

Vehicle Capital Reserve Contributions Shortfalls

Date:	October 31, 2013
To:	Government Management Committee
From:	Chief Corporate Officer
Wards:	All
Reference Number:	P:2013\Internal Services\Fleet\Gm13002Fleet – (AFS 18279)

SUMMARY

This staff report is in response to the Government Management Committee's meeting of September 9, 2013 item # GM24.15 – 2014 Service Level Review – Government Management Committee Programs, recommendation #3 with respect to divisions that have not been committing sufficient capital reserve contributions for vehicle replacements and the associated replacement/sustainability concerns and increased costs. Fleet Services in collaboration with Divisions and Financial Planning will develop a strategy to establish minimum reserve balances to be maintained by all City Programs and Agencies.

RECOMMENDATIONS

The Chief Corporate Officer recommends that:

1. City Council request the Director, Fleet Services in conjunction with Director, Financial Planning to develop a financing strategy to determine a minimum vehicle reserve balance, which fully funds and optimizes the replacement of vehicles for all affected divisions. The strategy is to be incorporated into the 2015 Budget submission process. Options may include;
 1. The utilization and rationalization of the current fleet complement
 2. Extending vehicle life cycles
 3. Increasing reserve contributions
 4. A combination of the above.

2. City Council request the Director, Fleet Services to establish a monthly replacement reserve contribution for all off-road vehicles and equipment and that the Director, Fleet Services in consultation with Director, Financial Planning determine the feasibility of including such contributions as part of the 2015 Operating Budget Process.
3. City Council request the Director, Fleet Services to continue to lead and educate Divisions on proper use and maintenance of vehicles in order to maximize useful life, minimize operating costs and maintain safety standards.

Financial Impact

In 2013, the forecasted net deficit in contributions to the City Vehicle and Equipment Replacement reserves is projected to be \$19.532 million. In 2014, the estimated net deficit in contributions from the divisions is \$2.619 million. Divisions will be utilizing the reserves to fund vehicle replacements resulting in no impact to the Capital Budget. There is no immediate financial impact on the 2013 and 2014 Budgets. The funds required to carry out the recommendations outlined in the report will be considered with future year budget processes. In 2015 with no changes to the contribution levels from the divisions, the net deficit (withdrawal) and potential impact to the Operating budget is estimated to be \$25.356 million. The total balance of the City Vehicle and Equipment Replacement reserves will be in a deficit position at the end of 2017 based on current information.

Table 1 – 2013 – 2023 Corporate Vehicle & Equipment Reserve Summary (000's)

Year	Projected Opening Balance	Estimated Contribution	Estimated Capital Plan	Net Contribution (Deficit)	Projected Closing Balance
2013	59,437	32,548	(51,779)	(19,532)	40,206
2014	40,206	33,335	(35,954)	(2,619)	37,587
2015	37,587	33,616	(58,972)	(25,356)	12,231
2016	12,231	33,376	(40,894)	(7,518)	4,713
2017	4,713	34,873	(44,589)	(9,716)	(5,004)
2018	(5,004)	34,416	(40,636)	(6,220)	(11,224)
2019	(11,224)	34,121	(42,926)	(8,805)	(20,029)
2020	(20,029)	33,790	(42,382)	(8,592)	(28,621)
2021	(28,621)	33,776	(39,575)	(5,779)	(34,420)
2022	(34,420)	34,019	(46,253)	(12,234)	(46,654)
2023	(46,654)	34,069	(42,283)	(8,214)	(54,868)
Total	59,437	371,939	(486,243)	(114,585)	(54,868)

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

At its meeting held on September 9, 2013, the Government Management Committee, in considering item GM24.15 – 2014 Service Level Review – Government Management Committee Programs, adopted a recommendation requesting that "the Chief Corporate Officer report back to the Government Management Committee on which divisions have not been committing sufficient capital reserve contributions for vehicle replacements and also what the replacement/sustainability concerns and increased costs are."

The report decision can be accessed at:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.GM24.15>

ISSUE BACKGROUND

The Fleet Capital Replacement Plan on State of Good Repair is funded from the respective Program and Agency Vehicle and Equipment Replacement Reserves. The Reserves are financed annually by the Program's budgeted contributions from their Operating Budgets. Vehicle and Equipment Replacement Reserves are established in accordance with the Municipal Code, Chapter 227, Article II, with the intent to promote efficiencies and to provide budget stabilization by moderating large fluctuations in annual replacement of vehicles and equipment. Fleet Services manages the vehicle and equipment replacement for 20 City Programs and Agencies. Although the Vehicle and Equipment replacement for Fire Services, Emergency and Medical Services, Toronto Zoo and Exhibition Place are reported through Fleet Services, these Programs procure and manage their own vehicles and equipment.

In 2005, City Council directed all programs, commencing in 2006 to commit to the policy of contributing to the Vehicle Equipment Replacement Reserve for all new purchases. Fleet Services was to establish the reserve contribution amount based on the:

$$\frac{\text{(Future replacement cost) less (end of life salvage value)}}{\text{Projected useful life}}$$

The reserve contributions ensure that adequate funds are available to facilitate the continued replacement of vehicles and equipment. The timely and continued replacement of vehicles and equipment strikes the optimum balance between depreciating asset value/re-sale value and rising repair costs/decreased reliability. For fleet replacements managed by Fleet Services, monthly contribution rates have been established for licensed vehicles as well as street sweepers and litter vacuums. Programs with off-road vehicles and equipment such as backhoes, tractors and mowers are required to make additional provisions in their annual reserve contributions for the future replacement of these units.

Accounting entries for the monthly reserve contributions are prepared by Fleet Services debiting the Division's cost centre and crediting the Division's reserve account. The transactions do not flow through Fleet Service's Operating Budget or accounts. As part of the year-end accounting process, the Vehicle and Equipment Replacement Reserves are reconciled to the budgeted amount in each Program's approved Operating budget by Accounting Services.

At the time of this Staff Report, a reconciliation of the Vehicle & Equipment Reserves indicates that all reserve accounts are projecting a positive balance for the end of 2013. A review of each Division and Agencies' reserve accounts has also resulted in identifying Divisions and Agencies that have a projected negative reserve balance in future years. By the end of 2017, the total balance of the City Vehicle and Equipment Replacement reserves will be in a deficit position of \$(5.004) million.

Table 2 – Projected Reserve Shortfalls – Major Divisions

Division	Projected Deficit Year	Projected Balance (000s)
Transportation Services	2015	(2,123)
Fire Services	2015	(2,518)
Parks, Forestry & Recreation	2016	(184)
Solid Waste Management	2017	(307)
Fleet Services	2017	(355)
Toronto Water	2017	(429)

COMMENTS

Commencing in 2006, Divisions have been funding the future replacement of licensed vehicle replacements, street sweepers and litter vacuums through the Vehicle Replacement Reserves by way of monthly contributions. This funding model allows divisions to budget consistently and ensures that sufficient funds are available to replace the asset at the end of the life cycle. As part of the current annual budget process, Fleet Services will recommend and provide estimates on the minimal amount of budgeted contributions to the Vehicle and Equipment Replacement reserves to the Divisions for the submission year. Estimates are based on:

1. The monthly replacement amounts for licensed vehicles, street sweepers and litter vacuums
2. The estimated replacement cost of off-road equipment due for replacement

The majority of off-road equipment such as backhoes, tractors and mowers are funded through a one-time annual contribution as needed. Starting in 2015, it is recommended that off-road units follow the same funding formula and make monthly contributions to the vehicle and equipment replacement reserves.

The attached Appendix 1 – 10 Year Vehicle Replacement Reserve Forecast summarizes each Program's reserve account over the 10-year capital-planning period. The 2014 estimated contribution levels are based on each Program's submission, whereas, the 2015-2023 planned amounts are based on the 2014 contribution levels and estimates provided by Financial Planning and the Programs.

Based on current information, we are forecasting Fire Services and Transportation Services to have insufficient funding for their 2015 estimated replacements. Parks, Forestry & Recreation and The Toronto Zoo will have insufficient funding in 2016. As part of the Fleet's annual capital budgeting process, reserve balances and the 10-year capital plan are reviewed with Programs and Agencies managed by Fleet Services. Fleet Services will explore options in consultation with Financial Planning and the Divisions to ensure that there is sufficient money to fund the replacement activities starting with the 2015 Budget process. Options may include:

1. The utilization and rationalization of the current fleet complement
2. Extending vehicle life cycles
3. Increasing reserve contributions
4. A combination of the above

Fleet Services will also be looking into long term financing options as part of a Request for Proposal that has been issued to conduct an external review of various facets in Fleet Services. The results of the external review of Fleet Services will provide insight into the development of sustainable financing strategies.

The financial impacts of not maintaining a sustainable reserve balance to adequately fund annual fleet replacement programs may include:

- Increased maintenance repair costs resulting from deferring the replacement of vehicles and equipment past the optimum life cycle.
- Increased vehicle downtime resulting in lost productivity.
- The cost of a temporary rental unit, if available resulting from the unit being deemed beyond economical repair or if unavailable, may result in disruptions to City services.
- Substantial financial pressure on future year operating budgets to fund the backlog on the replacement program.

Fleet Services continues to provide training and education to client Divisions on proper use and maintenance of vehicles and equipment. Through effective vehicle and lifecycle management, Fleet Services in conjunction with the Divisions have been able to extend asset lifecycles, which has mitigated the incurrence of any increased costs while meeting safety standards. Going forward, timely replacement of assets must continue in effort to ensure that increased operating costs are not recognized as a result of delayed replacement due to a shortage of capital funds.

As noted above, the funding model for vehicle replacements such as cars, street sweepers and litter vacuums that operate on the roadway has worked well. In addition to adjusting

for underfunding and replacement of off-road equipment through monthly replacement contributions, Fleet Services will also work with the Divisions to establish minimum annual balances for replacements. To ensure that vehicles and equipment can be replaced in a timely manner, Fleet Services is recommending a minimum reserve balance of:

$$\frac{(\text{Future Replacement Value}) \text{ less (end of life salvage value)}}{\text{Projected useful life}}$$

Table 3 – Average Annual Replacement Cost

<u>Division/Agency</u>	<u>Estimated Replacement Cost</u>	<u>Average Expected Life</u>	<u>Average Annual Replacement Cost</u>
Arena Boards of Management	756,645	10.00	75,665
City Clerk's Office	385,523	9.60	40,159
City Manager's Office (Human Resources)	18,175	8.00	2,272
Economic Development, Culture & Tourism	274,268	9.70	28,275
Facilities & Real Estate	4,946,795	9.40	526,255
Fleet Services	487,177	10.00	48,718
Information & Technology	160,824	9.30	17,293
Municipal Licensing & Standards	4,625,902	9.10	508,341
Parks, Forestry & Recreation	79,978,306	10.10	7,918,644
Purchasing & Materials Management	365,061	9.00	40,562
Shelter, Support & Housing Administration	609,204	10.00	60,920
Solid Waste Management Services	102,773,515	9.40	10,933,353
Policy, Planning, Finance & Administration	133,603	8.00	16,700
Engineering & Construction Services	2,326,705	9.70	239,866
Toronto Buildings	303,184	8.00	37,898
Toronto Community Housing Corporation	6,419,501	8.80	729,489
Toronto Public Health	348,838	9.80	35,596
Toronto Public Library	2,232,145	10.00	223,215
Toronto Water	61,234,899	10.00	6,123,490
Transportation Services	73,739,275	10.00	7,373,928
FLEET MANAGED PROGRAMS	342,119,545		34,980,639
Emergency Medical Services	29,969,703	6.52	4,596,580
Exhibition Place	6,509,892	10.00	650,989
Fire Services	97,100,000	12.36	7,855,987
Toronto Zoo	6,366,554	10.00	636,655
NON FLEET MANAGEMENT PROGRAMS	139,946,149		13,740,211
GRAND TOTAL	482,065,694		48,720,850

On an annual basis, commencing with the 2015 budget process it is recommended that Fleet Services in conjunction with Financial Planning identify funding issues to the Vehicle Replacement Reserves such that divisions can make necessary adjustments to their respective Budget submissions.

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SIGNATURE

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ATTACHMENTS

Appendix 1 – 10 Year Vehicle Replacement Reserve Forecast