

**REPORT OF THE DIRECTOR OF FINANCE & TREASURER
RE. DISCRETIONARY RESERVES REPORT & CAPITAL FORECAST
FOR THE CONSIDERATION OF COUNCIL**

OBJECTIVE

To provide information pertaining to the state of the reserves and provide a capital forecast through 2026.

RECOMMENDATION

That the report of the Director of Finance/Treasurer re: Discretionary Reserves Report and Capital Forecast; be received

and that the Budget Committee consider the state of reserves and the five-year capital forecast when considering municipal contributions to the reserves in the 2022 operating budget

Respectfully Submitted



Amy Sonnenburg
Director of Finance & Treasurer &
Acting Chief Administrative Officer

BACKGROUND

Providing an update from the report dated January 11, 2021, the purpose of this report is to summarize the various reserves held by the City, and analyze the current and forecasted state of the discretionary reserves. Included is the projected five-year capital forecast, and the relationship this forecast has with the current reserves.

REASONS FOR RESERVES

PREVENTION OF BORROWING

The cyclical nature in the collection of municipal taxes and also the receipting of grants and other incomes creates an unsteady cash flow. Often, the City has secured provincial/federal grants, where the timelines to complete work can cause upfront expenditures (before the grant is received). If the City did not have reserves it would be required to borrow, at a significant cost to cover expenditures.

ABILITY TO RESPOND TO LONG TERM CAPITAL NEEDS

The presence of reserves allows the City to respond to capital requirements. An example of this is the road, water, and waste water infrastructure improvements that have been made in the current and prior years. Within all City owned buildings, there is a need for ongoing capital repairs. The City's fleet relies on reserves to both maintain and replace major equipment. The existence of reserves allows for a steady tax levy.

REDUCTION/ELIMINATION OF BANK CHARGES

The City reserves allow for a competitive tendering process and the ability to negotiate very reasonable terms with the bank. These terms provide a nominal interest rate and set service fees.

TYPES OF RESERVES WORKING FUNDS, DISCRETIONARY, DIRECTED AND OBLIGATORY

WORKING FUNDS

The Working Funds Reserve has no specific committed purpose and includes transfers from annual surplus accumulation. The Working Funds can be used to cover various outstanding obligations, with council approval.

DISCRETIONARY RESERVES

Established by Council to earmark revenue for particular purposes under the authority of the Municipal Act for any future expenditure for which it may spend money. Council may by bylaw provide that the funds raised for a reserve fund be expended, pledged or applied to a purpose other than that for which the fund was established. Earnings derived from the investment of a reserve fund shall form part of that reserve fund. Historically, departments have earmarked operational levied dollars for future spending. Discretionary reserves include Fleet, Information Technology, Public Works, Library, Economic Development, Building & Facilities, Miners Memorial Care Fund, Protection to Persons & Property, Physician Recruitment, Mount Dufour Ski Hill, Management & Planning Studies, Wireless Towers, Community Services Capital, Community Improvement Plan, Land Sales / Purchases, Community Hub and Mississagi Park.

DIRECTED RESERVES

Are committed reserves (for specific activities) or by council direction. Earnings derived from the investment of a reserve fund shall form part of that reserve fund. These include Elections, Sick Leave (eliminated in 2020), Landfill Site (closure and post-closure costs), Water and Wastewater Capital, Accessibility, Waterfront Development, Building Code, Arts & Culture (Civic Centre), Cemetery Capital Development.

OBLIGATORY RESERVES

Obligatory reserves are created when required by legislation. Examples are revenues received under provisions of the Development Charges Act, Planning Act, or Municipal Act, and include Federal Gas Tax and Provincial Dedicated Gas Tax. The Provincial Gas Tax reserve was created to deposit gas tax transfers, these monies must be used to fund the expansion of public transportation infrastructure and levels of service in the City. The Federal Gas Tax is provided under an agreement signed with the Government of Ontario and the Association of Municipalities of Ontario (AMO). This funding must be used on capital projects for public transit, water, wastewater, and solid waste or community energy systems.

HISTORICAL MUNICIPAL CONTRIBUTIONS

Reserve contributions come from the Operational Budget and the User Pay Budget. From the operational budget, the average annual contribution is (\$1,795,986)¹, or 15%.

OPERATIONAL BUDGET			
Year	Municipal Contribution	Tax Levied Budget Per Financial Statement	Reserve Contribution as a % of levies
2017	(1,979,060)	11,601,348	17%
2018	(2,103,617)	11,541,159	18%
2019	(1,668,332)	12,054,294	14%
2020 ²	(1,621,730)	12,315,808	13%
2021 ²	(1,534,012)	12,681,804	12%

The User Pay – Water and Waste Water budget has an average annual contribution is \$1,467,850 or 33%; as recommended in the Water Wastewater Study (2015) an additional 7% annual contribution to reserves was recommended and adopted by Council.

USER PAY – WATER/WASTE WATER BUDGET			
Year	Municipal Contribution	User Pay Budget	Reserve Contribution as a % of levies
2017	(894,760)	3,858,699	23%
2018	(1,473,746)	4,128,810	36%
2019	(1,543,207)	4,398,828	35%
2020 ²	(1,655,814)	4,706,760	35%
2021 ²	(1,771,721)	5,049,002	35%

¹ All contributions to reserve are presented as negative values, a negative balance is good, where the reserve remains healthy, a positive value shows that a reserve is overspent.

² 2020 & 2021 are based on unaudited financial statements

INTEREST CONTRIBUTIONS

The City earns interest on investments held at Edward Jones, Northern Credit Union, One Investment, and RBC. Interest revenue is reconciled at year end and distributed amongst the reserves based on the average balance held throughout the year. The exception to the above rule is the Community Hub (Recreation) and Waterfront Development (Elliot Lake Residential Development Corp. ELRDC) which earn interest separately on the balances held.

Year	Opening Balance	Interest Revenue	% interest
2017	(14,797,576)	(306,399)	1.94%
2018	(16,867,172)	(306,566)	1.67%
2019	(19,860,648)	(436,920)	2.06%
2020	(22,510,177)	(353,561)	1.50%
2021	(24,643,000)		

Investment activity has been negatively impacted in 2020 due to the pandemic. Current investments are maintained and reinvested as needed using the guidelines per the investment policy for the City.

FUTURE EXPENDITURES AND CONTRIBUTIONS

Contributions to reserves need to be reflective of future needs for the City. A five-year analysis of anticipated future expenses is detailed in Appendix One. Not all reserves are noted to have future expenses; those reserves are not forgotten, they may be used on a responsive basis to address emergency needs, have planned purchases far off in the future (i.e. a ladder truck for Fire in 2040), or are specific purpose reserves (i.e. cemetery capital). Future expenditures have been based on the current conditions of buildings, equipment, fleet and infrastructure. Not taken into consideration are activities that are emergent, as these cannot be forecast.

Recently, the Facilities Department reviewed in detail the needs of existing recreational facilities; Collins Hall, Centennial Arena and the Ruben Yli Juuti Center. This significantly changed the outlook for expenditures from the facilities reserves. An emergent point of concern is noted at Centennial Arena, in a recent evaluation the ice surface and piping are being run until the point of failure. Upon failure, this repair is estimated to be \$750,000. This is not forecast in the future expenditures as the point of failure cannot be reasonably estimated.

In the analysis to follow, there is no forecasted increase in contribution to reserves in the operational budget. Per the Water and Waste Water Rate Study, council has adopted a 7% increase for contribution to reserves, this increase is included year over year for from 2022-2027.

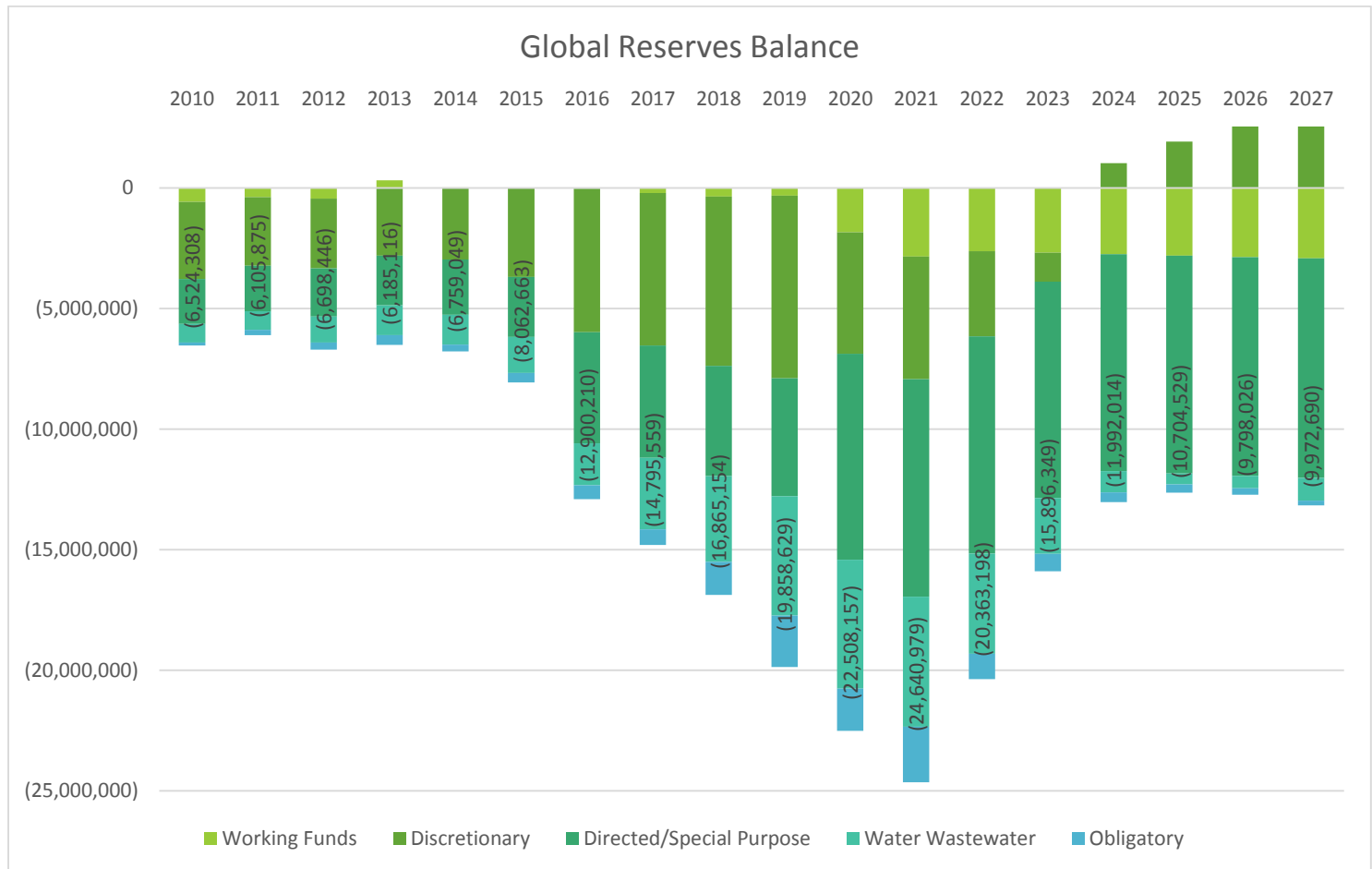
Excluded in future projections is the contribution from interest revenue. Interest revenue is volatile and unpredictable. According to the City's auditor, the threshold for materiality is \$500,000. Until an excess in revenue of \$500,000 annually can reliably be secured, it is not recommended to be taken into consideration for future planning.

ANALYSIS

THE GLOBAL RESERVE

Appendix Two offers a historical and forecasted overview of the reserves

The chart below depicts the global total held in reserves from 2010-2019 (per audited financial statements), the 2020 (unaudited), and forecasted balances based on future expenses (Appendix One).



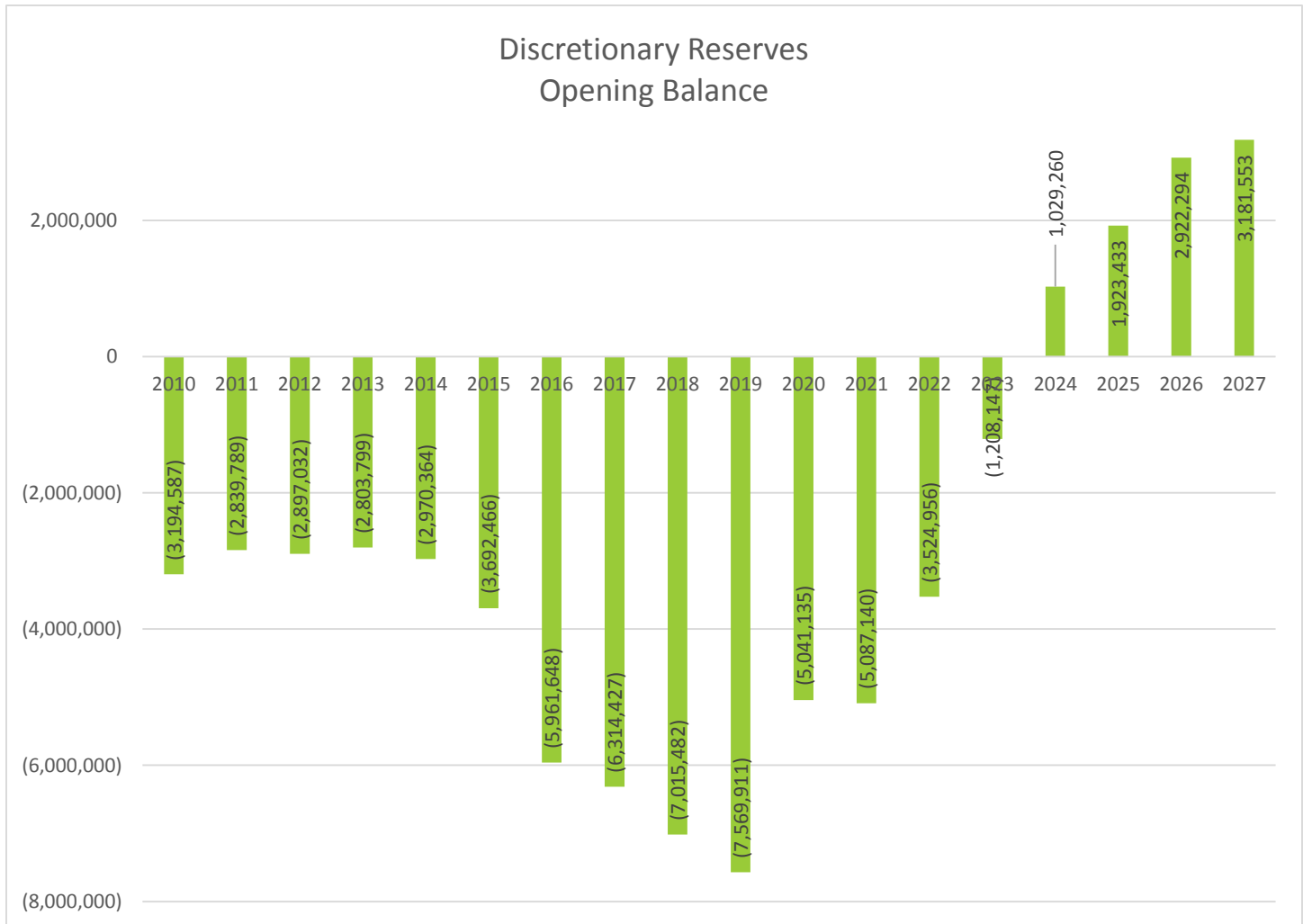
Although, we maintain available balance in the global reserves, discretionary reserves are fully depleted by 2024.

THE WORKING FUNDS RESERVE

The balance of the working funds reserve has increased over the years. This is attributed to the 2019 balancing of the financial statements for historical surpluses, and the addition of the 2020 (unaudited) surplus. There is no hard rule around a balance to be maintained in the working funds reserve. Most standards are based on a formula to have enough unrestricted cash to cover operating expenses for a number of months. A commonly used reserve goal is three to six months' expenses. At the high end, reserves should not exceed the amount of two years' budget. Considering that the global budget for the City is roughly \$17M, operating costs would be roughly at \$1.4M per month. The working funds are considered healthy and should be maintained.

DISCRETIONARY RESERVE

Based on projected needs (Appendix One), analysis of the discretionary reserve funds proves that if we continue with no increase in contribution the city cannot continue with the planned expenditures, and will deplete the reserves by 2024.



From Appendix Two, the average (from 2017-2020) capital expenditures from discretionary reserves is \$2,800,000. Logically, we need to contribute at least what we are spending. Currently, contribution to the discretionary reserves from the operating budget is \$1,440,137 annually. This has been historically adjusted at year end for revenue (or deficits) for specific reserves i.e. Wireless Towers, Library and the Miner's Monument.

There are two options to ensure that we have an available balance in the reserves, increase contribution, or reduce expenditures; thereby reducing capital projects in infrastructure and fleet.

INCREASED CONTRIBUTIONS TO THE DISCRETIONARY RESERVE

Using the same principle as the Water/Waste Water Reserve increases, the following tables details a balance of reserves if a year over year percentage increase to contribution were applied, beginning in 2022.

Discretionary Fund Opening Balance

Increase	5%	10%	15%	20%	25%
2021	(5,087,140)	(5,087,140)	(5,087,140)	(5,087,140)	(5,087,140)
2022	(3,524,956)	(3,524,956)	(3,524,956)	(3,524,956)	(3,524,956)
2023	(1,280,153)	(1,352,160)	(1,424,167)	(1,496,174)	(1,568,181)
2024	809,639	582,817	348,795	107,572	(140,852)
2025	1,476,811	1,000,306	492,837	(46,674)	(619,309)
2026	2,165,313	1,330,799	413,027	(593,944)	(1,696,270)

Annual contributions to the discretionary reserves funds are detailed below, here we see that to achieve an average contribution equivalent to the average expenditure, we need to increase the contributions by at least 25% annually, where parity is achieved in 2024.

Total Contribution from the Operating Budget

Increase	5%	10%	15%	20%	25%
2021	(1,440,137)	(1,440,137)	(1,440,137)	(1,440,137)	(1,440,137)
2022	(1,512,144)	(1,584,151)	(1,656,158)	(1,728,164)	(1,800,171)
2023	(1,587,751)	(1,742,566)	(1,904,581)	(2,073,797)	(2,250,214)
2024	(1,667,139)	(1,916,822)	(2,190,268)	(2,488,557)	(2,812,768)
2025	(1,750,496)	(2,108,505)	(2,518,809)	(2,986,268)	(3,515,959)
2026	(1,838,020)	(2,319,355)	(2,896,630)	(3,583,522)	(4,394,949)

To achieve the increases to reserves, year over year increases to the operating budget are detailed below.

Increase to Operating Budget

Increase	5%	10%	15%	20%	25%
2021					
2022	72,007	144,014	216,021	288,027	360,034
2023	75,607	158,415	248,424	345,633	450,043
2024	79,388	174,257	285,687	414,759	562,554
2025	83,357	191,682	328,540	497,711	703,192
2026	87,525	210,850	377,821	597,254	878,990

REDUCTION OF CAPITAL PROJECTS

Appendix One, a details anticipated future projects.

It is not recommended to delay Fleet Management replacement needs, as this will have a direct affect on increased expenses within the operational budget (causing increased maintenance expenses). Within the forecasted expenditures for Linear, Traffic Operations & Roadside Management, major infrastructure projects are planned annually. To improve the reserves outlook, consideration could be given to fewer projects annually. Within Buildings and Facilities, projected maintenance activities are detailed; however, emergent needs are not forecast.

DIRECTED – SPECIFIC PURPOSE RESERVES & OBLIGATORY RESERVES

At this time, the Directed - Specific Purpose and Obligatory Reserves have an available balance through 2027. The overall trend is a steady reserve balance within these two categories.

FINANCIAL IMPACT

Any increase to the operating budget in any given year has a direct impact on the levy. If we do not consider increasing the contributions to the Discretionary Reserves, projects and planned expenditures will not be possible without taking on financed debt.

SUMMARY

It is recommended that Council consider the state of reserves and the five-year capital forecast when considering municipal contributions to the reserves in the 2022 operating budget.