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2010 REVIEW OF RESERVES AND RESERVE FUNDS

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report dated September 6, 2010, from the Commissioner of Finance.

1. RECOMMENDATIONS

It is recommended that:

1. The following reserve funds be established:
   a) An Information Technology Development Reserve Fund for information technology capital projects related to expansion, enhancement or improvement, as approved by Council.

   b) A Fuel Cost Stabilization Reserve Fund for differences between actual and budgeted fuel rates during the year (based on projected volumes) as well as any costs or savings arising from fuel price hedging transactions.

2. The Social Housing Reserve Fund be renamed the Social Housing Development Reserve Fund and its purpose clarified to state that the funds are to be used for expenditures related to new affordable housing projects either developed for Housing York Inc., or third parties as approved by the Region.

3. The transfers between reserves, reserve funds and deferred revenue accounts shown in Table 2 of this report be approved.

4. The Regional Solicitor be authorized to prepare all necessary by-law(s) to give effect to these recommendations.

2. PURPOSE

As part of an ongoing examination, this report reviews the adequacy of selected reserve and reserve fund accounts, including the need to create new reserve funds.

3. BACKGROUND

Municipal capital planning strategies rely heavily on reserves and reserve funds

The *Municipal Act*, 2001 provides authority to municipal councils to establish and fund reserve and reserve fund accounts.

Typically reserves are established as part of a prudent fiscal strategy to help smooth the financial impact of capital programs. In the case of York Region, reserves and reserve funds related to capital asset replacement will support the refurbishment and replacement of over $14 billion of assets currently owned and/or identified in its 10-year capital plan (and beyond). Other reserves and reserve funds are established to provide support for unexpected expenditures, or to meet expected future obligations for items such as insurance and human resource related claims.

As shown in Table 1, the balance of reserves and reserve funds at the end of December 2009 was just under $1.3 billion which represents a 45% increase over the amount held five years ago by the Region. A more detailed listing of reserve and reserve fund balances at the end of 2009 is contained in *Attachment 1* to this report.

Table 1
Reserve and Reserve Fund Balances
As at December 31, 2009
($ millions)

Reserve Category	2004	2009
Growth Capital Reserves – DC's	448.8	425.6
User Rate Reserves- Water/Wastewater	80.8	(1.6)
General Capital Reserve (Note 1)	96.9	235.9
Capital Asset Replacement Reserves	7.4	231.7
Other Capital Reserves	105.7	160.0
Move Ontario 2020 projects		67.0
Operating Reserves (Note 2)	146.1	165.1
Expected Ending Balance	**885.7**	**1,283.7**

Note 1: As shown in Table 3 in this report, approximately $110 million in the General Capital Reserve at the end of 2009 is committed or proposed to be committed, leaving an approximate adjusted balance of $127 million.
Note 2: Operating Reserves include funds in the amount of $64 million for expected future obligations related to insurance, and human resources claims, a $39 million reserve fund for working capital, a $37 million reserve fund for tax stabilization to meet unexpected operating expense and $25 million in the Social Assistance Reserve Fund.

Reserve requirements are monitored on a regular basis

A review of selected reserves and reserve funds has been completed bi-annually since 2000, including the 2006 Long Range Fiscal Planning Strategy report. That report highlighted a need to significantly increase the amount of funding for replacement capital in order to meet expected future needs.

Since 2007, Council has responded by approving annual incremental apportionments to the Asset Replacement Reserve Fund equal to 1% of the tax levy. Future funding increments are planned to until 2013 at which time the annual contribution is expected to reach approximately $45 million.

Development Charge reserves for water, wastewater and roads have recently been examined as part of a by-law amendment study. Other growth related reserves will be re-examined as part of a detailed development charge review expected in 2012.

The adequacy of rate supported reserve funds related to water and wastewater asset replacement are currently being reviewed by an external consultant and will be reported upon to Council at a later date.

4. ANALYSIS AND OPTIONS

Except as otherwise noted, only those reserves and reserve funds which are deemed to require change at this time have been reported upon. Others, including those related to working capital, insurance, and tax stabilization were found to be adequately and appropriately funded.

Information Technology Capital Reserves

The 2010 Information Technology capital plan indicates approximately $133 million of funding will be required over the next 10 years. Of this, approximately $65 million will be for the replacement of printers, PC’s and servers, which is shown to be funded from the existing Equipment Replacement Reserve Fund. Software licenses in the amount of $4 million will be funded from the Software Acquisition Reserve.   The remaining $64 million of project expenditures relate to system enhancement and replacement of telecommunications and other hardware is shown to be funded from the General Capital Reserve..

A separate Information Technology Development Reserve Fund should be established and funded

There is currently no dedicated source of tax levy funding for Information Technology development. Historically Information Technology capital growth and enhancement projects have been funded from the General Capital Reserve. This is not a typical use of the General Capital Reserve whose purpose is to address non-planned, non-recurring expenditures. Using this reserve also introduces an element of uncertainty as the primary source of revenue for the reserve fund is from operational surpluses.

Information Technology projects will continue to be an important part of the Region's service delivery and will continue to require additional funds as technology advances and changes. It is recommended that a new Information Technology Development Reserve Fund be established and as an interim measure sufficient funding be transferred from the General Capital Reserve Fund to cover the cost of planned projects until the end of 2012 (approximately $9 million). Furthermore, it is recommended that a strategy for long-term tax levy funding of approximately $3 million per year beginning in 2013 be considered as part of future budgets.

The existing balances for Long-Term Disability and WSIB Reserve Funds need to be re-aligned to reflect actuarial requirements and future budgeted rates reviewed

The Long-Term Disability Reserve Fund was established by Council in 2002 to cover disability claims for all eligible full- time permanent employees as well as associated administration expenses. The LTD Reserve Fund also funds other related staffing and program costs related to Disability Management and Workplace Wellness. Additionally, as a self-insured employer, the Region is responsible for occasional settlements arising from litigation which are funded from the LTD Reserve Fund.

The Region's external actuarial consultant has estimated the accrued LTD benefit obligation at the end of 2009 to be approximately $15.9 million compared to the balance of $21.2 million in the reserve, representing a surplus of 33%. It is recommended that $2.6 million of this surplus be transferred to the WSIB Reserve Fund which would still provide additional funds for potential growth in the liability. Furthermore, as part of the 2011 Budget, staff will review the current chargeback rate schedule for LTD to better align it with the actuarial requirement.

In 1996, the Region became a WSIB Schedule 2 employer and responsible for funding its own workplace accident claims rather than participate in the insurance pool.

The Region's external actuarial consultant has estimated the expected WSIB obligation to the end of 2009 at approximately $9.3 million compared to the balance of $8.1 million in the reserve. The proposed transfer of $2.6 million, discussed above, from the LTD Reserve Fund will meet the estimated obligation and also provide additional funds for potential growth in the liability. Furthermore, as part of the 2011 Budget, staff will review the current chargeback rate schedule for WSIB to better align it with the actuarial requirement.

The purpose of the Social Housing Reserve Fund should be clarified but funding is adequate to meet short to mid term development obligations

The Social Housing Reserve Fund was established by Council in 1998 to fund capital expenditures associated with social housing units within the Region as well as GTA pooling costs related to social housing. At the end of 2009, it had a balance of $72.3 million. A number of projects have been approved but not yet completed which when completed would leave a balance in the reserve of approximately $45 million.

In 2002, Council adopted the Affordable Housing Strategy which set an objective of developing 100 units of affordable housing per year. Assuming other levels of government match the Region's contribution and based on current costs, operating and financing assumptions, it is estimated the Region would need to contribute about $11 million of equity for every 100 units it builds. If the 100 unit annual development target is met, there would be sufficient funds in the Reserve Fund to last until at least 2015.

Since 1998, other reserves have been established related to social housing and the Region no longer has a variable GTA pooling commitment. Therefore, for planning purposes, it is recommended that the Social Housing Reserve Fund be renamed the Social Housing Development Reserve Fund and its purpose clarified that it be used only for new affordable housing development, whether for projects developed by the Region directly for HYI, or for funds to be contributed to third party projects by the Region.

Finally, this Reserve Fund also contains $1.7 million which was received from the Federal government to support capital repair costs. It is recommended this amount be transferred from the Social Housing Reserve Fund to the Non-Profit Housing Capital Repair and Maintenance Reserve Fund.

Contributions to Non-Profit Housing Capital Repair and Maintenance Reserve Fund are insufficient to meet forecasted needs

The Non-Profit Housing Capital Repair and Maintenance Reserve Fund was established in 2002 to fund costs related to the repair, maintenance and refurbishment of non-profit housing facilities administered by the Region, including facilities owned by third parties. At the end of 2009, it had a balance of $3.537 million.

The Building Condition Assessments (BCA's) that were completed in 2005 of the non-profit projects projected that the Region may need to provide about $65 million to housing groups over the period 2006-2015 to cover unfunded repairs and maintenance.

In the last two years, the Region has received approximately $16 million of stimulus funding from other levels of government for the purposes of social housing capital repair and refurbishment. Although these funds have met some immediate and mid-term needs it is anticipated when the building assessments are updated again in 2011, there will still be significant projected costs. A clearer picture of future funding needs can be determined at that time.

Council approved a tax levy allocation of $1 million in 2009 and a further $2 million in 2010 to the Reserve Fund. It is recommended that as part of the 2011 budget process that the contribution level be reviewed again in light of the expected future need.

The Social Assistance Reserve Fund should be re-allocated over time to meet the needs of non-profit housing capital repair and maintenance or other items that may be identified in the Community and Health Services Multi-Year Plan

The Social Assistance Reserve Fund was established in 1998 to cover unanticipated costs resulting from increased social assistance caseloads within the Region as well as GTA pooling costs related to social assistance. At the end of 2009, there was approximately $24.6 million in the Reserve Fund.

As part of the 2008 review of reserve and reserve fund adequacy, it was noted that the Region's contribution to GTA will be fully phased out by 2013. As well, the Province has indicated that it will assume full costs related to the Ontario Disability Support Program (ODSP) in 2011 and costs for Ontario Works (OW) benefits by 2018.

Therefore, it is recommended that starting in 2011, the Social Assistance Reserve Fund be reduced proportionally to the Region's potential exposure with the funds being transferred to the Non-Profit Housing Capital Repair and Maintenance Reserve Fund or for other items that may be identified in the Community and Health Services Multi-Year Plan process. Decisions on the phase-out and transfers will form part of future operating budgets approvals.

Fuel price volatility to be partially addressed through a new Fuel Cost Stabilization Reserve Fund

Regional fuel costs in the past five years have been extremely volatile, ranging from a low of $0.80 cents a litre to a high of nearly $1.40 a litre. Every cent of fuel price variability impacts the bottom line by more than $200,000 each year. As part of an overall strategy to help stabilize fuel costs, Council authorized a fuel price hedging program in January 2009 to fix the underlying cost of a portion of the fuel volumes used in 2010.

As this is expected to be an ongoing strategy, it is recommended that a Fuel Cost Stabilization Reserve Fund be established. This Reserve Fund may be used to administer some or all differences between budgeted and actual gasoline or diesel fuel rates, for budgeted volumes. Furthermore, benefits or losses associated with fuel price hedging transactions realized during a calendar year would also be transferred into or paid out of the reserve.

Funding for this reserve will be from cost savings realized, however in the event of a loss for the year, it would be funded from operational surplus.

General capital reserve

The General Capital Reserve was established in 1995, and can be used for any purpose determined appropriate by Council. The reserve is funded by tax levy surpluses at the end of each year. It has typically been used for non-recurring, or unplanned expenditures. After adjusting for significant planned expenditures which have already been committed and the transfer of $9.1 Million for the Information Technology Reserve Fund, the balance in this Reserve Fund will be approximately $127 million.

As identified in the 2008 reserve report to Council, the target for the General Capital Reserve should be approximately 10% of expected capital expenditures for the year. Therefore, based on the average capital expenditure level for the next five years (as found in the 2010 10-year Capital Budget) the reserve target would be approximately $95.5-$100 million. As a result, the General Capital Reserve is expected to be fully funded for at least the mid-term period.

5. FINANCIAL IMPLICATIONS

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

Table 2
Proposed Transfers to/from Reserves and Reserve Funds
($Millions)

Reserve Fund	**Transfer from**	**Transfer to**
General Capital	9.1	
IT Development		9.1
Housing – General	1.7	
Housing – NP R&M		1.7
Human Resources – WSIB		2.6
Human Resources – LTD	2.6	
Totals	13.4	13.4

6. LOCAL MUNICIPAL IMPACT

The examination of reserve adequacy supports the effective continuation of programs and services to local municipal residents, and ultimately the on-going economic prosperity of the Region's local municipal partners. There is no direct financial impact to local municipalities stemming from the recommendations contained in this report.

7. CONCLUSION

The Region conducts periodic reviews of the adequacy of its reserve and reserve funds. This report recommends the transfer of funds among specified reserves and reserve fund to better match expected future expenditure requirements and obligations. Additionally, the report recommends a sustainable and predictable approach for the funding of the IT Capital Plan.

For more information on this report, please contact Len Bulmer, Head of Financing and Reserves at Ext. 1676.

The Senior Management Group has reviewed this report.

(The attachment referred to in this clause is attached to this report.)

Reserve and Reserve Fund Balances
At December 31, 2009

Reserve /Reserve Fund	Balance -$
Development Charges	425,616,601
Equipment replacement	39,859,051
Working capital	39,443,307
Vacation Pay	725,755
OMERS (Type 3)	94,604
Group benefits	4,592
Capital reserve	235,871,203
Roads infrastructure	109,526,649
Social housing	72,257,402
Facilities rehabilitation & replacement	71,352,413
Move Ontario capital	67,099,453
Tax stabilization	36,861,843
Roads capital	28,471,282
Social assistance	24,649,515
Long term disability	21,197,210
Solid waste management	19,454,646
Insurance	16,992,541
Sick leave	16,861,447
Regionally owned housing	10,957,650
Workers' compensation	8,070,176
Transit	7,901,041
Non profit housing capital	4,230,030
Innovation	3,537,454
Computer software acquisition	3,088,891
Provincial gas tax	2,308,500
Provincial highways	1,727,591
Land securement	1,407,059
Alternative Community Living	179,327
Seized funds	162,725
Insurance claims & certificate system	10,286
Federal Gas Tax	15,310,614
Capital reserve (water & sewer)	-1,631,868
Total Reserves and Reserve Funds	1,283,598,989