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## 2022 OPERATING BUDGET BRIEFING NOTE

### Contributions to and Withdrawals from Reserves/Reserve Funds

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#### 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 (collectively referred to as reserves in this document). The projected year-end balances of inflows to and outflows from reserves is reported as part of the budget process for both the Capital and Operating Budgets.

#### Key Points:

- Reserves and reserve funds represent funds received for legislatively obligated and/or restricted purposes, which are to be invested for specific and eligible purposes.
- The majority of the City's reserve amounts are restricted or committed funds based on legislative or third party agreements, Council-directed activities, or to fund expenses approved in the City's operating and capital budgets. As of September 30, 2021, all but \$263.7 million in reserve balances were committed, leaving funding available for emergency requirements equal to 1.75% of the City's total 2022 Operating Budget.
  - In addition to existing reserve commitments included in the City's 10-Year Capital Plan, reserves balances will also support planned commitments that are not yet reflected in the City's capital program, that either reside outside the 10 year planning period or are currently in the early stages of design and will be brought forward for Council consideration as part of the capital plan upon completion of detailed design and associated project costing.
- Reserves receive annual contributions from the following sources: operating budget including dedicated capital levies, 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.

**City-wide Reserve / Reserve Funds Inflows / (Outflows):**

The City utilizes reserves as a funding source to finance both operating and capital expenditures. Table 1 below details the combined net impact of inflows / (outflows) of City reserves. Essentially, the table demonstrates if the reserves are growing or depleting over time, based on the combined impact of planned contributions and withdrawals.

Table 1 provides information as follows:

- Budgeted Net Inflow / (Outflow) – the combined impact of budgeted contributions and draws from reserves, split between:
  - Operating Reserves – primary purpose to fund costs associated with operations; and
  - Capital Reserves - primary purpose to fund capital projects.
- Actual Net Inflow / (Outflow) – the combined impact of actual operating and capital expenses funded from reserves and actual reserve contributions made in 2021 and prior years.

**Table 1: Historical 5-Year Reserves/Reserve Funds Inflow / (Outflows)**

Description	2017	2018	2019	2020	2021
Budgeted Net Inflow/(Outflow):					
Operating Reserves	(86)	(61)	(63)	(56)	(36)
Capital Reserves	(125)	(171)	(70)	(58)	(84)
<b>Budgeted Net Inflow/(Outflow)</b>	<b>(211)</b>	<b>(233)</b>	<b>(134)</b>	<b>(115)</b>	<b>(120)</b>
Actual Net Inflow/(Outflow)	435	1,210	322	1,526	347
<b>Actual Ending Balance</b>	<b>4,527</b>	<b>5,737</b>	<b>6,059</b>	<b>7,585</b>	<b>7,935*</b>

\* Year-End projection based on Q3 Reserve report, reflecting all expected 2021 draws.

As reflected in Table 1, the annual budget historically includes withdrawals from reserves that exceed reserve contributions. Budgeted net outflows have ranged from \$115 million to \$233 million over the last 5 years.

- As can be seen in Table 1, actual reserves have had net inflows over the last five years. The budgeted variance in capital reserves is largely dependent on the timing of the capital expenditure, while operating reserve have been positively impacted by underspending or overachieved revenues, which is predominately leveraged to support capital investments consistent with the City's surplus management policy. Staff review the continuity of each reserve to ensure adequacy of available funding over both the 10-Year Capital Plan and future year operating outlooks.

Table 2 below provides the consolidated view of city-wide withdrawals (outflows) and contributions (inflows) to the City's operating and capital reserves, as recommended in the 2022 Capital and Operating Budgets.

- The table also provides the estimated combined year-end closing balances for reserves over the next three years.

**Table 2: Reserve/Reserve Fund Three-Year Forecast**

Reserve/ Reserve Funds Impacted by the 2022 Budget	Projected Balance as of December 31, 2021	2022			Estimated Year-End Balance		
		Outflow	Inflow	Net	2022	2023	2024
Operating Reserve/Reserve Funds	1,997	(488)	307	(181)	1,817	1,798	1,791
Capital Reserve/Reserve Funds	5,939	(2,203)	1,824	(379)	5,570	4,798	4,336
<b>Reserves/Reserve Funds TOTAL</b>	<b>7,935</b>	<b>(2,691)</b>	<b>2,131</b>	<b>(560)</b>	<b>7,388</b>	<b>6,595</b>	<b>6,127</b>

The staff recommended 2022 Operating Budget includes \$307 million in budgeted contributions (inflows) to operating reserves, compared to \$488 million in budgeted withdrawals (outflow) reflecting a negative variance of \$181 million.

- The estimated year-end balance over a 3 year period, is calculated based on the 2022 budgeted and future year planned annual withdrawals and contributions, consistent with current budget levels.
  - This serves as an early warning sign on the potential health of the reserves and any need for corrective action to address any potential issues.
  - These reserves are reviewed as part of the annual budget process, from which analysis and funding strategies are recommended to either reduce withdrawals or increase contributions to ensure healthy status.

While operating reserves are projected to remain steady year-over year based on budgeted levels, capital reserves year-end balances are projected to decline over the next 3 years. This decline is mainly driven by Toronto Water's 10-Year Capital Plan that includes increased expenditure to fund multi-year capital projects for Treatment plants. These are planned projects for which Toronto Water built the reserves balance over the past few years since the timing of revenue collection and expenditure funding is not aligned.

### **Reserves & Reserve Fund Adequacy**

The City has two financial principles related to Reserves and Reserve Funds adopted by the City 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. There is a total 252 reserves detailed in Appendix 1 of this briefing note, of which 9 are forecasted to experience a negative closing balance in future years starting from 2022. Financial Planning in conjunction with Accounting Services is continuing to monitor and report on the health of the City's reserves throughout each fiscal year.

- Budget adjustments will be brought forward for Council consideration as needed to address reserve adequacy concerns reflected in reserve continuities.
- For the reserves with anticipated third party funding, the expenditure will be reduced to match available funding to the extent third party funding is not secured.

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.

The budgeted contributions and withdrawals for each reserve are detailed in Appendix 1 in this briefing note and also can be found in Appendix 10 of the Budget Notes for each respective City Program and Agency.

Please note that figures for individual reserves included in Appendix 1 of this briefing note may differ from the figures shown in the Program/Agency Budget Notes. This is due to updated 2021 year-end balances available following finalization of 2022 Budget Notes in some instances.

## **Appendix:**

Appendix 1: Reserves and Reserve Funds Balance and Forecast.

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