



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning & Policy Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	May 12, 2014
SUBJECT/REPORT NO:	Reserve Policies - Update (FCS14028) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	John DiBattista 905-546-2424 Ext 4371 Brian McMullen 905-546-2424 Ext 4549
SUBMITTED BY:	Mike Zegarac General Manager Finance & Corporate Services Department
SIGNATURE:	

RECOMMENDATION

- (a) That the Reserve Policy for the Administration of Financial Reserves and Reserve Funds, attached as Appendix "A" to Report FCS14028, be approved;
- (b) That the Reserve Policy for the Tax Stabilization Reserve, attached as Appendix "B" to Report FCS14028, be approved;
- (c) That the Reserve Policy for the Unallocated Capital Levy Reserve, attached as Appendix "C" to Report FCS14028, be approved;
- (d) That the Reserve Policy for the Waste Management Recycling Reserve, attached as Appendix "D" to Report FCS14028, be approved;
- (e) That the Reserve Policy for the Enterprise Fund Reserve, attached as Appendix "E" to Report FCS14028, be approved.

EXECUTIVE SUMMARY

Reserves play a very important role in the City's finances and provide a strong indicator of the City's overall financial health. One of the key attributes of financial sustainability is appropriate reserve fund levels. Adequate reserve balances provide financial flexibility, mitigate risk, weather uncertainty, and ensure the ongoing financial stability of the Corporation. Reserves are also leveraged to sustain City infrastructure, support programs and form an important part of the City's financial strategies.

The balance in City's Reserves and Obligatory Reserve Funds at December 31, 2013 (unaudited) of \$796 million represents a significant asset.

Council has approved a number of reserve policies over the past fourteen years with the most substantial policy approved by Council in October 2005 in Report FCS05111. Appendix "A" to Report FCS14028 provides a policy for the administration of reserves and reserve funds that documents the practices that have been established and followed. The policy documents the roles, responsibilities and authorities of Council and City Administration or Management and general guidelines.

One of policy statements requires a periodic review of reserves. Report FCS14028 initiates the review process recommended in the Policy.

To ensure that the City's reserve remain in a healthy position, staff will review the City's individual reserves over the next several years in order to develop a formal reserve policy that defines the appropriate level of the individual reserve's target levels, review the reserve's purposes and review how resources will be allocated for the reserve's replenishment. Each year staff will review a specific number of individual reserves and report to Council recommending the approval of the policies.

Report FCS14028 includes reserve policies for the following reserves:

Tax Stabilization Reserve	110046
Unallocated Capital Levy Reserve	108020
Waste Management Recycling Reserve	112270
Enterprise Reserve Fund	112243

Information report FCS13026 presented to the General Issues Committee at its meeting on February 28, 2013 suggested the review of the Tax Stabilization Reserve, the Unallocated Levy Reserve, the Investment Stabilization Reserve and the Waste Recycling Reserve. The Investment Stabilization Reserve which was to be part of the initial review has been replaced with Enterprise Reserve Fund (112243). The deferral is due to discussions revolving around the future use of the Investment Stabilization Reserve and, therefore, policy recommendations for this reserve will be included in a future report.

Alternatives for Consideration – Not Applicable

FINANCIAL – STAFFING – LEGAL IMPLICATIONS (for recommendation(s) only)

Financial:

The rationale for the recommended target levels for each of the reserves and the financial impact, if any, on the operating and capital budgets is documented in the following pages. Table 1 shows the balance in each of the reserves included in Report FCS14028.

Table 1: Reserve Balances as at December 31, 2013 (unaudited)

	<u>2013</u> \$000 s
Tax Stabilization Reserve	12,137
Unallocated Capital Levy Reserve	21,794
Waste Management Recycling Reserve	3,455
Enterprise Fund Reserve	1,544
Total	<u>38,930</u>
Total All City Reserves and Obligatory Reserve Funds	<u>796,190</u>

Tax Stabilization Reserve - 110046

The purpose of the Tax Stabilization Reserve is to offset extraordinary and unforeseen operating expenditures, to offset operating revenue shortfalls, to fund operating program phase-ins, to fund pilot programs and one-time grants and to fund operational reviews and departmental reorganizations. To ensure there are sufficient funds to achieve the intended purpose of the reserve, a minimum target balance should be set. In addition, a timeline to achieve the minimum target should be proposed.

According to Best Practices of the Government Finance Officers Association (GFOA), the target balance of stabilization reserves ranges between 5% and 15% of the annual operating revenues or no less than one to two months of regular fund operating expenditures.

It is being proposed that the Tax Stabilization Reserve balance target level be 5% of the previous year's Tax supported Operating Budget Net Levy which is defined as tax levy excluding Police, Library and HECFI, with a ceiling of 10% of the net tax levy. The target balance of 5% is approximately \$27.8 million based on the 2013 net tax levy. As at December 31, 2013, the tax stabilization reserve balance of \$12.1 million (with an uncommitted balance of \$5.6 million) results in a shortfall from the target of \$15.7 million.

Reserve Policy for the Tax Stabilization Reserve is attached as Appendix "B" to Report FCS14028. The sustainability of the Tax Stabilization Reserve from 2009 to 2013 with projections for 2014 to 2016 is illustrated in Appendix "F" to Report FCS14028.

The City should aim to attain the target balance over a 5 year period. This can be accomplished, at Council's discretion, either through annual contributions from the operating fund, through directing one-time unexpected sources of operating revenues or

by transferring a portion of the yearend tax supported operating budget surplus to the Reserve.

It should be noted that the Working Fund Reserve (112400) can also be drawn upon in the event of extraordinary and unforeseen operating expenditures. As at December 31, 2013 the balance in this reserve was \$19.0 million.

Unallocated Capital Levy Reserve – 108020

The purpose of the Unallocated Capital Levy Reserve is to fund capital projects of the Tax supported Capital Budget, to fund emergency capital repairs, to fund capital projects not included in the yearly capital budget submission, to fund capital opportunities as they arise either through direct contribution or through borrowing of funds.

The reserve with a balance of \$21.8 million as at December 31, 2013 has provided funding for projects in the Tax supported Capital Budget in the last three years (2011 to 2013) of \$8.1 million, \$18.6 million and \$13.3 million, respectively. In addition, funding for projects approved in year for the last three years was \$7.8 million and commitments for the next three years (2014 to 2016) are \$10.5 million. The reserve balance as a percentage of Tax supported Operating Budget Capital Levy is 30% and of the approved Tax supported Capital Budget is 10% averaged over the past five years.

In order to provide sufficient flexibility and protection for unforeseen capital related events, it is being recommended that the target level be maintained at 10% of the five year average approved Tax supported Capital Budget. Based on the five year average Tax supported Capital Budget the target balance would be \$24.2 million as at December 31, 2013. As the unallocated capital levy reserve balance was \$21.8 million, a shortfall of \$2.4 million results.

Reserve Policy for the Unallocated Capital Levy Reserve is attached as Appendix “C” to Report FCS14028. The sustainability of the Unallocated Capital Levy Reserve from 2009 to 2013 with projections for 2014 to 2016 is illustrated in Appendix “G” to Report FCS14028.

The City should aim to attain the target balance over a 5 year period. This can be accomplished, at Council’s discretion, by transferring a larger portion of the yearend Tax supported Operating Budget surplus in Capital Financing accounts and/or by directing one-time unexpected sources of capital revenues to this reserve.

Waste Management Recycling Reserve – 112270

The Waste Management Recycling Reserve was established in 1992 to fund future deficits in the Recycling Program. The proposed purpose of this reserve is amended to fund recycling operating budget deficits, offset recycling revenue shortfalls, fund recycling program improvements, such as, pilot programs and capital infrastructure projects.

Waste Management Recycling revenues to an extent are unpredictable because pricing for the recycling products are based on current market condition which are influenced by supply and demand of the products and can vary substantially over a year. Over the past 8 years, the revenue variances have ranged from a deficit of \$2.9 million in 2009 to a surplus of \$1.5 million in 2012. Over the last 8 years only 2 years had positive variances while 6 years had negative variances. It is therefore being recommended that the target balance related to recycling revenue variance be set at \$3.0 million.

Waste management capital budget projects have been funded from the Hamilton Future Fund and, more recently, have been funded by the issuance of long term debt. The ten year capital budget for waste management of \$9 million could be funded with transfers from reserve once the balance is sufficient. It is also recommended that an additional \$1 million target balance be added to the \$3 million for recycling revenue variance to be used for recycling infrastructure improvements and/or projects.

The combined target balance for this reserve is recommended at \$4 million. The reserve balance was \$3.4 million as at December 31, 2013.

Reserve Policy for the Waste Management Recycling Reserve is attached as Appendix “D” to Report FCS14028.

Enterprise Fund Reserve – 112243

The purpose of the Enterprise Fund reserve is to fund one-time costs associated with innovative ventures and alternative service delivery that yield ongoing operating savings. The operating savings are then used to repay the initial investment, thus ensuring funds for future cost saving measures. Once the costs are repaid, the savings then have a beneficial impact on the Tax supported Operating Budget.

A target balance is not being recommended for this reserve because the initial funding was part of a one-time grant from the Province in 1999 to assist with the initial City of Hamilton and Region of Hamilton-Wentworth administrative amalgamation and no direct funding from the City’s resources is being used to replenish the reserve. The reserve is being sustained by the repayment of funds borrowed against the Province’s original contribution.

Reserve Policy for the Enterprise Fund Reserve is attached as Appendix “E” to Report FCS14028.

Staffing: N/A

Legal: N/A

HISTORICAL BACKGROUND (Chronology of events)

Information Report FCS13026 Reserve Funding By Category was presented to the General Issues Committee at its meeting on February 28, 2013. Within the report, staff stated that a review of specific reserves would occur annually in order to develop a formal reserve policy that defines the appropriate level of the reserves’ target levels, review the reserves’ purposes and review how resources will be allocated for the reserves replenishment.

Even though the timeline for the review has now been modified, the information report suggested the following reviews:

Year 2013:

- 110046 Tax Stabilization Reserves
- 108020 Unallocated Capital Levy Reserve
- 112300 Investment Stabilization Reserve
- 112270 Waste Management Recycling Reserve

Year 2014:

- 110025 Fleet Vehicle Replacement Reserve
- 104050 Building Permit Fees Stabilization Reserve
- 100033 EMS Equipment Replacement Reserve
- 112243 Enterprise Fund Reserve

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

An initiative is being undertaken by staff to develop policies for individual reserve as well as develop target balances for each reserve. Due to the large number of individual reserves, a select number of reserves will be updated annually and presented to Council for review.

RELEVANT CONSULTATION

Public Works Department - Business Administrator

ANALYSIS AND RATIONALE FOR RECOMMENDATION

(Include Performance Measurement/Benchmarking Data if applicable)

N/A

ALTERNATIVES FOR CONSIDERATION

(Include Financial, Staffing, Legal and Policy Implications and Pros and Cons for each alternative)

Financial: The financial implications of alternatives for each of the reserves are documented in the following pages.

Tax Stabilization Reserve – 110046

An alternative to the recommended policy would be that the annual Tax supported Operating Budget surplus be automatically transferred to the Tax Stabilization Reserve until the target reserve balance of \$27.8 million is achieved. This alternative limits Council's flexibility by directing the surplus to other reserves or capital projects to fund strategic priorities and objectives and, therefore, it is not being recommended.

Unallocated Capital Levy Reserve – 108020

One alternative to the recommended policy would be establishing reserves to replace the City's infrastructure capital assets. The tax supported tangible capital assets have a cost of \$7 billion, net book value of \$4.5 billion and estimated replacement value of \$17 billion as at December 31, 2013. Rate supported tangible capital assets and capital projects have different funding sources and are not included in the policy for this reserve. The useful lives of the tax supported tangible capital assets range from 3 years to computer hardware and software to 50 years for local roads to 100 years for machinery and equipment. In 2013 the amortization expense was \$173 million and the financial impact of budgeting this level of investment is prohibitive and, therefore, it is not being recommended.

Waste Management Recycling Reserve – 112270

An alternative to the recommended policy includes establishing reserves to replace the City's infrastructure capital assets. The Municipal Recycling Facility has a cost of \$20 million, net book value of \$16 million and estimated replacement value of \$37 million as at December 31, 2013. Based on a useful life of 40 years, a contribution to the reserve at \$1 million per year would provide sufficient funds to replace the facility. This option would impact future tax supported operating budgets, and it would not meet the City's current practice of debt financing waste management capital projects. Therefore, it is not being recommended.

Enterprise Fund Reserve – 112243

No alternatives are being considered as there are commitments to repay amounts borrowed from this reserve in recent years.

Staffing: N/A

Legal: N/A

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN

Strategic Priority #2

Valued & Sustainable Services

WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.

Strategic Objective

- 2.1 Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

APPENDICES AND SCHEDULES ATTACHED

Appendix “A” to Report FCS14028 Reserve Policy - Administration of Reserves

Appendix “B” to Report FCS14028 Reserve Policy - Tax Stabilization Reserve

Appendix “C” to Report FCS14028 Reserve Policy - Unallocated Capital Levy Reserve

Appendix “D” to Report FCS14028 Reserve Policy - Waste Recycling Reserve

Appendix “E” to Report FCS14028 Reserve Policy - Enterprise Fund Reserve

Appendix “F” to Report FCS14028 Tax Stabilization Reserve Analysis

Appendix “G” to Report FCS14028 Unallocated Capital Levy Reserve Analysis