



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning and Policy Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	October 13, 2015
SUBJECT/REPORT NO:	2014 Reserve Report (FCS15060)(City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Joshua Van Kampen 905-546-2424 Ext 1434
SUBMITTED BY:	Mike Zegarac General Manager Finance & Corporate Services Department
SIGNATURE:	

RECOMMENDATION

That the 2014 Reserve Report and the 2014 Reserves Detail Report, with 2013 Comparative figures and 2015 Projections, attached as Appendix "A" to Report FCS15060 be approved.

EXECUTIVE SUMMARY

The purpose of this report is to present Council with a summary of the City's 2014 Reserves' Status and the 2014 Reserves' Detail with 2013 Comparative figures and 2015 Projections and, if applicable, recommend updated and/or consolidated policies through Council Report recommendations governing the use and limits of these reserves. The 2015 forecast is based on budgeted transfers to and from the reserves, as well as, other; known requirements, anticipated income and investment activities.

Appendix "A" to Report FCS15060 illustrates, on a per reserve basis, the overall reserve position for 2013 and 2014, and the reserve projection for 2015.

The City's Reserve position continues to ensure that the City remains in a strong net creditor financial position, as demonstrated by the City's "AA" (stable) Credit Rating, which provides the financial flexibility to address the capital infrastructure needs and limit the impact of unexpected events.

Table 1 summarizes the overall Reserve positions as of December 31, 2013, as of December 31, 2014 and projected balances as of December 31, 2015.

Reserves, Obligatory Reserves, and Reserve Funds at December 31, 2014, totalled \$877.9 million, a \$13.5 million or 1.5% increase over the 2013 balance of \$864.4 million.

If not for program surpluses of \$26.7 M and W.I.P Savings of \$7.7 M the balance of the overall reserves would be decreased by \$34.4 M or a 2.4% decrease.

The overall reserve balance for 2015 is forecasted to decrease by \$117.1 million or 13.3% from \$877.9 million in 2014 to \$760.8 million in 2015.

TABLE 1

<u>Overall Reserve Position</u>		Projected	
	Balance	Balance	Balance
	<u>Dec 31, 2013</u>	<u>Dec 31, 2014</u>	<u>Dec 31, 2015</u>
	\$	\$	\$
Tax Supported Reserves	408,855,814	412,760,656	337,746,575
Rate Supported Reserves	219,078,610	223,891,745	216,835,250
Obligatory Reserves	175,434,552	194,840,365	176,314,805
Sub-total before FF	803,368,977	831,492,766	730,896,630
Reserve Funds-Future Fund	61,116,215	46,435,735	29,879,844
	864,485,192	877,928,501	760,776,474

Alternatives for Consideration – Not Applicable

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

Financial: N/A.

Staffing: N/A.

Legal: N/A.

HISTORICAL BACKGROUND (Chronology of events)

Importance of Reserves

Prudent fiscal management of reserves is imperative. Reserves provide flexibility against uncertainties which inevitably arise in today's changing municipal environment. Over the years, the use of Hamilton's reserves has met several financial objectives. They have been used to moderate tax and rate increases, to fund or expand Hamilton's capital program and to reduce long-term debt. The appropriate use of reserves will reduce financial risks to taxpayers and ratepayers in the future. Further, maintaining

reserves at adequate levels will provide the City of Hamilton with financial flexibility while forming a cornerstone of its' financial integrity.

Capital Markets and Credit Rating

Responsible fiscal management translates into an ability to borrow in financial markets at attractive interest rates. Credit rating agencies consider reserve policies along with other financial policies including short term financial planning and long term financial planning (i.e. operating and capital budgets) when determining the credit rating of a local government.

On June 26, 2015, Standard and Poor's Rating Services affirmed the City of Hamilton's AA (stable) rating for long-term issuer credit and senior unsecured debt. The rating is due to the City's exceptional liquidity, very strong economy and very predictable and well-balanced local government framework. In Standard and Poor's report they viewed Hamilton's strong financial management as a positive impact on our credit rating.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

Reserve Policies are listed in Appendix "A" to Report FCS15060

RELEVANT CONSULTATION

Staff from all City Departments, including staff from the Hamilton Police Service and Hamilton Public Library, have reviewed and provided information for the preparation of the 2014 Reserve Report and the 2014 Reserves Detail Report, attached as Appendix "A" to Report FCS15060.

ANALYSIS AND RATIONALE FOR RECOMMENDATION

(Include Performance Measurement/Benchmarking Data if applicable)

The following pages will provide some highlights of the 2014 actual activities, balances and transactions and 2015 forecasts for the Reserves, Obligatory Reserves and Reserve Funds.

2014 Actual Activities

The overall Reserve position increased by a \$13.4 million or 1.5% from \$864.5 million in 2013 to \$877.9 million in 2014.

The increase is a result of the 2014 contributions to the reserve (\$235.0M) exceeding the 2014 funding from the reserves (\$221.5M) by \$13.5 million.

Table 2 summarizes the 2014 reserve transactions by category.

TABLE 2

OVERALL RESERVE POSITION - 2014 ACTIVITY
BY RESERVE GROUP (\$Millions)

	<u>Tax Supported Reserves</u>	<u>Rate Supported Reserves</u>	<u>Obligatory Reserves</u>	<u>Future Fund Reserves</u>	<u>Total Reserves</u>
Balance - January 1, 2014	\$408.9	\$219.1	\$175.4	\$61.1	\$864.5
Add: Interest Earned	17.9	5.1	2.6	1.3	26.9
Collections\Recoveries	0.0	0.0	65.4	0.0	65.4
Provision for Asset Replacement & Capital Improvements	26.4	0.0	0.0	0.0	26.4
Gas Tax Revenues	0.0	0.0	40.5	0.0	40.5
Repayments of Internal Debt	6.4	3.8	1.0	7.3	18.5
Program Surpluses	20.6	6.1	0.0	0.0	26.7
Fees\Donations\Sales\Recoveries	5.1	0.0	0.0	0.0	5.1
W.I.P. Savings	7.7	0.0	0.0	0.0	7.7
Special Levy-Ward Infrastructure Investment	13.4	0.0	0.0	0.0	13.4
Other Revenues	1.8	2.0	0.7	0.0	4.5
Sub-Total	99.2	17.0	110.1	8.6	235.0
Less: Capital Program Funding	(64.3)	(10.6)	(71.0)	(23.3)	(169.2)
Vehicle & Equipment Funding	(16.4)	0.0	0.0	0.0	(16.4)
To Operating Fund	(10.1)	(1.6)	(10.1)	0.0	(21.8)
Program Phase-ins\Pilot Programs\Grants\Reviews	(3.7)	0.0	0.0	0.0	(3.7)
Debt Repayment	(0.9)	0.0	(9.5)	0.0	(10.4)
Sub-Total	(95.4)	(12.2)	(90.6)	(23.3)	(221.5)
Balance - December 31, 2014	\$412.7	\$223.9	\$194.9	\$46.4	\$877.9
Change in Reserve Position (\$)	\$3.8	\$4.8	\$19.5	(\$14.7)	\$13.5
Change in Reserve Position (%)	0.9%	2.1%	10.0%	(31.6%)	1.5%

The following highlights some of the transactions which contributed to the net \$13.5 million increase in 2014 Reserves' balance by Category and separated by transfers to and from reserves.

Highlights by Reserve Category:1. Tax Supported Reserves-Net increase of \$3.8 Milliona) 2014 Contribution to the Reserves (\$99.2 Million)

- \$26.4 million transferred to reserves to provide for asset replacement and capital improvements. Provisions were set aside for vehicle replacement (\$14.8M), for equipment replacement (\$5.4M), for facility repairs and upgrades (\$2.7M), and for parkland purchases (\$3.5M).
- \$17.9 million was transferred to the reserves for investment income (\$9.6M) and capital gains (\$8.3M) earned from the City's Investments.

- \$20.6 million was transferred to reserves from program surpluses consisting of Deferred Capital Financing Program (\$9.0M), employee related programs (\$6.9M), Red Light Camera Program (\$2.0M), and other various surpluses (\$2.7M).
- \$13.4 million transferred to reserves for Special Levy-Ward Infrastructure Investment (Wards 1-8).
- \$5.1 million transferred to reserves from the sale of assets, from HUC dividends, and from Terrapure (Newalta) Landfill Royalty fees.
- \$7.7 million returned to reserves from unused capital funding.

b) 2014 Funding from the Reserves (\$95.4 Million)

- \$64.3 million transferred from reserves for investment in the Capital Infrastructure Program consisting of (\$66.8) in Capital Improvements, consisting of Ward Specific Infrastructure improvements (\$14.4M) and consisting of Transit related capital improvements (\$14.1M).
- \$16.4 million transferred from reserves for the replacement of Vehicles (\$13.3M) and for the replacement of Equipment (\$3.1M).
- \$3.7 million transferred from reserves to fund Program\Phase-ins\Pilots and One-Time grants.
- \$10.1 million transferred from reserves to the Operating Fund to offset employee related costs (\$7.5M) and to recover program administrative costs (\$2.6M).

2. Rate Supported Reserves-Net increase \$4.8 Million

a) 2014 Contribution to the Reserves (\$17.0 Million)

- \$6.1 million transferred to reserves from program surpluses within the Wastewater program (\$3.3M), within the Waterworks program (\$0.6M) and within the Storm Sewer Program (\$2.2M)
- \$5.1 million transferred to the reserves for investment income.
- \$3.8 million repayment of reserve borrowings to assist with the funding of Development Charge capital funding shortfall.

b) 2014 Funding from the Reserves (\$12.2 Million)

- \$1.6 million transferred from reserves to the Operating Budget to fund a Revenue Variance to ensure that the revenue and expenditure budgets are the equal.

- \$10.6 million transferred from reserves for investment in the Capital Infrastructure Program for Wastewater Program (\$5.3M), Waterworks program (\$3.7M), and for the Storm Sewer Program (\$1.6M).

3. Obligatory Reserves-Net increase \$19.5 Million

a) 2014 Contribution to the Reserves (\$110.1 Million)

- \$65.4 million transferred to reserves from collections and recoveries consisting of Development Charge collections (\$56.7M) and consisting of Parkland Dedication fees (\$8.7M).
- \$40.5 million transferred to reserves from Gas Tax revenues consisting of Provincial Gas Tax revenues (\$10.4M) and Federal Gas Tax revenues (\$30.1M).

b) 2014 Funding from the Reserves (\$90.6 Million)

- \$71 million transferred from reserves for investment in Development Related Capital Infrastructure.
- \$9.5 million transferred from reserves for debt repayment from Development Charge collections for borrowings to off-set capital funding shortfalls.
- \$10.1 million transferred from reserves to the Operating Budget representing Provincial Gas Tax funding for the Transit Program.

4. Hamilton Future Fund Reserves-Net decrease \$14.7 Million

a) 2014 Contribution to the Reserves (\$8.6 Million)

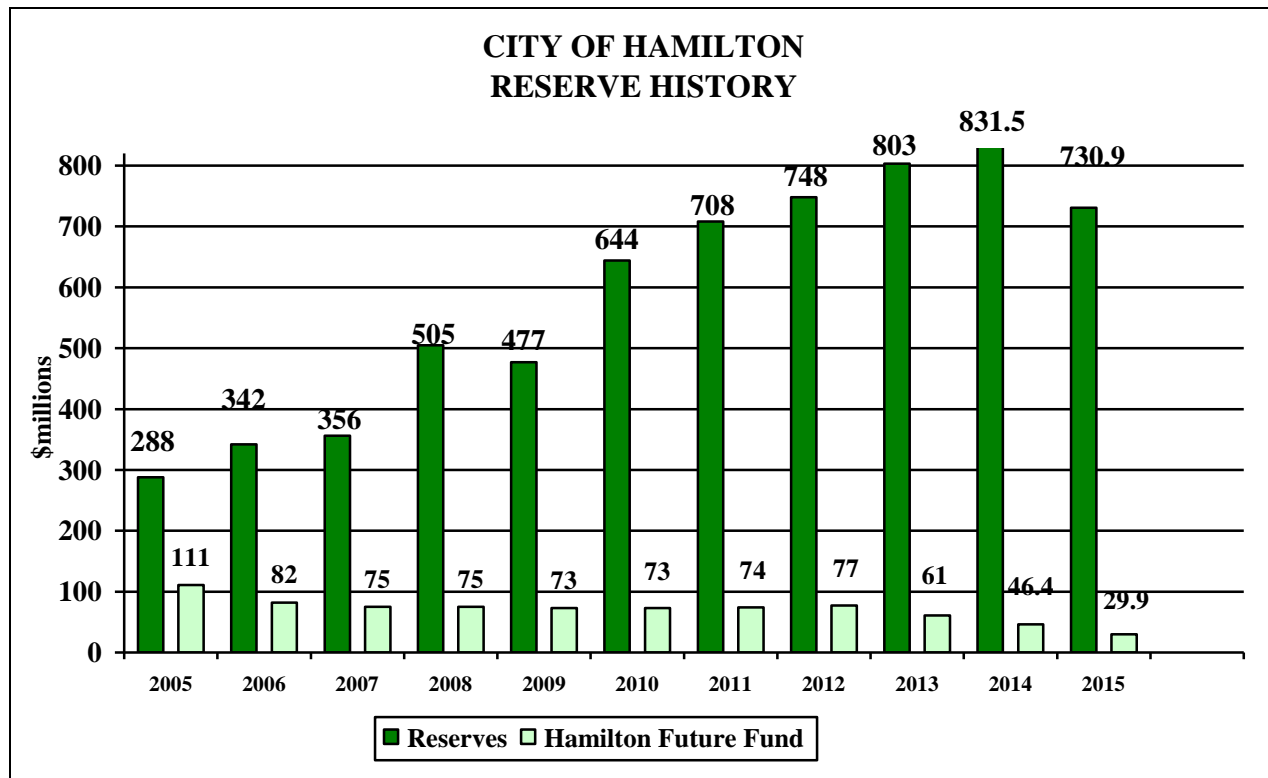
- \$7.3 million transferred to reserves for debt repayments related to Capital Program Borrowing.
- \$1.3 million transferred to the reserves for investment income earned from the Future Fund Investments.

b) 2014 Funding from the Reserves (\$23.3 Million)

- \$12 million transferred from reserves to fund the Stadium Precinct Development and Pan Am Games.
- \$4.5 million transferred from reserves to fund the McMaster Health Care Centre.
- \$5.4 million transferred from reserves to fund primarily waste capital projects, these funds are borrowed and then repaid with interest.

Ten Year History and 2015 Reserve Projection

The following Graph shows a 10-year reserve history and 2015 reserve projections for the City of Hamilton:



Over the last 10 years, the reserve balances have increased from \$288 million in 2005 to \$730.9 million in 2015.

The increase is primarily the result of new reserves being added over the last 10 years from contributions from external or internal sources. The following provides examples of new reserves funded either from external or internal sources:

External Sources:

- Provincial Contribution for Wastewater Improvement (Wastewater Improvement Subsidy Reserve)
- Provincial Pan Am Stadium Contribution (Pan Am Stadium Reserve)
- Federal Gas Tax Funding Agreement (Federal Gas Tax Reserve)
- Provincial Gas Tax Agreement (Transit Gas Tax Reserve)
- Capital Gains on Investments (Investment Stabilization Reserve)
- Provincial North Glanbrook Industrial Park Contribution (Red Hill Business Park Reserve)
- Provincial Quick Wins Funding (Rapid Transit Capital Reserve)

Internal Sources:

- Strategic Capital Project Reserve
- Parkland Acquisition Reserve
- Area Rating Special Infrastructure Levy (Wards 1 to 8 Capital Reinvestment Reserves)
- Economic Development Investment Fund
- Energy Conservation Initiatives Reserve

2015 Reserve Projections

Table 3 summarizes the projected 2015 reserve activity compared to the 2014 actual activity.

TABLE 3

Comparison of 2014 Actual and 2015 Forecast Reserve Activity (\$Millions)		2014 Actual \$	2015 Projection \$	Increase (Decrease) \$
	Opening Balance	864.5	877.9	13.4
Add:	Interest Earned	26.9	18.3	(8.6)
	Collections\Recoveries	65.4	70.3	4.9
	Provision for Asset Replacement & Capital Improvements	26.4	19.3	(7.1)
	Gas Tax Revenues	40.5	40.5	0.0
	Repayments of Internal Debt	18.5	16.8	(1.7)
	Program Surpluses	26.7	28.9	2.2
	Fees\Donations\Sales\Recoveries	5.1	13.1	8.0
	W.I.P. Savings	7.7	15.0	7.3
	Special Levy-Ward Infrastructure Investment	13.4	13.4	0.0
	Other Revenues	4.5	4.8	0.3
		235.0	240.4	5.3
Less:	Capital Program Funding	(98.2)	(127.5)	29.3
	Capital Program Funding - Development Charges	(71.0)	(132.6)	61.6
	Vehicle & Equipment Funding	(16.4)	(56.2)	34.4
	To Operating Fund	(21.8)	(16.9)	13.2
	Program Phase-ins\Pilot Programs\Grants\Reviews	(3.7)	(10.6)	6.9
	Debt Repayment	(10.4)	(13.7)	3.3
		(221.5)	(357.5)	148.7
	Ending Balance	877.9	760.8	(117.1)

The overall reserve balance is projected to decrease by \$117.1 million or 13.3% from \$877.9 million in 2014 to \$760.8 million in 2015.

Even though there are several reasons for the projected decrease, the primary cause is the anticipated increase in 2015 Capital program spending and Vehicle and Equipment spending in the amount of \$127.5 million and \$56.2 million, respectively.

There are several capital funding sources, such as Development Charges receipts, Federal Gas Tax receipts, Vehicle and Equipment reserve transfers, that are allocated to Capital projects based on actual expenditures. This practice inflates the projection in capital spending because the forecast includes both the 2015 approved budget and prior years' approved unfunded capital approvals.

Of the \$357.5 million for capital funding in 2015, \$149.3 million was approved in 2015 and \$208.2 million was carried over from prior year's approvals.

Table 4 shows the 2015 approved funding and amounts carried over from prior years by Reserve Type.

TABLE 4

2015 Approved and Prior Year's Approved Capital Funding By Reserve Type (\$ Millions)							
	<u>D.C. Charges</u>	<u>Gas Tax</u>	<u>Future Fund</u>	<u>Program Reserves</u>	<u>Vehicle\ Equipment</u>	<u>Capital\ Other Reserves</u>	<u>Total Reserves</u>
2015 Approved Funding	40.7	37.1	11.6	7.8	23.5	28.6	149.3
Prior Year's Approved Funding	86.8	21.2	14.8	28.5	32.7	24.2	208.2
2015 Projected Funding	127.5	58.3	26.4	36.3	56.2	52.8	357.5

Sustainability of Reserves

The 2014 Reserves' Detail Report, attached as Appendix "A" to Report FCS15060 indicates whether the reserves are sustainable. The criteria used to determine sustainability is as follows:

- If the annual contributions are sufficient to off-set future requirements;
- If there are committed contributions to the reserve; and
- If there is a financial plan in place to ensure target levels are met and maintained.

Table 5 lists the individual reserves which are non-sustainable and provides an explanation of their status.

TABLE 5

Reserve Number	Reserve Name	Source of Funds	Non-sustainability Explanation	Progress Over 2013
Stabilization Reserves				
110046	Tax Stabilization Reserve	Operating Budget Surpluses	To provide sufficient flexibility and protection for unforeseen events the reserve balance should be around 5% of the previous year's tax levy for City purposes. (\$39 million based on 2014 Tax Levy). The 2015 projected balance is \$5.8 million.	↓
110044	OW Stabilization Reserve	Provincial Grant Payments Variances	This reserve does not currently have a financial plan in place to ensure there are sufficient funds in the reserve to allow offsets of large fluctuations in caseloads.	↓
112218	Best Start Initiative	Provincial Best Start Funding (2005/06)	There are no committed contributions to this reserve.	→
Planning and Development				
100036	Auchmar Estates - Repairs	Net rental revenues and donations	Donations and rental revenues are not sufficient to fund the repairs.	→
108021	Parking Capital Reserve	Contributions from Operating Fund via surplus revenues from plate denials.	The current contributions to this reserve are not sufficient to sustain the needed capital improvements for HMPS. Requests for the annual increases will be part of future annual operating budgets.	↓

Reserve Policies

Staff will continue to review the City's individual reserves over the next several years in order to develop formal policies for individual reserves that define 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.

Formal policies were approved by City Council on May 14th, 2014 through report FCS14028 for the following four reserves:

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

The report included target balances for each reserve and compared the target balances to the existing balances.

The following highlights the approved target balances for each reserve and compares them to the actual 2014 reserve balances:

Tax Stabilization Reserve - 110046

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.

The approved Tax Stabilization Reserve balance target level is 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 \$28.7 million based on the 2015 net tax levy. As at December 31, 2014, the tax stabilization reserve balance of \$13 million (with an uncommitted balance of \$5.8 million) results in a shortfall from the target of \$15.7 million.

Unallocated Capital Levy Reserve – 108020

In order to provide sufficient flexibility and protection for unforeseen capital related events, a target level of 10% of the five year average approved Tax supported Capital Budget was approved. Based on the five year average Tax supported Capital Budget the target balance should be \$25.3 million as at December 31, 2014. As the unallocated capital levy reserve balance was \$28 million, a surplus of \$3.3 million results. Projected funding of capital projects during 2015 will reduce the reserve balance below the target level.

Waste Management Recycling Reserve – 112270

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 2010 to a surplus of \$3.4 million in 2013. Over the last 8 years only 3 years had positive variances while 6 years had negative variances. Therefore a target balance related to recycling revenue variance was approved 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. Thus, an additional \$1 million target balance was 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 \$4 million. The reserve balance was \$3.7 million as at December 31, 2014.

Enterprise Fund Reserve – 112243

A target balance was not approved 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.

Outstanding Liabilities

The City provides certain employee benefits that require funding in future years, which are currently estimated at \$334.7 million as of December 31st, 2014. The City has established reserves to provide for some of these liabilities while other amounts, such as, accrued vacation have been recorded as liabilities. The amounts in the reserves to provide for the liabilities total \$68.4 million, thus leaving net employee-related liabilities to be recovered in the future from either reserves or the operating fund at \$266.3 million.

These liabilities are only 25.7% funded (2013 – 20.8%) and currently there is no Public Sector Accounting Board (PSAB) requirement to provide funding for the net unfunded liability portion of these employee benefits of \$266.3 million either from reserves or taxation. These unfunded liabilities can be funded as they occur in future years, either from the operating budget or from dedicated reserves after consultation with Council either through a Report or through the Budget process.

The City owns and operates one open landfill and maintains twelve closed landfills. The open site is estimated to reach capacity and close in 2043. The estimated liability for future costs associated with the operational site and post-closure care of the closed sites is estimated at \$27.2 million net of provisions in the Reserves.

Including the landfill site, total liabilities to be recovered, in the future, are estimated at \$293.5 million.

Table 6 summarizes the estimated future liabilities by category.

TABLE 6

Estimate of Outstanding Liabilities (\$ 000's)		
	<u>2014</u>	<u>2013</u>
Employee Benefits and Future Obligations:	\$	\$
Sick Leave Benefit Plan	54,263	51,144
Long Term Disability Plan	20,970	19,362
Worker's Safety & Insurance Board Liabilities (WSIB)	71,022	70,086
Vacation Benefits	25,012	24,572
Retirement Benefits	132,528	127,236
Pension Benefit Plans	103,051	107,393
Pension Valuation Allowance	0	0
Net unamortized actuarial gain (Loss)	-72,137	-81,148
	334,709	318,645
Less:		
Provisions in Reserves and Balance Sheet	-68,370	-66,360
	-68,370	-66,360
Employee Related Liabilities to be recovered in the future	266,339	252,285
Waste Management Facilities liabilities:		
Open and Closed landfill sites	28,084	28,655
Less:		
Provisions in Reserves	-925	-903
Waste Management liabilities to be recovered in the future	27,159	27,752
Total Liabilities to be recovered in the future	293,498	280,037

ALTERNATIVES FOR CONSIDERATION

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

This is an Information Report dealing primarily with historical information; therefore, this section is not applicable.

ALIGNMENT TO THE 2013 – 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.

Prudent fiscal management of reserves is imperative. Reserves provide flexibility against uncertainties, which inevitably arise in today's changing municipal environment. Over the years, the use of Hamilton's reserves has met several financial objectives. They have been used to moderate tax and rate increases, to fund or expand Hamilton's capital program and to reduce long-term debt. The appropriate use of reserves will reduce financial risks to taxpayers in the future. Further, maintaining reserves at adequate levels will provide the City of Hamilton with financial flexibility while forming a cornerstone of its financial integrity.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report FCS15060 - 2014 Reserves Detail Report, with 2013 Comparative figures and 2015 Projections.