



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning, Administration and Policy Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	August 15, 2019
SUBJECT/REPORT NO:	2018 Reserve Report (FCS19062) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Marcel Cerminara (905) 546-2424 Ext. 4371
SUBMITTED BY:	Brian McMullen Director, Financial Planning, Administration and Policy Corporate Services Department
SIGNATURE:	

RECOMMENDATION(S)

- (a) That the 2018 Reserve Report and the 2018 Reserves Detail Report, with 2017 Comparative figures and 2019-2021 Projections, attached as Appendix "A" to Report FCS19062, be approved;
- (b) That the reserves listed in Appendix "B" to Report FCS19062 be closed;
- (c) That a Climate Change Reserve #108062 be established with a sustainable funding source identified through the 2020 Budget process.

EXECUTIVE SUMMARY

The purpose of Report FCS19062 is to present Council with a summary of the City's 2018 Reserves' Status and the 2018 Reserves' Detail with 2017 Comparative figures and 2019-2021 Projection. The 2019-2021 forecast is based on budgeted transfers to and from the reserves, as well as, other known requirements, anticipated income and investment activities.

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 at December 31, 2017 and 2018 and projected balances for December 31, 2019, 2020 and 2021.

Reserves, Obligatory Reserves and Reserve Funds-Future Fund at December 31, 2018, totalled \$946.1 M, a \$48.3 M or 4.9% decrease over the 2017 balance of \$994.4 M. A significant portion of this decrease is as a result of 2018 DC Capital financing exceeding DC collection by \$50.4 M. A further contributing factor to the decrease is a \$19.4 M Roads Rehabilitation Loan from the Investment Stabilization Reserve approved by Council as part of the 2018 Budget.

The overall reserve balance for 2019 is forecasted to decrease by \$154.8 M or 16.4% from \$946.1 M in 2018 to \$791.3 M in 2019. The following highlights some of the transactions which contribute to the forecasted \$154.8 M decrease in 2019:

- \$102.3 M from reserves for capital requirements from DC Reserves to fund growth
- \$60.4 M from reserves for Wastewater Treatment Plant upgrades
- \$57.0 M from reserves for capital requirements such as roads from Federal Gas Tax
- \$15.2 M from reserves for DC Debt repayment
- \$14.7 M from reserves for Public Transit vehicle replacement
- \$10.1 M from reserves for Fire vehicle purchase
- \$7.2 M from reserves for Public Works vehicle purchase
- \$6.0 M from reserves for Service and Expansion of the Red Hill Business Park

TABLE 1

Overall Reserve Position	Balance	Forecast	Forecast	Forecast	Forecast
	Dec 31, 2017	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021
	\$	\$	\$	\$	
Tax Supported Reserves	436,977,023	405,063,307	368,190,599	383,726,270	406,526,063
Rate Supported Reserves	260,982,698	255,316,835	171,932,532	123,878,402	98,004,670
Total Non Obligatory	697,959,722	660,380,142	540,123,131	507,604,672	504,530,733
Obligatory Reserves	252,126,422	237,055,288	198,194,277	192,951,067	203,069,754
Sub-total before Future Fund	950,086,143	897,435,430	738,317,408	700,555,739	707,600,487
Reserve Funds-Future Fund	44,322,301	48,634,530	52,950,286	56,821,456	60,994,366
Total Reserves	994,408,444	946,069,960	791,267,694	757,377,195	768,594,853

*Note: Anomalies due to rounding

Forecasts do not include the potential impact of Bill 108 *“More Homes, More Choice Act”*. Refer to Report FCS19057(a) / LS19023(a) for further details.

A Climate Change Reserve is being established as per Council at its meeting on May 23, 2018 through General Issues Committee Report 18-011. A funding source will be identified during the 2020 Budget Process with the assistance of the City’s Corporate Climate Change Task Force.

Alternatives for Consideration – Not Applicable

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: N/A

Staffing: N/A

Legal: N/A

HISTORICAL BACKGROUND

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 November 8, 2018, S&P's Global Rating Services affirmed its AA+ (stable) credit rating for the City of Hamilton for long-term issuer credit and senior unsecured debt. The high rating is due to the City's exceptional liquidity, very strong economy and very predictable and well-balanced local and regional government framework. In S&P's report, they viewed Hamilton's solid management as well as the City's high and increasing operating surpluses, modest deficits after capital spending, large internal liquidity levels and low debt burden as contributing factors to its rating.

Debt Indicators

As at December 31, 2018, the City had total debt outstanding of \$429 M (excluding Mortgages and Lease Purchase Agreements). This number is expected to increase substantially with forecasts showing potential approved debt outstanding of \$723 M in 2019 and \$896 M in 2020. The amount of actual debt outstanding may be less because of timing of debenture issues, delay in project closings, projects deferrals, etc. The increase can be attributable to substantial investment in the City's Water, Wastewater, and Storm Infrastructure, Social Housing Infrastructure, West Harbor Initiatives, Transit Infrastructure, as well as significant Development Charge supported debt to fund both Rate and Tax related growth infrastructure needs.

Development Charge debt is funded from DC reserves. Staff monitor DC reserves with a focus on deferring growth infrastructure until the risk of non-sustainable DC revenue is minimized.

Selected financial indicators related to potential outstanding debt forecasts can be found in Table 2.

TABLE 2

Selected Financial Indicators					
	Fiscal Year End December 31				
	2016	2017	2018	2019^(f)	2020^(f)
Operating Revenues (\$M's)*	1,526	1,575	1,624	1,680	1,739
Reserve Balances (\$M's)	903	994	946	791	757
2016 Census Population	536,917	536,917	536,917	536,917	536,917
Approved Debt Outstanding**	404	356	429	723	896
Debt as % of Operating Revenues	26%	23%	26%	43%	52%
Debt per Capita (\$'s)	752.44	663.04	799.01	1,346.58	1,668.79
Debt to Reserve Balance	45%	36%	45%	91%	118%

Notes:

*Operating Revenues based on S&P methodology and forecasts

** Debt excludes mortgages and lease purchase agreements

^(f) - Forecast

Monitoring of Reserve Program

A formal Performance Audit Report (2017-01) was conducted on the reserve program in early 2017 resulting in 13 recommendations through Report AUD17-011. Staff has made a conscious effort to act on those 13 recommendations.

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OUR Culture: Collective Ownership, Steadfast Integrity, Courageous Change, Sensational Service, Engaged Empowered Employees.

Staff continues to work toward reviewing and creating policies for all reserves, including developing target balances for key reserves. Staff continues to rationalize existing reserves, looking for opportunities to consolidate or close reserves which lack a defined corporate purpose. The goal of the reduction in total reserves is to increase effectiveness and efficiency of reserve and administration activity.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

The 2018 Reserve Report (Report FCS19062) is prepared in accordance with City of Hamilton Reserve Policy – Administration of Financial Reserves and Reserve Funds as well as relevant legislation and agreements (i.e. the *Municipal Act*, *Development Charges Act*, *Building Code Act* and Federal Gas Tax Fund).

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 2018 Reserve Report, the 2018 Reserves Detail Report, attached as Appendix “A” to Report FCS19062, as well as reserves recommended for closure attached as Appendix “B” Report FCS19062.

ANALYSIS AND RATIONALE FOR RECOMMENDATION(S)

2018 Actual Activities

The overall reserve position decreased by \$48.3 M or 4.9% from \$994.4 M in 2017 to \$946.1 M in 2018. The decrease is a result of the 2018 transfers from reserve (\$361.3 M) exceeding transfers to reserve (\$313.0 M) by \$48.3 M. Table 3 summarizes the 2018 reserve transactions by category.

TABLE 3

Overall Reserve Position - 2018 Activity by Reserve Group (\$Millions)

	Tax Supported Reserves	Rate Supported Reserves	Obligatory Reserves	Future Fund Reserves	Total Reserves
Balance - January 1, 2018	\$437.0	\$261.0	\$252.1	\$44.3	\$994.4
Add:					
Interest Earned	10.4	5.9	6.2	1.2	23.7
Collections / Recoveries	9.8	2.6	91.8	0.0	104.2
provisions for Reserve	27.9	0.0	0.0	0.0	27.9
Gas Tax Revenues	0.0	0.0	44.5	0.0	44.5
Repayments of Internal Debt	4.2	0.5	1.0	8.7	14.4
Program / Capital Surpluses	31.5	16.5	1.1	0.0	49.1
Fees / Donations / Sales	17.0	0.0	0.0	0.0	17.0
Special Levy-Ward Infrastructure Investment	13.4	0.0	0.0	0.0	13.4
Other Revenues	10.9	7.0	0.9	0.0	18.8
Sub-total	125.1	32.5	145.5	9.9	313.0
Less:					
Capital Program Funding	65.8	31.2	141.9	4.0	242.9
Vehicle and Equipment Funding	22.5	0.0	0.0	0.0	22.5
To Operating Fund	12.9	7.0	10.9	0.0	30.8
Inter Reserve Transfers	20.5	0.0	0.0	0.0	20.5
Program Phase-ins / Pilot Programs / Grants / Reviews	2.6	0.0	0.0	1.6	4.2
Borrowings to be Repaid	23.0	0.0	7.7	0.0	30.7
Property Purchases	8.6	0.0	0.0	0.0	8.6
Other Expenditures	1.2	0.0	0.0	0.0	1.1
Sub-total	157.1	38.2	160.5	5.6	361.3
Balance - December 31, 2018	\$405.0	\$255.3	\$237.1	\$48.6	\$946.1

Reserve Closings

As part of the annual Reserve Report process and consistent with Recommendation 4 of Appendix “A” to Report AUD17011 Performance Audit, reserves are reviewed for potential closure. There are several reasons that reserves are recommended for closure and they are as follows:

- Reserves which are set-up with limited funds, to be used for a specific purpose, are recommended for closure once the funds are depleted.
- The original purpose of the reserve is no longer valid. Thus, the reserve is recommended for closure and the remaining funds are reallocated to other uses.
- Council recommends that the remaining funds in a specific reserve be reallocated for uses in other areas.
- Low activity, low balance reserves are consolidated within larger reserves to increase effectiveness and efficiency of reserve and administrative activity.

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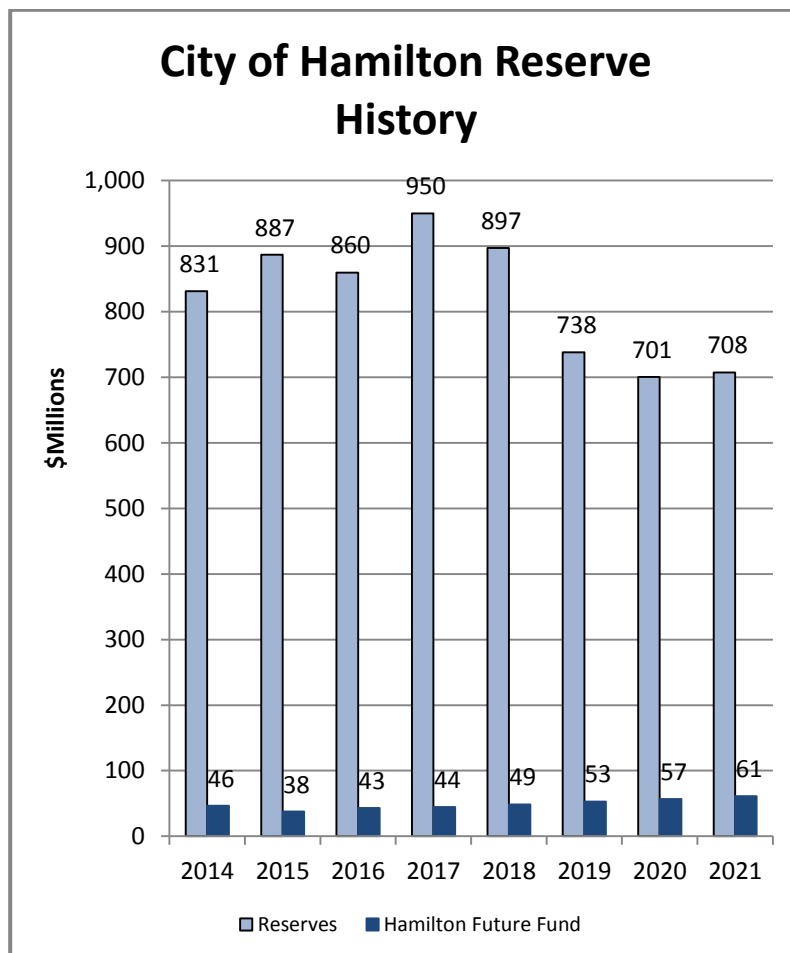
At the time Report AUD17011 was submitted to Council in the spring of 2017, the City had 158 active reserves. Since then, 18 reserves have been closed with eight new reserves opened. Report FCS19062 recommends closing a further five reserves while opening one reserve. Staff will continue to monitor the number of reserves, looking to close or consolidate, where possible. The goal of the reduction in total reserves is to increase effectiveness and efficiency of reserves and administration activity.

Appendix “B” to Report FCS19062 lists the reserves recommended for closure and the reason for closure.

Reserve Balances

Graph 1 shows a five-year reserve history and 2019-2021 reserve projections for the City of Hamilton.

Graph 1



Over the last five years, the reserve balances have increased from \$831M in 2014 to a peak of \$950 M in 2017, to current balances of \$897 M at December 31, 2018 (for tax supported, rate supported and obligatory reserves). The increase is primarily the result of the addition of the Dedicated Wastewater Treatment Plant Reserve of \$100 M in 2010 as well as the change in accounting treatment of DC Reserves increasing DC balances by over \$100 M from 2011 to 2015. Staff is forecasting a decrease in the reserve balances of over \$100 M in the next two years, primarily due to completion of the Woodward Wastewater Treatment, funding of Federal Gas Tax projects and clearing parkland dedication liabilities.

Rate Supported reserves are being used to fund a substantial portion of the Woodward Wastewater Treatment Plant upgrade as well as the Biosolids Project. Both projects combined will be drawing over \$150 M from Rate Reserves within the next three years.

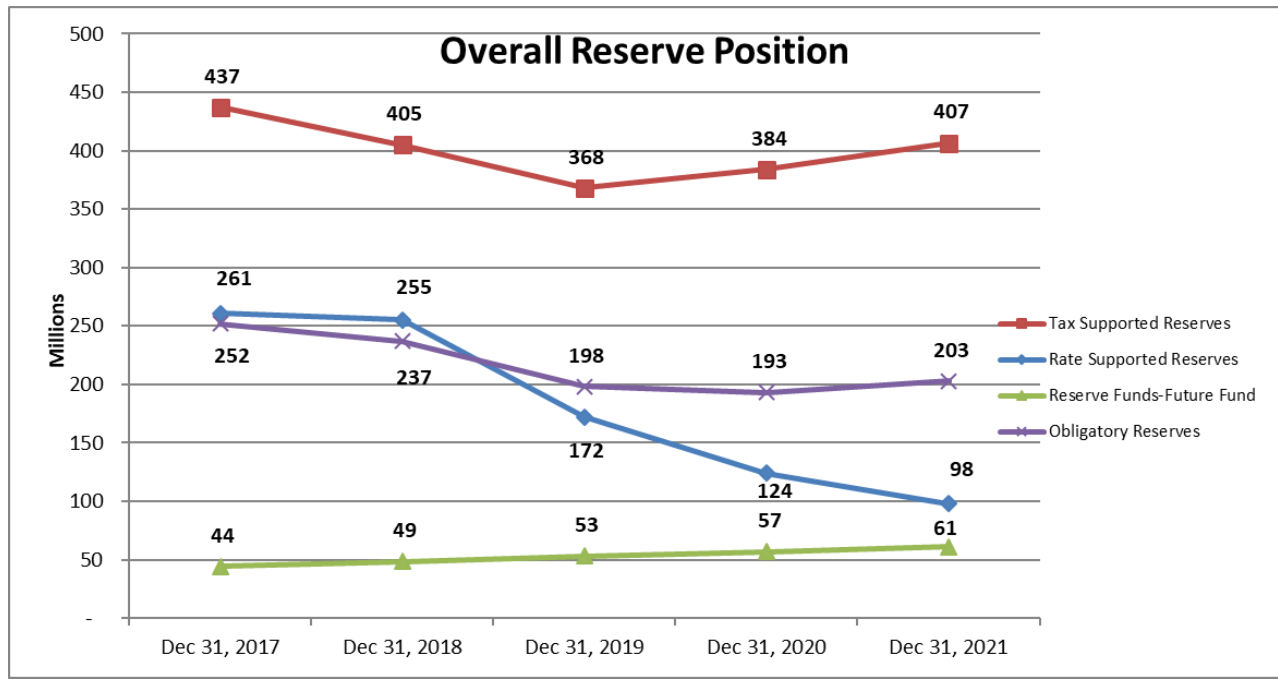
Obligatory Reserve balances will decrease by over \$30 M over the next three years as a result of over \$300 M being spent on capital infrastructure construction and debt repayment related to growth as well as the aforementioned parkland dedication liability and Federal Gas Tax project funding.

The DC reserves of the Obligatory Reserves are a function of development activity and capital infrastructure construction. Where capital infrastructure is required in advance of the development, debt issuances will be closely monitored to reduce the risk of DC reserve non-sustainability. Soft services have more flexibility and can often come online after a significant amount of the development and related collections have been completed. Therefore, soft services typically require fewer debt issuances.

Tax Supported Reserves are forecasted to decrease by over \$30 M as a result of initiatives such as the Downtown Office Accommodation Strategy, future capital budget funding and vehicle purchases.

Graph 2 shows reserve history for 2017 and 2018 and reserve projections for 2019 to 2021 by reserve group.

Graph 2



Sustainability of Reserves

The 2018 Reserves’ Detail Report, attached as Appendix “A” to Report FCS19062, 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.

The following list shows the reserves which are determined to be non-sustainable as of June 2019:

- 100033 Hamilton Paramedic Service – Equipment Replacement Reserve
- 110021 Hamilton Fire Department – Vehicle Replacement Reserve
- 108020 Unallocated Capital Reserve
- 110046 Tax Stabilization Reserve
- 110044 Ontario Works Stabilization Reserve
- 110041 Social Housing Stabilization Reserve
- 112205 Winter Control Reserve
- 104060 Golf Course Improvement Reserve

112203	Red Light Camera Reserve
999998	Developer Recoveries Reserve
112035	Sick Leave Liability- General Reserve
112270	Waste Management Recycling Reserve

Outstanding Liabilities

The City provides certain employee benefits that require funding in future years which are currently estimated at \$373.2 M as at December 31, 2018. 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 \$90.4 M thus leaving net employee-related liabilities to be recovered in the future from either reserves or the operating fund at \$282.8 M.

These liabilities are only 24.2% funded 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 \$282.8 M 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. Consistent with Recommendation 2 of Appendix “A” to Report AUD17011 Performance Audit, Corporate Services will continue to monitor these liabilities to ensure a funding source is available as they come due.

The City owns and operates one open landfill and maintains 12 closed landfills. The open Glanbrook site is estimated to reach capacity and close in 2055. The estimated liability for future costs associated with the operational site and post-closure care of the closed sites is estimated at \$70.4 M net of provisions in the reserves. This liability amount is a significant increase from the 2017 amount primarily as a result of two factors; resetting the post period monitoring of closed landfills to 50 years; and the addition of internal staff costs being added to the landfill liability calculation. It is important to note that this is an estimated amount and will be funded on an as-needed basis as future landfill liabilities come due.

Including the landfill site, total liabilities to be recovered in the future, are estimated at \$353.2 M. Table 4 summarizes the estimated future liabilities by category.

TABLE 4

Estimate of Outstanding Liabilities (\$000's)

	2018	2017
Employee Benefits and Future Obligations	\$	\$
Sick Leave Benefit Plan	57,470	55,982
Long-Term Disability Plan	27,869	26,687
Workplace Safety & Insurance Board (WSIB) Liabilities	93,436	88,537
Vacation Benefits	26,906	27,478
Retirement Benefits	151,311	146,547
Pension Benefit Plans	9,917	9,132
Net Unamortized Actuarial Gain (Loss)	6,268	13,224
	<u>373,177</u>	<u>367,587</u>
Less:		
Provisions in Reserves and Balance Sheet	-90,418	-89,929
Employee Related Liabilities to be Recovered in the Future	282,759	277,658
Waste Management Facilities Liabilities		
Open and Closed Landfill Sites	71,559	24,174
Less:		
Provisions in Reserves	-1,134	-1,080
Waste Management Liabilities to be Recovered in the Future	70,425	23,094
 Total Liabilities to be Recovered in the Future	 <u>353,184</u>	 <u>300,752</u>

Outstanding Internal Loans

Consistent with Recommendation 10 of Appendix “A” to Report AUD17011 Performance Audit, Corporate Services began reporting in 2017 the outstanding internal loan balances from reserves as well as annual internal repayments to ensure transparency in the reporting process. As at December 31, 2018, the total principal outstanding was \$32.1 M with annual repayments of \$5.0 M. Twenty-nine internal loans are currently outstanding with maturities ranging from 2019 to 2032.

The outstanding principal on internal loans from reserves was significantly increased by \$21.4 M through the 2018 budget process. The \$21.4 M was loaned out of Investment Stabilization Reserve (112300) for Emergency Roads Rehabilitation and the Ancaster Arts Centre. Appendix “C” to Report FCS19062 provides a detailed summary of all outstanding internal loans from reserves.

Climate Change Reserve and Action Plan

A Climate Change Reserve is being established as per Council at its meeting on May 23, 2018 through General Issues Committee Report 18-011. A funding source will be identified during the 2020 Budget Process with the assistance of the City's Corporate Climate Change Task Force.

Staff will look to include a climate change component, where possible, to capital projects and programs approved through the annual capital budget. Council will receive an annual report outlining how much of the City's budget was used for climate change initiatives or capital projects.

ALTERNATIVES FOR CONSIDERATION

N/A

ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN

Economic Prosperity and Growth

Hamilton has a prosperous and diverse local economy where people have opportunities to grow and develop.

Clean and Green

Hamilton is environmentally sustainable with a healthy balance of natural and urban spaces.

Built Environment and Infrastructure

Hamilton is supported by state of the art infrastructure, transportation options, buildings and public spaces that create a dynamic City.

Our People and Performance

Hamiltonians have a high level of trust and confidence in their City government.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report FCS19062 – 2018 Reserves Detail Report, with 2017 Comparative figures and 2019-2021 Projections

Appendix "B" to Report FCS19062 – Reserves Recommended for Closure

Appendix "C" to Report FCS19062 – Internal Loan from Reserves Summary

MC/dt