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## 2020 OPERATING BUDGET BRIEFING NOTE

### Contributions to and Withdrawals from Reserves/Reserve Funds

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#### Issue/Background:

This briefing note consolidates the information provided in Budget Notes on the budgeted and planned contributions (inflows) to and withdrawals (outflows) from program-specific and corporate reserves and reserve funds (collectively referred to as reserves in this document). The projected year-end balances of inflows to and outflows from reserves is reported as part of the budget process for both the Capital and Operating Budgets.

#### Key Points:

- Reserves are monies set aside by Council to finance future expenditures for which it has authority:
  - to spend money,
  - to defend the City against an unbudgeted or unforeseen event that may result in a budget deficit such as an economic downturn,
  - to align cash flow estimates with investment rate & project activities which may fluctuate from one year to the next, or
  - to accumulate funds for future capital requirements, contingent liabilities or occasional expenses such as municipal elections every four years.

Reserves receive annual contributions from the following sources: operating budget, funding secured by legislation or contractual agreements (Development Charges Reserve Funds, Section 37/45 Reserve Funds), grants and transfers from the provincial and federal government and from private donors. Maintaining healthy balances in the reserves is a critical component of a financial plan, as it strengthens long-term fiscal sustainability.

#### City-wide Reserve / Reserve Funds Inflows / (Outflows):

City utilizes reserves as a funding source to finance both operating and capital expenditures. Table 1 below details the combined net impact of inflows / (outflows) of City reserves. Essentially, the table demonstrates if the reserves are growing or depleting over time, based on the combined impact of planned contributions and withdrawals.

Table 1 provides information as follows:

- Budgeted Net Inflow / (Outflow) – the combined impact of budgeted contributions and draws from reserves, split between:
  - Operating Reserves – primary purpose to fund costs associated with operation; and
  - Capital Reserves - primary purpose to fund capital projects.
- Actual Net Inflow / (Outflow) – the combined impact of actual operating and capital expenses funded from reserves and actual reserve contributions made in 2019 and prior years.

**Table 1: Historical 5-Year Reserves/Reserve Funds Inflow / (Outflows)**

Description	2014	2015	2016	2017	2018	2019
Budgeted Net Inflow/(Outflow):						
Operating Reserves	(2)	(117)	(51)	(72)	(34)	(26)
Capital Reserves	(358)	(278)	(241)	(139)	(199)	(108)
<b>Budgeted Net Inflow/(Outflow)</b>	<b>(360)</b>	<b>(395)</b>	<b>(292)</b>	<b>(211)</b>	<b>(233)</b>	<b>(134)</b>
Actual Net Inflow/(Outflow)	102	163	314	435	1,211	52
<b>Actual Ending Balance</b>	<b>3,542</b>	<b>3,705</b>	<b>4,019</b>	<b>4,454</b>	<b>5,665</b>	<b>5,717</b>

Note: Budgeted inflow excludes interest income

As reflected in Table 1, the annual budget historically includes withdrawals from reserves that exceed reserve contributions. Variances have ranged from \$134 million to as much as \$395 million.

- The budgeted variance noted in capital reserves is largely dependent on the timing of the capital expenditure. Staff review the continuity of each capital reserve to ensure adequacy of available funding over the 10-Year Capital Plan.
- The budgeted variance noted on the operating reserves speaks to reserve sustainability. A negative annual variance can contribute to inadequate reserve balances over a period of time.
  - Gains have been made over the last five years to reduce the negative variance budgeted within operating reserves, with a significant change in 2016 coupled with steady decreases over the last three years.
  - A key objective in the development of the staff recommended 2020 Operating Budget was to grow the health of our reserves. This has been achieved and is reflected in Table 2, where budgeted contributions to operating reserves total \$449 million, compared to draws of \$426 million, demonstrating a positive budgeted variance of \$23 million.
- It is important to note that the City's actual reserve balances are trending up. Ending balances have grown from \$3.5 billion in 2014 to a projection of \$5.7 billion in 2019. This is primarily due to underspending experienced in the City's capital program, as funds remain available in capital reserves for use when expenditures occur.

Table 2 below provides the consolidated view of city-wide withdraws (outflows) and contributions (inflows) to the City's operating and capital reserves, as recommended in the 2020 Capital and Operating Budgets.

- The table also provides the estimated combined year-end closing balances for reserves over the next three years.

**Table 2: Reserve/Reserve Fund Three-Year Forecast**

Reserve/ Reserve Funds Impacted by the 2020 Budget	Projected Balance as of December 31, 2019	2020		Estimated Year-End Balance		
		Outflow	Inflow	2020	2021	2022
Operating Reserve/Reserve Funds	916	(426)	449	939	1,030	1,148
Capital Reserve/Reserve Funds	4,801	(1,763)	1,433	4,471	3,648	3,141
<b>Reserves/Reserve Funds TOTAL</b>	<b>5,717</b>	<b>(2,188)</b>	<b>1,882</b>	<b>5,410</b>	<b>4,679</b>	<b>4,289</b>

As previously noted, the staff recommended 2020 Operating Budget includes \$449 million in budgeted contributions (inflows) to operating reserves, compared to \$426 million in budgeted withdrawals (outflow) reflecting a positive variance of \$23 million.

- This reflects a positive swing of \$49 million compared to the 2019 Budget that included a \$26 million negative variance.
  - It should be noted that the staff recommended 2020 Operating Budget also includes a small portion of funding from reserves categorized above as capital reserves. Examples include Section 37, Development Charge and Public Realm reserves. This treatment is consistent in both Table 1 and Table 2, enabling annual comparisons.
- The estimated year-end balance in each budget year, over a 3 year period, is calculated based on the 2020 budgeted and future year planned annual withdrawals and contributions, consistent with current budget levels.
  - This serves as an early warning sign on the potential health of the reserves and any need for corrective action to address any potential issues.
  - These reserves are reviewed as part of the annual budget process, from which analysis and funding strategies are recommended to either reduce withdrawals or increase contributions to ensure healthy status.

While operating reserves are projected to remain steady year-over year based on budgeted levels, capital reserves year-end balance are projected to decline over the next 3 years. This decline is mainly driven by the following:

- Toronto Water's 10-Year Capital Plan includes increased expenditure starting in 2021 to fund multi-year capital projects for Treatment plants. These are planned projects for which

Toronto Water built the reserves balance over the past few years since the timing of revenue collection and expenditure funding is not aligned.

### **Reserve / Reserve Funds with Forecasted Negative Balances**

There is a total 249 reserves detailed in Appendix 1 and Appendix 2 of this briefing note, of which 17 are forecasted to experience a negative balance by year-end at some point over the next three years, with 2 reserves projecting a negative balance by year-end 2020.

Staff will continue to monitor the health of these reserves and consider required adjustments through the annual budget process. Immediate concerns will also be addressed through the following strategies:

- Monitor the actual transactions for 2019 and update the 2020 opening balance;
- Reflect the interest income and allocate to the qualified reserve funds accordingly; and
- If necessary, allocate 2019 surplus operating funds to the reserves as part of the Tax and Rate surplus allocation process.

Financial Planning in conjunction with Accounting Services is continuing to monitor and report on the health of the City's reserves throughout each fiscal year.

### **Reserves & Reserve Fund Adequacy**

In accordance with City's 2005 Long-Term Financial Plan, two financial principles related to Reserves and Reserve Funds were adopted by Council:

- Reserves & Reserve Funds should be used for:
  - Anticipated liabilities
  - Aligning cash flow estimates with revenues & expenditures that are subject to cyclical functions
  - Extraordinary large purchases
  - Self-financing of on-going activities
  - Acting as an endowment
- Reserves & Reserve Funds should be funded to the level required for their purpose.

At its meeting on January 31, 2018, City Council adopted item EX29.23 Administrative Amendments to Reserve Fund Accounts - 2017 with a recommendation to revise the purpose and criteria for Tax Stabilization Reserve to be used only to fund non-recurring operating expenditures.

The budgeted contributions and withdrawals for each reserve is detailed in Appendices 1 and 2 in this briefing note for Corporate and Program Specific Reserves and also can be found in Appendix 9 of the Budget Notes for each respective City Program and Agency.

Please note that figures for individual reserves included in Appendix 1 and 2 of this briefing note may differ from the figures shown in the Program/Agency Budget Notes. This is due to updated 2019 year-end balances available following finalization of 2020 Budget Notes.

**Appendices:**

Appendix 1: Corporate Reserves and Reserve Funds Balance and Forecast.

Appendix 2: Program Specific Reserves and Reserve Funds Balance and Forecast.

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