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Under state statutes, cities, towns and districts can establish reserve funds to provide for extraordinary or unforeseen expenditures. A reserve can be established and funded as a line item in the annual budget, or it can be created by a separate budget article and funded through a transfer from a specified revenue source. The annual, cumulative reserve balance cannot exceed five percent of the prior-year property tax levy in a town ([M.G.L. c. 40, §6](#)), three percent of the prior-year levy in a city ([M.G.L. c. 40, §5A](#)), or five percent of the prior year's receipts in a district ([M.G.L. c. 40, §5C](#)).

Transfers out of a reserve require a majority vote of a town finance committee, city council on recommendation of the mayor, district prudential committee (if any), or district commission. An expenditure cannot be made directly from a reserve fund but instead must be transferred to another account, even if newly created, for the charge to then be posted against it.

In practice, the amount appropriated to reserves reflects a financial management decision. During difficult economic periods, a higher reserve can meet the expectation of more frequent transfer requests from departments that struggle with lean budgets. During periods of revenue growth when departments are given more spending latitude, the likelihood of fewer requests justifies a lower reserve balance. Given the diverse range of financial conditions among cities, towns and districts, there is no consensus best practice on an appropriate reserve fund size, either in absolute dollars or as a percentage of the total budget. Historical practice can serve as a guide if reserve fund transfers have been tightly managed under consistent rules.

Extraordinary or unforeseen expenditures refer to expenses that could not be anticipated before the setting of the tax rate or could not be determined when the budget was approved. Generally, if a diligent budget process could have anticipated the cost, it does not qualify as unforeseen. However, the definition of an emergency falls, in the first instance, to the finance committee, city council, or district and can include circumstances where delays to act would be prohibitively costly or when the requested amount is too small to justify the expense of calling a special town meeting. Common sense should prevail. Ultimately, reserve transfers cannot be used to bypass or render invalid legitimate town meeting decisions or the budget review approval process in cities and districts.

Finally, funds in a reserve account cannot be earmarked for a particular purpose. Even if so targeted, the vote would not be binding on the city council, town finance committee, or district prudential committee. At year-end, any remaining reserve fund balance closes to free cash.