

Contribution to Reserves & Reserve Funds

Overview

Under the *Municipal Act*, Council has the authority to establish reserves as required. Reserves and reserve funds can be formed to meet specific liabilities such as the replacement/acquisition of capital assets or the stabilization of the tax levy and/or user rates in the face of uncontrollable circumstances. In addition, the *Development Charges Act* and other legislation require that municipal governments maintain specific reserves. Such reserves include development charge deferred revenue and sinking funds associated with the issuance of certain debt (sinking fund reserves are excluded from this discussion). The majority of the Region's reserves are segregated and legally restricted to only meet the purpose for which the reserve fund was established (e.g. water, wastewater, solid waste, and provincial highways).

The Region's financial philosophy has been developed through a combination of historical prudence and the adoption of best practices among municipal governments. This philosophy was embodied in the Financial Mission Statement, adopted by Council in 1999, which formally commits the organization to fiscal responsibility and sound financial management to ensure adequate funding of services and capital infrastructure. In conjunction with the Financial Mission Statement, Council adopted the following Financial Principle, which specifically addresses the use of reserves:

"Adequate reserves will be maintained to:

- 1. Replace and rehabilitate major capital infrastructure assets as required.**
- 2. Provide a buffer for significant unanticipated expenditures beyond the control of the Region; and**
- 3. Supply funds for new major capital assets identified in the long-term corporate strategy."¹**

In addition, adequate reserves promote fiscal opportunity reflecting a primary goal of Vision 2026.

The Region's practice with respect to reserves is a major factor in maintaining the "AAA" rating assigned to it by credit rating agencies. This rating allows York Region to raise funds in the capital markets at the lowest possible borrowing rates which minimize the long-term costs for infrastructure capital.

As at December 31, 2004 it is estimated that the Region's reserve balances will total approximately \$822.4 million with \$422.3 million held in Development Charge Reserves and \$400.1 million in other reserves.

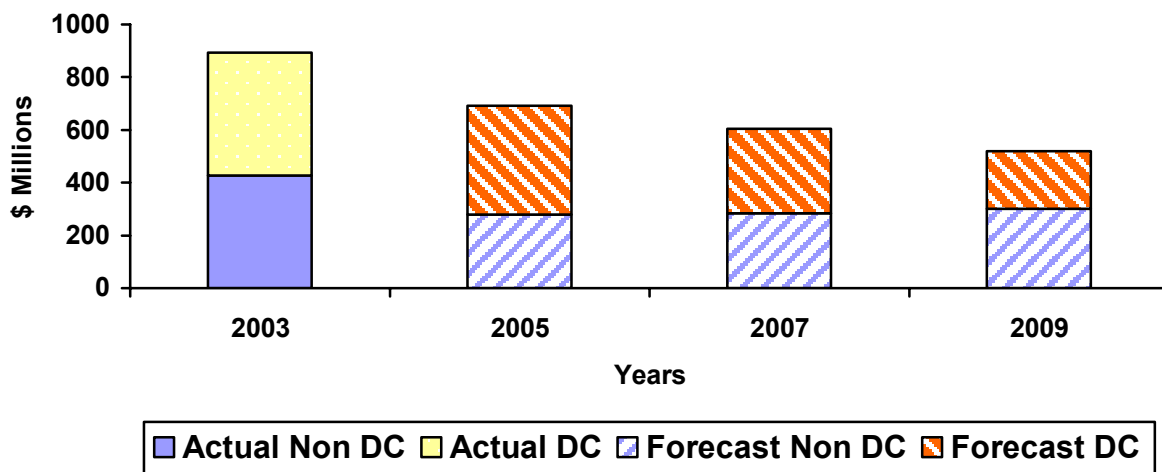
¹ The Regional Municipality of York, 1999 Annual Report, p.32.

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Over the ten year period from 1994 to 2004, reserves and reserve funds (including development charge reserves) have increased approximately 668% (from \$123 million in 1994 to \$822 million by the end of 2004). This rapid growth resulted from prudent policy decisions approved by Council to augment existing reserves as required and to establish new reserves based as needed.

Significant progress has been made to date to bring reserves to their current levels. However, given current contribution rates and forecasted usage, reserves including development charges are expected to decline significantly over the next few years (see Graph 1).

Graph 1 - Total York Region Reserve Balances*

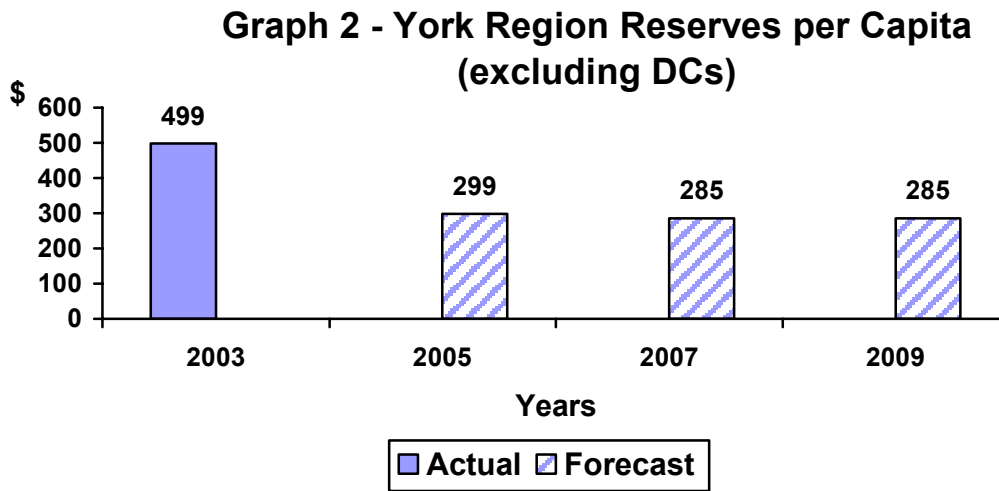


* Forecasts are based on current contribution rates net of projected expenditures as contained in the 2005 10-year capital forecast.

Future demand in areas such as Water and Wastewater, Social Housing, Transit and Roads, and Building Rehabilitation, will continue to present funding challenges and will necessitate even greater reliance on appropriately funded reserves. As Graph 1 above indicates reserves including development charge reserves peaked at the end of 2003 at approximately \$892 million and are projected to decline to approximately \$520 million by the end of 2009.

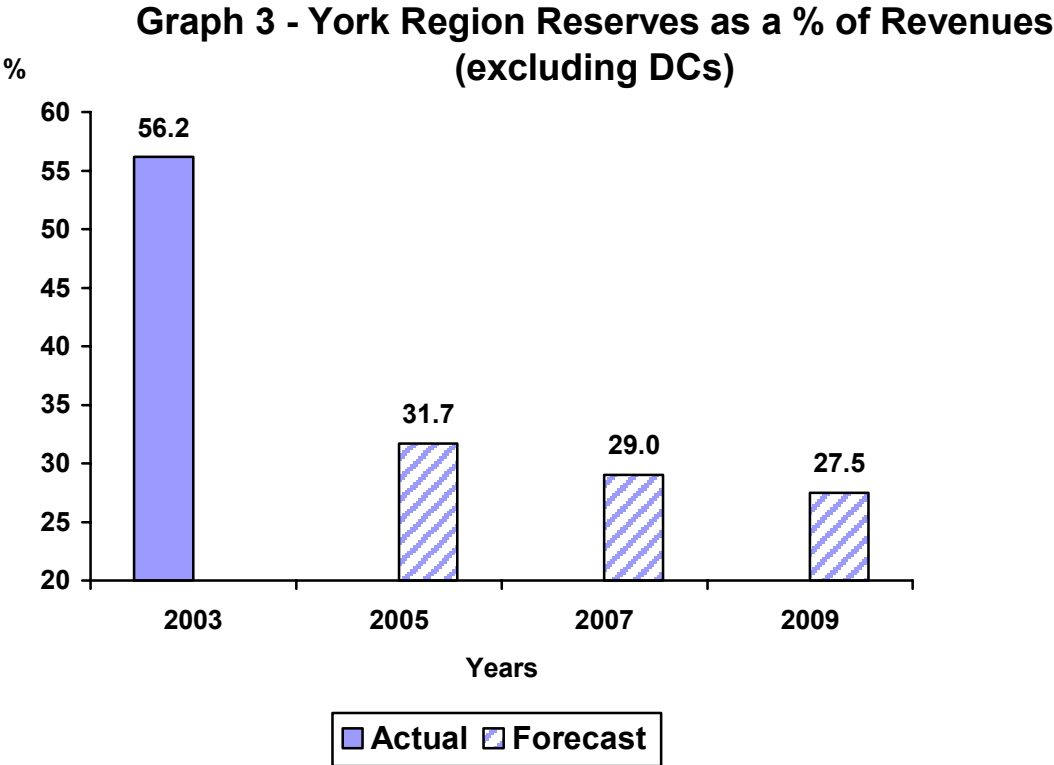
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Graph 2 depicts the trend of reserves per capita (excluding development charges) from 2003 to 2009. Per capita reserves based on current projections peak at the end of 2003 at \$499 and decline steadily to \$285 by the end of 2009. The forecasted decline in per capita reserves is a result of an overall decline in projected reserve balances of \$126 million and an increase in population of approximately 197,000 people over the time horizon. Since population influences many of the expenditures made by the Region, Graph 2 projects a trend towards less fiscal flexibility for funding these expenditures.



Reserves as a percentage of revenues depict a similar pattern (see Graph 3). In this case the graph indicates that reserves as a percentage of revenues peak in 2003 at 56.2% (equivalent of 6.7 months revenue) and decline to 27.5% (equivalent of 3.3 months revenue) by 2009. Again the decline in this measurement is a result of reserve balances not keeping up with a projected increase in revenues of approximately \$332 million.

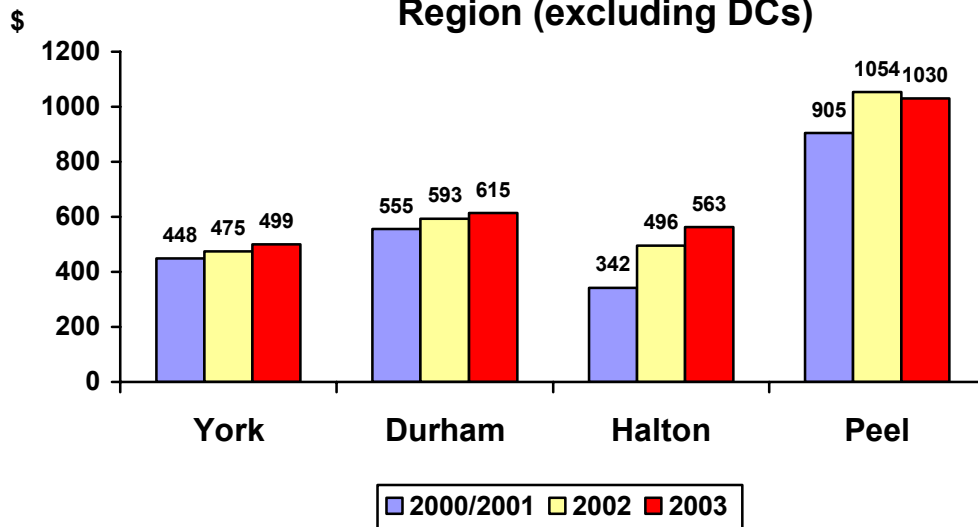
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Comparing York’s reserve balances with other regional municipalities in the GTA provides further evidence of the need to continue to enhance York’s reserves. As indicated in Graph 4 reserves held by the Regions of Durham, Halton and Peel exceed York’s reserves on a per capita basis. Both Durham and Peel hold significantly higher reserves per capita than York or Halton. Halton, however has seen a substantial increase in its reserve position over the prior two years increasing per capita reserves on the order of 60%.

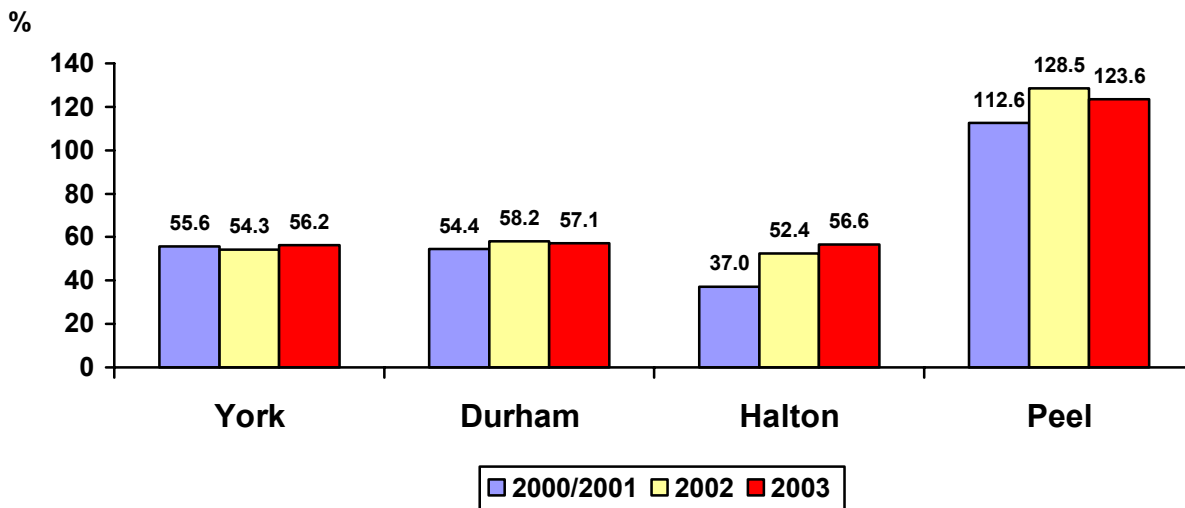
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Graph 4 - Comparison of Reserves per Capita by Region (excluding DCs)



Although reserves as a percentage of revenues are in line with Durham and Halton (see Graph 5) it should be noted that these figures reflect York's reserve position as at the end of 2003 and that its profile going forward is projected to decline considerably relative to its peers.

Graph 5 - Comparison of Reserves as a % of Revenues (excluding DCs)



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Both of these comparisons indicate that the Region of York's discretionary reserves are not keeping pace with its GTA neighbours and earlier benchmarks and that contributions to reserves must be increased to keep them in line with population and revenue growth. The availability of adequate and appropriate reserves is an important factor cited by credit rating agencies when assessing the Region's financial profile.

In its 2004 review Moody's Investors Service stated the Region's AAA rating "is supported by a track record of prudent fiscal management, generating positive financial results, an expanding assessment base, high levels of reserves and low levels of debt." Standard and Poor's (S&P) echoes these views in their 2004 report which stated the Region's rating "reflect its vigorously expanding local economy, very strong liquidity levels, and solid financial performances." Given projected usage of reserves and greater reliance on debt financing S&P was motivated to comment that "pressure on liquidity levels is not expected to diminish as capital budgets should continue to increase in size annually for the future." These concerns therefore prompted S&P to state in their concluding remarks that "**although the region might shift from a net creditor to a net debtor in the next few years, significant deterioration of the region's financial position beyond current expectations may result in lowered ratings.**"

It is necessary therefore that the Region continues to implement and foster prudent reserve and reserve fund policies especially in light of the intense capital financing pressures which it faces over the next 5 to 10 years. To that end staff is planning to undertake a comprehensive review in 2005 of the adequacy of reserves in conjunction with the anticipated capital assets and replacement study.

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Review of Major Reserves

The following sections examine more closely several of the Region's major reserves in order to highlight significant aspects particular to each which may impact their future outlook. These reserves include: Water, Wastewater, Transit, Social Assistance, Social Housing, Capital Asset Repair and Rehabilitation, General Capital, Development Charges and Tax Stabilization.

Water and Wastewater Reserve Funds

Projected End of 2005(Combined): \$33.6 million Target: TBD

The Water and Wastewater Reserve Funds were established in 1991 with the primary purpose of funding major maintenance and replacement of water and wastewater plants and facilities, and the funding of the non-growth component of new water and wastewater plants and facilities. Funding for these reserve funds is provided from surcharges on the water and wastewater user rates. In addition any surpluses in the water and wastewater annual operating budgets are also placed in these reserve funds.

These reserve funds were last reviewed by Hemson Consulting in 1999. This review found that reserves would be sufficient to meet all planned expenditures provided that the annual contribution rate was adjusted for inflation, which was projected to be 2% per year. However, it is now anticipated that new provincial guidelines and standards invoked as a consequence of the Walkerton crisis will have a significant impact on the future requirements for those facilities. In order to assess the potential financial impact of these changes and accelerated growth generally on reserve requirements, Council has approved the funding of a consultant's review which is expected to be completed in 2005.

The 2004 Budget and preliminary 2005 Budget include transfers of approximately \$16 million and \$36 million from these reserves to balance the Water/Wastewater operating budget, respectively. For projection purposes we are assuming that the 2006 and beyond Water/Wastewater rates will be increased at least to avoid these transfers to cover operating deficits (mainly originated by contributions from operations to the capital program).

Transit Reserve Fund

Projected End of 2005: \$5.6 million Target: \$20 million (subject to review)

The Transit Reserve Fund was established in 1999 to fund capital expenditures relating to Regional and GO Transit programs. Funding for this reserve fund was provided from tax levy savings which occurred in 1998 and 1999 due to the

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recovery of GO Transit surpluses. It has been assumed that this reserve fund will be only used for financing capital expenditures related to conventional transit and GO Transit programs. The Region's rapid transit needs are not yet fully known and will be dealt with as part of the York Region Rapid Transit program in conjunction with proposals developed with York Consortium 2002.

In January 2001, the Region assumed responsibility for local transit services from the area municipalities. Transit demand as identified in the Transportation Master Plan is expected to increase significantly over the next 10 years and beyond. Costs relating to the maintenance and replacement of existing transit fleet are expected to average over \$8.4 million per year. Costs relating to expanded services are forecasted to average \$12.6 million per year (excluding Rapid Transit needs). Up to 80% (non-D.C. portion) or \$10.1 million per year of these costs could be funded from this reserve.

Since a long-term replacement strategy is yet to be determined a large percentage of the cost for new and replacement buses are currently forecasted to be debentured. It is anticipated that a reserve strategy could be adopted which would see a phase in of tax levy contributions that could be used to fund rehabilitation/replacement of vehicles and fleet expansion.

The Transit program has a very broad mandate; hence, there is a need to better determine the future use of this reserve. The Transit Reserve Fund is to be the subject of a staff study in 2005 to determine its adequacy and potential sources of funding. Based on initial analysis the Transit Reserve Fund's preliminary target has been estimated at \$20 million.

Social Assistance Reserve Fund

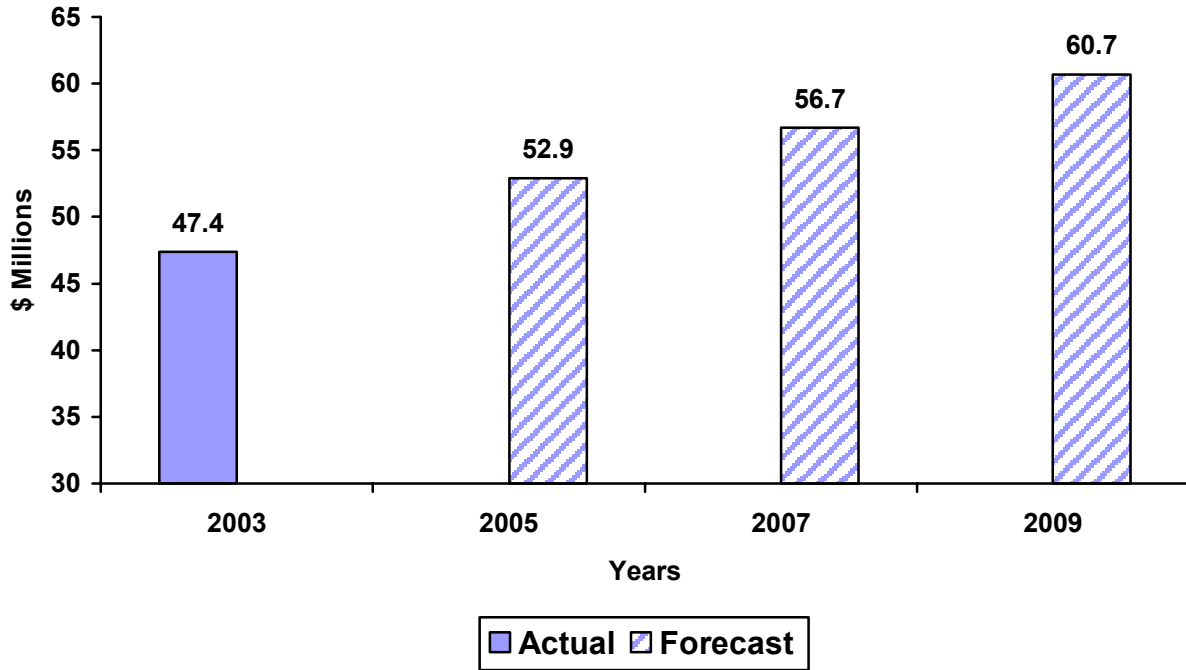
Projected End of 2005: \$52.9 million

Target: \$73.0 million

The Social Assistance Reserve Fund was established in December 1998 to fund unanticipated costs incurred following the adoption of the Regional Budget. These intra-year cost overruns could result from increases in either the Region's social assistance caseloads or higher GTA pooling costs. Social assistance costs are of a non-discretionary nature and represent a major component of the Region's operating budget (the 2004 Regional Budget for Social Assistance was \$73.3 million or 14.2% of the total regional net operating expenditures).

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Graph 6 - Social Assistance Reserve



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Funding for the Social Assistance Reserve Fund has been provided from a number of sources including an allocation equal to 80% of the Local Service Realignment (LSR) surplus, allocation from surplus revenues and tax levy contributions. The original target of \$45.9 million was considered to represent the average in-year increase in costs of caseloads experienced during the last significant recession which occurred between 1991 and 1993. This amount was deemed sufficient to provide funding to cope with the average caseload increases for approximately nine months.

Prior to the recession of the early 1990's, social assistance caseloads as a percentage of population averaged 0.5%. During the recession, caseload ratios more than tripled to represent 1.7% and remained near that level for almost four years. Furthermore, caseloads were observed to remain substantially high (above 1% population) for over six years. The actual number of caseloads in fact increased more than five fold between 1989 and 1993 when caseloads finally peaked.

For 2004 the Region's caseloads are approximately 4,100 per month or 0.5% of population, similar to levels experienced prior to the last recession. This is in part due to the stable economic environment of the last several years but also due to the more stringent eligibility requirements set by the Harris government at the end of 1995. Should another recession similar to the early 1990's reoccur, social assistance caseloads and their associated costs could be expected to at least double and remain at higher than normal levels for a period of two or three years.

Net Regional expenditures for Social Assistance programs in 2004 were budgeted at \$34 million. Additionally, Social Assistance GTA pooling estimates for 2004 were approximately \$40.0 million. During a prolonged recession these combined costs could increase to approximately \$150 million or more and remain there for up to three years or longer.

The current reserve target was established using a lower population base and calculated to cover up to nine months of cost overruns. The potential demands on this reserve have therefore changed over time due to both inflation and population growth. Consideration should be given to adopt a higher reserve target equal to a least one year's potential increase in social assistance costs up from the current target of nine months. This would require increasing the existing target of \$45.9 million by \$27.1 million to bring the new target to \$73 million.

Funding for this increase should continue to be provided from 80% of the unspent tax levy budgeted for social assistance program entitlements and GTA pooling costs and whenever possible appropriations from the Region's budget.

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Social Housing Reserve Fund

Projected End of 2005: \$45.7 million

Target: T.B.D.

The original target of \$25 million for the Social Housing Reserve Fund was set in April 2000 and was based on expenses experienced in other jurisdictions for similar housing stock. GTA pooling costs, which were based on 1997 service levels, increase year to year due to changes in inflation, mortgage rates and assessment levels. However, the impact from these variables is not expected to result in significant demands on the reserve fund.

In 2002, Council adopted a Housing Supply Strategy which outlined the Region's direction for the production of affordable home ownership, rental and non-profit housing. Current objectives are to provide up to 200 units of affordable housing per year over the next 10 years.

Capital costs for social housing requirements are projected to total \$168 million over that time period. These capital costs are not subject to funding by way of the Development Charge Reserve as currently there is no D.C. levy in place to fund Social Housing (including non-profit housing) requirements. Additionally, the possibility of increasing the level of funding contribution from the Provincial government to match the current Federal program is uncertain. Therefore, if Council authorizes funding to undertake the completion of the Housing Supply Strategy based on the current Provincial and Federal funding commitments, the Region would be required to contribute over \$70 million towards the program.

Additionally, social housing provider reserves for capital repair and replacement are significantly underfunded by approximately \$50 to \$60 million.

The Social Housing Reserve Fund was established in 1998 to fund future capital expenditures associated with social housing units within York Region. The target for this reserve was based on expenses experienced in other jurisdictions for similar housing stock. Funding for the Social Housing Reserve fund has been provided from 80% of the L.S.R. surplus funds as well as from funds directed from unbudgeted supplementary tax revenues.

Capital Asset Repair and Rehabilitation Reserve Fund

Projected End of 2005: \$ 6.4 million

Target: \$10.0 million

The Capital Asset Repair and Rehabilitation Reserve Fund (previously the Major Building and Rehabilitation Reserve Fund) was established in October 2000 to smooth the cost of capital outlays associated with the Region's buildings, such as roof replacements, equipment repair for heating, air conditioning and elevator systems, carpet replacement, etc. In 2002 it became apparent that the reserves

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should also be used to fund expenditures for purposes other than just for buildings including parking facilities, major equipment or infrastructure refurbishment.

The target for this reserve is currently \$10 million, representing 5% of the estimated replacement cost of the buildings covered, in accordance with industry standards. The estimated value of the 32 buildings and related infrastructure served by this reserve fund is approximately \$200 million, which includes leased properties such as the South Service Centre whose repairs and rehabilitation are the Region's responsibility. This target will be reviewed again in 2005 based on its new mandate and will incorporate the findings from a capital asset maintenance and replacement study.

Funding of \$3.3 million annually will continue to be provided through appropriations from the Region's budget.

General Capital Reserve

Projected End of 2005: \$61.9 million

Target: No Specified Target

The General Capital Reserve was established in 1995 to provide funding for new non-recurring capital expenditures such as new Police Headquarters, EMS vehicles, and technology equipment. In the past the General Capital reserve has received funding from contributions derived from unallocated year-end surpluses. Uses of this fund include: strategic technology initiatives, the acquisition of transit buses from area municipalities and upgrades to police and fire mobile radio systems and infrastructure. This reserve continues to meet its objectives and provides Council with long-term flexibility for major new capital initiatives. Because of the discretionary nature of this reserve, no target has been established.

Development Charge Reserves

Projected End of 2005: \$412.2 million

Target: No Specified Target

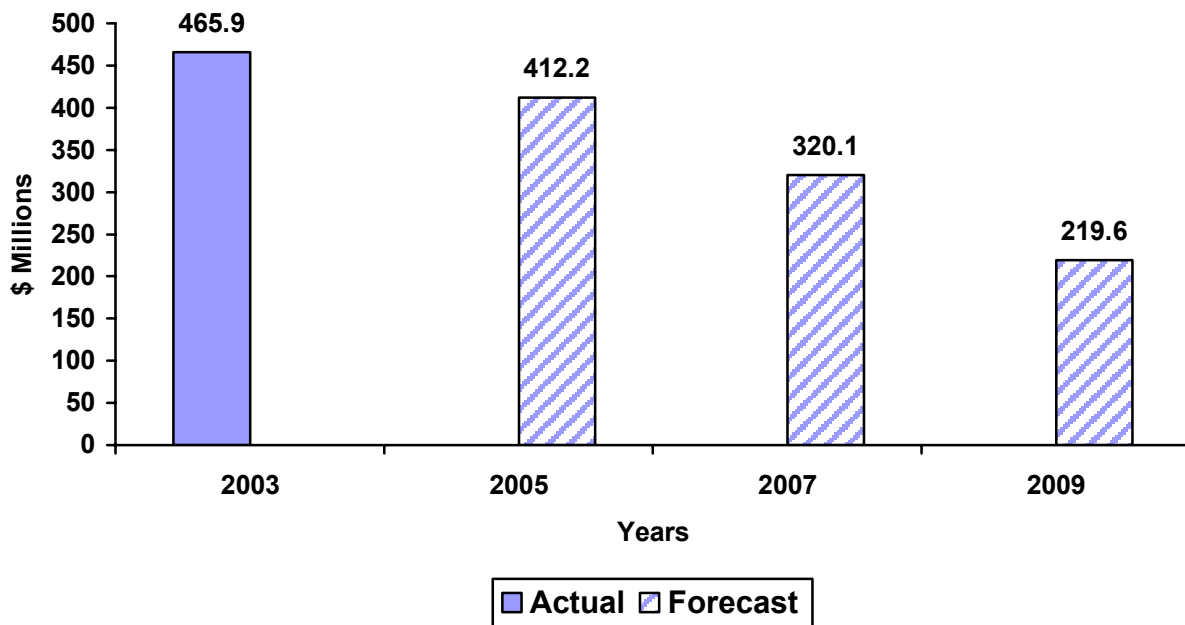
The Development Charge Reserve funds growth-related capital projects. Development Charges continue to represent about 50% of the Region's total reserves. Given the strong growth experienced by the Region over the past few years, this reserve has grown rapidly. However, Development Charges will finance the bulk of the Region's growth-related infrastructure the demands for which are becoming increasingly more significant.

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In May 2003 Council approved the new Development Charge Bylaw which incorporated adjustments to existing development charge rates and introduced new development charges for Regional transit. These revised and new rates came into effect on June 22, 2003. Transit development charges are being phased in over four years in order to tie these fees to the level of completion of the proposed transit capital plan. The new fee structure for all development charges will continue to be in effect for the next three years. However, due to increased Provincial requirements causing significant cost increases in water and sewer capital projects, and accelerated capital programs, there is a need to amend the current Development Charge By-law to recover these increased costs.

Graph 7 shows that if the current Development Charge By-law is not adjusted to reflect increased capital costs and accelerated capital programs, development charge reserves will decline significantly over the next several years.

Graph 7 - Development Charge Reserves



An amendment to the Development Charge By-law to prevent this decline is anticipated to be completed in the spring of 2005.

Tax Stabilization Reserve Fund

Projected End of 2005: \$20.0 million

Target: \$20.0 million

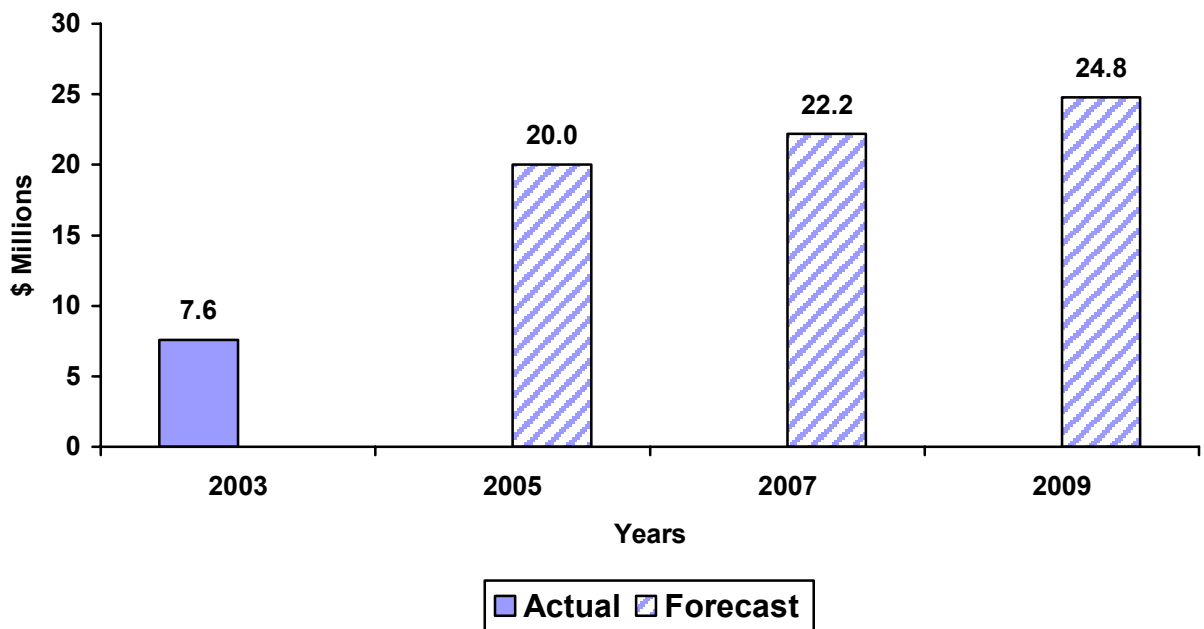
As part of the 2002 review of reserves and reserve funds, staff undertook a survey of various large cities and regional municipalities to compare the size and type of

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reserves that municipalities operated as compared to those held by the Region. It was revealed that most of the major municipalities had a specific reserve for tax stabilization purposes. The uses for the reserve varied but generally included funding temporary tax revenue shortfalls or dramatic one time increases in expenditures for such needs as winter maintenance, emergency services as well as other contingencies, such as costs associated with involvement in a major OMB hearing.

Based on the GFOA guidelines for a larger government entity it was determined that an appropriate target for York Region would be 5% of general fund operating revenues. The rationale for a lower end target was supported by the fact that York has access to a Working Capital Reserve (currently at \$35 million) that could also be used in the case of significant unanticipated shortfall. Furthermore, net operating expenditure used for the target should exclude water and wastewater (rate supported) programs as well as social assistance costs (which are specifically covered by the Social Assistance Reserve). Therefore, based on 2004 data, the recommended target should be ($\$400.0 \text{ million} \times 5\%$) \$20.0 million.

Graph 8 - Tax Stabilization Reserve



The Tax Stabilization Reserve Fund will continue to be financed by directing a contribution up to 50% of any unallocated year end surplus, in order to achieve and maintain the target. Based on prior year surpluses, this reserve would achieve its target by the end of 2005 (see Graph 8). As general fund operating revenues will

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continue to rise due to growth and inflation the target for this reserve will need to be reset on an annual basis.

Conclusion

The maintaining of reserves at levels adequate to help fund planned infrastructure expenditures, or provide for unknown contingencies, or meet certain future financial obligations is an essential component of the Region's financial management program. Historically, regular contributions to reserves have been an important factor helping to establish the healthy financial profile the Region now enjoys. Therefore the adequacy of existing and the need for new reserves must be constantly monitored in order that the Region can continue to meet the needs of its constituency.

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Region of York Reserves (millions of \$)

Reserve Name	Purpose	Source of Funding	Year Established	Estimated End of 2004 Balance	Estimated End of 2005 Balance
Capital Reserves					
Development Charges	Growth infrastructure	Fixed charge	1991	\$422.3	\$412.2
Wastewater	Wastewater repairs/rehab.	Rate surcharge	1991	41.5	3.6
Water	Water repairs/rehab.	Rate surcharge	1991	51.4	30.0
Solid Waste Mgmt.	Waste Mgmt.	T.B.D.	1993	25.5	12.7
General Capital	Non-recurring capital	Suppl. Rev. (SR)	1995	68.8	61.9
Social Housing	S.H. Dev/Building repairs	80% LSR surpl./SR	1998	47.8	45.7
Transit	York/GO Transit	T.B.D.	1999	7.0	5.6
YRT Mobility Vehicle	Mobil. Plus vehicles repl.	Lease revenue	2002	0.2	0.3
Roads Capital	Capital carry over	Carry over	1998	4.6	0.0
Provincial Highways	Provincial roads capital	Province	1996	2.2	2.3
Land Securement	York Greening	Annual Budget	2001	3.6	4.7
Vehicle Replacement	Fleet capital	Usage charge	1997	2.7	3.4
IT Equip. Replacement	IT capital	Annual Budget	1993	0.2	0.0
Capital Assets R & R	Reg'l bldg. repairs/rehab.	Annual Budget	2000	7.2	6.4
Alt. Comm. Living	Building repairs	Province	1997	0.1	0.1
Children's Centres	Building repairs	Lease payments	1996	0.3	0.3
Non-Profit Housing	Building repairs	T.B.D.	2002	0.0	0.0
Innovation	System upgrades	Reimbursement	2002	0.8	1.5
Sub Total				686.2	590.9
Corporate Reserves					
Working Capital	Short-term funding	Suppl. Rev.	1991	35.8	35.8
Insurance	Insurance deduct./claims	Annual Budget	1994	3.1	3.2
Ins. Claims System	Enhance Ins. System	Licensing Fees	2003	0.0	0.0
Property Tax Write-offs	Property tax write-offs	Suppl. Rev.	2000	3.0	3.0
Tax Stabilization	Tax Stabilization	Suppl. Rev.	2002	14.4	20.0
Sub Total				56.3	62.0
Social Serv. Reserves					
Social Assistance	Unanticipated S.A.costs	80%LSRsurplus/SR	1998	51.4	52.9
Child Benefit	Child poverty issues	NCB cost savings	1998	0.7	0.4
Sub Total				52.1	53.3
Human Res. Reserves					
Group Benefits	Benefit claims	Payroll Surcharge	1991	0.0	0.0
Sick Leave – Region*	Vested sick leave benefits	Budget and OMERS Surplus	1982	4.6	4.7
Sick Leave – Police*	Vested sick leave benefits	OMERS Surplus	1999	10.3	10.6
WSIB	Workers comp. benefits	Annual Budget	1996	7.4	7.6
Vacation Pay	Vacation liability	Annual Budget	1991	0.7	0.7
OMERS	Police Pension surplus	Payroll Surcharge	1995	0.1	0.1
Long Term Disability	LTD liability	Annual Budget	2002	4.5	4.7
Sub Total				27.6	28.4
Police Serv. Reserves					
GTA Crime Abatement	GTA crime abatement unit	Provincial Grant	1998	0.1	0.05
Seized Money	YRP seized money	Seized or uncl. \$	1999	0.1	0.06
Sub Total				0.2	0.1
TOTAL				\$822.4	\$734.7

* From 1999 to 2003 funding provided from OMERS surplus.