the fund at any time to change the purpose(s), as long as the new purpose(s) constitute allowable capital expenditures, but it must list the purpose(s). A unit may not appropriate moneys to a capital reserve fund to save money for unknown or unnamed future capital expenditure(s).

But how specific must the unit be in listing the “purpose(s)?” Could a unit that wishes to save money for a variety of future capital expenditures related to its water system, simply state the purpose as “water system projects” or must it list each separate project (such as water line expansion, water treatment plant roof maintenance, water tank painting, etc.)? The answer is not entirely clear. **G.S. 159-18** requires a unit to list all the “purposes” for which it is establishing or maintaining the reserve fund. It does not provide further guidance on the level of specificity. The statute, however, allows a local government to establish a capital reserve fund only for the purposes for which a unit may issue bonds. The most comprehensive list of purposes for which counties and municipalities may issue bonds is in **G.S. 159-48**. The level of specificity in which projects are listed in this statute provides at least some guidance to local governments as to how detailed the stated purposes must be in a capital reserve fund. The local unit likely could list its water-system related purposes as follows—“to provide for the unit’s water system, including without limitation facilities for the supply, storage, treatment, and distribution of water.” This is one of the authorized purposes for which counties and municipalities may issue general obligation bonds under **G.S. 159-48(b)(21)**.

***2. May a local government use a capital reserve fund to accumulate money to provide a grant or loan to a private entity to fund a private capital project?***

No. Counties and municipalities have broad authority to appropriate monies to private entities as long as the monies are spent by the private entities on a project or activity in which the local governments are statutorily authorized to engage. See **G.S. 153A-449**; **G.S. 160A-20.1**. And there is broad statutory authority for local governments to support private capital projects particularly for economic development purposes. See, e.g., **158-7.1**. But a local government may not accumulate funds in a capital reserve fund that it later loans or grants to a private entity to fund a private capital project. A local government only may establish a capital reserve fund to save moneys for public capital projects.

A local government may accumulate funds through fund balance that it ultimately loans or grants to a private entity for a private capital project. Alternatively, a local unit may appropriate the moneys to the private entity each year and allow the private entity to save the funds over time.

***3. May moneys held in a capital reserve fund be invested? If so, what are the available investment options? And, must the investment returns be allocated to the capital reserve fund?***

Moneys held in a capital reserve fund may be invested pursuant to any of the allowable investment options in **G.S. 159-30**. The moneys in a reserve fund may be pooled with other local government revenues for purposes of investing but any interest earned on the capital reserve fund moneys must be allocated back to the reserve fund. **G.S. 159-30(e)**.

***4. May a local government establish a trust fund to accumulate moneys over time and create a stream of income to finance future general government expenses?***

No. A trust fund is used to “account for moneys held by a local government . . . as an agent or common-law trustee or to account for a retirement, pension, or similar employee benefit system.” **G.S. 159-13(a)(3)**. A local government may not establish a trust fund and invest moneys to create a stream of income for future general government expenditures. Instead, a local unit must save revenue through fund balance or a capital reserve fund.

## Links

- [canons.sog.unc.edu/?p=6869](https://canons.sog.unc.edu/?p=6869)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-18.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-18.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-48.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-48.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_153A/GS\\_153A-449.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-449.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-20.1.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-20.1.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_158/GS\\_158-7.1.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_158/GS_158-7.1.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-30.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-30.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-13.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-13.html)