

**Region of Waterloo**

**Corporate Services**

**Corporate Finance**

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**To:** Strategic Planning and Budget Committee

**Meeting Date:** February 8, 2023

**Report Title:** Reserves and Reserve Funds Update

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**1. Recommendation**

For Information.

**2. Purpose / Issue:**

To provide an overview of the Region's reserves and reserve funds as well as details on contributions and utilization included in the Region's preliminary 2023 operating budget and 2023-2032 capital program.

**3. Strategic Plan:**

Long term financial sustainability is reflected in the Region's 2019-2023 Corporate Strategic Plan: Focus Area 5: Responsive and Engaging Public Service includes Objective 5.4 "Ensure the Region provides value for money and long term financial sustainability".

**4. Report Highlights:**

- The Region has established reserves and reserve funds over the years to provide funding for future capital investments and to serve a tax and user rate stabilization function. Both contributions to and utilization of reserves and reserve funds are subject to annual budget approval by Council.
- The strategic use of reserves and reserve funds is an important fiscal tool which helps to strengthen Waterloo Region's long-term financial position. The Region's reserve and reserve fund holdings are lower than most "triple A" rated municipal peers.
- Capital reserves are an integral part of supporting asset management plans required under O. Reg 588/17 Asset Management Planning for Municipal Infrastructure. Infrastructure funding programs offered by senior levels of government require that municipalities have an asset management plan in place in order to be eligible for infrastructure program funding.

- Appendix A outlines the purpose, funding source, 2022 opening balances, and operating budget contribution for each reserve and reserve fund that the Region carries. Additionally for capital reserves, the proposed 2023 utilization and utilization in the 2023-2032 capital program is also provided.

## **5. Background:**

### **Purpose of Reserves and Reserve Funds**

Reserves and reserve funds are an essential component of municipal long term financial planning. The use of reserves and reserve funds is an important fiscal and risk-mitigation tool which helps to strengthen Waterloo Region's long-term financial position. Funds set aside in reserves and reserve funds are used as:

- A source of funding to mitigate significant fluctuations in tax and user rate revenue caused by one time or emerging issues;
- A source of funding for capital projects, thereby reducing the need for long term borrowing or significant levy and user rate increases

Healthy reserve and reserve fund balances provide flexibility to deal with fluctuating cash flows and operating variances and play an important role in funding most Regional capital programs.

### **Reserves**

A reserve is an allocation of accumulated net revenue (from property taxes or other sources) set aside for a designated purpose. Funds held in a reserve can be utilized at the discretion of Council. Reserves form part of the overall funding strategy for Regional programs set out in the annual operating budget and multi-year capital plan.

### **Reserve Funds**

A reserve fund is established based on a statutory requirement or defined liability payable in the future and is usually prescriptive as to the basis for collection and use of monies in the fund. There are two types of reserve funds: obligatory reserve funds and discretionary reserve funds.

- Obligatory reserve funds are created when required by statute or legislation so that revenue received for special purposes is segregated from the general revenues of the municipality. Obligatory reserve funds are created solely for the purpose prescribed for them, e.g. Regional Development Charges, Canada Community Building Reserve Fund (formerly the Federal Gas Tax Transfer).
- Discretionary reserve funds are established whenever Council wishes to set aside a certain portion of any year's revenues to finance a future expenditure for

which it has the authority to spend money, or to provide for a specific contingent liability established at the discretion of Council.

### **Legislative Provision and Regional Policies**

Section 289(4) of the “Municipal Act” (“The “Act”) provides that “In preparing the annual budget, an upper-tier municipality may provide for such reserve funds as the municipality considers necessary.” Under the Act, reserves and reserve funds may be created by by-law or by Council resolution.

The most recent comprehensive Reserve and Reserve Fund Policy Update was provided in report COR-FSD-17-06 dated February 14, 2017. Through a follow up report (COR-FSD-17-19 Reserve and Reserve Fund Strategy dated June 20, 2017) Council established target contributions and balances for Regional reserves and reserve funds. Subsequent reports provided updates on the adequacy of reserve and reserve funds and recommended revisions to target contributions and balances as needed.

Appendix A lists the Region’s reserves and reserve funds and outlines sources and use of funding as well as opening 2022 balances. Contributions to reserves and reserve funds included in the preliminary 2023 operating budget, which are subject to annual budget approval, are also detailed, along with proposed utilization in the 2023-2032 capital program. Reserve and reserve fund assets are invested to generate interest income and to ensure that funds are available for the intended use when needed.

### **Long Term Financial Sustainability**

Municipalities must comply with legislated requirements of the Asset Management Planning for Municipal Infrastructure regulation (O.Reg 588/17). This regulation sets out, amongst other things, the requirement that municipalities develop and update their Asset Management Plan (AMP) on a periodic basis. In order to be eligible for funding programs offered by senior levels of government the Region must state its compliance with this regulation. The AMP is an ongoing and long-term planning tool that allows municipalities to optimize investment decisions for their infrastructure assets.

Developing and adhering to an AMP ensures that the right work is done at the right time taking into account asset condition, expected useful life, and consequence of failure in order to minimize the full lifecycle cost of utilizing the asset in the delivery of municipal services.

Previous AMP updates highlighted that, with respect to Regional infrastructure, funding gaps exist in certain areas. In 2016, Regional Council approved the implementation of the Capital Asset Renewal Funding strategy in order to address the funding gap for capital asset renewal. The approved strategy strives to achieve 100% pay-as-you-go funding for renewal works across all regional services. This in turn preserves Regional debt capacity for new and significant infrastructure expansion.

As a result of this strategy, the Region has been able to reduce, but not entirely eliminate, the amount of debt required for renewal works and continued implementation of the strategy is required. The Region is also experiencing a period of increasing growth which is leading to significant debt financing of required expansion projects. The Region's 2023-2032 capital renewal program still relies on debt as a financing tool for some renewal works which reduces the Region's overall financial flexibility. Both of these factors result in the need for a significant amount of debt financing for these projects to proceed, putting pressure on the Region's Aaa credit rating. Maintaining and increasing contributions to reserves and reserve funds is critical to achieving long term fiscal sustainability.

### **Tax Stabilization Reserve**

The Tax Stabilization Reserve (TSR) is used to "phase-in" the operating budget impacts of service and funding expansions and mitigate the tax impacts of unforeseen operating events. The TSR has an upper limit of \$15 million, which was increased from \$10 million in 2017. At the time, the \$15 m limit represented approximately 4.5% of the Regional property tax levy and now reflects 3.6% of the 2022 Regional property tax levy. The TSR does not have a budgeted source of funding and relies solely on tax supported operating surpluses to be replenished.

The balance in the TSR at the beginning of 2022 was \$15.0 million. Through the 2022 budget, \$5.9 million from the TSR has been committed to fund various initiatives as outlined in the following table.

<b>Budgeted TSR commitments in 2022</b>	<b>2022 Budget (\$ millions)</b>
Equity Investment phase-in	\$2.50
University of Waterloo School of Optometry capital grant	\$1.00
Paramedic Services – 2021 service expansion	\$0.56
Paramedic Services – 2022 service expansion	\$0.47
Upstream Initiatives Transition Fund	\$0.50
Technology Investment phase-in	\$0.50
Wellbeing Waterloo Region	\$0.25
Upstream Initiatives (estimated carry over of unspent funds, actual funds carried over was \$180,300)	\$0.13
<b>Total</b>	<b>\$5.91</b>

Actual utilization of the TSR in 2022 will differ from budgeted allocations due to 2022 expenditure variances. The year-end reporting process is well underway and staff will report the results to Council in March.

The preliminary 2023 operating budget proposed to utilize \$7.9 million from the TSR for various initiatives set out in the following table:

<b>Proposed TSR commitments in 2023</b>	<b>Preliminary 2023 Budget (\$ millions)</b>
Fuel Price increase phase-in	\$3.50
Paramedic Services – 2022 service expansion	\$1.54
Paramedic Services – proposed 2023 service expansion	\$1.15
Equity Investments phase-in	\$1.25
Wellbeing Waterloo Region	\$0.25
Upstream Initiatives (estimated carry over of unspent funds)	\$0.16
<b>Total</b>	<b>\$7.84</b>

Budgeted commitments from the TSR across the 2022 approved budget and the 2023 preliminary budget total approximately \$13.6 million. Unallocated funding available in the TSR, prior to any potential 2022 surplus allocation and adjustments for 2022 actual utilization, is approximately \$1.4 million.

#### **6. Area Municipality Communication and Public/Stakeholder Engagement:**

Nil.

#### **7. Financial Implications:**

The strategic use of reserves and reserve funds is an important fiscal tool which helps to strengthen Waterloo Region's long-term financial position. Contributions to reserves and reserve funds, as outlined in this report, are subject to annual budget approval.

#### **8. Conclusion / Next Steps:**

Staff will provide an update on reserve and reserve fund balances once 2022 year-end results have been finalized.

#### **9. Attachments:**

Appendix A: Region of Waterloo Reserves and Reserve Funds

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