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2008 REVIEW AND REALIGNMENT OF RESERVES AND RESERVE FUNDS

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report, November 24, 2008, from the Commissioner of Finance:

1. RECOMMENDATIONS

It is recommended that:

1. Funding in the amount of $9.965 million for the Developing Opportunities for Ontario Renters (DOOR) program be transferred to the Social Housing Reserve Fund.

2. The Property Tax Write-Off Reserve Fund be discontinued and that future write-offs be funded from the Tax Stabilization Reserve Fund.

3. The Capital Asset Repair and Rehabilitation Reserve Fund be renamed the Facilities Rehabilitation and Replacement Reserve Fund.

4. The following new reserve funds be established and funded by annual appropriations from the operating budget to provide for the replacement and major rehabilitation of infrastructure:
   - Roads Infrastructure Reserve Fund
   - Regionally Owned Housing Reserve Fund
   - Transit Vehicle and Infrastructure Reserve Fund

5. Future annual contributions from the tax levy budget to fund capital asset replacement and debt reduction be allocated to these reserves as identified annually.

6. Funding in the amount of $67.6 million for the Move Ontario 2020 Quick Wins Program be placed in a new reserve to be called the Move Ontario Reserve Fund.

7. Transfers to and from Reserve Funds as outlined in Table 5 of this report be approved.

8. The Surplus Management Policy be revised as follows:

   (a) 80% of the unspent tax levy within the year budgeted for Social Housing programs be contributed to the Social Housing Reserve Fund, the remaining 20% be contributed to the Working Capital Reserve Fund; then,

(b) The remaining net operating surplus, except where otherwise directed by Council will be allocated to the following reserve funds in the order listed until they reach their target:

- Reserves which fund potential third party liabilities to the Region which are for WSIB, Long-Term Disability and self insured claim payment; then
- The Working Capital Reserve
- The Tax Stabilization Reserve Fund; and then
- The General Capital Reserve Fund.

9. The Regional Solicitor be authorized to prepare the necessary by-law(s) to give effect to the above recommendations.

2. PURPOSE

This report reviews the need and adequacy of selected reserve and reserve fund accounts and recommends transfers to and from reserve funds as well as changes to the Surplus Management Policy.

3. BACKGROUND

Reserves and Reserve Funds are key elements of a Municipality's Financial Planning Strategy

The *Municipal Act* provides municipal councils with the authority to establish and fund reserves and reserve funds to either meet statutory requirements such as those for Development Charges or workers compensation benefits or to meet specific financial objectives of Council.

As shown in Table 1, the balance of reserve funds held by the Region as at September 2008 was approximately $1.1 billion.

Table 1
Reserve Fund Balances
As at September 30, 2008

Reserve Category	$ Amount (000)'s
Growth Capital Reserves	501,410
User Rate Reserves	15,758
General Capital Reserve	208,531
Capital Replacement Reserves	44,300
Other Capital Reserves	146,667
Sub-total	916,666
Operating Reserves	188,820
Total	1,105,486

The adequacy of reserve funds for York Region was last discussed as part of a Long Range Fiscal Planning Strategy report approved by Council in 2006. At that time it was estimated that without any intervention the reserves used to fund new capital development and the replacement of these assets ("capital reserves") could be depleted by as early as 2015. Council recognized the need to take steps to ensure these capital reserves were available when required in the long-term. These initiatives in the past three years have included:

- The compilation of an inventory of assets owned by the Region prepared in 2006;
- Amendments to the Region's development charge discount policy in 2007; and,
- Preliminary funding of the rehabilitation and replacement of capital assets starting in 2007 including:
    - A non-specific allocation of $6.2 million representing 1% of the tax levy for capital asset replacement. An additional 1% of the levy, for a total of $12.8 million was included as part of the 2008 Budget. The preliminary 2009 Budget contains a further 1% for a total of 3% or approximately $21.0 million. The existing plan calls for three more years of incremental increases to reach our funding goal;
    - Council approved a policy to fund Capital Asset Replacement Reserves in an amount equal to 50% of the last complete year's supplementary tax receipts (net of write-offs). This amounted to funding of $6.3 million in 2007; and
    - Council authorization to set aside $11.8 million each year for debt reduction associated with funding the cost of replacement assets.

With these funding sources in place, current projections now indicate that capital reserve balances will remain positive for at least the next 10 years, however, the adequate funding of replacement reserves remains an important component of moving the Long Range Fiscal Planning Strategy forward.

Analysis of Development Charge and User Rate Reserves are excluded from this report

The adequacy of development charge reserves was last examined as part of a formal review in 2007 and will not be reviewed again as part of this report.

Also, the adequacy of asset replacement and rate stabilization reserves related to water and wastewater assets funded from related user rates will be discussed in the annual rate setting report which will be the subject of a budget report to Council in December 2008.

4. ANALYSIS AND OPTIONS

An analysis of the need and adequacy of the key operating, general capital, and replacement reserves currently held by the Region representing about 80% of these reserves, was undertaken for this report, however, this report only focuses on those reserve funds where material changes are recommended. The report also looks at the need to revise the Region's Surplus Management Policy.

4.1 Operating Reserves

Social Assistance Reserve Fund should be reduced to $25 million from the current balance of $61 million

The Social Assistance Reserve Fund was established in 1998 to fund unanticipated costs resulting from increased social assistance caseloads within the Region and GTA pooling costs related to social assistance. The reserve is funded from appropriations made from time to time from the operating budget as directed by Council. Additionally 80% of any unspent tax levy budgeted for Social Assistance is transferred to the reserve fund.

The reserve strengthens the Region's financial position by effectively dealing with such events of sudden and severe economic downturn, which could financially undermine its ability to deliver critical services.

In the 2006 Ontario budget, it was announced that GTA Pooling payments would be frozen at 2005 levels and then phased-out over six years commencing in 2007. The funding for unanticipated GTA pooling payment increases from this reserve is no longer required.

An analysis undertaken to determine the amount needed to absorb York Region's own incremental social services costs in the case a major economic downturn of the magnitude of the early 1990's indicates the target for the Social Assistance Reserve could be reduced to $25 million.

The Province has recently completed a review of service provision responsibility between it and municipalities. It has now committed to the full funding of Social Assistance transfer payments by 2018.

Further study of the Social Housing Reserve Fund should be made with an interim transfer of $9.665 million related to program funding

The Social Housing Reserve Fund was established in 1998 to fund unanticipated GTA pooling payments under the *Social Housing Reform Act* as well as future capital expenditures related to social housing units in York Region.

A one-time grant of $9.665 million in 2007 received from the Province under the Developing Opportunities for Ontario Renters (DOOR) program is currently held in a deferred revenue account. It is recommended this funding be transferred to the Social Housing Reserve Fund allowing interest to accrue which can be used to further program objectives.

In the recently completed review of service provision responsibilities between the Province and municipalities, it was decided that Social Housing costs and responsibilities will remain with municipalities. It is recommended that staff complete a review of the long-term reserve fund needs for Social Housing and report back to Council.

No adjustments should be made to the Tax Stabilization Reserve Fund

The Tax Stabilization Reserve Fund was established in 2002 for the purpose of funding temporary in-year revenue shortfalls and unpredictable one-time expenditures which could significantly increase the tax levy.

Historically, the target set for this reserve has been set at 5% of net operating revenues based on a recommendation of the Government Finance Officers Association. In 2007, the Region's net operating expenditures adjusted for water and waste water expenditures which have their own rate stabilization reserves, and social assistance costs which can be supplemented by the Social Assistance Reserve were $701 million. This would translate into a recommended minimum reserve balance of approximately $35 million indicating a current shortfall of about $9 million compared to its current $26 million balance.

While this reserve fund is currently below target, the Region also has $37 million in the Working Capital Reserve which could be used in an emergency to cushion an increase in expenditure or decrease in revenues experienced in any given year.

Therefore, it is not recommended that any adjustments be made to the Tax Stabilization Reserve Fund at this time, but that the reserve continue to be funded through operating surpluses until it reaches its target.

WSIB Reserve Fund should be reduced to $7 million from its current balance of $15 million

The WSIB Reserve Fund was established in 1996 when the Region decided to become a self- insured employer becoming liable for its own claims.

The Region completed an updated review of its WSIB liability for financial reporting purposes in 2007. This review indicated that the Region's WSIB recorded liability should be $4.6 million to meet its expected obligations.

It is recommended however, that the WSIB Reserve Fund balance be only reduced to $7 million to provide for the actuarial liability as well as any potential catastrophic occurrence.

Property Tax Write-off Reserve Fund should be discontinued and future tax write-offs funded from the Tax Stabilization Fund

The Property Tax Write-Off Reserve Fund was established in 2000 to fund property tax write-offs and tax rebates on vacant commercial and industrial properties. The reserve is funded from appropriations made from time to time from the operating budget, supplementary tax receipts, allocations made at the discretion of Council, and investment earnings from funds held in the reserve fund.

A review of supplementary tax receipts net of write-offs since the inception of this Reserve indicates that net annual receipts have ranged from $7 million in 2002 to $18 million in 2005. It is not anticipated in the near to mid term that annual net supplementary tax receipts will be in a negative balance. However, because growth in the Region is slowing and will eventually be stable, this could be the case in the long term.

It is recommended the Property Tax Write-off Reserve Fund be discontinued and that any future tax write-offs be funded from the Tax Stabilization Reserve Fund if needed.

4.2 General Capital Reserve

General Capital Reserve Fund should have a target reserve of $70 million

The General Capital Reserve Fund was established in 1995 to fund unspecified non-recurring capital expenditures. This Reserve Fund has been used in the past to fund such items as the purchase of the Baker Sugar Bush, The Y2K Strategy, and Police and Fire Dispatch Technology.

The main source of revenue for this fund has been surpluses from operations as provided by the Surplus Management Policy approved by Council. In addition, Council has directed that, starting in 2007, $11.8 million annually be placed in the reserve fund for the purpose of debt reduction. As noted in Section 4.4 of this report, it is now recommended that this funding be specifically allocated to capital replacement reserves from where it can be drawn upon in lieu of future debt as needed.

In March 2006, the Region received a one time grant from the Ministry of Health and Long Term Care in the amount of $5.067 million as part of a move toward 50/50 cost sharing of land ambulance services. In April 2006, Council approved placing this grant in the General Capital Reserve Fund for future EMS asset replacement. One withdrawal of $367,000 was made in 2006 to these funds. It is recommended the remaining balance of $5,168 million including accrued interest be placed in the Equipment Replacement Reserve Fund.

It is proposed that the target for General Reserve Fund should be set at $70 million for 2009, an amount which represents approximately 10% of the Region's 2008 Capital Budget. Based on previous uses of this reserve fund, an allowance of 10% should provide adequate flexibility to the Region should a need arise.

4.3 Further Funding Still Needed for the Replacement of Capital Assets

There is a large disparity between the replacement cost of assets owned by the Region and the amount of the Region's replacement reserves.

As shown in Table 2, an inventory of the Region's assets at the end of 2005 estimated that their replacement value would be approximately $6.0 billion.

Table 2
Present Value Replacement Cost of Regionally Owned Assets
As at December 2005

Asset Class	Replacement Value(000) $	% of Total Replacement Value
Roads	2,559,470	43.8
Buildings	365,692	6.2
Equipment	74,068	1.3
Housing	292,214	5.0
Buses	211,582	3.6
Other Vehicles	39,147	0.7
Sub-Total	3,542,849	60.6
Water and waste water	2,300,293	39.4
Total	5,843,142	100

Note: These numbers are in 2005 dollars. Replacement costs have increased at an approximate rate of 6% annually in the past 3 years.

Sources: *Capital Asset Replacement Strategy Project,* S. M. Fletcher, May 2006 and York Region Finance Department

Notes: Excludes software replacement which is funded through the annual operating budget:
The Fletcher report did not deal with computer system replacement as most of the Region's computer infrastructure was leased at the time

While Council has taken significant steps toward providing funding for the rehabilitation and replacement of capital assets, there is only $44.3 million in reserves now identified for this purpose.

Further, based on the Fletcher report it is estimated the Region would need to set aside nearly $1.5 billion by the end of 2018 to meets its on-going and long term asset replacement financial obligations for assets other than those related to water and wastewater. With current available funding it is estimated there could be a cumulative shortfall in this requirement of nearly $450 million by 2018.

It is recommended that funds from reserves identified as being in excess of the targets proposed in this report totalling $135 million plus future interest, be transferred to replacement reserves funds. This would reduce the funding gap over the next 10 years from an estimated $450 million to $250 million.

If the tax levy contribution currently being made to asset replacement is increased by a further 1% per year until 2012- at which time it will represent a total of 6% of the tax levy- and maintained at that level on a going forward basis, it is estimated the funding gap could be reduced to about $50 million by 2018.

New Replacement Reserves are required to fund infrastructure replacement needs

It is recommended the following new reserves be established to more accurately identify and fund infrastructure replacement needs:

- Roads Infrastructure Reserve Fund
- Regionally Owned Housing Reserve Fund
- Transit Vehicle and Infrastructure Reserve Fund

Also, for greater clarity, it is recommended that the existing Capital Asset Repair and Rehabilitation Reserve Fund be renamed the Facilities Rehabilitation and Replacement Reserve Fund to more accurately reflect its purpose which is to fund major capital renovations, rehabilitations and replacement of Regionally owned buildings excluding affordable housing. This reserve would continue to be funded from annual appropriations from the operating budget.

$135 million should be transferred to Replacement Reserve Funds

The allocation of the proposed transfer of funding to replacement reserves should be based on the following factors:

- The expected useful life of the asset class
- The average age of the asset
- How often the assets need to be replaced
- The degree to which funding for asset replacement and rehabilitation is already planned in the Region's budgets. These factors were used in the allocation outlined in Table 3.

Table 3
Proposed Allocation to Replacement Reserve Accounts

Capital Asset Replacement Reserve	Proposed Allocation based on 10 year Requirement $ M's	Proportion of $135 M Allocation %
Road Infrastructure	103.9	77.0
Equipment Replacement	13.1	9.7
Regionally Owned Housing	10.2	7.6
Other Vehicles	7.8	5.7
Total	135.0	100.0

Sources: *Capital Asset Replacement Strategy Project*, S. M. Fletcher, May 2006 and York Region Finance Department

4.4 Identification of Tax Levy Contribution's for Capital Asset Replacement

The annual operating budget now provides approximately $30.1 million of non-specified funding for capital asset replacement and debt reduction. It is recommended that these contributions be directed to the specific reserves each year based on an annual review of the future funding requirements of each asset type.

Further analysis is required

As noted earlier, this report only examines the reserve requirements based on the 2006 capital asset inventory until 2018. Updated reserve studies will be required to determine reserve and cash flow requirements for the next 25 years. It is expected these further studies could change funding requirements going forward as additional significant assets are added to the analysis. For example the proposed 2009 Capital Budget forecasts an additional $11 billion of assets be added to the Region's infrastructure in the next 10 years.

Finally, it can reasonably be expected there will be a shift required to fund the replacement of rapid transit vehicles and related assets, as significant replacement of these assets will start to occur beyond the 10 year horizon used in this report. A further staff report on this matter will be completed and reported back to Council.

4.5 Other

$67.6 million of Move Ontario 2020 Funds should be moved into a separate reserve

The Region was informed on March 31, 2008 by the provincial Minister of Transportation that it would receive $67.6 million of funding under the Move Ontario 2020 Quick Wins Program to invest in transit vehicles and transit infrastructure.

It is recommended that funding in the amount of $67.6 million related to funding received by the Region by the Province in relation to the Move Ontario 2020 Quick Wins Program be placed in a separate reserve account named the Move Ontario Reserve Fund with expenditures being restricted to those projects outlined in the underlying agreement for the purposes allowed in the funding agreement between the Province and the Region.

4.6 Revisions to the Surplus Management Policy

Currently, annual operational surpluses are allocated to the General Capital Reserve. Best practice involves ensuring that reserves which represent offsets to potential liabilities to the Region should be adequately funded at all times. These reserves include the Insurance Reserve, and the WSIB and Long Term Disability Reserve.

It is recommended the Region's Surplus Management Policy be revised as follows:

(a) 80% of the unspent tax levy within the year budgeted for Social Housing programs be contributed to the Social Housing Reserve Fund, the remaining 20% be contributed to the Working Capital Reserve Fund; then,

(b) Remaining operational surpluses should be allocated in the following order until each reaches the target level:
- Reserves which fund potential third party liabilities to the Region which are for WSIB, Long-Term Disability and self insured claim payment; then
- The Working Capital Reserve, then
- The Tax Stabilization Reserve Fund; and then
- The General Capital Reserve Fund.

4.7 Next Steps

The allocations recommended in this report among the Capital Asset Replacement Reserves are preliminary. An updated inventory of assets owned by the Region should be completed and reviewed in the context of standard replacement reserve models. The results of this analysis will be brought back to Council.

Much of the preliminary work has been done to complete a comprehensive Long Range Fiscal Planning Strategy. Staff will determine the need for an external consultant to develop an integrated model to forecast optimum tax, development charge, debt, investment and reserve levels for the Region. Staff will report to Council regarding the progress of the formulation of the Strategy prior to the presentation of the 2010 operating budget.

5. FINANCIAL IMPLICATIONS

The following table summarizes the transactions to Reserve Funds proposed in this report.

Table 5
Proposed Transfers to/from to Reserve Funds
as at September 30, 2008
$ Millions

Reserve Fund	Current Reserve Fund Balance	Proposed Transfer to (from) Fund	Adjusted Reserve Fund Balance
Inter Fund Transfers			
Social Assistance	60.972	(35.972)	25.000
WSIB	14.793	(7.793)	7.000
Property Tax Write-off	3.000	(3.000)	0
General Capital	208.531	(93.403)	115.128
Road Infrastructure		103.900	103.900
Equipment Replacement	1.107	18.268	19.375
Regionally Owned Housing Replacement	0	10.200	10.200
Other Vehicles	6.769	7.800	14.569
Total Fund Transfers	**295,172**	**0**	**295,172**
Transfers from Deferred Revenue			
Social Housing	51.237	9.665	60.902
Move Ontario 2020 Quick Wins	0	67.600	67.600

Note: Based on further approved budgeted expenditures it is expected the General Capital Reserve Fund will have a balance of about $70 million by the end of 2009.

6. LOCAL MUNICIPAL IMPACT

The long term provision of Regional capital assets and infrastructure is vital to the on-going safety of local municipal residents and the on-going economic prosperity of local municipalities. The completion of a Long Term Fiscal Planning Strategy will enable the orderly replacement of these assets when required.

7. CONCLUSION

Regional Council authorized the development of a Long Term Fiscal Planning Strategy in 2006. Much of the work needed to complete the Strategy has been completed. The review of reserve fund need and adequacy is another step toward the finalization of the Strategy which will be completed before the review of the 2010 budget by Regional Council.

The review of replacement reserve funds outlined in this report indicates there is a balance in excess of $200 million in the non-specific General Capital Reserve Fund at the same time there is a large and growing funding gap related to Replacement Reserve Fund accounts. This gap can be significantly lessened by transferring $135 million to Capital Asset Replacement Reserve Funds from other reserve fund accounts while continuing to allocate an additional 1% annual tax levy to capital asset replacement for the next several years.

For more information on this report, please contact Len Bulmer, Reserve and Debt Specialist at Ext.1676.

The Senior Management Group has reviewed this report.