

Subject: **Preliminary Reserve Strategy**

Meeting Date: Tuesday, October 24, 2023

Prepared By: Kinza Barney, Corporate Services Director

Presented By: Kinza Barney, Corporate Services Director
Marika von Mirbach, Financial Planning Coordinator

RECOMMENDED MOTION:

That Council accept the report on a 'Preliminary Reserve Strategy' for information, as presented.

STRATEGIC PLAN ALIGNMENT: (Check all that apply)

	<input type="checkbox"/>		<input checked="" type="checkbox"/>		<input type="checkbox"/>		<input checked="" type="checkbox"/>		<input checked="" type="checkbox"/>
High Quality Infrastructure		Economic Resilience		Quality of Life		Effective Leadership		Level of Service	

RELEVANT LEGISLATION:

Provincial (cite)- *Section 283.1 of the MGA* requires municipalities to develop at minimum a three-year operating plan and five-year capital plan annually. This encourages municipalities to make day-to-day and annual budgeting and service delivery decisions with guidance from a long-term plan. The use of reserves can support municipalities in developing realistic and achievable capital plans and can ensure they have contingency funding in the ability of unforeseen economic instability that may impact taxation revenues.

Council Bylaw/Policy (cite) – *Reserves Policy (16-1)* establishes guidelines and procedures for County reserves.

BACKGROUND/PROPOSAL:

Reserve funds are vital to a municipality's financial health and enable municipalities to plan for future operating and capital needs, avoid interest expenses associated with debt, generate investment income and strategically manage cash flow throughout the fiscal year. Healthy reserves are a result of effective policy surrounding the management of such, as well as effective long term-planning that can accurately inform appropriate reserve levels.

The County's reserves represent a source of funding that is restricted for specific future expenditures, to provide stability to tax rates, and to fund unanticipated emergent financial needs. The County currently has 17 reserve funds that have a combined value of \$59,876,390, as of December 31, 2022.

The County uses guiding documents, such as bylaws, policies, and external agreements, to support the management of reserve funds. At present, annual reserve contributions are determined based on asset acquisition costs and historical trends.

To fund an expense from a reserve fund, operational areas must have an approved budget to use the reserve fund and the expense must be an allowable use of the reserve fund. Finance is responsible for reviewing the overall expenses, confirming alignment between the expenditure and permitted reserve uses, and transferring funds from a reserve to offset the expense.



The updates proposed are intended to:

- Reposition reserves to draw greater alignment between Capital Reserves and Tangible Capital Asset (TCA) categories.
- Clearly identify intended uses for each reserve fund.
- Identify the funding source(s) and relevant documents for each reserve.
- And to support the transition to a more robust reserve strategy that will further define reserve funds that align with the County's future asset replacement and repair needs. (Future State)

DISCUSSION/OPTIONS/BENEFITS/DISADVANTAGES/OTHER CONSIDERATIONS:

The proposed adjustments to County Reserves are being brought forward for consideration in alignment with the intended purposes noted above. The changes, if approved, would result in strategic realignments and renaming of existing reserves and provide greater clarity around the intended uses of reserves, how reserves are funded, and identify any relevant documents.

Reserve Structure

Proposed changes to the Reserve Structure are noted below and are intended to draw greater alignment between capital reserves and TCA categories. The reserves are categorized as either operating or capital in nature.

Operating Reserves - are used to minimize impacts on service delivery and the general tax-levy by accommodating fluctuations in program revenue and expenses for operations that are intended to be self-sustaining.

Capital Reserves - are used to fund major capital projects and infrastructure investments, such as building construction, road maintenance, or the purchase of large equipment. These reserves ensure that municipalities have the necessary funds available to undertake significant capital initiatives without relying solely on debt financing.

Key Changes

- 1) **Amalgamation of all 'Contingency' related reserves into a single reserve, titled 'Contingency & Rate Stabilization'.**

This provides for a streamlining of funds intended for similar purposes. The existing reserves that fall under this category have similar purposes, in that they relate to unanticipated expenditures outside of operating budgets and support Council's desire to contain tax rates for rate payers. The specific uses permitted can be defined under the 'purpose' which was not previously well defined.

- 2) **Amalgamation of all 'Roads' related reserves into a single reserve, titled 'Engineered Structures – Roads'.**

This provides for an alignment with Tangible Capital Asset categories and the streamlining of all reserve funds intended to support the construction or betterment of tangible capital assets that fall under this category, for example: roads, road signs, lighting, guard rails and bridges. This amalgamation allows for greater flexibility to support relevant infrastructure needs irrelevant of their specific location or type (ie. roads vs. bridges).

The proposed allocations of current reserves (46% - Hamlet Infrastructure' and 54% - Infrastructure) are based on the Net Book Value (NBV) of each specific Tangible Capital Asset



(TCA) category. This same principle has also been assigned to the realignments noted below for 'Water and Wastewater'.

3) **Amalgamation of all 'Water & Wastewater' related reserves into a single reserve, titled 'Engineered Structures – Water & Wastewater'.**

This adjustment also provides for an alignment with Tangible Capital Asset categories and the streamlining of all reserve funds intended to support the construction or betterment of tangible capital assets that fall under this category, for example: distribution systems, treatment plants, reservoirs, hydrants; collection systems; lift stations; pumps; lagoons. This amalgamation allows for greater flexibility to support relevant infrastructure needs irrelevant of their specific location or type.

4) **Reallocation of Transitional Funds reserve.**

The transitional funds reserve was originally created to temporarily hold surplus funds from incomplete projects that were to be carried forward into the following year. This function is no longer required and updated processes mean this reserve can subsequently be dissolved, with funds reallocated to the Contingency & Rate Stabilization Reserve, or another reserve of Council's choosing.

5) **Name change of the 'Parks' Reserve to 'Recreation, Parks and Cemeteries' Reserve**

This adjustment draws greater clarity between the title and intended use of the reserve and expands its scope to include cemeteries. The funds currently positioned inside this reserve were intended for the purposes of advancing Horseshoe Canyon related initiatives and that specific funding will remain available for its intended purpose.

6) **Name change of the 'Planning' Reserve to 'Designated Recreational' Reserve**

This proposed change is to draw alignment between the title and use of the reserve. The funds within this reserve are from fees imposed upon subdivision of lands in place of municipal and school reserves and are for disbursement, as outlined within a Municipal and School Board Reserve agreement or as determined by the Subdivision Authority, as per the Municipal Government Act.

Further details pertaining to this realignment and specific reserve balances, as at December 31, 2022, are noted below.

	Proposed Structure	Balance (as at December 31, 2022)	Previous Structure	Balance (of individual reserves under previous structure)
Operating	Contingency & Rate Stabilization	9,757,462	Contingency	1,606,646
			Revenue Stabilization Reserve	6,978,680
			Emergency Disaster	536,024
			Transitional Funds	636,112
	Information Technology	267,366	Information Technology	267,366
Gravel	2,099,528	Gravel	2,099,528	



Capital	Capital Equipment Replacement	9,691,216	Capital Equipment Replacement	9,691,216
	Buildings	2,072,704	Buildings	2,072,704
	Engineered Structures – Roads	20,745,228	Roads	17,747,378
			Bridges	1,086,270
			Hamlet Infrastructure (46%)*	1,520,580
			Infrastructure (46%)*	391,000
	Engineered Structures – Water & Wastewater	14,297,208	Water	4,232,000
			Water Service Area	5,870,638
			Environmental	1,950,541
			Hamlet Infrastructure (54%)*	1,785,029
Infrastructure (54%)*			459,000	
Recreation, Parks and Cemeteries	802,999	Parks	802,999	
Designated Recreational Reserve	142,679	Planning	142,679	

* Percentage allocations between Roads and Water & Wastewater are based on the Net Book Value (NBV) of that specific TCA Category.

Funding Sources

All County Reserves are currently funded through contributions identified as part of the annual budget. Administration has identified additional funding sources that could serve as complimentary options to existing funding strategies. Those strategies are noted within this report, along with additional contexts for each of the identified proposals.

Administration acknowledges that the County has a large inventory of tangible capital assets and most notably a considerable level of Water related assets, exceeding those of most comparator municipalities. Under current funding models, the County utilizes the acquisition costs of those assets and historical trends to inform annual reserve contributions that are intended to support the life-cycle costs of those assets, including eventual replacement and/or retirement of the asset(s).

As the replacement costs for such assets are anticipated to exceed initial acquisition costs, this will result in a future shortfall between the required capital funding to sustain existing levels of service and the available funding, also known as an 'Infrastructure Gap'. While the data required to complete an accurate assessment of the scope of the Infrastructure Gap is not available today, Administration is proposing an interim transitional strategy that supports the pro-active planning for replacement of high-value assets, prior to the future collection of more robust data.

The County's existing asset inventory along with their associated values are noted below. As indicated above, those values are based on acquisition costs.



Tangible Capital Asset Inventory and Values

TCA Category	TCA Value (as at December 2022)	% of TCA
Land	\$ 2,383,818	2.09%
Land Improvements	\$ 1,809,812	1.59%
Buildings	\$ 14,970,296	13.13%
Engineered Structures (incl. Roads / Water Wastewater)	\$ 83,382,367	73.13%
Machinery & Equipment	\$ 5,693,374	4.99%
Vehicles	\$ 5,773,318	5.06%
	\$ 114,012,985	

Transitional Funding Options

Administration has focused on two potential funding options to support the effective long-term planning for the eventual replacement of high-value assets, and to proactively manage the Infrastructure Gap. The identified funding strategy focuses on both *investment income* and *operational surpluses*, of which further details are provided below.

Investment Income serves as a revenue source for the County, however, it relies heavily on external factors that are outside of the County’s direct control (ie. Interest rates), thereby making it a fluctuating and unreliable revenue source. At present, budgeted investment income funds operations that directly impact the County’s ability to sustain defined levels of service. Reliance on irregular revenues for such purposes could result in unintended correlating fluctuations in tax rates. A gradual reduction in reliance on investment income in a controlled fashion that supports the long-term financial sustainability of the organization enables an improved ability to fund life cycle costs of existing tangible capital assets.

Proposal

At present, the County budgets approximately \$763,000 annually and this funding is relied on to offset operational expenses. To mitigate the County’s reliance on this revenue source, Administration proposes a gradual transition that would see revenues associated with investment revenue, beyond budgeted amounts, automatically transferred into a newly defined reserve intended for this specific purpose. This would result in the gradual reduction in budgeted investment income revenue and subsequent gradual reduction in reliance on those funds to fund day-to-day County operations.

Year	2024	2025	2026	2027	2028
Proposed Budget	\$600,000	\$450,000	\$300,000	\$150,000	\$0

For historical context and to serve as an indicator of future values, below outlines the budgeted versus actual investment income over the past 10 years. This data demonstrates an average annual investment return of approximately \$607,665. While similar investment revenues are not guaranteed in the future, the proposed strategy allows for the reallocation of such variable revenues towards a function that supports long-term sustainability while also helps mitigate unanticipated impacts to levels of service.



Investment Income (10 Years): Budget vs. Actuals

Year	Budget	Actual	Variance
2023	\$ 763,984	\$ 1,718,892*	\$ 954,908
2022	\$ 525,000	\$ 1,251,242	\$ 726,242
2021	\$ 302,800	\$ 339,772	\$ 36,972
2020	\$ 702,800	\$ 479,507	\$ (223,293)
2019	\$ 402,000	\$ 1,044,263	\$ 642,263
2018	\$ 212,000	\$ 829,569	\$ 617,569
2017	\$ 252,000	\$ 448,952	\$ 196,952
2016	\$ 277,000	\$ 304,454	\$ 27,454
2015	\$ 254,400	\$ 389,919	\$ 135,519
2014	\$ 229,000	\$ 381,306	\$ 152,306
	Average (10 Year)	\$ 607,665	

*2023 actuals identified above are estimates only.

Annual Surplus Operating Funds have also been identified as a potential funding source to support the management of the County’s anticipated Infrastructure Gap. Municipalities are mandated to operate within a balanced budget and Administration actively works to identify strategies that support cost containment efforts. While Administration and Council collectively work to budget at a level that supports the County’s defined levels of service, there are multiple factors that impact budget variances. The allocation of surplus funds are currently determined through Council motion at year end.

Proposal

Administration recommends the automatic allocation of 75% of any surplus operational funds at year end to a newly defined ‘Infrastructure Gap Reserve’ to support the effective management of an anticipated Infrastructure Gap, of which the scope is yet to be accurately defined.

As the organization matures in Asset Management and Administration is able to determine both the scope of the Infrastructure Gap and the degree to which each asset classification contributes to the overall gap, funds within this reserve can then be reallocated to the appropriate reserve for each of those identified asset classes. For example, if it is determined that the water and wastewater assets contribute to 57% of the County’s Infrastructure Gap then 57% of the funding allocated within the Infrastructure Gap reserve would be reallocated to the ‘Engineered Structures – Water & Wastewater’ Reserve.

Reserve Balances

The strategy outlined within this report does not include the identification of minimum nor optimum reserve levels. The determination of those factors requires a more wholistic analysis that will need to take into account data that is not currently available. Proposed projects that form part of Council’s 2024 budget deliberations will help support the collection and analysis of data that will more effectively inform both of those factors.



FINANCIAL & STAFFING IMPLICATIONS:

Adjustments to the reserves structure bare no financial implications for the County, as the restructuring itself is intended to support the effective management and accurate utilization of reserves.

Should Council choose to adopt the establishment of an Infrastructure Gap Reserve with the proposed funding sources, the scope and degree of financial implications will be reflective of the specific direction provided by Council. The partial reallocation of investment income and/or operational surpluses into an Infrastructure Gap Reserve will reduce accessibility to those funds to support immediate operational needs, however, the strategy provides for long-term asset management and financial planning that supports sustained service delivery in areas that rely heavily on key infrastructure.

The restructuring and identification of defined uses for all County reserves supports staff in their ongoing efforts to manage the reserves in accordance with Council's direction.

RECOMMENDED ENGAGEMENT:

Directive Decision (Information Sharing, One-Way Communication)

Tools:	Individual Notification	Other:	
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ATTACHMENTS:

Schedule A: Reserve Listing

COUNCIL OPTIONS:

1. Accept the report for information, as presented.
2. Request additional information.

FOLLOW-UP ACTIONS:

The feedback provided by Council will help inform the next stage of the reserve strategy development which will include the updating of Reserves Policy (16-1).

At a future state, following the collection and analysis of the appropriate data, Administration will bring forward to Council identified recommended funding levels for each of the County's Reserves.

APPROVAL(S):

Mike Haugen, Chief Administrative Officer Approved-

Kinza Barney, Director of Corporate Services Approved-

