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2019 OPERATING BUDGET BRIEFING NOTE

Contributions to and Withdrawals from Reserves/Reserve Funds

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. 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 main difference in financial structure between Reserves and Reserve Funds is the allocation of investment income of Reserve Funds that must be allocated to, and form part of, the Reserve Fund; while 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 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 and reserve funds is a critical component of a financial plan, as it strengthens long-term fiscal sustainability.

Table 1 below provides a summary of the Reserves/Reserve Funds with proposed contributions and/or withdrawals in the 2019 Staff Recommended Operating Budget and 2019-2028 Capital Budget and Plan.

Table 1: Reserve/Reserve Fund Summary (Operating & Capital) in \$ Millions

Reserve/ Reserve Funds Impacted by the 2019 Budget	Projected Balance as of December 31, 2018	2019		Estimated Year-End Balance		
		Outflow	Inflow	2019	2020	2021
Program Specific Reserves/Reserve Funds	3,128	(1,083)	1,063	3,108	2,676	2,238
Corporate Reserves/Reserve Funds	2,034	(1,114)	860	1,780	1,578	1,519
Reserves/Reserve Funds TOTAL	5,162	(2,197)	1,923	4,888	4,254	3,757

Note: Table 1 is based on the 2019 Staff Recommended Operating and Capital Budget. The 2020 and 2021 planned 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, is 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 health of the Reserves/Reserve Funds and any need for corrective action to address any potential issues. These reserves and reserve funds are reviewed as part of the annual budget process, from which analysis and funding strategies are recommended.

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 & 2 for Corporate & Program Specific Reserves and Reserve Funds in this briefing note and also can be found in Appendix 10 of the Budget Notes for each respective City Program and Agency.

2019 Staff Recommended 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.

The 2019 Staff Recommended Operating Budget includes contributions to and withdrawals from Corporate Reserves/Reserve Funds.

- Some of the Reserve Funds that are funding operating expenditures and have provisions for future years include:
 - Sick Leave Reserve Fund
 - Employee Retiree Benefits Reserve Fund
 - Insurance Reserve Fund
- The operating budget utilizes the Tax Rate Stabilization Reserve which is used as a one-time funding source to enable fiscal stabilization.

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.

The 2019 Staff Recommended Operating Budget includes contributions to and withdrawals from Program Specific Reserves/Reserve Funds:

- Some of the Reserve Funds that are funding operating expenditures and have provisions for future years include:
 - Tree Canopy Reserve Fund
 - National Child Benefit Supplement Reserve Fund
- The operating budget utilizes the TTC Stabilization Reserve which is used as a one-time funding source to mitigate its operating budget pressures.

2019-2028 Staff Recommended Capital Budget and Plan

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.

The 2019-2028 Staff Recommended Capital Budget and Plan utilizes withdrawals from Corporate Reserve/Reserve Funds to fund capital expenditures, such as:

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

It should be noted that the above noted reserves and reserve funds receive annual contributions from the operating budgets to fund capital expenditures. For example:

- 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.
- Every Program and Agency contributes to the Vehicle & Equipment Replacement Reserve to fund the replacement of fleet inventory.

Program Specific Reserve and Reserve Funds established for capital purposes, are primarily used to leverage additional funding to address Program specific capital requirements.

The 2019-2028 Staff Recommended Capital Budget and Plan utilizes withdrawals from Program Specific Reserves/Reserve Funds to fund capital expenditures. These include but are not limited to the following:

- Homes For The Aged Reserve Fund
- Parkland Acquisition Reserve Funds
- Casa Loma Capital Maintenance Reserve Fund
- Tree Canopy Reserve Fund
- Light Emitting Diode (LED) Reserve Fund

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.

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

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.

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 \$44 million based on 2019 Staff Recommended Budget. Based on the 2018 projected year-end balance and 2019 Staff Recommended Budget submission, the uncommitted balance in Tax Rate Stabilization reserve is projected to be \$15M.
- Historically, the Insurance Reserve Fund has had a target representing 7 annual payouts of \$5 million, or \$35 million. As a result of a recent review, it has been suggested that the reserve fund balance target be increased to the equivalent of the expenditure obligations for the policy period established by actuarial annual report. The 2018 report identifies the current target amount as \$72M. Based on the 2018 projected year-end balance and 2019 Staff Recommended Budget submission, the forecasted Insurance Reserve Fund balance at the end of 2019 is \$23M.
- The guideline for Employee Benefits Reserve Funds is equivalent to the Council approved target ratio of 2 times annual employee benefit costs of an estimated \$463 million in 2018. Based on the projected 2018 year-end balance and 2019 Staff Recommended Budget submission, the remaining balance in Employee Benefits Reserve Funds is forecasted to be at \$204M.
- The Land Acquisition Reserve Fund provides funding to various capital projects for the respective entity from the net sale proceeds generated from the disposal of surplus properties. Due to the growing decline of City's surplus inventory available for sale, the Land Acquisition Reserve Fund balance is at the lowest level in the past 5 years. The total uncommitted balance in Land Acquisition Reserve Fund is \$23M.
- Capital Financing Reserve provides financing for capital projects that would otherwise be financed through the issuance of debentures. Based on the approved capital expenditures to receive the funds and future year inflow estimates provided in 2019 Staff Recommended Budget, the Capital Financing Reserve projected to have an uncommitted balance of \$16M at the end of 2026.

Historically, the City has been relying on one-time reserve and reserve fund withdrawals to balance its operating budget in funding its ongoing operations. The City is working towards eliminating one-time bridging strategies and continues to seek sustainable funding sources instead. For 2019, the Toronto Transit Commission (TTC) Recommended Operating Budget reflects the use of TTC Stabilization Reserve as a one-time funding source to help mitigate its operating budget pressures.

Also, a number of program specific reserve and reserve funds are being depleted as a result of continued budget pressures. Financial Planning in conjunction with Accounting Services and Corporates Finance are continuing to monitor and report on the health of the City's reserve and reserve funds throughout each fiscal year. In 2019, Corporate Finance will be working on review of the health of City's key reserves and reserve funds.

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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