



## **REPORT FIN-2013-006**

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TO: Mayor and Members of Council

FROM: Mary Hasan, Director of Finance/Treasurer

SUBJECT: Financial Policies regarding the Establishment and Contribution to Working Reserves and Reserve Funds

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### **RECOMMENDATIONS**

That Report FIN-2013-006 - Financial Policies regarding the Establishment and Contribution to Working Reserves and Reserve Funds be received;

That Council establish and define Working Reserves and Reserve Funds in accordance with Report FIN-2013-006; and

That Council adopt a policy to allocate any budget surplus to the Township's Working Reserves for the purpose of meeting future liabilities in accordance with Report FIN-2013-006.

### **ORIGIN/BACKGROUND**

Under the Municipal Act, Council has the authority to establish Working Reserves and Reserve Funds by Township policies and/or through Provincial legislation. Working Reserves and Reserve Funds can be formed to meet various liabilities such as the replacement and/or acquisition of capital assets or the stabilization of the tax levy. In addition, the Development Charges Act, the Planning Act, the Building Code Act, and other legislation require that municipal governments maintain specific Reserve Funds.

Both Working Reserves and Reserve Funds are considered during the annual operating and capital budget process and for the purpose of long-term financial planning.

Working Reserves are an appropriation from net revenue at the discretion of Council, after the provision for all known expenditures. Working Reserves have no reference to any specific asset and do not require the physical segregation of money or assets. Working Reserves are part of the general revenue fund, and therefore, do not earn interest on their own, as is the case of reserve funds.

A Reserve Fund differs from a reserve in that the reserve fund assets are segregated and restricted to meet the purpose of the reserve fund. All earnings derived from such

investments must form part of the reserve fund. There are two types of reserve funds: obligatory reserve funds and discretionary reserve funds.

## **DISCUSSION: ALLOCATION OF SURPLUS**

### **Surplus to Offset Taxes**

Typically, surpluses are distributed among established Working Reserves. The practise in the Township in the past has been to use the previous year's surplus to offset taxes in the following year.

Using surplus as a funding source for the next year's operating budget is not considered a best practise as it is not sustainable.

For example, if the Township's 2014 operating budget is increasing by \$100,000 because we are introducing an annually recurring new program at the Township and this new cost is funded with the previous year's surplus, what happens in 2015 if there is no 2014 surplus? Does the Township increase taxes in 2015 to fund this program? Do we discontinue this new program?

Typically, the practise in other municipalities is to utilize the previous year's surplus to (one-time) increase next year's tax-funded capital program. The money is allocated to a one-time capital expenditure and not on-going operations. For example, this was done at the Township in 2013 for the washroom addition at the Puslinch Community Centre where \$115,000 of the capital cost was funded with the 2012 surplus.

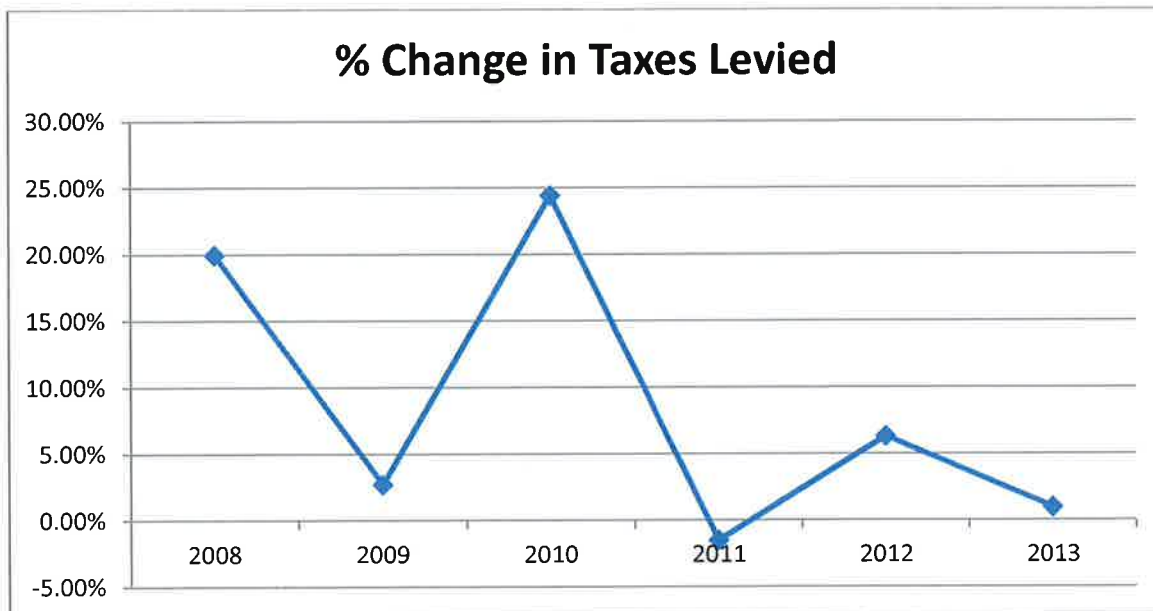
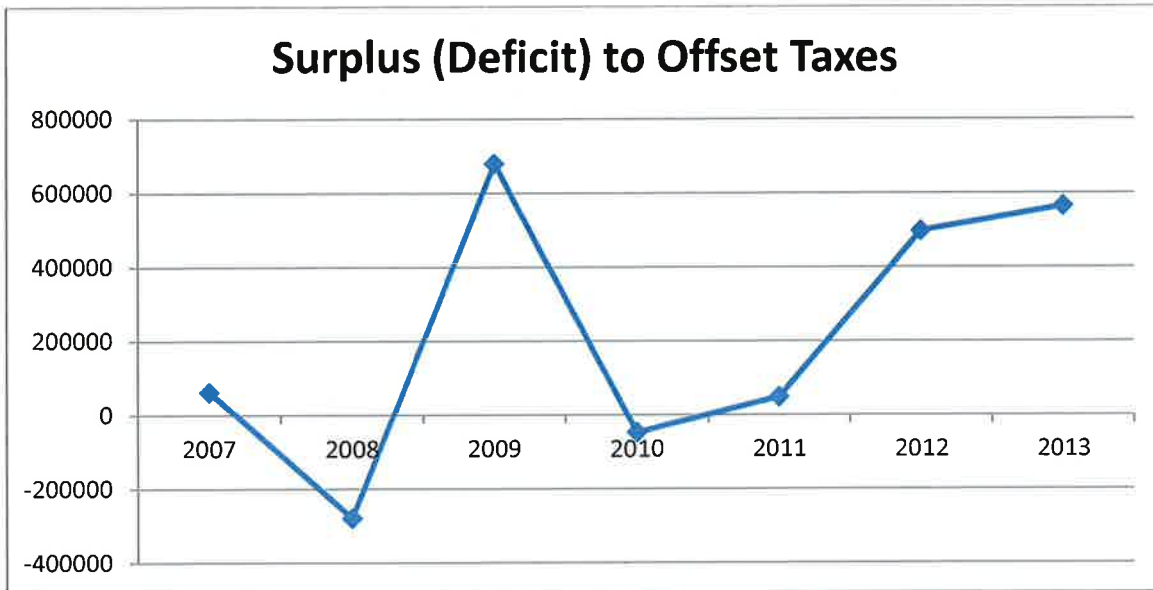
In 2013, the Township offset the tax rate by \$567,230. This resulted in an increase in the Township's levied taxes of only 1% from the previous year. If the Township was not in a surplus position in 2012, the result would have been a tax increase of 18.64% in 2013. Please see below for a table of these figures for the past 7 years:

	FORMULA	2007	2008	2009	2010	2011	2012	2013
MUNICIPAL TAXATION	A	\$1,875,436	\$2,250,212	\$2,311,461	\$2,876,127	\$2,833,316	\$3,012,763	\$3,042,500
CAPITAL-AUDITED FINANCIALS *		N/A	\$2,850,353	\$2,159,940	\$3,149,903	\$550,164	\$1,246,085	\$1,772,600
1% OF MUNICIPAL TAXATION	B = A * 1%	\$18,754	\$22,502	\$23,115	\$28,761	\$28,333	\$30,128	\$30,425
SURPLUS/(DEFICIT) TO OFFSET TAXES	C	\$65,342	\$(277,068)	\$681,783	\$(45,614)	\$50,594	\$500,000	\$567,230
% TAX CHANGE IF NO SURPLUS/(DEFICIT)	C/B	3.48%	(12.31%)	29.50%	(1.59%)	1.79%	16.60%	18.64%
% CHANGE IN TAXES LEVIED FROM PREVIOUS YEAR			19.98%	2.72%	24.43%	(1.49%)	6.33%	0.99%

**\*In 2008, 2009 and 2010 a significant portion of the Capital expenditures relate to the Carroll Pond Drainage project and the Multi Use Recreational Facility project.**

**\*Please note that the Capital from the Audited Financial Statements for the years 2007 to 2012 does not include the contribution to reserves amount. Please note that the 2013 Capital figure is the amount per the 2013 Approved Capital Budget.**

The above table shows that when there was a deficit, the taxes levied increased significantly. For example, in 2008 the taxes levied increased by 19.98% from 2007. This was due to the large deficit of \$277,068 in 2007. In 2010, the taxes levied increased by 24.43% because there was a deficit of \$45,614 in 2009. The effect in 2010 was much more significant because the 2009 surplus to offset taxes was a very high amount of \$681,783. Please see the graphs below which depict this in a graphical form.



As you can see from the graphs and table above, offsetting taxes can result in a very volatile tax base year over year.

For the reasons above, offsetting levied taxes with the previous year's surplus/(deficit) is not a practise that Township staff recommend be continued.

### **Surplus Allocation by Department**

Below is a table of the capital expenditures by department:

- The 2012 figures are the actual capital expenditures incurred in 2012

- The 2013 figures are the budgeted capital expenditures per the approved 2013 Capital Budget
- The 2014-2018 capital expenditures are the proposed expenditures which will be discussed at the upcoming Capital Budget meeting scheduled for December 11, 2013.

	2012 (ACTUAL)	2013 (BUDGET)	2014 PROPOSED	2015 PROPOSED	2016 PROPOSED	2017 PROPOSED	2018 PROPOSED	TOTAL	% OF TOTAL CAPITAL EXPENSES
ADMIN	12,211	63,000	61,400	380,000	0	0	20,000	616,611	6%
ROADS	821,983	1,109,000	1,151,300	928,000	1,103,400	956,700	1,005,700	7,076,083	61%
PARKLAND	0	60,000	28,100	0	55,000	225,000	575,000	943,100	8%
ORC	0	0	25,000	80,000	8,000	0	0	113,000	1%
RECREATION	111,017	305,000	120,000	0	0	0	165,000	701,017	6%
FIRE	206,918	87,000	51,196	1,012,100	715,000	15,000	0	2,087,214	18%
TOTAL								11,537,025	

**Note: The 2014 to 2018 figures are preliminary figures and are subject to change.**

**Note: The building department has not been included in the above analysis because under the Building Code Act, 1992, the total amount of fees must not exceed the anticipated reasonable costs of the principal authority to administer and enforce the Building Code Act in its area of jurisdiction. Therefore, all of the Building department's surplus will be allocated to the Building Reserve Fund.**

The purpose of the above table is to provide the proportion of capital expenditures by department in order to determine an appropriate allocation percentage of the surplus. We recommend some changes to the allocations calculated above for the reasons below:

- The Administration department has Corporate Working Reserves which are applicable to the organization as a whole. These Corporate Working Reserves include Corporate Accessibility, Corporate Information Technology Hardware, Corporate Information Technology Software, Administration Office Repairs and Restoration (see pages 6 and 7 of this report for definitions of these Working Reserves). These Corporate Working Reserves were not present in previous years. In order to properly distribute to these Working Reserves, a 6% allocation of the surplus (as calculated above in the Administration line item) is not sufficient to meet the Township's Corporate requirements.
- The Roads department has access to additional funding such as the Gas Tax Fund (discussed on page 11) and the Aggregate Levy (discussed on page 13).

Therefore, the revised allocation table below takes these factors into account resulting in a larger allocation percentage for the Administration department of 12% and a smaller allocation percentage for the Roads department of 55%.

DEPARTMENT	% SURPLUS ALLOCATION RECOMMENDED
ADMIN	12%
BUILDING	100% OF BUILDING'S SURPLUS
ROADS	55%
PARKLAND	5%
ORC	5%
RECREATION	5%
FIRE	18%

## **DISCUSSION: ESTABLISHING & DEFINING WORKING RESERVES AND RESERVE FUNDS**

**Please note that the Working Reserves and Reserve Funds balances will be provided at the next Capital Budget meeting on December 3, 2013.**

Working Reserves and Reserve Funds should be defined to indicate what the funds can be drawn upon for.

### **Working Reserves**

In most municipal settings, accounts have to be paid before property taxes, grants and other revenues become available, including revenues still to be collected for the previous year. A municipality can obtain a short-term loan to meet this need, but borrowing incurs interest charges. In order to reduce, and, if possible avoid short-term borrowing, a Working Reserve is one financial management technique that can be helpful and provides a cash management device to enhance cash flow. It also eliminates the need to levy for the full cost of various capital projects in one particular budget year.

See below for establishing and defining the Township's Working Reserves.

### **Administration:**

#### Administration Office Repairs and Restoration:

Definition: Funds set aside each year for future building repairs or to help offset major renovations in the Administration, Fire Hall, and Roads offices of the Township.

Surplus Allocation: 12.5%

Corporate Accessibility:

Definition: In 2005, the Government of Ontario enacted the Accessibility for Ontarians with Disabilities Act (AODA, 2005). Under the AODA, 2005 both upper and lower tier municipalities are required to comply.

Examples: Facilities, websites, communications, etc. must be accessible in accordance with the standards of the AODA.

Surplus Allocation: 2.5%

Also note that there is \$10,000 of annual funding available from the County of Wellington for Accessibility projects.

Corporate Information Technology Software:

Definition: To provide funding for Information Technology Software to implement the Township's Information Technology Architecture Plan.

Examples: Website functionality, Keystone Software Financial Report Integration, GIS Integration, Access Database-Building, Records Tracking Software, Datafix (Voters' List), etc.

Surplus Allocation: 2.5%

Corporate Information Technology Hardware:

Definition: To provide funding for Information Technology Hardware to establish a consistent cycle for computer hardware replacement.

Examples: Laptops have a typical lifecycle of 4 years and require a significant outlay of financial resources as they are replaced. It is recommended that the Township's computers be replaced at once for the purpose of coordinating training related to the upgraded software and for ease of providing support. Other examples include servers, monitors, etc.

Surplus Allocation: 2.5%

## **Roads:**

### Replacement and Restoration of Aging Infrastructure:

Definition: The purpose of this Working Reserve is to fund the current infrastructure deficit at the Township. This reserve is established from surpluses for the replacement of aging infrastructure to offset the effects of annual amortization.

Examples: The Asset Management Plan due for completion by December 31, 2013 indicates which infrastructure requires remedial action.

Surplus Allocation: 40%

### Roads Equipment Replacement:

Definition: This Working Reserve is established to provide future budget contributions for capital equipment replacement in the Roads department.

Examples: Plow trucks (8 year lifecycle), pick-up trucks (5 year lifecycle), backhoe & ton & half truck (10 year lifecycle), and graders (20 to 25 year lifecycle), etc.

Surplus Allocation: 10%

## **Parkland:**

### Parkland Infrastructure Enhancement Working Reserve:

Definition: The purpose of this Working Reserve is to fund enhancements to current Parkland infrastructure and to fund new Parkland development at the Township. This reserve is established from surpluses for the replacement and enhancement of Parkland assets.

Examples: Splash pad, Puslinch Community Centre Parkland Development, and Floodlighting in Aberfoyle. These are all reserves which were aimed to be set up in 2014 per the 2013 Capital Budget. Other examples will be included in the Asset Management Plan due for completion by December 31, 2013.

Surplus Allocation: 5%

## **Optimist Recreation Centre:**

### Optimist Recreation Centre Equipment Replacement:

Definition: Future budget contributions for capital equipment replacement in the Optimist Recreation Centre.



Examples: Ice resurfer, floor scrubber, half tonne pick-up, etc. Other examples will be included in the Asset Management Plan due for completion by December 31, 2013.

Surplus Allocation: 2.5%

Optimist Recreation Centre Facility Improvement:

Definition: Funds set aside each year for future building repairs or to help offset major renovations at the Optimist Recreation Centre.

Surplus Allocation: 2.5%

**Recreation:**

Recreation Equipment Replacement:

Definition: Future budget contributions for capital equipment replacement in the Puslinch Community Centre.

Examples: Stove, fridge, etc.

Surplus Allocation: 2.5%

Recreation Facility Improvement:

Definition: Funds set aside each year for future building repairs or to help offset major renovations in the Community Centre.

Examples: Upgrading the entire kitchen, etc.

Surplus Allocation: 2.5%

**Fire:**

Vehicle Replacement:

Definition: Future budget contributions for vehicle replacements

Examples: Aerial truck, pick-up truck, etc.

Surplus Allocation: 12.5%

Equipment Replacement:

Definition: Future budget contributions for equipment replacement.

Examples: Defibrillators, radio communication interfacing, etc.

Surplus Allocation: 2.5%

## **Reserve Funds:**

Reserve Funds differ from Working Reserves in that Reserve Funds are segregated from general revenues and restricted in use to meet the purpose of the Reserve Fund. There are two types of Reserve Funds: Obligatory Reserve Funds and Discretionary Reserve Funds.

### **Obligatory Reserve Funds**

An obligatory reserve fund, as per statute or legislation requirements, is comprised of funds received for special purposes and are segregated from the general revenues of the Township. Obligatory reserve funds are created solely for the purpose prescribed for them.

Examples of Obligatory Reserve Funds include:

- Monies received in lieu of land for park purposes as set out under Subsection 42 (14) and (15) of the Planning Act;
- Monies received in lieu of land for park purposes under a subdivision agreement as set out under Subsection 51.1 (5) of the Planning Act;
- Monies received as development charges as set out under Subsection 16 (1) of the Development Charges Act;
- Monies received as part of the Federal Gas Tax Funding Program; and
- Monies received in building permit fees.

### Cash in Lieu of Parkland:

Directly from the Planning Act, 1990, all money received by the municipality and all money received on the sale of land less any amount spent by the municipality out of its general funds in respect of the land, shall be paid into a special account and spent only for the acquisition of land to be used for park or other public recreational purposes, including the erection, improvement or repair of buildings and the acquisition of machinery for park or other public recreational purposes.

Examples: The Drainage Project at the ORC was budgeted for \$60K in the 2013 approved Capital Budget. The project came in much higher at \$111,658 inclusive of HST. In the August 14, 2013 Sixteenth Regular Council Meeting Report FIN-2013-002 regarding the Optimist Recreation Centre Drainage Project was received and it was recommended in that report that the additional funds in the amount of \$51,658.50 be derived from the surplus from the Gore Road Project. However, the funds in the Parkland in Lieu Reserve Fund could have been utilized to fund the additional capital outlay associated with the Drainage project. However, at this time staff are reconciling and confirming the amounts in the respective Reserve Funds and Working Reserves and will provide this information at the December 3, 2013 Capital Budget meeting.

### Development Charges - Corporate Studies, Roads, Parkland Indoor, Parkland Outdoor, and Fire:

These Reserve Funds are comprised of development charges received at building permit stage through registered plans of subdivision and through individual land severances. These reserve funds are restricted by the Province's development charge legislation and the Development Charges Act that dictates these funds are to be used for growth related projects.

### Federal Gas Tax Rebate:

This Reserve Fund was established in December 2005 as per the agreement between the Township and The Association of Municipalities of Ontario for transfer of Federal Gas Tax Revenues to be used for future capital work. In 2009, municipalities received an amending agreement extension to receive funding for the period 2010 to 2013. A list of eligible project categories from the program includes:

- Local Roads and Bridges that contribute to sustainable outcomes;
- Public Transit (including active transportation such as sidewalks and bicycle lanes);
- Capacity Building;
- Community Energy Systems;
- Water/Wastewater; and
- Solid Waste

The new categories eligible in the 2014 funding agreement which will be provided in early January/February include: Culture, Tourism, Sport & Recreation, Airports, Brownfield Redevelopment, and Disaster Mitigation.

**Note: We received \$205,185.08 in 2013 and assumed a 0.3% decline. The Ministry announced that the Gas Tax Fund would be indexed at 2% per year in \$100M increments. The indexing formula increases the national allocation by 2% per year, but has a 'rounding' provision which increases the actual payment only when the calculation passes the next \$100 million threshold. The benefits of indexing do not reach municipal governments until 2016. Ontario's allocation has declined by approximately \$1.8M (0.2%) from 2013 to 2014 because Ontario did not grow as fast as other provinces from 2006 to 2011 Census. There will also be some re-distribution within Ontario because of population changes in each municipality. Ontario's population has grown by approximately 5.6% between the 2006 to 2011 Census. Puslinch's population has grown less than this amount at 5.08% (Population in 2006 – 6,689 and population in 2011 – 7,029). Since Puslinch's municipality has grown less than Ontario, our allocation will also decrease.**

### Building Surplus Reserve Fund:

The purpose of the reserve is to allow a municipality to establish reserves which may only be used to help stabilize slow years in terms of building activity and permit revenue. Under the Building Code Act, 1992, the total amount of fees must not exceed the anticipated reasonable costs of the principal authority to administer and enforce the Building Code Act in its area of jurisdiction. Therefore, all of the Building department's surplus will be allocated to this Reserve Fund.

### **Discretionary Reserve Funds**

A discretionary reserve fund is not segregated from the general revenues of the Township, based on Council direction, to finance a specific future expenditure or to provide for a specific contingent liability so that the funds are available as required.

### Winter Maintenance Reserve Fund:

This Reserve Fund was to be set up per Council's resolution dated January 26, 2012 to provide winter maintenance funding as needed to offset unusual/severe winter maintenance costs.

Surplus Allocation: Operating surplus funds from account number 01-0030-4214-Sand/Salt will be captured annually and capped at one year's winter maintenance budget. If the winter maintenance expenditures exceed the amount budgeted, the deficit will be drawn from the Winter Maintenance Reserve Fund.

**Note: The surplus of funds of \$57,409.09 for winter maintenance costs (account number 01-0030-4214) in 2012 had not been transferred to a Winter Maintenance Reserve Fund. We recommend that the 2012 surplus not be transferred in 2013 as this would have to be obtained through the tax levy. Going forward, these transfers will be completed at year-end based on the surplus in account number 01-0030-4214 – Sand/Salt.**

### Fire Wage Reserve

This wage reserve fund was to be set up per the Eighth Regular 2012 Council Meeting whereby surplus funds are captured annually and capped at no more than \$100,000.00. If wages exceed the budget, the deficit will be drawn from the wage reserve.

**Note: This Reserve Fund was not created in the previous year. Staff recommend that this Reserve Fund not be initiated due to the importance of reviewing the surplus as a corporate wide initiative if deemed appropriate. We recommend that the methods discussed on page 9 of this report be used for allocating the Township's surplus to the Fire department's reserves.**

## Fire Capital Reserve Account

Fire & Rescue Other Income from Accident Insurance Claims were to be allocated to the Capital Reserve account along with the Ministry of Transportation's revenue and development charges to be used for capital equipment and apparatus replacement. This was a resolution carried by Council at the Eighth Regular 2012 Meeting.

**Note: Township Staff propose that other income from accident insurance claims and the Ministry of Transportation's revenue be allocated to the appropriate operating revenue accounts. The Capital Reserve account has development charges within it which should be appropriately segregated from operating revenues and other Fire reserves. We recommend that at year-end, when the Township's surplus is finalized and audited, a portion of the surplus will be allocated to capital equipment and apparatus replacement for the Fire Department as discussed on page 9 of this report. It is important to segregate operating items from capital items and to review the Township's surplus as a corporate wide initiative rather than departmentally.**

## Aggregate Levy

There is no legislation in the Act at this time that restricts how the Aggregate Levy should be used. We recommend that the Aggregate Levy be used to fund Roads projects because the Aggregate Industry has a direct effect on the Township's Roads infrastructure. Based on our review of previous year budgets, the practise has been to include this funding as a revenue item with no expenditure associated with it. It has been used to fund the operations of the Township and has been allocated to the General Bank Account.

## **Financial Implications**

The financial implications of this policy will be known when the 2013 surplus/deficit is finalized after RLB's completion of the audit in mid-February. There are financial implications discussed throughout this report for utilizing a surplus to offset levied taxes.

## **Applicable Legislation and Requirements**

Refer to the body of the report for the applicable legislation for the various Reserve Funds discussed.

## **Attachments**

Schedule A - Financial Policies regarding the Establishment and Contribution to Working Reserves and Reserve Funds – PowerPoint Presentation for Council