2
RESERVES AND RESERVE FUNDS POLICY

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report, September 26, 2006, from the Commissioner of Finance:

1. RECOMMENDATIONS

It is recommended that:

1. The Reserves and Reserve Funds Policy, shown on Attachment 1, be adopted including specific recommendations to fund the rehabilitation and replacement of major capital assets starting in the year of acquisition.
2. Staff prepare a further report on proposed targets and potential funding strategies with respect to the reserves and reserve funds; and
3. Staff be authorized to take all actions necessary to implement this recommendation.

2. PURPOSE

The purpose of this report is to establish a policy governing the management of the Region's reserves and reserve funds.

3. BACKGROUND

Under the *Municipal Act*, Council has the authority to establish reserves and reserve funds as required. Reserve and reserve funds can be formed to meet specific liabilities such as the replacement/acquisition of capital assets or the stabilization of the tax levy and/or user rates in the face of uncontrollable or unanticipated circumstances or expenditures. Other reserves are established to meet specific legislation such as those for development charge revenue, workers' compensation benefits and sinking funds associated with issuance of certain debt. The majority of the Region's reserves are segregated and legally restricted to only meet the purpose for which the reserve was established (e.g. water, wastewater, solid waste, and provincial highways).

Reserves and reserve funds have been long recognized as key elements of the Region's current and capital financing program. The Region's philosophy relating to reserves and reserve funds has been developed through a contribution of historical prudence and the adoption of best practices among municipal governments. This philosophy was embodied in the Financial Mission Statement, adopted by Council in 1999, which highlights the Region's commitment to fiscal responsibility and sound financial management, including ensuring adequate funding of services and capital infrastructure.

In conjunction with the Financial Mission Statement, Council adopted the following Financial Principle, which specifically addresses the use of reserves:

"Adequate reserves will be maintained to:

1. *Replace and rehabilitate major capital infrastructure assets as required;*
2. *Provide a buffer for significant unanticipated expenditures beyond the control of the Region; and*
3. *Supply funds for new major capital assets identified in the long-term corporate strategy."*

Reserves and reserve funds help support the Corporation's pay-as-you-go policy regarding the funding of capital infrastructure expenditures. Their availability and proper use also help to reduce financing costs by avoiding over reliance on debt financing. The establishment of capital asset replacement reserves recognizes that current tax and rate payers are benefiting from capital assets which were originally paid for through development charges, and that they should contribute towards their replacement.

The Corporation's practice with respect to reserves significantly influences the "AAA" rating assigned to it by credit rating agencies. This rating allows the Corporation to raise funds in the capital markets at the lowest possible borrowing rates which minimize the long-term costs for infrastructure capital.

4. ANALYSIS AND OPTIONS

The Reserves and Reserve Funds Policy formalizes the practices and procedures which govern their management by specifically addressing the following issues:

- Defining objectives; and
- Establishing expected standard of care.

4.1 Objectives

A formal statement of objectives is a central element of a successful municipal reserves and reserve funds management program. It assists Council and staff in developing appropriate guidelines and procedures. The primary objectives for reserves and reserve funds, in order of priority;

- Adherence to statutory requirements;
- Promotion of financial stability and flexibility; and
- Provision for major capital expenditures.

4.1.1 Adherence to Statutory Requirements

Regulations under the *Municipal Act*, the *Development Charges Act* and the *Workplace Safety and Insurance Act*, require municipal governments to maintain specific statutory reserves and/or reserve funds. The Region currently has the following statutory reserves.

- Development Charges Reserve Fund
- Sinking Funds Reserve Fund
- WSIB Reserve Fund

These statutory reserve funds have been duly authorized by by-law and approved by Council and it is the objective of the Region to meet all regulations set out under provincial regulations regarding the creation, maintenance and management of these reserve funds.

A number of other statutory requirements govern the management of reserves and reserve funds. These include:

(a) Section 417(4) of the *Municipal Act* requires money raised for a reserve fund to be paid into a special account and may be invested in securities or classes of securities prescribed by Ontario regulation 438/97.

(b) Section 418(3) of the *Municipal Act* allows a municipality to combine money held in any fund (including General, Capital and Reserves and Reserve Funds) for investment purposes.

(c) Section 418(4) requires earnings from combined investments to be credited to each segregated fund in proportion to the amount invested in it.

4.1.2 Promotion of Financial Stability and Flexibility

Creating and maintaining adequate reserves and reserve funds promotes stability in the Region's current and capital budget programs and provides flexibility to its longer term capital financing requirements.

An important Regional goal is to maintain year-over-year continuity in the tax levies and user rates charged to residents. The existence of tax and rate stabilization reserves as well as those for vehicle and equipment replacement promotes this type of continuity or stability. The Policy therefore states that the Region shall establish and maintain adequate reserves and reserve funds to provide for:

- Known and recurring material cash flow deficiencies;
- Large or lumpy periodic or one-time payments;
- Long-term contingencies;
- Potential liabilities; and
- Unanticipated expenditures

Included in the Policy will be the requirement to compare the Region's reserves to the levels maintained by other similarly rated municipalities with similar responsibilities.

4.1.3 Provision for Major Capital Expenditures

In the past the Region has recognized the need to fund growth related capital projects from development charge contributions and to provide for the eventual replacement of certain capital infrastructure assets.

Recently the Commissioner of Finance undertook a review of the Region's existing capital asset inventory and initiated the development of the Long Range Fiscal Planning Strategy. That review and strategy identified the need to develop a capital financing plan that would provide for the replacement over the next 50 years of approximately $6.0 billion of existing infrastructure as well as the replacement of new capital assets as they are acquired.

To achieve this, the following principles have been incorporated into the policy:

- Reserves for the full cost of replacement or rehabilitation of major assets will be funded from ongoing operations at a rate which reflects the consumption of that asset by current ratepayers. *Contributions to this reserve will commence in the fiscal year that the asset is acquired or put in service;*
- Where the total cost is material, the purchase of minor assets which must be replaced on an ongoing basis (e.g. computers, furniture, vehicles) will be made from a reserve maintained at a three to five year rolling average (based on the asset's useful life) of the anticipated expenditure requirements and funded from operations; and
- Reserves should be maintained for growth related capital projects to be fully funded from developer contributions. That component of the growth related project which benefits the existing ratepayers shall be funded from tax/rates in the year the project is built or reserve funds established for that purpose.

4.2 Expected Standard of Care

The Reserves and Reserve Funds Policy established guidelines for the standard of care relating to delegation of authority, the ongoing management of reserves and reserve funds, reporting requirements and responsibilities. These guidelines are intended to ensure that best practice procedures are understood and implemented by those individuals responsible for their management and are meant to compliment those standards set out in the Region's Code of Conduct Policy.

4.3 Need for Further Analysis

As previously cited, in connection with new accounting guidelines regarding capital assets, the Commissioner of Finance has undertaken a review to identify and inventory the Region's existing capital assets. In addition, the Long-Range Fiscal Planning Strategy of which a preliminary draft was presented to Council in February 2006 identified the need to develop capital financing plan and a capital asset management plan. As part of the future development of this strategy, staff will need to analyze and project appropriate target levels for capital infrastructure reserves and reserve funds. This analysis should form part of a comprehensive report establishing target balances for all reserves and reserve funds where practicable as well as identifying funding sources to meet those targets. This work will be discussed during the annual budget process and is anticipated to be completed in the spring of 2007.

5. FINANCIAL IMPLICATIONS

Implementation of this policy will formalize the guidelines for the effective management of the Region’s reserves and reserve funds. The existence of adequate reserve and reserve funds will promote financial flexibility and stability and have been cited by bond rating agencies as an important determinant in maintaining the Region’s superior credit rating. The funding of asset replacement reserves will impact future years’ budgets and will be highlighted in each year.

6. LOCAL MUNICIPAL IMPACT

There is no direct impact from these recommendations on local area municipalities.

7. CONCLUSION

By approving this Policy, Council is putting in place appropriate quidelines to promote best practices in the management of the Region’s reserves and reserve funds. This policy specifies the objectives and standard of care and ensures the effective and prudent use of the Region’s reserves and reserve funds.

The Senior Management Group has reviewed this report.

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