



**Staff Report T2014-25
Strategic Financial Plan
Policy Paper No.2
Reserve and Reserve Funds**

December 15, 2014

Submitted to: Mayor and Council
Submitted by: John Brown, CAO
Dennis Sloan, Deputy Director Financial Planning and Policy Development
Subject: Review of Reserves and Reserve Funds

PURPOSE

To provide Council with an overview of reserves and reserve funds and provide recommendations on consolidation of current accounts.

RECOMMENDATION:

That Council receive Staff Report T2014-25 and refer the report to the Strategic Initiatives Committee for further review

1. BACKGROUND

The effective use and management of Reserves and Reserve Funds is a critical aspect of an organization's Strategic Financial Plan (SFP) and continued long-term financial sustainability.

"A Strategic Financial Plan is a statement of principles, programs and policies formally approved by Council that serves as a framework for Council to make financial decision and provides a guide for the Town's overall financial Strategy"

The development of a SFP is an incremental process and a review and analysis of the relevancy and adequacy of the Town's Reserves and Reserve Funds is an important step in that process. Other steps currently underway include Operational Review Phase II, the development of Debt Controls and the continued development and refinement of an Asset Management Plan.

This analysis of Reserves and Reserve Funds will assess and confirm:

1. Continued relevancy with to respect Council's priorities and needs and,
2. Adequacy of current funding levels to meet intended need

2. INPUT FROM OTHER SOURCES

BMA Management Consulting Inc. 2014 Municipal Study

1. BMA Management Consulting Inc. Assessment of the Town of Collingwood's Financial Health, January 2014
2. BMA Management Consulting Inc. Assessment of the Town of Collingwood's Financial Health, November 2014
3. Watson and Associates, Town of Collingwood Asset Management Plan June 24, 2014
4. This report was reviewed by Department Heads December 9, 2014 and recommended to proceed to Council.

3. APPLICABLE POLICY OR LEGISLATION

N/A.

4. ANALYSIS

Contrary to popular belief, Reserves and Reserve Funds do not serve as a "rainy day" fund. This is in fact far from accurate as reserves fulfill a critical financial need for municipalities. They:

- Make provisions for the replacement / rehabilitation of existing Town assets;
- Provide for future liabilities;
- Provide a source of contingency funding for one time and unforeseeable events; and,
- Provide flexibility to manage debt levels and protect the Town's financial position.

A Reserve is an allocation of revenues set aside at the discretion of Council to provide for future expenditure requirements such as working funds, contingencies, equipment replacement or any other municipal need. They are generally used in conjunction with the Operating Program to support or supplement activities which are normally funded from general revenues. They are typically used either to mitigate the impact of fluctuations in operating costs and revenue or to accumulate funds for future or contingent liabilities. In addition:

- Reserves are part of the accumulated surplus and are not segregated.
- Council has discretion to redirect the funds in a Reserve for any purpose that is of general benefit to the municipality at large.
- Reserves are created by provision in the current budget or by transferring unexpected or surplus funds via a resolution or motion.

Reserve Funds on the other hand are segregated from the general assets of the municipality and, as such, are placed in a separate bank account with all/any interest earned added to the reserve fund. They are established by By-Law and are restricted to meet a specific purpose but are generally associated with the capital program. There are two types of reserves funds, Discretionary and Obligatory. Obligatory Reserve Funds are mandatory reserves created by statute such as Development Charges,

Cash in Lieu of Parkland and Gas Tax funding. Council has no control over the use of the funds and the funding is through transfers from Federal or Provincial governments as in the case of Gas Tax funding or collected as a charge on development as is the case with Development Charges and Cash in Lieu monies. Conversely, discretionary reserve funds are created by council through By-Law for a specific use defined by council and their use is entirely at the discretion of council. Typically discretionary reserve funds are associated with large capital asset requirements and the funds would be accumulated via transfers from the operating fund over a number of years.

As of December 31, 2013 the Town had \$25.7MM in Reserves, \$6.3MM in Discretionary Reserve Funds and \$8.4MM in Obligatory Reserve Funds for a total of \$40,380M. Generally, as was highlighted in the BMA Health of the Town study January 2014, the Town's Reserves are considered inadequate, particularly so with respect to the Town's Capital Asset Management Plan (AMP) needs. In the most recent update to the Assessment of the Town of Collingwood's Financial Health by BMA Consulting Inc., the Town of Collingwood's Tax Discretionary Reserve Ratio as of Dec 31, 2013 was 37% whereas the average for our peer municipalities was 40%. Furthermore, based on the 2014 Budget projections, the total 2014 year end Reserve values are expected to be lower by \$2MM and a significant portion of the current Discretionary Reserves (\$2MM COLLUS Sale proceeds) are already committed to the Hume Street widening project in 2015. Taking this into account, the Town's Tax Discretionary Reserve Ratio would then be even lower at 27%.

Capital Asset Reserves

The Town of Collingwood's Capital Reserves are comprised of the following Reserves and Reserve Funds:

<u>Type</u>	<u>Category</u>	<u>Name</u>	<u>2013 Balance</u>	<u>2014 Estimated Balance</u>
Reserve	Working Funds	General	\$625,031	\$377,031
Reserve	General Government	Computer Systems	\$144,697	\$ 120,467
Reserve	General Government	Fleet	\$33,264	\$ 42,263
Reserve	General Government	COLLUS Sale Proceeds	\$2,200,000	\$2,000,000
Reserve	Protection Services	Fire Equipment	\$217,278	\$317,277
Reserve	Transportation Services	Roadways	\$916,555	\$430,555
Reserve	Transportation Services	Transit	\$144,700	\$19,603
Reserve	Environmental Services	Sewage Lagoon , Treatment, Service Charge	\$15,348,544	\$14,241,320
Reserve	Parks, Recreational and Culture	Harbourlands, General	\$8,606	\$8,606
Reserve	Library	Capital, General, Internet	\$62,900	\$48,900
Reserve Fund	Discretionary: Financial Policy	Lifecycle Replacement	\$1,871,659	\$1,277,075
Total			\$21,573,234	\$18,883,098

The Town of Collingwood's Reserves are particularly inadequate with respect to provisions for the rehabilitation and replacement of existing capital assets. This is true relative to the current level of the fund, the amount of funding that is occurring annually and the method by which they are funded. The AMP prepared by Watson and Associates in June 2014 highlighted a considerable funding deficit for which they recommended for the Town's Tax Based Assets a Taxation Levy increase of 3.6% for the next

eight years decreasing to 1.8% in the following 12 years in order to bring funding up to adequate levels. For Water and Wastewater Rate based assets there was a similar proposal requiring a 2.5% increase for Water and 3.5% increase for Wastewater over the next ten years. These are very significant increases for the Town's residents whose tax levy per capita is already the sixth highest in the 2014 BMA Ontario Municipal Study of 95 Ontario Municipalities.

Other commonly used indicators of Capital Asset Reserve health and adequacy are:

- Capital Reserve Contributions as a ratio to Capital Asset Value
 - Compares level of reserve funding with the gross book value (historic cost) of capital assets.
 - Town of Collingwood 2013: \$8.6MM vs. \$237MM or 2.9%
 - General guideline 2-3%
- Capital Reserve Contributions as % of Amortization
 - Provides insight on the level of reserve funding for future capital purposes compared to the total amortization in the current year. In general capital reserve contributions should be at least equal to the amount of amortization that occurs annually.
 - Town of Collingwood's amortization for 2013 amounted to \$8.6MM whereas contributions to Capital Reserves were \$5.7MM or 66% (\$1.4 Discretionary Reserve Funds and \$4.3MM Reserves)¹
- Asset Consumption Ratio
 - Unamortized balance of Capital Assets relative to historical cost. This ratio is an indicator of the relative age of the Town's assets and replacement needs. Higher ratios indicate increasing asset replacement needs.
 - December 31, 2013 Collingwood ratio was 35% As compared to average of 37.6% and Median 37%. Our objective should be to exceed the median or at least meet the average.

One of the Town's primary Capital Asset reserves is the Lifecycle Replacement Discretionary Reserve Fund. This Reserve Fund was created October 2010² in anticipation of the development of an AMP. The purpose of this reserve was for "the replacement or rehabilitation of existing capital infrastructure excluding those expenditures that are funded entirely by user fees." Its funding to date has been from a portion of the annual Operating Surplus³ which is not budgeted for. However, having now received the results of the AMP by Watson and Associates, the magnitude and necessity of the funding required is better understood and it is proposed that this funding would more appropriately be funded through a Capital Levy which is included in the annual budget. The amount of the Capital Levy will initially be based on the Watson and Associates estimates but future funding will be based on the AMP model now being developed by Treasury staff. Further details with regard to the development of the AMP model will be addressed in a separate report and analysis.

Additional proposed changes regarding Capital Asset Reserves are as follows:

1. The assets from the following reserves are included in our current Asset Plan from Watson and therefore can be collapsed and their accumulated reserves added to the Lifecycle Replacement Reserve Fund.

¹ 2013 FIR

² T2010-09 Oct 4, 2010

³ Operating Surplus Policy : 30% Lifecycle Replacement, 30% Tax Stabilization, 10% Non DC Growth, and remaining 30% as per CAO and Treasurer Discretion

- a. General Government Reserves:
 - i. General
 - ii. Computer Systems
 - iii. Fleet
- b. Protection
 - i. Fire Equipment
- c. Transportation
 - i. Transit
- d. Parks, Recreation and Culture
 - i. General, Harbourlands

As the Capital Asset Plan is continuing to be developed and refined, further changes to the Capital Asset Reserves will be required as the process continues and as such, reports and proposals will be prepared for Council’s review and approval accordingly.

Contingency Reserves

The Town of Collingwood’s current Contingency Reserves are as follows:

<u>Type</u>	<u>Category</u>	<u>Name</u>	<u>2013 Balance</u>	<u>2014 Estimated</u>
Reserve	Working Funds	Operating Contingency	\$300,000	\$185,868
Reserve	Working Funds	Capital Contingency	\$1,000,000	\$981,945
Reserve	Contingencies	Disaster Relief	\$6,850	\$7,850
Reserve	Contingencies	Emergency Social Services	\$19,056	\$19,056
Reserve	Contingencies	WSIB	\$333,745	\$283,745
Reserve Fund	Discretionary	Tax Rate Stabilization	\$2,500,000	\$2,845,848
Total			\$4,159,651	\$4,324,312

Contingency reserves serve the following purposes:

- Maintain Cash Flow
- Minimize need for short -term borrowing
- Fund urgent, unforeseen expenditure requirements
- Minimize changes in property tax rate and to smooth out fluctuations due to onetime expenditures.

The Government Finance Officers Association (GFOA) recommends contingency reserves in the amount of 5-15% of own source revenues to be adequate. At the end of 2013 the Town’s contingency reserves amounted to 9% (\$4.2MM / \$46.9MM). No change is currently recommended with respect to the current annual funding method or the amount until such a point as the reserve goes below 7.5%.

The Tax Rate Stabilization Reserve Fund was created October 4, 2010 as part of a package of financial policies which included the Lifecycle Replacement Reserve Fund discussed above. While it serves the same overall purpose as the Operating Contingency Reserves, it is meant for longer-term capital contingencies whereas the operating contingencies are meant for current year operating contingencies.

The following recommended changes are proposed for the contingency reserve:

- 1) Rename Tax Rate Stabilization Reserve Fund
 - a) Proposed name would be "Capital Contingency and Internal Loan Reserve Fund"
 - (1) To reinforce its intended use for Capital contingency and not tax rate stabilization
 - (2) Propose that this reserve also serve as source for internal lending for smaller Capital Projects under \$0.3MM which typically would not be debentured.
- 2) WSIB
 - a) Originally setup as contingency for WSIB to cover the first \$0.5MM of a potential claim for which we are liable for as a Schedule 2 employer. This is no longer required as additional insurance now covers this. More recently the reserve has served as a Salary Contingency fund
- 3) Disaster and the Emergency Social Services
 - a) Originally created by motions of council. It is believed the original intent of these has since been eclipsed. This requires more research but they can likely be collapsed.

Other Reserves and additional recommendations

There are a handful of Reserves that have been created at some point in the last few years for which the intended purpose never materialized or that purpose is now no longer valid. Therefore we propose the following Reserves be collapsed.

1. Legal Reserve
 - a) This reserve was created for a specific legal issue which did not materialize for the Planning Department.
2. Mayor's Gold Tournament Reserve
 - a) Timing related to charitable donations.
3. Sustainability
 - a) Program initiative of previous Council
4. Physician Attraction
 - a) Established to be used to attract Physicians to live and work in Collingwood
5. Affordable Housing
 - a) Obsolete reserve related to a affordable housing program
6. BCRY Railway
 - a) The railway has ceased operations, this reserve should be collapsed

The following two reserves are unique in their origin and require further investigation in term of how to properly close them. The third item, Lighthouse Restoration, is really monies held in trust and as such can be moved to liabilities section of General Ledger as it in fact not a Reserve at all.

1. Hwy 26 Sewer Line
 - a) These funds were received from a developer in the early 1990s to be held for future extension of sewers on Hwy 26 West.
 - b) There is no By-Law, setup by previous Treasurer. Requires further research
2. Parks and Recreation (lot levys)
 - a) Parks and Recreation Land, Culture and Greening Reserve Funds originated from lot levy legislation (pre Development Charge legislation).
 - b) This are also potentially obsolete reserves which could be collapsed. More research required.

- 3. Lighthouse Restoration
 - a) Held in trust for Lighthouse Restoration Committee
 - b) More appropriately should be move to Accounts Payable within general ledger

5. EFFECT ON TOWN FINANCES

N/A

6. APPENDICES & OTHER RESOURCES

N/A.

SIGNATURES

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