REPORT FOR ACTION

Obligatory Reserve Funds (Deferred Revenues) and Reserves and Council-Directed Reserve Funds (Accumulated Surplus) as at December 31, 2020

Date: June 22, 2021
To: Audit Committee
From: Chief Financial Officer and Treasurer
Wards: All

SUMMARY

This report summarizes the changes impacting the City of Toronto (the City)'s obligatory reserve funds (deferred revenues), and reserves and Council-directed reserve funds (accumulated surplus) as at December 31, 2020.

The City's deferred revenues (obligatory reserve funds) and reserves and Council-directed reserve funds (accumulated surplus) are subject to annual changes based on funding contributions, transfers, and drawdowns, which are authorized by legislation, third-party agreements, and Council's approvals. The tables and appendices reflect information by major category.

As at December 31, 2020, the City recognized $7,585.8 million of deferred revenues (obligatory reserve funds) and reserves and Council-directed reserve funds (accumulated surplus), which consist of the following balances:

- Committed funds for legislated, contractually bound or Council-directed activities ($5,983.2 million);
- Committed funds to offset capital costs and pressures on rate-based activities ($678.3 million); and
- Uncommitted and available funds for the City to respond to various unanticipated costs and to stabilize various funding sources, including the tax base ($924.3 million).

The uncommitted funds balance of $924.3 million includes the City's Tax Rate Stabilization Reserve balance of $704.6 million. Due to the uncertainty of the financial impact of the COVID-19 pandemic, the City deferred a number of capital projects to be funded from Capital from Current and the Provincial Gas Tax, in addition to reallocating capital funding from permanent underspending, in order to make a one-time contribution of $377.4 million to the reserve, in addition to a one-time contribution to the reserve of

$212.8 million from the 2019 City operating surplus. Additional net amounts totalling $23.4 million were contributed to the reserve in 2020. These Council approved contributions will be used to offset COVID-19 financial impacts in the event adequate Federal/Provincial Safe Restart funding support is not provided in 2021 and going forward.

The reported balances include Council approved reserve and reserve fund loans that were granted to various agencies, City programs, and external parties, which must be repaid to the respective deferred revenues (obligatory reserve funds) and reserves and Council-directed reserve funds (accumulated surplus).

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. The Audit Committee receive this report for information.

FINANCIAL IMPACT

There are no current or known future year financial impacts arising from the recommendations contained in this report.

DECISION HISTORY

As per Chapter 227 of the Municipal Code, the Chief Financial Officer and Treasurer will report inflows and outflows of the City's deferred revenues (obligatory reserve funds), reserves, and discretionary reserve funds on a quarterly basis, to the Budget Committee. To view prior period reports online, please see the links below:

Obligatory Reserve Funds (Deferred Revenues), Reserves, and Council-directed Reserve Funds Report – September 30, 2020
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.BU19.10

Obligatory Reserve Funds (Deferred Revenues), Reserves, and Council-directed Reserve Funds Report – June 30, 2020
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX16.13

COMMENTS

Background

Reserves and reserve funds represent an allocation of the City's funds, which have accumulated over time and may be used to replace capital assets, provide a measure of financial flexibility to react to budget funding shortfalls, and to address the financial impacts of significant unexpected issues in a timely manner.

These funds are managed to achieve an optimal rate of return on a risk-adjusted basis in accordance with the Council –approved Investment Policy. Shorter term funds are managed internally to meet cash flow needs, while funds not immediately required are guided by the Toronto Investment Board who has contracted external investment managers to handle longer term commitments.

Deferred revenues (obligatory reserve funds) represent funds received by the City that are recognized as earned revenue only after the delivery of required performance obligations. Deferred revenues represent liabilities that the City must settle in the future.

A properly balanced approach to the planning and use of reserves and reserve funds is considered good financial management and is a key component of the City's strong credit rating. The City has a formal policy to align with best practices, support the stewardship and oversight of reserves and reserve funds, and demonstrate accountability.

A summary of the major financial balances that are referenced throughout this report is as follows:

- Deferred revenue (obligatory reserve funds): advance payment for goods and/or services that the City has not yet provided to a government, government organization, third-party entity, or individual. Deferred revenues are only taken into income with the execution of activities or stipulations specified in legislation, contract, or agreement. These balances earn interest, and are reported as a liability in the City's consolidated financial statements.
- Reserve: an allocation of accumulated net revenue, which can be set aside for a specific use and does not reflect earned interest. Reserves are disclosed in the City's accumulated surplus in the City's consolidated financial statements.
- Council-directed reserve fund: funds earning interest income that have been set aside in response to a by-law. Similar to reserves, Council-directed reserve funds are a component of the City's accumulated surplus in the consolidated financial statements.

Deferred revenues (obligatory reserve funds) and reserves, and Council-directed reserve funds (accumulated surplus) are impacted by the following types of transactions, which occur throughout the year:

- Budgeted transfers: fund inflows and outflows made in accordance with Council's approvals during the regular budgeting cycle, or through ad hoc requests.
- Deferred revenue changes: receipt of cash payments made prior to the City's provision of a good and/or service, as well as reduction of the overall balance to

account for amounts earned as revenue subsequent to the satisfaction of a legislative requirement or terms and conditions of a third-party contract or agreement (performance obligations).
- Loans from deferred revenues (obligatory reserve funds), reserves and reserve funds to finance various operating and capital programs (e.g. Residential Energy Retrofit Program) using interest-free or low interest arrangements. The loans are managed through formalized agreements and are repayable back to the deferred revenue (obligatory reserve fund), reserve, or discretionary reserve fund within five to 50 years.
- Interest income allocations: earnings allocated to deferred revenues (obligatory reserve funds) and Council-directed reserve funds on an annual basis based on the interest forecasted to be earned from three-month Treasury Bills at the time of the preparation of the annual operating budget.

Deferred revenues (obligatory reserve funds) and reserves and discretionary reserve funds (accumulated surplus) balance as at December 31, 2020

As at December 31, 2020, the City recognized a deferred revenues (obligatory reserve funds) and reserves and discretionary reserve funds balance of $7,585.8 million (2019: $6,059.0 million); this balance includes loans receivables of $69.3 million. The City's deferred revenues (obligatory reserve funds), reserves, and discretionary reserve funds balance increased by $1,526.8 million or 25.20%, which resulted mainly from the following activities:

- Transfer of $912.9 million from Water and Wastewater programs to the Water and Wastewater Capital Reserve Fund for capital financing;
- Receipt of $903.3 million of development charges, park levies and Section 37 funds;
- Allocation of the 2019 year-end operating surplus of $487.3 million to various reserves and reserve funds;
- Receipt of $184.3 million in Provincial Gas Tax revenue;
- Less a reduction of $1,249.9 million for payments made for various capital projects during the year from the Water and Wastewater Capital Reserve Fund and the Vehicle and Equipment Replacement Reserve

Net contributions made to the City's Tax Rate Stabilization Reserve in the amount of $613.6 million are intended to provide funding to offset COVID-19 financial impacts in the event adequate Federal/Provincial Safe Restart funding support is not provided in 2021 and going forward.

The City allocated $85.9 million in interest income to the deferred revenue (obligatory reserve funds) and Council-directed reserve fund balances at year-end. The 2020 rate applied to the year's interest allocation decreased slightly to 1.57% from 1.65% in 2019.

The following table summarizes the City's total deferred revenue (obligatory reserve funds), reserve, and discretionary reserve fund balances, which includes loans receivable balances, as at December 31, 2020, with a comparison to December 31, 2019.

Table 1: Deferred revenues (obligatory reserve funds), reserves, discretionary reserve funds balances, including loans receivables ($ millions)

	Dec. 31, 2020	Dec. 31, 2019
Deferred revenues (obligatory reserve funds):		
Restricted by Provincial legislation		
Development charges	1,678.2	1,223.3
Parkland acq. / new development	745.2	645.0
Planning Act	393.2	333.0
Provincial Gas Tax revenues for Public Transit1	0.0	21.5
Building Code Act service improvement	151.9	122.5
	2,968.5	2,345.3
Restricted by agreements with third parties		
Community services	67.2	68.2
Third party agreements	18.6	20.7
Public Transit funds	96.5	157.1
State of good repair	10.5	10.3
Parking Authority	1.5	1.4
Water / wastewater	1,152.0	1,204.8
	1,346.3	1,462.5
Total deferred revenues (obligatory reserve funds) in the City's consolidated financial statements:	4,314.8	3,807.8
Reserves:		
Corporate	612.4	654.1
Stabilization	822.8	203.1
Water / wastewater	165.6	99.8
Donations	1.8	1.8
	1,602.6	958.8
Council-directed reserve funds:		
Employee benefits	478.3	295.5
Corporate	696.6	573.2
Community initiatives	213.7	177.3
State of good repair	279.8	246.4
	1,668.4	1,292.4
Total reserves and Council-directed reserve funds – accumulated surplus in the City's consolidated financial statements	3,271.0	2,251.2
Total deferred revenues (obligatory reserve funds), reserves, and Council-directed reserve funds	**7,585.8**	**6,059.0**

Please refer to Appendices A, B, and C for details supporting the above reserves and Council-directed reserve funds, as well as Appendices D, E, and F for details supporting the loans receivables.

The following table summarizes the City's loans receivable as at December 31, 2020, with December 31, 2019 comparatives, that have been included in Table 1 totals.

Table 2: Loans receivable balances ($ millions)

	Dec 31, 2020	Dec. 31, 2019
Deferred revenues:		
Restricted by Provincial legislation		
Development charges[1]	11.4	10.6
	11.4	10.6
Restricted by agreements with third parties		
Community services	8.1	8.2
	8.1	8.2
Total deferred revenues loans	19.5	18.8
Reserves:		
Stabilization	11.6	11.6
	11.6	11.6
Council-directed reserve funds:		
Corporate	16.6	19.3
Community initiatives	21.6	22.2
	38.2	41.5
Total reserves and Council-directed reserve funds loans	49.8	53.1
Total deferred revenues (obligatory reserve fund), reserve, and Council-directed reserve fund loans	**69.3**	**71.9**

[1]These balances are associated with loans that the City provided to external parties using the development charges reserve fund. Please refer to Appendix D for a list of external parties that have received a loan.

Please refer to Appendices D, E, and F for details supporting the loans receivables.

2021 Activity to Date

There is limited Reserve and Reserve Fund activity in the first quarter of the fiscal year. However, summary information related to rate-based program transfers and as a result of development charges is being provided for information.

During the first four months of 2021, the balances of Deferred Revenues (obligatory reserve funds) and Reserves and Discretionary Reserve Funds (Accumulated Surplus) increased by $384.0 million, or 5.06%, which is mainly due to the following activities:

- Transfer of $236.6 million from Water and Wastewater programs to the Water and Wastewater Capital Reserve Fund for capital financing;
- Receipt of $142.5 million of development charges;
- Less: payments of development charge refunds of $7.70 million.

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SIGNATURE

Heather Taylor
Chief Financial Officer and Treasurer

ATTACHMENTS

Appendix A:	Deferred Revenues (Obligatory Reserve Funds) as of December 31, 2020
Appendix B:	Accumulated Surplus - Reserves as of December 31, 2020
Appendix C:	Accumulated Surplus - Council-Directed Reserve Funds as of December 31, 2020
Appendix D:	Loan Receivable Balances - Deferred Revenues (Obligatory Reserve Funds) as of December 31, 2020
Appendix E:	Loan Receivable Balances - Reserves as of December 31, 2020
Appendix F:	Loan Receivable Balances - Council-Directed Reserve Funds as of December 31, 2020