





The Importance of Reserves and Reserve Funds

Maintaining adequate reserve and reserve funds is essential to a municipality's capacity to maintain service levels in current and future periods without incurring significant changes in annual taxation levels or unwelcome breaks in services. Reserves and reserve funds are a critical component of a municipality's long-term financing plan. The purpose for maintaining reserves is to:

- Provide stability of tax rates in the face of variable and uncontrollable factors (consumption, interest rates, unemployment rates, changes in subsidies)
- Provide financing for one-time or short-term requirements without permanently impacting tax and utility rates
- Make provisions for replacements/acquisitions of assets/infrastructure that are currently used to deliver services, and are wearing out
- Avoid sudden tax or debt increases to address capital funding requirements
- Provide flexibility to address unanticipated investment opportunities or to finance unplanned expenditures
- Manage the municipality's daily cash requirements without relying on short-term borrowing
- Support the concept of intergenerational equity by setting funds aside now for liabilities incurred in the current period but that are not payable until some future period

Reserve Fund Guiding Principles

Since amalgamation, the City of Greater Sudbury has considered the following principles to support its financial and service delivery planning:

Principle	Status
1. Plan for the replacement of infrastructure through the use of life cycle costing and the development of replacement reserves.	
2. Undertake regular reviews of remaining life and condition of assets and determine required annual reserve contributions sufficient to ensure that 90% of approved infrastructure rehabilitation / replacement schedules can be met at the required time.	
3. Facility, equipment and infrastructure replacement reserves should be established and funded to ensure that 90% of approved infrastructure rehabilitation / replacement schedules are met (long-term).	
4. Establish a Stabilization Reserve for programs that are susceptible to significant annual expenditure fluctuations (ie. Winter Maintenance). Program budgets should be based on a moving five year historical average of program spending. In years when surplus funds occur in these programs, surpluses should be reserved, provided an overall City surplus	

exists. Where the City's overall surplus is less than the program surplus, funds should only be reserved up to the level of the overall City surplus.	
5. Establish reserves to provide funding for future liabilities (ie. sick leave, post-employment benefits, WSIB). Contributions to these reserves should be set, at a minimum, at an amount sufficient to ensure the liability does not increase.	✓

As this report illustrates, these principles have not been consistently applied each year. These principles will be updated in a revised Reserves and Reserve Funds Policy and By-Law that will be presented for Council's approval during 2019. In January and April 2019, Council has approved the creation and funding of three Holding Accounts, as well as consolidation of the uncommitted Capital Financing Reserve Fund through approval of the revised Capital Budget Policy. The three Holding Account Reserves (Capital, Water, and Wastewater) will be funded from capital project surpluses and be used to fund project deficits. The City will continue to make progress and address these guiding principles through action from the Asset Management Plan and Long-Term Financial Plan.

The City has established stabilization reserve funds such as Winter Control, Tax Rate Stabilization, Water and Wastewater. However, the Winter Control Reserve Fund balance has been depleted in order to fund deficits in this area for the past few years. In addition, the balance in Tax Rate Stabilization Reserve has decreased due to funding of projects/programs as approved by Council, as well as the annual operating deficit for the past few years, in order to minimize the impact on the annual property tax levy.

2018 Reserves and Reserve Funds Balances

The City of Greater Sudbury has reserves and reserve funds in the amount of \$147.4 million as of December 31, 2018 (2017 - \$142.8 million).

In summary, the following are the highlights:

(in millions)	2018
Balance: January 1, 2018	\$142.8
Add: Interest earned	3.1
Less: Net transfers from Operating	7.7
Net transfers to Capital	(6.3)
Balance: December 31, 2018	147.4

A sample of the investments made during 2018 from reserve funds include:

- Maley Drive Extension \$8.5M
- Tom Davies Square Parking Garage Roof & Courtyard Renovation \$800K
- Tandem Multi-Function Winter Control Vehicles \$1.1M
- Tom Davies Square Elevator Replacement \$856K
- St. Joseph's Parking Lot Redevelopment \$701K

A major change to the capital budget policy and approach to capital project management resulted in the contribution of \$15.3 million to reserves funds from capital projects that were in progress but exceeded the maximum allowable timeframe for project completion under the new policy.

The balance consists of:

(in millions)	2017	2018
Reserves	6.6	4.2
General Reserve Funds	51.6	52.6
Capital Financing and other Capital Reserve Funds	84.6	90.6
Total Reserve and Reserve Funds	\$142.8	\$147.4

The main difference between a reserve and a reserve fund is that a reserve does not earn interest, whereas a reserve fund is in a separate fund and is credited, on a monthly basis, with the interest it has earned.

Please see Appendix A for tables illustrating the trends in reserve and reserve funds over the past five years.

Please see Appendix B and C which provides a more detailed explanation of each of the City's reserves and reserve funds as well as examples of projects within the committed balances at the end of 2018. Some balances in 2018 are higher than 2017 as the 2019 Budget was approved in February 2019, whereas the 2018 Budget was approved in December 2017 and the commitments from reserve funds were recorded for the 2017 year end.

Of the total balance of \$147.4 million, there are reserves and reserve funds which are included in a "committed" reserve fund for a specific project or program which accounts for approximately \$56.8 million (2017 was \$83.5 million). Refer to Appendix B and C which provides additional information on these committed reserve funds.

The annual operating and capital budgets as approved by Council include draws from reserves and reserve funds in order to fund various expenses such as capital projects, which are completed over several years or funds set aside for significant capital projects to be completed in the future, or deductibles for insurance claims, sick leave payouts and so on.

The funds remain in committed reserve funds as approved by Council in the annual budgets (or supplemental Council reports throughout the year) until the expenses have been paid, which may occur over several years. Any capital projects that have reserve funds identified as a funding source that are cancelled at a later time, would be uncommitted in order to use for future capital projects/expenses or used to fund over-expenditures in other capital projects in accordance with the existing Capital Budget Policy. The primary difference between the 2018 forecast and actual year end results is

the result of timing differences associated with actual project deliverables compared to plan.

Comparison to Other Municipalities

The City's level of reserve funds is low in comparison to other municipalities in Ontario. The comparison used is the "Reserves and Reserve Funds as a Percentage of Total Taxation (excluding Water/Wastewater)" as taken from the 2018 BMA Municipal Study. This ratio is a key measure of the financial health of a municipality and illustrates the municipality's capacity for asset renewal, reduces reliance on external debt, helps manage annual tax levy changes, and managing unplanned expenditure requirements. The City's rate of discretionary reserves as a percent of taxation is 39%. This is lower than the last available average of 69% for municipalities with a population over 100,000 as illustrated on Appendix D or median of 68% of all municipalities within the study as shown on Appendix A.

The City has pressures in comparison to other municipalities in Ontario where it has a significant quantity of mature capital assets that require asset renewal, rehabilitation and replacement on a relatively low taxation base. When taking into consideration that a significant portion of reserve funds are committed to existing projects that are currently underway, the importance of incorporating a plan to sustain reserves and reserve funds at minimum levels becomes clear.

The Reserve Fund Guiding Principles are examples of "best practice" guidance that will be part of planned revisions to the Reserves and Reserve Funds Policy & By-Law. These will be presented to Council in 2019. Similarly, the application of these principles will be illustrated in recommendations that support the implementation of the Long Term Financial Plan and Asset Management Plans.

The effect of insufficient reserves and reserve funds is to increase reliance on other funding sources, such as increases to the property tax levy or external debt financing. Alternatively, service levels could be adjusted and plans could be more tightly controlled to reduce the financial impacts of unplanned projects.

Long Term Financial Plan

The long-term financial plan recommends the following change relating to reserve and reserve funds:

"While the City has established minimum and maximum amounts for some reserve and reserve funds, consideration could be given to undertaking a detailed reserve and reserve fund review that will establish minimum amounts for all reserve funds so as to ensure the sufficiency of these funds. This review would include a re-evaluation of reserves and reserve funds where minimum and maximum amounts have already been established."

This plan highlights the need for the City to strengthen reserve fund levels and increase its capacity to manage the risk that a future significant event(s) creates an unfavourable impact on the annual property tax levy. Specifically, this will include recommended minimums and maximum reserve levels, and changes to the number and scope of applicable reserves for different service areas.

The Effect of Asset Management Plans on Reserves and Reserve Funds

The condition assessments included in Asset Management Plans will clarify understanding about asset renewal requirements, their timing, and alternatives to address service level expectations. This marks a change from prior periods, since it anticipates more consistent and routine preventive maintenance activities will be used to maximize each asset's expected service capacity.

In addition, the City's efforts to strengthen asset condition information will assist in management of asset renewal, maintenance and replacement decisions with a focus on keeping desired service levels in place. With changes to capital budgeting processes that will increase the assurance capital funding is applied to the city's highest priority needs, it is reasonable to anticipate more reserve funding will be desirable. This further reinforces the need for a review of the City's reserves and reserve funds.

A capital levy recommended in the long-term financial plan was described as follows:

"Practically, the City will be unable to generate the necessary level of incremental funding for capital expenditures due to constraints from an affordability and debt capacity perspective. However, in order to ensure sufficient financing for future capital expenditures, the City may wish to consider expanding the level of available capital funding through the implementation of a multi-year capital levy. Similar to the 10 year series of water and wastewater rate increases implemented by the City in 2001, this strategy would involve a recurring increase in the City's budget specifically allocated to capital purposes, including capital expenditures, debt servicing costs or reserve fund contributions."

Staff believe a greater allocation to capital budgets will be required to sustain service levels and address asset management requirements. A capital levy is one way this could be addressed in future budgets.

Overall, the city's evolving asset management plans illustrate funding requirements for asset renewal/replacement that exceed our ability to fund them. Building reserves and reserve funds for anticipated renewal and replacements are important to sustain service levels and manage the effect of annual taxation changes on taxpayers.

Revised Capital Budget Policy and Prioritization Tool

Staff developed a revised Capital Budget Policy that was presented to Council in January 2019 and was used in the development of the 2019 Capital Budget. It is based on one contribution to capital (instead of former multiple capital envelopes by area such as Roads, Leisure, Buildings, Fire, etc) being used as a funding source for capital projects. The selection of projects funded for the 2019 Capital Budget was based on staff's completion of the new capital prioritization tool. The goal is to fund the highest priority projects for the overall organization to the benefit of the City and its citizens. Once the prioritization is complete, staff provides funding sources and make appropriate recommendations.

The focus of the prioritization process is well aligned with the Long-Term Financial Plan and Asset Management Plans. These changes in capital budgeting result in a more streamlined approach to capital financing reserve funds and reflect the approach in the Capital Budget Policy to invest in the highest order capital priorities enterprise wide with one capital funding source. Further refinements to the Reserves and Reserve Fund By-law for Council's approval in 2019 will include additional streamlining of operating and capital related reserve funds. The streamlined capital reserves will be an integral part of a more transparent and more easily understood overall financing strategy for capital investments by the City.

The following tables are a summary of the uncommitted Capital Financing Reserve Funds after consolidation and funding of various commitments from the 2019 budget as well as the three Holding Account Reserves which were approved by Council during 2019.

These amounts represent funding available for future capital projects to rehabilitate and replace existing capital assets which have significant infrastructure requirements, as well as any in-year investments or emergencies required. In addition, when there is an operating budget deficit, it is funded equally by the Tax Rate Stabilization Reserve as well as the Capital Financing Reserve Fund – General.

In early 2019, challenges and pressures are emerging that may require allocations from reserve and reserve funds such as:

- Capital construction tenders are coming in higher than budgeted.
- Provincial government budget changes are still being understood but are very likely to result in unbudgeted costs. If the municipal portion of costs will increase without an appropriate funding source, this may result in an operating deficit for 2019 that will be funded equally from the Tax Rate Stabilization Reserve as well as the Capital Financing Reserve Fund – General.
- At time of writing this report, Council is reviewing options for Development Charges rates. If development charges rates are reduced, it may impact the annual operating budget as assessment growth may be directed to growth related capital projects as opposed to increased operating costs to provide services to new development. In addition, the development charge revenues collected will be lower than calculated that may impact the available amount of reserve funds for

future capital projects.

These pressures will impact 2020 and future operating and capital budgets as funding from reserve funds may not be available.

Capital Related Reserves and Reserve Funds	Amounts Available as of April 2019
Capital General Holding Account Reserve	\$4,000,000
Capital Financing Reserve Fund – General	\$8,816,871
Total	\$12,816,871

Water & Wastewater Reserves/Reserve Funds	Amounts Available as of April 2019
Water Rate Holding Account Reserve	\$1,500,000
Wastewater Rate Holding Account Reserve	\$1,500,000
Capital Financing Reserve Fund – Water	\$9,940,507
Capital Financing Reserve Fund – Wastewater	\$7,121,166
Total	\$20,061,673

Appendix E provides further details on the uncommitted capital financing reserve funds along with Council approved commitments during 2019 relating to the Budget as well as consolidation into the Capital Financing Reserve Fund – General and funding of the three respective Holding Account Reserves.

Conclusion

This report describes the City's reserves and reserve fund balances and their importance in managing the City's financial condition. The City would benefit from more robust reserve and reserve fund levels so that it can minimize the risk of service interruptions due to asset failure, fund anticipated asset management investments that have not previously been a routine part of the city's annual budgets and maintain its preparedness for unanticipated in-year funding requirements. Therefore, staff will present recommended revisions to the Reserves and Reserve Funds Policy & By-Law for Council's approval in 2019.

Appendices

Appendix A – Historical Trend in Reserves and Reserve Funds

Appendix B – Reserves (Non-Interest Bearing)

Appendix C – Reserve Funds (Interest Bearing)

Appendix D – Tax Discretionary Reserves (less WWW) as % of Taxation for Municipalities with over 100,000 Population

Appendix E – Creation of Holding Account Reserves and Consolidation of Capital Financing Reserve Funds