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2018 OPERATING BUDGET BRIEFING NOTE

Contributions to and Withdrawals from Reserves/Reserve Funds

Issue/Background:

This briefing note consolidates 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, contingent liabilities or occasional expenses such as municipal elections every four years.
- The primary difference between Reserves and Reserve Funds is that all earnings (i.e. interest) from the investment of Reserve Funds must be allocated to, and form part of, the Reserve Fund; while the earnings from Reserves are allocated to the operating budget as investment revenue.
- The City maintains the reserves, and two types of reserve funds: Obligatory Reserve Funds and Council-Directed 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.
 - **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.
 - **Council Directed Reserve Funds** are created by Council for specific purposes through by-laws.

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

- **Corporate Reserves and Reserve Funds**, used to provide funding for operating and capital items of a corporate nature.
- **Program Specific Reserves and Reserve Funds**, 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. Maintaining healthy balances in the reserves and reserve funds is a critical component of a City's long-term financial plan, 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 2018 Preliminary Operating Budget and 2018-2027 Capital Budget and Plan.

**Table 1
Reserve/Reserve Fund Summary (Operating & Capital)**

Reserve/ Reserve Funds Impacted by the 2018 Budget (In \$000s)	Projected Balance as of December 31, 2017	2018		Estimated Year-End Balance		
		Withdrawals	Contributions	2018	2019	2020
Program Specific Reserves/Reserve Funds	2,143,183	(1,211,233)	1,024,417	1,956,367	1,408,882	942,692
Corporate Reserves/Reserve Funds	2,188,907	(826,131)	648,480	2,011,255	1,893,448	1,879,057
TOTAL Reserves/Reserve Funds	4,332,090	(2,037,364)	1,672,896	3,967,622	3,302,330	2,821,749

Note: Table 1 is based on the 2018 Preliminary Operating and Capital Budget. The 2019 and 2020 preliminary withdrawals do not reflect additional contributions that may arise in those two years, such as Tax and Rate surplus contributions.

The estimated year-end balance in each budget year, over a 3 year period, are subsequently calculated based on the budgeted annual withdrawals/contributions, to ensure that Reserves/Reserve Funds are not in a deficit position in any given year. This 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 budgeted contributions and withdrawals for each Reserve/Reserve Fund are detailed in Appendix 1 for Corporate & Program Specific Reserves and Reserve Funds in this briefing note and also in the Operating and Capital Budget Notes for each respective City Program and Agency.

2018 Preliminary Operating Budget

Corporate Reserves and Reserve Funds established for operating purposes, are used to address items of an operational 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 financial exposure, and to provide for post-employment employment benefits.

Some of the major Corporate Reserve/Reserve Funds with inflows/outflows included in the 2018 Preliminary Operating Budget are:

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

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 included in 2018 Preliminary Operating Budget include:

- Social Assistance Stabilization Reserve
- National Child Benefit Supplement Reserve Fund
- Election Reserve Fund
- Exhibition Place Conference Centre Reserve Fund
- Toronto Police Services Modernization Reserve

2018 Preliminary 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 included in 2018 Preliminary Capital Budget include:

- Capital Financing Reserve
- Land Acquisitions Reserve Fund
- Strategic Infrastructure Partnership Reserve Fund
- Development Charges – Transit Reserve Fund
- Section 37, Section 42 & 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 specific capital requirements. Some of the Program Specific Reserve/Reserve Funds with inflows/outflows included in 2018 Preliminary Capital Budget include:

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

Reserves & Reserve Fund Adequacy

In the 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.

Within these principles is the notion of fund adequacy, 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 \$42 million. The actual year-end balance is projected to be \$40 million by the end of 2017. Any additional anticipated draws from 2018 Preliminary Budget Process will further reduce this balance.
- Water and Wastewater Stabilization Reserves (XQ1003 & XQ1004) have a target balance of \$30 million. The balance above this amount shall be distributed to the Water Capital Reserve Fund (43%), and to the Wastewater Capital Reserve Fund (57%).

- Historically, Insurance Reserve Fund (XR1010) had a target amount representing 7 annual payouts of \$5 million, or \$35 million. As a result of a recent review, it has been suggested to gradually increase the reserve balance to a value of a one year's budget for Insurance & Risk Management at \$65 million.
- The reserve fund guideline for Employee Benefits is equivalent to the Council approved target ratio of 2 times annual employee benefit costs of an estimated \$426 million in 2017. The actual balance for this reserve fund is projected to be \$250 million by the year-end of 2017.

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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