



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

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	October 22, 2020
SUBJECT/REPORT NO:	2019 Reserve Report (FCS20068) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Marcin Zukowski (905) 546-2424 Ext. 2162
SUBMITTED BY:	Brian McMullen Director, Financial Planning, Administration and Policy Corporate Services Department
SIGNATURE:	

RECOMMENDATION(S)

- (a) That the 2019 Reserve Report and the 2019 Reserves Detail Report, with 2018 Comparative figures and 2020-2022 Projections, attached as Appendix "A" to Report FCS20068, be received;
- (b) That COVID-19 Reserve #108006 be established with previously approved initial funding of \$1,144,000.

EXECUTIVE SUMMARY

The purpose of Report FCS20068 is to present Council with a detailed summary of the status of the City of Hamilton's reserves as of December 31, 2019 in comparison to the 2018 year-end balance, as well as, projections for the years 2020-2022. The 2020-2022 forecast is based on budgeted transfers to and from the reserves, as well as, other known requirements including anticipated income and investment activities.

The response to the COVID-19 pandemic will result in significant financial pressures for the remainder of 2020, as well as, the next several years. Recommendation (b) of Report FCS20068 will formally establish the COVID-19 reserve that the General Manager, Finance and Corporate Services, was authorized to transfer \$1,144,000 into through Recommendation (c) of Report FCS20040(a), "Financial Implications of COVID-19 Response". This reserve will also hold the necessary funds related to the Safe Restart Agreement as required to carry over to the 2021 fiscal year and offset ongoing COVID-19 financial pressures beyond 2020.

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 capital infrastructure needs and limit the impact of unexpected events.

Table 1 summarizes the overall reserve positions as at December 31, 2018 and 2019 and projected balances for December 31, 2020, 2021 and 2022.

Reserves, Obligatory Reserves and Reserve Funds-Future Fund at December 31, 2019, totalled \$996.8 M representing a \$50.7 M, or 5.4%, increase over the 2018 balance of \$946.1 M. A significant portion of this increase is the result of 2019 Development Charge (DC) collections exceeding DC Capital financing by \$58.9 M, as well as, a \$13.4 M increase in the Parkland Dedication Reserve. The overall increase was partially offset by draws on Rate Supported Reserves of \$31.1 M. The balance of the changes is detailed in Appendix "A" to Report FCS20068.

The overall reserve balance for 2020 is forecasted to decrease by \$57.5 M, or 5.8%, from \$996.8 M in 2019 to \$939.3 M in 2020 based on current commitments. The decrease is primarily driven by Rate Supported Reserves in the amount of \$61.5 M for wastewater treatment plant upgrades, as well as, \$2.7 M in Tax Supported Reserves for the Waste Management Recycling Program.

TABLE 1
Overall Reserve Position

	Balance	Balance	Forecast	Forecast	Forecast
	Dec 31, 2018	Dec 31, 2019	Dec 31, 2020	Dec 31, 2021	Dec 31, 2022
	\$	\$	\$	\$	\$
Tax Supported Reserves	405,063,307	390,768,941	385,309,605	400,771,482	426,746,538
Rate Supported Reserves	255,316,835	221,743,518	160,210,366	110,939,203	111,939,101
Total Non Obligatory	660,380,143	612,512,459	545,519,971	511,710,685	538,685,639
Obligatory Reserves	237,055,288	331,278,863	336,634,951	361,924,279	416,491,017
Sub-total before Future Fund	897,435,431	943,791,322	882,154,922	873,634,965	955,176,657
Hamilton Future Fund Reserves	48,634,530	52,963,110	57,099,064	60,589,610	66,524,164
Total Reserves	946,069,961	996,754,432	939,253,986	934,224,575	1,021,700,821

***Note:** Anomalies due to rounding

Forecasts do not include the potential impact of: (1) Bill 108 *"More Homes, More Choice Act"* (refer to Report FCS19057(b) / LS19023(b) for further details); and (2) Bill 197, the *Covid-19 Economic Recovery Act, 2020* (refer to Report LS20020).

The reserve forecasts are estimated based on current commitments and do not reflect pressures from the COVID-19 pandemic response. Revenue sources for reserves have been updated to the extent that they can be reasonably predicted but may further be impacted as the socio-economic impacts of COVID-19 become known. Financial impacts on reserve balances as a result of COVID-19 will be addressed in the 2021 budget process.

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 the City's reserves has met several financial objectives, such as to moderate tax and rate increases, to fund or expand the City's capital program and to limit long-term debt. The appropriate use of reserves reduces financial risk to tax and rate payers 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 October 18, 2019, S&P's Global Rating Services (S&P) 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 institutional framework. In S&P's report, they viewed Hamilton's solid management, as well as, the City's operating surplus, modest deficit after capital spending, large internal liquidity levels and low debt burden as contributing factors to its rating. At the writing of Report FCS20068, S&P Global Rating Services was conducting its review of the City of Hamilton's credit rating for 2020 with the target release date of October 14, 2020.

Debt Indicators

As at December 31, 2019, the City had total debt outstanding of \$401 M (excluding Mortgages and Lease Purchase Agreements). Total approved debt for the City is \$819 M, which includes previously approved debt not yet issued. This number is expected to increase with forecasts showing potential approved debt outstanding of \$1,192 M in 2022. The amount of actual debt outstanding may be less because of timing in debenture issuance, delay in project closings or project deferrals. The increase in debt over the next three years is 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.

The annual debt payments are planned for and recovered through the property tax levy (tax supported debt), rate user fees (rate supported debt) or DC reserves (DC supported debt) depending on the nature of the debt. Staff monitors and reports on both Council approved and legislative thresholds through the annual budgeting process and anytime new debt is being considered for approval.

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

TABLE 2

	<u>Selected Financial Indicators</u>				
	Fiscal Year End December 31				
	<u>2018</u>	<u>2019</u>	<u>2020(f)</u>	<u>2021(f)</u>	<u>2022(f)</u>
Approved Debt Outstanding (excluding Mortgages and Lease Purchase Agreements) (\$M's)	429	401	819	1053	1192
Debt per Capita (\$)	750.94	692.48	1,395.51	1,770.70	1,984.65
Debt Per Capita Year Over Year (% Change)	13%	-8%	102%	27%	12%
Debt to Reserve Balance	45%	40%	87%	113%	117%

***Note: Anomalies due to rounding**

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

The 2019 Reserve Report (Report FCS20068) 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, the Hamilton Police Service and the Hamilton Public Library have reviewed and provided information for the preparation of the 2019 Reserve Report and the 2019 Reserves Detail Report, which is attached as Appendix “A” to Report FCS20068.

ANALYSIS AND RATIONALE FOR RECOMMENDATION(S)

2019 Actual Activities

The overall reserve position increased by \$50.7 M, or 5.4%, from \$946.1 M in 2018 to \$996.8 M in 2019. The increase is due to a year-over-year increase in Obligatory Reserves of \$94.2 M, which was largely attributed to a \$58.9 M increase in 2019 Development Charge collections over capital financing requirements, as well as, a \$13.4 M increase in the Parkland Dedication Reserve. The increase was partially offset by a \$31.4 M decrease in Rate Supported Reserves and a \$14.3 M decrease in Tax Supported Reserves. Table 3 provides a summary of activity by reserve group.

Recommendation (b) to Report FCS20068 seeks approval to establish a COVID-19 Reserve for the purpose of funding infrastructure requirements for physical distancing, managing cash flow implications of lost revenues and providing emergency relief funding for programs experiencing deficits over the next few years. The COVID-19 Reserve will hold carry over emergency grant funding related to the Safe Restart Agreement.

TABLE 3
OVERALL RESERVE POSITION
2019 ACTIVITY BY RESERVE GROUP (\$Millions)

	Tax Supported Reserves	Rate Supported Reserves	Obligatory Reserves	Future Fund Reserves	Total Reserves
Balance - January 1, 2019	\$405.1	\$255.3	\$237.1	\$48.6	\$946.1
Add: Interest Earned	13.4	5.5	6.5	1.2	26.6
Provisions for Reserve	49.2	0.5	0.0	0.0	49.7
Program / Capital Surpluses	25.1	10.3	2.3	0.0	37.7
Repayments of Internal Debt	8.0	0.5	0.9	8.4	17.8
Collections / Recoveries	7.2	0.0	115.4	0.0	122.6
Gas Tax Revenue	0.0	0.0	69.2	0.0	69.2
Special Levy-Ward Infrastructure Investment	13.8	0.0	0.0	0.0	13.8
Fees / Donations/ Sales	2.9	0.0	15.4	0.0	18.3
Other Revenue	3.6	0.5	0.0	0.0	4.1
Sub-Total	123.2	17.3	209.7	9.6	359.8
Less: Capital Program Funding	33.6	44.7	39.9	0.0	118.2
Capital Financing	0.0	0.0	50.4	0.0	50.4
Vehicle and Equipment Funding	35.4	0.0	0.0	0.0	35.4
Borrowing to be Repaid	1.6	0.0	9.7	0.0	11.3
To Operating Fund	0.1	0.0	10.9	0.0	11.0
Program Phase-ins/Pilot /Grants	7.4	0.0	0.0	0.0	7.4
Property Purchases	16.4	1.6	0.0	0.0	18.0
Inter Reserve Transfers	7.4	2.7	0.0	0.0	10.1
Other Expenditures	35.9	1.9	4.2	5.3	47.3
Sub-Total	137.8	50.9	115.1	5.3	309.1
Balance - December 31, 2019	\$390.8	\$221.7	\$331.3	\$53.0	\$996.8

*Note: Anomalies due to rounding

Reserve Balances

Over the last five years, the reserve balances have increased from \$887 M in 2015 to a balance of \$944 M as at December 31, 2019 (excludes Future Fund Reserves). The increase is primarily the result of increases in reserve provisions and overall collections, including Development Charges and Federal Gas Tax, offset by reductions in capital program funding and capital financing charges.

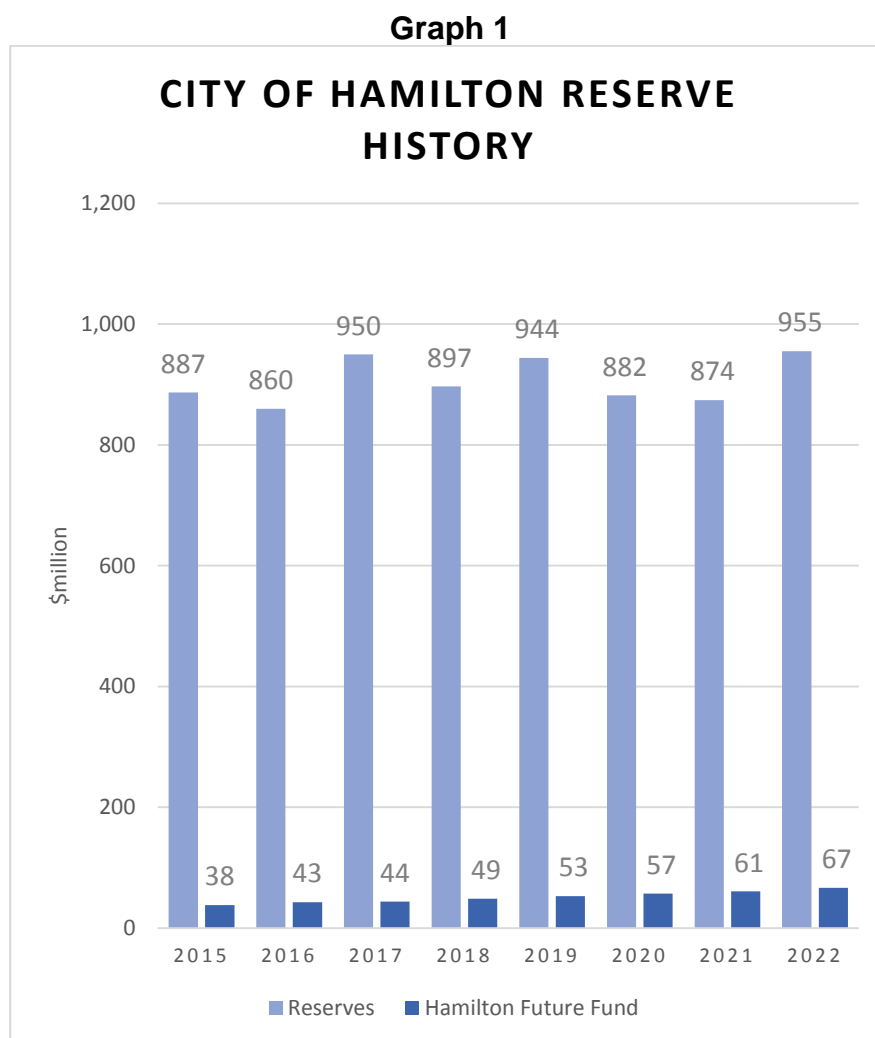
Staff is forecasting a decrease in reserve balances of \$70.2 M (excludes Future Fund Reserves) over 2020 and 2021, primarily due to completion of the Woodward Wastewater Treatment and Biosolids project, funding of Federal Gas Tax projects and clearing parkland dedication liabilities.

By 2022, Obligatory Reserve balances are expected to increase by \$85.2 M mainly due to an anticipated increase in collections versus capital spending. Revenue collections have not been adjusted for changes in the growth forecast due to COVID-19. Staff are working with other municipalities to closely monitor the financial impact of COVID-19 on future development.

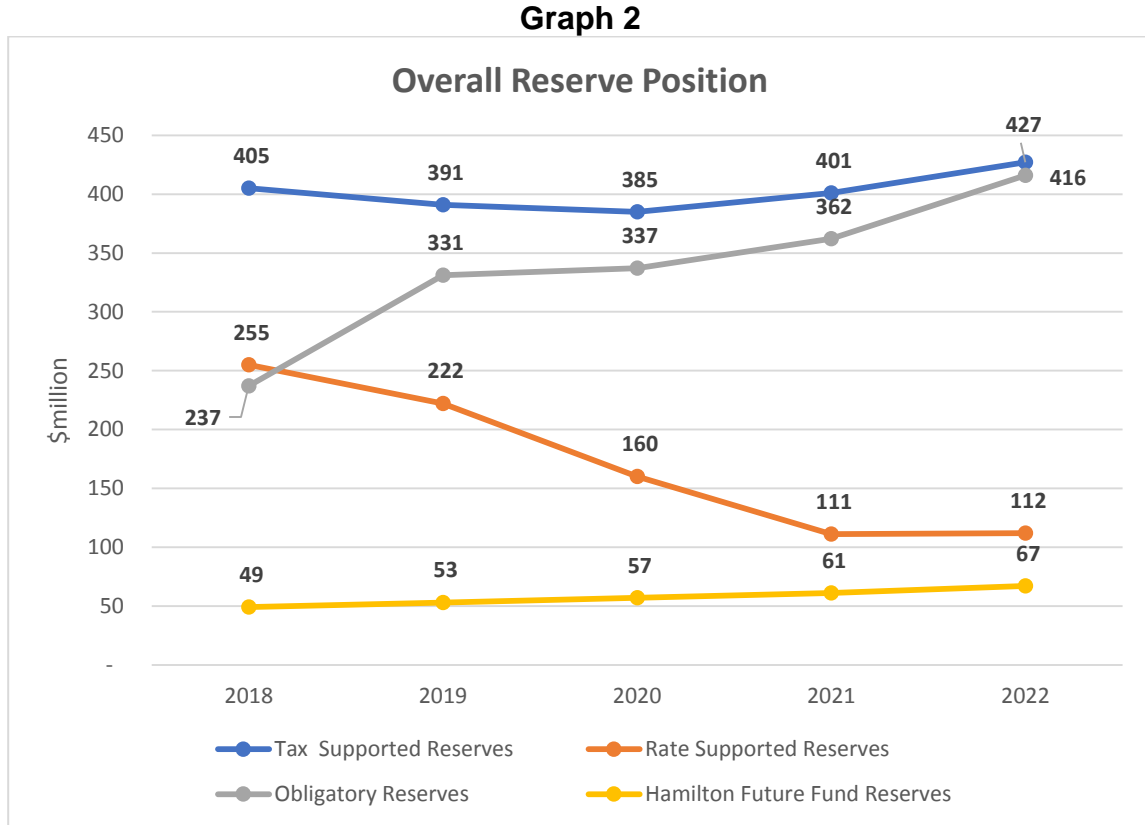
The DC reserves classified under Obligatory Reserves are a function of development activity and capital infrastructure construction. Where capital infrastructure is required in advance of the development, debt issuances will be closely monitored to ensure sustainability of the DC reserves. Soft services (i.e. recreation, library, parking) 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 increase by \$36.0 M by 2022, as a result of additional funding through the Investing in Canada Infrastructure Program (ICIP), Transit Stream which provided alternative funding for transit vehicle replacement that would have previously been funded through Tax Supported Capital Reserves.

Graph 1 shows a five-year reserve history and 2020-2022 reserve projections for the City of Hamilton.



Graph 2 shows reserve history for 2018 and 2019 and reserve projections for 2020 to 2022 by reserve group.



Sustainability of Reserves

The 2019 Reserves Detail Report, attached as Appendix “A” to Report FCS20068, indicates whether the reserves are sustainable. The criteria used to determine sustainability is as follows:

- If the annual contributions are sufficient to offset future requirements over the three-year forecast 2020-2022;
- 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 forecast to be non-sustainable as of July 2020:

100033 - Hamilton Paramedic Service – Equipment Replacement
110021 - Hamilton Fire Department – Vehicle Replacement
108020 - Unallocated Capital Levy
112035 - Sick Leave Liability – General
110046 - Tax Stabilization

110041 - Social Housing Stabilization
110044 - Ontario Works Stabilization
112203 - Red Light Camera Project
112205 - Winter Control
112270 - Waste Management Recycling
999998 - Developer Recoveries

The sustainability of reserves continues to be assessed. There may be different approaches to addressing reserve sustainability depending on the nature and purpose of the reserve.

Outstanding Liabilities

The City provides certain employee benefits that require funding in future years, which are currently estimated at \$369.7 M as at December 31, 2019. 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 \$92.2 M, or 24.2%, of the total liability thus leaving net employee-related unfunded liabilities to be recovered in the future from either reserves or the operating fund at \$280.4 M.

Currently, there is no Public Sector Accounting Board (PSAB) requirement to provide funding for the net unfunded liability portion of these employee benefits 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. A financing strategy requires approval by Council either through a report or through the Budget process. Corporate Services staff 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 \$70.2 M net of provisions in the reserves. This liability amount is primarily comprised 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 \$350.7 M. Table 4 summarizes the estimated future liabilities by category.

TABLE 4
ESTIMATE OF OUTSTANDING LIABILITIES (\$000's)

Employee Benefits and Future Obligations:	2019(\$)	2018(\$)
Sick Leave Benefit Plan	58,789	57,470
Long-Term Disability Plan	33,431	27,869
Worker's Safety and Insurance Board Liabilities (WSIB)	97,787	93,436
Retirement Benefits	153,571	151,311
Vacation Benefits	26,806	26,906
Pension Benefit Plans	(2,196)	9,917
	368,188	366,909
Net Unamortized Actuarial Gain	1,513	5,762
Valuation Allowance	2,994	506
	372,695	373,177
Less:		
Provisions in Reserves and Balance Sheet	(92,253)	(90,418)
Employee Related Liabilities to be Recovered in the Future	280,442	282,759
Waste Management Facilities Liabilities:		
Open and Closed Landfill Sites	71,420	71,559
Less:		
Provisions in Reserves	(1,189)	(1,134)
Waste Management Liabilities to be Recovered in the Future	70,231	70,425
Total Liabilities to be Recovered in the Future	350,673	353,184

Outstanding Internal Loans

Internal borrowing from Reserves reduces reliance on external debenture borrowings which, in turn, reflects favourably on the City's Credit Rating. It also provides Council with an alternative financial tool in dealing with Capital budget pressures.

Borrowing from a reserve is permitted only if the analysis of the reserve's funds indicates excess funds are available and the use of these funds will not impact the reserves current operations. As at December 31, 2019, the total principal outstanding for internal loans from reserves was \$28.6 M with annual repayments of \$5.1 M and maturities ranging from 2020 to 2032. Loans of \$1.2 M related to energy efficiency were added in 2019. Appendix "B" to Report FCS20068 provides a detailed summary of all outstanding internal loans from reserves.

COVID-19 Reserve

At the direction of Council, staff undertook a review of all approved capital projects across the organization to identify projects that could be delayed in an effort to offset the anticipated negative budget variance for 2020. As a result of that review, staff recommended the closure of nine capital projects, that were either completed or cancelled and to direct the remaining Capital Levy funds of \$1,144,000 towards the establishment of a COVID-19 Reserve, which was approved through Report FCS20040(a).

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 FCS20068 – 2019 Reserves Detail Report with 2018 Comparative Figures and 2020-2022 Projections

Appendix “B” to Report FCS20068 – Internal Loan from Reserves Summary

MZ/dt