

Region of Waterloo

Corporate Services

Corporate Finance

To: Administration and Finance Committee

Meeting Date: August 15, 2023

Report Title: Tax Stabilization Reserve and Working Funds Reserve

1. Recommendation

For information.

2. Purpose / Issue:

To provide additional information on two specific reserves, being the Tax Stabilization Reserve (TSR) and the Working Funds Reserve (WFR), as requested by Committee at its May 2023 meeting.

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 purpose of the TSR is to temporarily mitigate or phase-in significant property tax impacts and to provide a source of funding for one-time initiatives. In 2021, the target balance for the TSR was updated from \$10M to \$15M in order to mitigate the level of draws from the reserve that could be expected, planned or otherwise. The TSR has been used in a variety of situations to offset or smooth-out temporary impacts on the property tax levy.
- The purpose of the WFR is to provide a base amount of cash flow and to mitigate the risk of a cash flow shortfall. In the past this has been particularly relevant for the Region in the first quarter of the year. The Region receives its share of property tax levy payments from area municipalities in nine equal installments from April 1 to December 1 in each year.

- Reserves such as the TSR and WFR serve a stabilization function and require adequate balances to mitigate potential draws. There is no budgeted funding source for these reserves; the reserves are replenished to the extent that annual operating budget surplus allows.

5. Background:

The Committee considered report COR-CFN-23-024 Reserve and Reserve Fund Policy update on May 9, 2023. The report outlined the plan to undertake a comprehensive review of the Region's Reserve and Reserve Fund policy in 2024. The Committee requested additional information on two specific reserves, being the Tax Stabilization Reserve and the Working Funds Reserve.

Tax Stabilization Reserve: The purpose of the TSR is to temporarily mitigate or phase-in significant property tax impacts and to provide a source of funding for one-time initiatives. In 2021, the target balance for the TSR was updated from \$10M to \$15M in order to mitigate the level of draws from the reserve that could be expected, planned or otherwise. At the time, \$15M represented approximately 3.8% of the regional property tax levy and is now approximately 3.2% of the 2023 regional property tax levy (excluding Police levy).

The TSR has been used in a number of situations over the years to mitigate temporary impacts on the property tax levy such as:

- To bridge temporary funding gaps for service expansions, such as the delay in provincial subsidy approval for Paramedic Services master plan implementation;
- To help phase-in the tax impacts of significant initiatives such as the Equity, Inclusion, Diversity and Reconciliation program; and
- To mitigate volatility in commodity prices such as fuel by temporarily funding a portion of a budgetary increases.

The 2023 budget contemplates the use of \$7.9M from the TSR and Council has approved additional uses of TSR since budget approval for Key Cultural Institution grants (\$340,000) and the reinstatement of Transit service (\$98,000) to date in 2023. A full list of uses is provided in the table below.

| Item | Allocation |
|---|-------------|
| 2023 Approved Budget: | |
| Fuel price increase phase-in | \$3,500,000 |
| Paramedic Services - 2022 service expansion | 1,536,322 |
| Paramedic Services - 2023 service expansion | 1,146,070 |

| Item | Allocation |
|--|--------------------|
| Equity Investment phase-in | 1,250,000 |
| Wellbeing Waterloo Region | 250,000 |
| Upstream Initiatives carry forward | 155,000 |
| ASE software implementation | 100,000 |
| Total 2023 Approved Budget | \$7,937,392 |
| 2023 In-Year Approvals: | |
| Grants for Key Cultural Institutions | 340,000 |
| Reinstatement of Transit service | 98,000 |
| Total 2023 In-Year Approvals | \$438,000 |
| Total 2023 Approved Commitments to Date | \$8,375,392 |

Working Funds Reserve: The purpose of the WFR is to provide a base amount of cash flow and to mitigate the risk of a cash flow shortfall. In the past, this has been particularly relevant for the Region in the first quarter of the year. The Region receives property tax levy payments from the area municipalities in nine equal installments, from April 1 to December 1 in each year. This arrangement can potentially lead to cash flow risks that are mitigated by the WFR until tax levy funding starts to flow to the Region. The Region currently carries \$10M in its Working Funds Reserve specifically for this purpose. Although the Region has had to draw upon this reserve only once in the past several years, it is good financial practice to maintain a reserve such as this for extraordinary circumstance, when and if they should arise.

Sources of funding: The TSR and WFR serve a stabilization function and require adequate balances to mitigate potential draws against the reserve. It is appropriate to establish targets for balances held in stabilization reserves. The target balance is generally based on a conservative estimate of potential draws against the reserve, planned or otherwise. There are no budgeted sources of funding for these reserves and these reserves are replenished only through operating budget surpluses in accordance with the Region's Reserve Allocation Policy. The current Surplus Allocation policy is as follows:

- 1) Transfer to the TSR an amount equal to the lesser of the surplus and the amount necessary to achieve a \$15 million balance in the TSR;
- 2) Transfer to the WFR an amount equal to the lesser of the balance of the surplus (after item 1) and the amount necessary to achieve a \$10 million balance in the WFR;

- 3) Transfer to the General Tax Supported Capital Reserve an amount equal to the balance of the surplus (after items 1 and 2), if any, in order to replace debt as a funding source for future capital projects.

While using funds from stabilization reserves may on the surface appear to be a way of reducing the current year property tax impact, this is not a sustainable approach as these reserves have no budgeted source of funding. Once depleted, the contribution from the reserve into the operating budget will need to be removed from future operating budgets. In addition, more than 96 per cent of the Region's reserves and reserve funds are committed to legislated, contractually bound or Council-directed commitments, or are required to support the 10-year capital and operating plan. This leaves a maximum of \$25 million available in the TSR and WFR to respond to unforeseen cash flow shortfalls and emergencies.

6. Area Municipality Communication and Public/Stakeholder Engagement:

Nil.

7. Financial Implications:

The Region's level of reserves has historically been low. This is commented on regularly through the annual credit rating update, and is a contributing factor in the Region's debt-to-reserve ratio being higher than other "triple A" rated municipalities. Having a sufficient level of reserves and reserve funds is a key indicator of long-term financial sustainability and provides a backstop when needed, as well allowing the Region to take advantage of investments and funding opportunities as they arise.

8. Conclusion / Next Steps:

Staff will provide further information on progress towards long-term sustainability through the 2024 Plan and Budget process. The Region's Reserve and Reserve Fund policy review will be completed in 2024.

9. Attachments:

Nil.

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