

Roberto Rossini
 Deputy City Manager & Chief Financial Officer

Financial Planning Division
 City Hall, 7th Floor, East Tower
 100 Queen Street West
 Toronto, Ontario, M5H 2N2

 Tel: 416-397-4229
 Fax 416-397-4465
 jlavita@toronto.ca
www.toronto.ca

2017 OPERATING BUDGET BRIEFING NOTE

Contributions to and Withdrawals from Reserves/Reserve Funds

Issue/Background:

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

Key Points:

Reserves and Reserve Funds 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 or contingent liabilities.

The City maintains the reserves, and two types of reserve funds: Council-Directed Reserve Funds and Obligatory Reserve Funds.

- **Reserves** are funded from the operating budget at the discretion of Council and make no reference to any specific asset and do not require the physical segregation of money or assets.
- **Council Directed Reserve Funds** are created by Council for specific purposes through by-laws.
- **Obligatory Reserve Funds** are funds received and set aside for specific purposes by legislation or contractual agreements. These funds can only be used for the purposes prescribed.

Further, the City classifies the above mentioned reserves and reserve funds into two distinct categories:

- **Corporate Reserves and Reserve Funds**, are used to provide funding for operating and capital items of a corporate nature.

- **Program Specific Reserves and Reserve Funds**, are established in response to specific programs or special funding that has been received.

Reserves and reserve funds receive annual contributions from the operating budget, from 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. It is a critical component of a City's long-term financial plan to maintain healthy balances in the reserves and reserve funds, as it strengthens long-term fiscal sustainability.

Table 1 below provides a summary of the Reserve/Reserve Funds with proposed contributions and/or withdrawals in the 2017 Preliminary Operating Budget and 2017-2026 Capital Budget and Plan.

Table 1
Reserve/Reserve Fund Summary

Reserve/ Reserve Funds Impacted by the 2017 Budget (In \$000s)	Projected Balance as of December 31, 2016	2017		Estimated Year-End Balance		
		Withdrawals	Contributions	2017	2018	2018
Program Specific Reserves/Reserve Funds	1,934,968	(1,005,054)	1,047,173	1,977,087	1,724,562	1,435,717
Corporate Reserves/Reserve Funds	1,323,840	(724,043)	690,613	1,290,410	1,188,433	1,087,904
TOTAL Reserves/Reserve Funds	3,258,808	(1,729,096)	1,737,786	3,267,497	2,912,994	2,523,622

Note: Table 1 is based on the 2017 Preliminary Operating and Capital Budget

The estimated year-end balance of each budget year is subsequently calculated based on the proposed annual withdrawals/contributions, to ensure that Reserves/Reserve Funds are not in a deficit position in any given year. It serves as an early warning sign on the potential depletion of Reserves/Reserve Funds and provides the need for corrective action to address any potential issues.

The Reserve/Reserve Fund balances are closely monitored by the Financial Planning Division (financial planning, budget and sustainability), Accounting Services Division (commitments/actual expenditure) and Corporate Finance (reserve balance sustainability and administration).

The preliminary contributions and withdrawals for each Reserve/Reserve Fund are detailed in Appendix 1 for Corporate & Program Specific Reserves and Reserve Funds.

Operating Budget

Corporate Reserves and Reserve Funds established for operating purposes, are used to address items of an operating nature including funds needed to finance future costs resulting from one-time, non-recurring operating pressures, to stabilize costs resulting from changes in services, to mitigate the financial exposure, to offset annual shortfall between amounts budgeted for property tax decreases and to provide for post-employment employment benefits.

Some of the major Corporate Reserve/Reserve Funds with inflows/outflows reported in the 2017 Preliminary Operating Budget are:

- Sick Leave Reserve Fund
- Employee Retiree Benefits Reserve Fund
- Tax Rate Stabilization Reserve
- Insurance Reserve Fund
- Innovation Reserve Fund

Program Specific Reserve and Reserve Funds maintained for operating purposes to fund specific services/activities, to provide funding to stabilize unanticipated operating budget variances or to align cash flow estimates with Program's funding when there are uneven costs.

Some of the Program Specific Reserve/Reserve Funds with inflows/outflows reported in 2017 Operating Budget include:

- Social Assistance Stabilization Reserve
- Union Station Reserve Fund
- Fleet Replacement Reserves
- National Child Benefit Supplement
- Developmental Charges Reserve Fund – Subsidized Housing

Capital Budget

Corporate Reserves and Reserve Funds established for capital purposes are used to hold funds for the acquisition or replacement of the City's major asset infrastructure, maintain funding for the replacement of vehicles and equipment utilized by City Programs and Agencies, and support funding of projects to address growth.

Some of the major Corporate Reserve and Reserve Funds with inflows/outflows reported in 2017 Capital Budget include:

- Capital Financing Reserve
- Land Acquisitions Reserve Fund
- Strategic Infrastructure Partnership Reserve Fund
- Development Charges – Transit Reserve Fund
- Section 37 & Section 45 Reserve Funds

As part of the Capital Plan, the City maximizes the use of available non-debt funding sources by setting aside 75% of non-committed surplus funds in the City's Capital Financing Reserve. Program Specific Reserve and Reserve Funds established for capital purposes, are primarily used to leverage additional funding to address Program's specific capital requirements.

Some of the Program Specific Reserve/Reserve Funds with inflows/outflows reported in 2017 Capital Budget include:

- Long-Term Care Homes & Services Reserve Fund
- Public Realm Reserve Fund
- Harbourfront Parklands Reserve Fund
- Parkland Acquisition Reserve Funds
- Water & Waste Water Capital Reserves
- Gardiner West Public Realm Improvements Reserve Fund

Reserves & Reserve Fund Adequacy

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

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

Within these principles is the notion of adequacy on allocating the funds for certain purposes (ie. funding anticipated liabilities or extraordinary large purchases) than others (ie. acting as an endowment or self-financing on-going activities).

Certain Reserve/Reserve Funds have an established funding target, such as the following:

- The Tax Rate Stabilization reserve has a target balance of 1% of the Tax Levy, which is equivalent to \$40 million. The actual year-end balance is projected to be \$16 million by the end of 2016.
- Water and Wastewater Stabilization Reserves (XQ1003 & XQ1004) have a target balance of \$30 million. However, balance above this amount shall be distributed to the Water Capital Reserve Fund (43%), and to the Wastewater Capital Reserve Fund (57%).
- Historically, the Insurance Reserve Fund (XR1010) has had a target amount representing 7 annual payouts of \$5 million, or \$35 million. As a result of a recent review, it has been determined that the reserve balance should gradually increase to a value of a one year's budget for Insurance & Risk Management at \$65 million.

Table 2 below, provides possible guidelines for general targets/benchmarks for the following categories of Reserves and Reserve Funds. However, most Reserves and Reserve Funds do not have specific targets.

Table 2
Reserve/Reserve Fund General Guidelines

Reserve / Reserve Funds	Proj'd Balance Dec. 2016 (\$M)	Possible Guideline (\$M)	Target / Benchmark
Stabilization Reserves Group	\$157	\$604	Stabilization Reserves/Revenues - Industry Range is 5-15% - Target 5%
Capital Financing (Corporate)	\$197	\$795	2% of Tax & Rate Supported 2017-2026 Capital Plan Expenditures
Other Corporate Reserves and Reserve Funds*	\$406	\$609	5% of Gross Tax and Rate Operating Budget
Employee Benefits Reserve Funds	\$239	\$428	Council approved target is a ratio of 2X Annual Employee Benefit Costs
Public Transit**	\$377	\$684	10% of 2017-2026 TTC Capital Plan Expenditures
State of Good Repair Group	\$303	\$397	1% of Tax & Rate Supported 2017-2026 Capital Plan Expenditures
Total	\$1,679	\$3,518	

Note: Table 2 is based on the 2016 Q3 Variance Report

* Other Corporate Reserve and Reserve Funds include Corporate Reserves & Corporate Reserve Fund Groups less Capital Financing Reserve, Transit Infrastructure RF and Scarborough Transit RF

** Public Transit group includes Scarborough Transit Reserve, Transit Infrastructure Reserve Fund and Development Charges Reserve Fund for Transit.

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

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

Further information: Andy Cui, Manager, Financial Planning Division,
(416)-397-4207; Andy.Cui@toronto.ca

Josie La Vita, Executive Director, Financial Planning Division;
(416)-397- 4229; Josie.Lavita@toronto.ca

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