

Staff Report



Financial Services Department

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REPORT TO: Finance and Corporate Services Committee

DATE OF MEETING: May 13, 2024

SUBMITTED BY: Jonathan Lautenbach, Chief Financial Officer, 519-741-2600 ext. 7334

PREPARED BY: Katie Fischer, Director of Financial Reporting & ERP Solutions, 519-741-2600 ext. 4630

WARD(S) INVOLVED: All Wards

DATE OF REPORT: May 13, 2024

REPORT NO.: FIN-2024-222

SUBJECT: Reserve Fund Policy Update

RECOMMENDATION:

That Policy FIN-RES-770 Reserve Funds be amended as identified in report FIN-2024-222; and,

That funds in the amount of \$400,863 be transferred from the Tax Stabilization Reserve Fund to the Investment Stabilization Reserve Fund; and further,

That funds in the amount of \$4,488,866 be transferred from the Tax Stabilization Reserve Fund to the Tax Capital Reserve Fund.

REPORT HIGHLIGHTS:

- The purpose of this report is to amend the City's Reserve Funds Policy, following a review by staff.
- The key finding of this report is to balance the risk and funding needs across the operating program (stabilization reserve funds) and capital program (capital reserve funds), supporting the City's asset management plan while maintaining reserve fund balances within their minimum and maximum ranges according to best practices as defined by the Government Finance Officers Association (GFOA).
- The financial implications result in a transfer of funds from the Tax Stabilization Reserve Fund to the Investment Stabilization Reserve Fund (\$0.4M) and to the Tax Capital Reserve Fund (\$4.5M). Funds will be factored into the 2025 budget to move forward with additional capital project work.
- This report supports the delivery of core services.

BACKGROUND:

The City's current Reserve Funds policy, FIN-RES-770, was approved in 2012 and was last reviewed in 2016. In line with the action items from the City's Long Term Financial Plan, staff have completed a review of the policy with a particular focus on stabilization reserve fund targets and how annual surpluses are allocated to reserve funds. With the exception of the COVID-19 pandemic impacts, the City has traditionally realized modest operating surpluses within approximately 1% of budget, demonstrating effective budget control practices. Reviewing the policy of how these surpluses are allocated supports the City's financial sustainability and asset management plan.

REPORT:

Allocation of Surplus

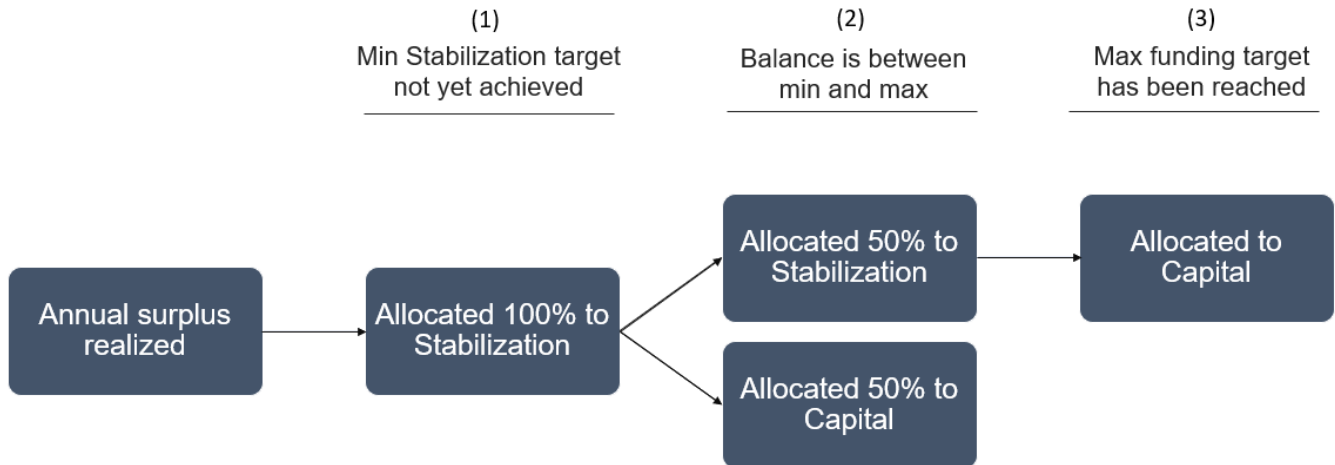
Under the existing Reserve Funds policy, surpluses resulting from the Operating and Enterprise budgets are allocated first to their associated stabilization reserve funds; once the stabilization reserve fund maximum target balance is reached, any additional funds are allocated to the associated capital reserve fund.

- Stabilization reserve funds are generally seen as the “rainy day funds”, used to provide a contingency for unforeseen events and stabilize fluctuations caused by one-time expenditures or revenue shortfalls.
- Capital reserve funds are used to assist in financing the capital program.

The City's reserve fund policy follows best practices, as identified by the Government Finance Officers Association (GFOA), in identifying minimum and maximum funding target levels for reserve funds. The City aims to maintain reserve fund balances within this minimum and maximum range, as part of its risk management strategy and financial plan.

The proposed changes to the reserve fund policy aims to balance the risk and funding needs across the operating program (stabilization reserve funds) and capital program (capital reserve funds). Similar policies are in place at other municipalities. As the stabilization reserve funds achieve their minimum funding target level, the balance would continue to grow should there be an annual surplus, while at the same time allowing the City to use funds for capital purposes.

The proposed new approach to the allocation of potential annual surpluses is as follows:



- (1) 100% of any surplus is allocated to the associated Stabilization reserve fund until its minimum funding target is achieved, recognizing that minimum thresholds are desired to mitigate operational risk.
- (2) After its minimum funding target is achieved, then 50% of the surplus would be allocated to the associated Stabilization reserve fund and 50% to the associated Capital reserve fund.
- (3) Once the Stabilization reserve fund has reached its maximum funding target, all remaining funding surplus would be allocated to the associated Capital reserve fund.

Before allocating funds for capital needs, the policy ensures the funding balance in the stabilization reserve fund remains within the best practices recommended by the GFOA. This approach would apply to the tax operations and all enterprises, with the exception of the Building Enterprise as it is governed by the *Building Code Act, 1992, S.O. 1992, c. 23*.

Surpluses resulting from the City's investment portfolio (within the operating budget) are treated similarly, but are proposed to be directed first to the Investment Stabilization reserve fund until its maximum funding target is met, after which they would be allocated to reserve funds using the same approach as a tax-supported operating surplus.

Other Proposed Changes

While the above represents the most significant changes to the draft Reserve Funds policy, staff additionally reviewed the overall policy. Proposed changes to the policy are highlighted in yellow in Attachment A, with strikethrough text being proposed deletions. The proposed Reserve Funds policy changes contain many of the same elements of the existing policy, with updated language in some areas following a review of policies from other municipalities. The following is a summary of changes proposed to the policy.

- The Investment Stabilization reserve fund's maximum target balance is proposed to increase from \$2.0 million to \$2.5 million, representing approximately 50% of the annual budget in investment income in the operating fund. The previous target of \$2.0 million was estimated as the impact if interest rates decreased by 1 percentage point. As the budget is determined based on historical average investment income, it is proposed instead to base the stabilization reserve fund on the budget, to assist with smoothing budgetary impacts resulting from the running three-year average.
- Policy Purpose: No changes to the language is proposed; this section consolidates the previous "Policy Content" and "Policy Purpose" from the existing policy.
- Definitions: Language was refined to make definitions clearer and more concise.
- Reserve Fund Classifications: It is proposed to replace the classification of "Development Charges Reserve Funds" with the wider classification "Obligatory Reserve Funds". This wider classification would include not only Development Charges Reserve Funds, but also other obligatory reserve funds such as Building Enterprise, Recreational Land, and Canada Community-Building Fund (formerly Gas Tax). This classification segregates reserve funds that Council does not have control to repurpose for any use other use than what the fund was prescribed for. The classification also aligns with the mandatory reporting to the Ministry of Municipal Affairs and Housing as part of the Financial Information Return.
- An "Authority" section has been introduced, referencing the Municipal Act, as well as a section on "Responsibilities" to identify key roles and responsibilities.
- The "Guiding Principles" have been updated, to better align to the overall financial plan for the City.
- The "Target Reserve Fund Levels" section has been updated; in particular, the policy now includes a "Schedule A" to more explicitly state the reserve funds that are approved, their purpose, funding source, intended use, and funding target.
- A new section entitled "Specific Policies" has been introduced. This section introduces a policy statement on how the City will allocate its annual surpluses as outlined above.
- Within the "Schedule A", it is proposed that the Building Enterprise Stabilization and the Building Enterprise Capital reserve funds be consolidated into one single "Building Enterprise" reserve fund. The *Building Code Act, 1992, S.O. 1992, c. 23* does not require more than one reserve fund to be established, and the capital needs of the Building Enterprise are not material relative to the City's overall reserve funds or the Building Enterprise operations. Having one single reserve fund for the Building

Enterprise will streamline the financial reporting and financial planning of this enterprise, and is consistent with other municipalities reviewed.

STRATEGIC PLAN ALIGNMENT:

This report supports the delivery of core services.

FINANCIAL IMPLICATIONS:

The 2023 books have been closed out, with the financial results reported to the Committee of the Whole on April 8, 2024 (FIN-2024-153). To support the City's asset management plan moving into the 2025 budget process, staff recommend the proposed reserve fund policy be applied to the 2023 year-end surpluses, resulting in transfers between reserve funds as identified in the following table. The change in reserve fund policy did not have an impact to funding transfers resulting from 2023 financial results for any of the Enterprises.

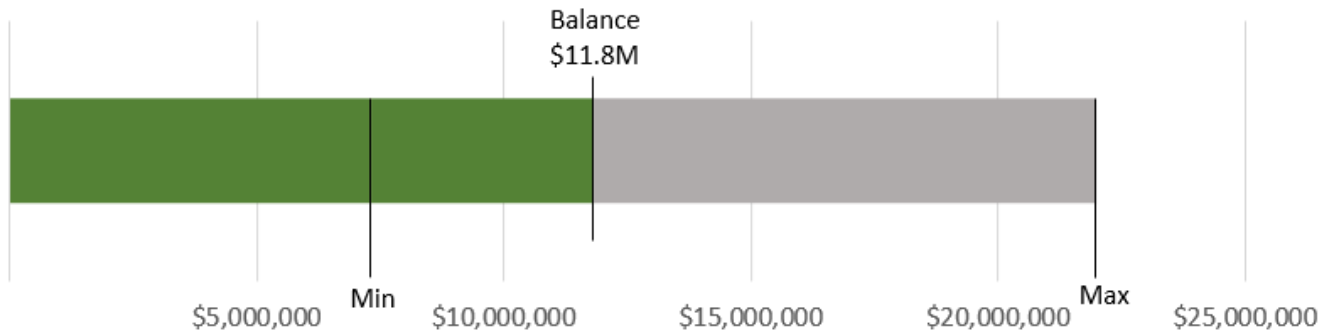
	Investment Stabilization Reserve Fund	Tax Stabilization Reserve Fund	Tax Capital Reserve Fund
Current balance following 2023 year-end	\$2.1M	\$16.7M	\$1.7M
Redistribute 2023 Investment Income Surplus	\$0.4M	(\$3.4M)	\$3.0M
Redistribute 2023 Operating Surplus	\$0	(\$1.5M)	\$1.5M
Revised balance	\$2.5M	\$11.8M	\$6.2M
Funding Target Min & Max	\$0-\$2.5M (Note 1)	\$7.3M-\$22.0M	\$0.8-\$2.25M (Note 2)
Additional (less) funds compared to existing policy	\$0.4M	(\$4.9M)	\$4.5M

Note 1: The funding target max for the Investment Stabilization reserve fund is currently \$2.0M and is proposed to be increased to \$2.5M.

Note 2: Tax Capital funds will be factored into the 2025 budget to move forward with additional capital project work.

The Tax Stabilization reserve fund balance remains within the funding target range and best practices as identified by the GFOA.

Tax Stabilization Reserve Fund Balance



COMMUNITY ENGAGEMENT:

INFORM – This report has been posted to the City’s website with the agenda in advance of the council / committee meeting.

PREVIOUS REPORTS/AUTHORITIES:

- *Municipal Act, 2001*

APPROVED BY: Jonathan Lautenbach, Chief Financial Officer

ATTACHMENTS:

Attachment A – Reserve Fund Policy