THE REGIONAL MUNICIPALITY OF YORK

Housing York Inc.
September 15, 2010
Report of the
General Manager

REVIEW OF INSURANCE RESERVE CONTRIBUTIONS

1. RECOMMENDATION

It is recommended that:

1. The Board of Directors approve adjustments to the management of the Housing York Inc. insurance reserve to reduce the target balance from $200,000 to $180,000, and reduce annual contributions by half to $25,000.

2. PURPOSE

This report seeks Board approval to reduce the current balance in the insurance reserve by $20,000 by returning these restricted funds to Retained Earnings, the original source of the insurance reserve fund. Approval is also requested to reduce annual contributions from $50,000 to $25,000 per year to be more affordable given the cost of rising insurance premiums and an amount needed to maintain a reasonable reserve fund balance.

3. BACKGROUND

The insurance reserve was established to smooth out the cost of claims by making fixed annual contributions

In 2006, the Board of Directors approved the establishment of a $200,000 insurance reserve using funds from Retained Earnings. The purpose of the reserve was to cover the cost of claims and deductibles which would otherwise impact the operating budget when an insurance incident was triggered. The current deductible of $10,000 per incident, although considered relatively high, was established in consultation with the Region's risk management staff. The deductible amount balances the cost of paying out a deductible versus the higher premium costs of a lower deductible. There are no immediate plans to change the current deductible amount. A $50,000 annual contribution from operating funds would follow the initial contribution to sustain the reserve in future years.

When the Board approved the reserve, periodic updates were requested to provide assurance that HYI was maintaining the right level of funding to the reserve. Financial activity in and out of the reserve has been disclosed annually in the notes to the financial statements.

HYI claims history has remained relatively constant since the inception of the reserve. Third party risk assessments on all buildings were completed in 2007 with minor findings which have been addressed. Further, York Region Risk Management and Insurance staff have conducted random checks on HYI buildings with favourable results. A future third party risk assessment will be scheduled in 2013.

Having consistent contributions to a reserve has worked well from an operating perspective. However, restricting more funds than necessary is not advantageous. The reserve balance at the end of 2009 is now nominally higher than the original $200,000 contribution. A lower reserve balance could be considered with no impact on HYI's risk profile.

4. ANALYSIS AND OPTIONS

A summary of the insurance reserve activity is provided in Table 1.

Table 1
Insurance Reserve Activity

	2006	2007	2008	2009
Balance, beginning of year	-	$151,929	$181,386	$187,708
Contributions	$200,000	50,000	50,000	50,000
Expenditures	48,071	20,542	43,678	36,451
Balance, end of year	$151,929	$181,387	$187,708	$201,257

The average balance of the reserve since inception is approximately $180,000.

Benchmark funding formula falls short of actual insurance premiums creating pressure on operating budget.

In addition to HYI's annual contribution to the reserve to smooth the cost of claims, the corporation pays annual insurance policy premiums to the Social Housing Services Corporation's pooled insurance program.

HYI receives subsidy funding for insurance premiums from its service manager, The Regional Municipality of York. In 2010 the escalation factor for insurance subsidy was 6.1%, however, HYI's actual cost for coverage on all buildings increased by 30% and the current policy cost is $261,000 per year.

The corporation could maintain an annual contribution to the reserve of $50,000; however, the rising cost of insurance premiums is now generating a budget pressure. Considering an alternate funding approach for the insurance reserve would mitigate the budget pressure without compromising the intended purpose of the reserve.

Three options were considered to provide financial flexibility while maintaining risk management objectives

Option 1 - Temporarily suspend contributions to the reserve for two years

This option suspends annual contributions for 2010 and 2011 and allows the corporation to gather two additional years of claims history. Waiving the contribution to the reserve for two years flows $50,000 each year back into the operating budget to provide some short-term relief for rising insurance premiums. However, if average annual expenditures prevailed, the reserve would drop to around $125,000. This would be considered less than optimal, particularly with new buildings slated for delivery next year.

Option 2 - Establish variable contributions to maintain the insurance reserve balance between $150,000 to $180,000

This option suspends contributions to the reserve until the year-end balance falls within the threshold range. The corporation would then use surplus operating funds to top-up the reserve within the range as needed. The disadvantage of this alternative is that the contributions become variable, subject to the claims performance experienced in any given year. While manageable, the predictability of fixed contributions is lost thereby reducing the appeal of this option.

Option 3 - Reduce reserve to $180,000 this year and lower annual contributions to $25,000

This model would release about $20,000 from the reserve to Retained Earnings this year. A lower balance of $180,000 is representative of the average year-end balance for the past four years. It is anticipated that future contributions of $25,000 per year from the operating budget would sustain the reserve in the range of $150,000 to $180,000 as proposed in option 2, but the annual contribution of $25,000 remains constant each year going forward.

Option 3 is recommended to allow the original objectives of the reserve to remain intact, while at the same time not over restricting operating funds through the annual contribution process. This will enhance the corporation’s financial flexibility to absorb the increasing premium costs currently experienced in the insurance sector.

Regardless of any option chosen, the reserve balance would continue to receive constant monitoring.

5. FINANCIAL IMPLICATIONS

Lower reserve target balance of $180,000 frees up $20,000 to be returned to Retained Earnings

When the $200,000 reserve was established using Retained Earnings funds, a review of the fund balance was planned following several years of experience. Since the year-end balance of the reserve has averaged $180,000 since inception, this lower amount emerges as a more reasonable balance to sustain.

Reduced contribution offsets higher insurance premium costs

The 2010 funding formula created a shortfall between what HYI received in funding for insurance costs and the actual cost of insuring the buildings. This was identified as a budget pressure during the approval process of the 2010 budget. Heading into the next budget cycle, there are no indicators to suggest that the cost of insurance premiums will lower. This creates a scenario for another funding gap in the upcoming budget cycle. This would continue to stress the operating budget for the buildings.

Reducing the annual contribution to the reserve by $25,000 per year frees up operating dollars to assist with the higher cost of insurance premiums. Based on historical trends, a lower contribution to the reserve will not affect the corporation’s risk profile or the intended objectives of the insurance reserve.

The Risk Management and Insurance Manager in York Region has been fully informed of the proposals and is supportive of the recommendation.

6. LOCAL MUNICIPAL IMPACT

There is no direct impact on local municipalities. However ongoing risk management strategies help ensure that HYI buildings are sufficiently insured and that potential risk factors have been identified. This lends itself to making buildings more secure for all HYI communities.

7. CONCLUSION

The HYI insurance reserve is maintaining sufficient funds to accommodate a $20,000 reduction in the insurance reserve in 2010, as well as lower annual contributions of $25,000 until the next third party risk assessment review scheduled for 2013.

For more information on this report contact Sylvia Patterson, Assistant General Manager, Housing York Inc., Housing and Long Term Care Branch at Ext. 2091.

The Senior Management Group has reviewed this report.

Recommended by:	Approved by:
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September 2, 2010

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Report Wizard v.9 July 21, 2009
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