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## 2021 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):

The 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 operations; 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 2020 and prior years.

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

Description	2015	2016	2017	2018	2019	2020
Budgeted Net Inflow/(Outflow):						
Operating Reserves	(117)	(51)	(86)	(61)	(63)	(56)
Capital Reserves	(278)	(241)	(125)	(171)	(70)	(58)
<b>Budgeted Net Inflow/(Outflow)</b>	<b>(395)</b>	<b>(292)</b>	<b>(211)</b>	<b>(233)</b>	<b>(134)</b>	<b>(115)</b>
Actual Net Inflow/(Outflow)	163	314	435	1,211	52	1,055
<b>Actual Ending Balance</b>	<b>3,705</b>	<b>4,019</b>	<b>4,454</b>	<b>5,665</b>	<b>5,717</b>	<b>6,772</b>

As reflected in Table 1, the annual budget historically includes withdrawals from reserves that exceed reserve contributions. Variances have ranged from \$115 million to as much as \$1.2 billion.

- 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 city continues to monitor and manage the reserve balances to ensure adequacy and sustainability. As can be seen in Table 1, the budgeted net outflow has been trending down over the years, however actual reserves have had net inflows due to underspending in both operating and capital resulting in ending balances growing from \$3.7 billion in 2015 to a projection of \$6.8 billion in 2020.

Table 2 below provides the consolidated view of city-wide withdrawals (outflows) and contributions (inflows) to the City's operating and capital reserves, as recommended in the 2021 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, 2020	2021			Estimated Year-End Balance		
		Outflow	Inflow	Net	2021	2022	2023
Operating Reserve/Reserve Funds	1,543	(343)	298	(45)	1,496	1,463	1,514
Capital Reserve/Reserve Funds	5,228	(2,010)	1,707	(302)	4,919	4,349	4,010
<b>Reserves/Reserve Funds TOTAL</b>	<b>6,772</b>	<b>(2,352)</b>	<b>2,005</b>	<b>(347)</b>	<b>6,415</b>	<b>5,812</b>	<b>5,524</b>

The staff recommended 2021 Operating Budget includes \$298 million in budgeted contributions (inflows) to operating reserves, compared to \$343 million in budgeted withdrawals (outflow) reflecting a negative variance of \$45 million.

- The estimated year-end balance over a 3 year period, is calculated based on the 2021 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 balances 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.

**Reserves & Reserve Fund Adequacy**

The City has two financial principles related to Reserves and Reserve Funds adopted by the City 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. There is a total 254 reserves detailed in Appendix 1 of this briefing note, of which 5 are forecasted to experience a negative closing balance in future years starting from 2022. 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. The City will consider required adjustments through the annual budget process. Immediate concerns will also be addressed through monitoring the actual transactions for 2020 and update the 2021 opening balance.

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 are detailed in Appendix 1 in this briefing note and also can be found in Appendix 10 of the Budget Notes for each respective City Program and Agency.

Please note that figures for individual reserves included in Appendix 1 of this briefing note may differ from the figures shown in the Program/Agency Budget Notes. This is due to updated 2020 year-end balances available following finalization of 2021 Budget Notes.

### **Appendix:**

Appendix 1: Reserves and Reserve Funds Balance and Forecast.

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**Date:** January 12, 2021