DATE: January 2, 2019
REPORT TITLE: OVERVIEW AND UPDATE ON THE STATUS OF RESERVES
FROM: Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

OBJECTIVE

To provide an overview of the reserves and an update on the overall sustainability of Regionally Controlled reserves with focus on the rate stabilization reserves, capital reserves and specialty reserves.

REPORT HIGHLIGHTS

- Reserve adequacy is an important factor in the Region’s overall financial condition as it impacts both financial sustainability and financial flexibility.
- Reserves are used as a tool to mitigate short term tax pressures and to meet long term financing requirements for the state of good repair of existing assets, service enhancements and non-Development Charge (DC) Growth.
- Tax Stabilization and Utility Rate (Water and Wastewater services) Stabilization Reserves are currently sufficient to adequately maintain the Region’s financial flexibility to mitigate service volatility.
- Analysis of Tax Supported Capital Reserve shows that maintaining current level of the reserve contribution will result in a shortfall of $1.6 billion in Tax Supported Capital Reserve by the end of 2038.
- Analysis of Utility Rate Supported Capital Reserve shows that maintaining the contribution at the current level will result in a shortfall of $1.6 billion in Utility Rate Supported Capital Reserve by the end of 2038.
- Review of the Specialty Reserves indicates the specialty reserves are at appropriate levels given the current risk environment with the exception of the Housing-Contingency Liability Reserve.
- Staff continue to assess the shortfall in the Housing-Contingency Liability Reserve, which will be addressed through management of overall reserves.
- Actions to address the shortfall in Tax and Utility Rate Capital Reserves will be brought forward for consideration as part of the 2019 Budget.
OVERVIEW AND UPDATE ON THE STATUS OF RESERVES

DISCUSSION

1. Background

This report provides an annual overview and update on the status of the Region’s reserves. The management of reserves is an important factor in the Region’s overall financial condition, as it impacts both financial sustainability and financial flexibility. The credit rating agencies have acknowledged the Region’s highly liquid reserves and reserve funds and its moderate level of debt as major attributes allowing it to achieve the Triple A (AAA) credit rating. Maintaining a high credit rating is a goal held by the Region which ensures its access to capital markets at very competitive rates, benefiting the Region and the local municipalities, and is critical to the long term financial sustainability of Regional services. The Region’s current Reserve Management Policy was established by Council on November 14, 2013 through the report “Implementation of the Long Term Financial Planning Strategy – Phase II”.

The Reserve Management Policy supports two key principles in the Long Term Financial Planning Strategy; “Ensuring the capital plan is sustainable” and “Maintaining the flexibility to mitigate the volatility in rates”. Reserves, reserve funds and specialty reserves are managed within larger pools much like investments, where the overall pooled risk is lower than the separate individual risks.

By pooling similar reserves into a portfolio, Council can more easily deploy the funds to areas of the greatest need. The policy classifies reserves into four major categories, being: Operating Reserve, Capital Reserve, Specialty Reserve, and, Reserve Funds.

2. Operating Reserves

The Rate Stabilization Reserves, as defined in the Reserve Management Policy, are the reserves arising from the operation of Regional programs. The Region has two Rate Stabilization Reserves: Tax Supported Rate Stabilization Reserves and Utility Rate (Water and Wastewater services) Supported Rate Stabilization Reserves. Surpluses from tax supported programs and utility rate supported programs are put into separate reserves. These reserves are used to minimize annual fluctuations in property tax and utility rate by providing funding for one-time costs, allowing significant pressures to be phased-in and addressing program pressures when there is some degree of uncertainty. Appendix I provides a summary of the status of the Rate Stabilization Reserves as at October 31, 2018.

a) Tax Supported Rate Stabilization Reserve

The Reserve Management Policy requires the balance of the Tax Supported Rate Stabilization Reserve be maintained within a range of a minimum of five per cent and a maximum of ten per cent of the total budget funded from property taxation. Due to prudent financial decisions, Council has built a healthy rate stabilization balance over the years. The reserve has provided Council with the flexibility to stabilize the impact of the economic volatility on the Region’s programs.

In July 2016, Regional Council approved the use of $38.3 million of the reserve to support new housing development as outlined in the report from the Commissioner of Human Services titled, “A New Plan for Housing Investment”. Therefore, as at October 31, 2018 the balance of Tax Supported Rate Stabilization Reserve is at $128 million or
9.1 per cent of the 2018 Tax supported total operating budget. The balance is within the range of five to ten per cent as prescribed in the Reserve Management Policy and is sufficient to provide financial flexibility to address one-time pressures and volatility within the tax supported operating budget including change in provincial funding and the potential GO Transit liability of $222 million by October 2018.

b) Utility Supported Rate Stabilization Reserve

The Reserve Management Policy also requires the balance of the Utility Rate Supported Rate Stabilization Reserve be kept within the range of a minimum five per cent and a maximum ten per cent of the total Utility Rate supported programs’ budget. As at October 31, 2018 the Utility Rate Supported Rate Stabilization Reserve has a balance of $38 million, which represents approximately 7.4 per cent of the 2018 Utility Rate supported total operating budget, which is in compliance with the Reserve Management Policy.

3. Capital Financing

The Region’s capital plans are financed through capital reserves, DC reserve funds, internal borrowing, external funding and debt. Capital Reserves provide financial flexibility to meet long term financing requirements and help achieve the long term financial sustainability of the Region’s assets. They are used to finance the state of good repair requirements of the existing assets and to fund other capital work not eligible for DC funding.

The capital financing sources used are largely dependent on the type of capital project. For example, DC funding can only be used for eligible growth related projects. A separate report titled “Development Charges Program Update” was provided to Council in June 2018, that detailed the status of development charge revenues, the growth related capital expenditure, the associated risks along with the mitigation measures and the adequacy of Development Charges Reserves. Appendix II, “Relationship between Capital Financing and Capital Plan” provides an overview of the relationship between the various sources of capital financing including Capital Reserves and the Capital Plan.

a) Asset Management

As detailed in the companion report titled “Enterprise Asset Management Update” on January 10, 2019, the Region owns and operates approximately $27.8 billion in infrastructure. Maintaining these assets in a state of good repair is essential to the provision of Regional services and in turn to the overall success of the Region of Peel. Consequently, the Region has established a goal of maintaining an overall infrastructure status of Good. This goal allows the Region to balance prudent investment in infrastructure in order to support efficient and reliable community services while maintaining affordable tax and utility rates.

The purpose of the Enterprise Asset Management Update report is to provide Council with an infrastructure status update and identify any emerging issues. The report concludes that the levels of investments proposed in the 2019 Capital Budget and Forecast is required to maintain the Region’s infrastructure at Council’s level of service targets. The report also indicates that Peel’s asset portfolio is currently rated Good or Very Good in relation to Council’s targets.
b) Determining the Cost of Future Capital Liability

i) Maintain Existing Service Level

Inflation is one of the variables that significantly impact the cost of maintaining or repairing assets such as buildings, roads and water mains. For capital work, there is a specific index that is often used known as the Construction Cost Index (CCI). The CCI reflects the cost of materials such as concrete, steel, asphalt and labour, which have historically increased at a rate faster than general inflation (see Appendix III for a chart that illustrates the impact of the Construction Cost Index on replacement costs).

The Region uses the Replacement Cost methodology to estimate the future capital requirements. Replacement cost recognizes that the cost to repair and ultimately replace an asset is significantly different from its historical cost due to the impact of inflation.

ii) Service Demand

There are increasing pressures for additional capital investment due to regulatory changes (e.g. changes for environmental protection), demand to improve service levels of existing Regional programs (e.g. more social housing required to address the waitlist), and other community changes due to population growth (e.g. need to increase road width for public transit, expand Paramedics to respond to call volume growth). These pressures contribute to the increases to the 20-year Tax and Utility Supported Capital Plans, which put strain on the capital reserves that are used to fund the increased requirements. It is expected that the completion of technical assessments, such as those that have been undertaken on the social housing stock, will help to support a longer term analysis of the reserves.

iii) Term of Council Priorities

During the 2015 – 2018 Term of Council (ToC), the Region is focused on eleven priorities including “Increase waste diversion” and “Increase affordable housing”. For example, over the past four years, Council has directed staff to increase waste diversion to 75 per cent by 2034 and to provide affordable housing to middle-income families. The 20-year Tax and Utility Supported Capital Plans reflect the capital requirements driven by the ToC priorities. These additional capital requirements have increased pressures on the capital reserves which are the major funding sources.

c) Funding

Funding for non-DC capital projects is generally provided from reserves that can be broken down into two major categories:

i) Tax Supported
ii) Utility Rate Supported

In the fall of 2007, Council adopted a strategy to increase reserves by one per cent tax rate each year for capital financing purposes to achieve long term financial sustainability.
By 2018, Tax Supported capital reserves have been enhanced by additional amount of $465 million since its implementation in the 2008 Budget which helped to fund the capital work required since that time.

Staff also presented Council with a report in 2008 outlining the need for increasing the utility rate to finance the expanding state of good repair budget and mitigate debt financing. Since 2009, utility rate increases in range of three – seven per cent have been implemented in annual budgets to strengthen Utility Rate Supported Capital reserves resulting into additional amount of $494 million in reserves by end of 2018.

The benefit of the increased reserve contributions will continue to grow over time ensuring Peel’s assets are adequately maintained and the capital program is sustainable.

i) Tax Supported Capital Financing

In order to meet Peel’s long term capital requirements while maintaining financial stability, staff use a twenty year capital forecast to assess the adequacy of Tax Supported capital reserves. Based on the evaluation of the capital plan to address Tax Supported state of good repair, service enhancement and non-DC growth requirements, it is estimated that approximately $5.0 billion is required over the next 20 years for Tax Supported Regionally Controlled services and for the state of good repair of the Affordable Housing stock in Peel (inflation adjusted). Based on the most recent assessment, keeping Peel's affordable housing stock in the state of good repair requires an investment of $417 million over the next ten years (also see section 4 – Specialty Reserves).

Current reserve levels and contributions are not sufficient to address the Region’s 20-year Tax Rate Supported Capital requirements. Staff are projecting a shortfall of $1.6 billion by the end of year 2038 (see Appendix IV for details). To mitigate the gap, it is proposed that a one per cent infrastructure levy increase be included in the 2019 Budget and for the next six years.

ii) Utility Rate Supported Capital Financing

Similar to Tax Supported services, staff use a twenty year capital forecast to assess the capital reserve adequacy for Utility Rate Supported services. It is estimated, based on the evaluation on the state of good repair capital requirements, that approximately $5.7 billion is required over the next 20 years for Utility Rate funded services including Water and Wastewater (inflation adjusted).

Current reserve levels and contributions are not sufficient to address the Region’s 20-year Utility Rate supported capital plan. Staff are projecting a shortfall of $1.6 billion by the end of year 2038 (see Appendix IV for details). In the 2019 Budget, it is proposed that the Council continue with the 5 per cent infrastructure levy increase and implement it each year for three more years until 2022.
iii) Infrastructure Funding

There has been an increased focus on infrastructure funding from the Federal government in municipal infrastructure areas such as Social Housing, Water and Wastewater. In 2017, during Phase 1 of the infrastructure funding program, the Region received $104 million under the Clean Water and Wastewater program to support the rehabilitation of key Regional infrastructure assets. It’s anticipated that Phase 2 of the infrastructure funding program will be announced by November 2019. Future infrastructure funding may be sustainable and significant to reduce the long term pressure of rising infrastructure levies.

4. Specialty Reserves

The Reserve Management Policy provides for a categorization of reserves referred to as Specialty Reserves. This category includes reserves for specific and defined purposes that fall outside of the broader requirements for capital financing, and rate stabilization. As required by the Reserve Management Policy, a review of these specialty reserves was performed. The results indicate that most of the specialty reserves are at appropriate levels given the current risk environment with the exception of the “Housing-Contingency Liability Reserve” – R1919.

The “Housing-Contingency Liability Reserve” R1919 was established to fund the expected gap in the state of good repair funding of Affordable Housing buildings in the Region. The housing stock contains approximately 20,000 units/homes, owned and managed by Peel Living and external housing providers. The reserve is used to provide capital grants or loans to service providers as a means to address the deficit in their sources of funding when fulfilling state of good repair requirements, and is also funded as part of the 1 per cent infrastructure levy due to Region’s mandate as Service Manager in ensuring safe and adequate supply of Affordable Housing (also see Section 3.c.i – Tax Supported Capital Financing).

5. Risks and Pressures

Reserves, reserve funds and specialty reserves ensure the capital plan is sustainable as well as provide flexibility to mitigate volatility in tax and utility rates. The continually evolving environment the Region is facing has resulted in increasing risks and growing pressures on service levels and hence on reserves, reserve funds and specialty reserves that are established to support service delivery to Peel residents and businesses.

a) Liability for Metrolinx (formerly GO Transit) Growth and Expansion Capital Cost

The Region’s legal obligation to contribute to the growth and expansion capital costs of Metrolinx (formerly GO Transit) is based on a by-law adopted by the Greater Toronto Services Board in 2000, the effect of which has been continued by a series of regulations. In 2001, the Region enacted By-law 45-2001 to collect a growth related portion of GO Transit capital costs as development charges. The effect of this by-law has been continued, also based on Provincial regulations. Pursuant to Council Resolution 2007-1367, which was approved on November 15, 2007, beginning with the January 2008 invoice, the Region has been only remitting payment for the amount actually collected by the Region through DC. This has resulted in a continually increasing accumulation of arrears over time.
The Region’s current practice is to accumulate funds in the GO Transit DC reserve fund until it reaches $750,000 at which point a payment in that amount is remitted. The rate of accumulation of unpaid invoices continues to outpace the rate of DC collection. As mentioned earlier, the Region’s GO Transit liability amounts to $222 million by October 2018.

Similar to Peel, Durham, Halton, Hamilton and York pay their Metrolinx capital contribution for the amount actually collected through DC. Toronto does not have a DC component for Metrolinx and it pays $20 million from tax each year until end of 2017. Toronto’s GO growth obligations to 2024/25 will be fulfilled by the City’s contributions to SmartTrack. As of 2018, Peel, York and Toronto have accrued all or partial liabilities while Durham, Halton and Hamilton have stopped accruing or have not accrued liabilities.

The Region/Province Dedicated Gas Tax Funds Letter Agreement does not expressly refer to the Region’s GO Transit Capital Contribution obligation, but instead incorporates by reference the Guidelines document, the effect of which is to make payment of the GO Transit capital contribution a pre-requisite of the Province’s obligation to release dedicated gas tax funds. Despite this, the Province has not in fact required that payment of the GO Transit contributions have been made before releasing the gas tax funds.

The Metrolinx board has the legal authority to repeal the by-law and to forgive the arrears, but in doing so is bound to act in the interests of the Province. It’s of staff’s view that the Metrolinx board would only act to do so in accordance with Provincial direction. With the change in provincial government and the province’s current financial review, it’s uncertain where the Metrolinx board will go regarding this matter. Based on the legal opinion and the risk assessment, the Region takes a conservative approach and continues to accrue the full amount of GO Transit liability.

Regions of Durham, Halton, Peel and York and the Cities of Hamilton and Toronto (the GTA/H municipalities) continue to face growing financial pressures arising from their own community priorities such as rehabilitating aging infrastructure as well as investing in new infrastructure which are vital to maintaining the quality of life in these communities. The councils of the GTA/H municipalities have repeatedly petitioned the Province to resolve the issue of municipal funding of the GO Transit Growth Capital Plan since the transfer of GO Transit back to the Province.

b) Other Pressures

The Region also faces other pressures that have an impact on reserves, reserve funds and specialty reserves including the following:

- Service enhancements such as the Seniors Health and Wellness Village, infrastructure requirements to achieve increased waste diversion and additional affordable housing to address unmet needs;
- Unanticipated capital work such as emergency watermain repair; and,
- Available funding to match Federal & Provincial infrastructure funding.
OVERVIEW AND UPDATE ON THE STATUS OF RESERVES

All of the above require the Region to maintain a certain level of reserve balance as prescribed in the Region’s Reserve Management Policy in order to sustain the capital plan and to provide flexibility to mitigate the volatility of rates.

CONCLUSION

Council’s current strategy of funding the sustainability of the Region’s capital plan through the one per cent infrastructure levy for tax supported capital as well as infrastructure levy increases for utility rate supported capital have helped to maintain its financial flexibility and sustainability of the capital program. As indicated in the Long Term Financial Planning strategy, reserves are an important factor in the Region’s overall financial condition as they impact both Financial Sustainability and Financial Flexibility.

Staff analyses project that capital reserve for state of good repair, service enhancements and growth will not be sufficient to meet the combined $3.2 billion in funding shortfall associated with the Region’s long term capital financing requirements. The proposed 2019 Budget will include capital infrastructure levies for Council consideration.

Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

Approved for Submission:

D. Szwarc, Chief Administrative Officer

APPENDICES

Appendix I – Rate Stabilization Reserves
Appendix II – Relationship between Capital Financing and Capital Plan
Appendix III – Construction Cost Index Trend
Appendix IV – Reserve Gap Analysis
Appendix V – Specialty Reserves

For further information regarding this report, please contact Norman Lum @ extension 3567 or via email at Norman.Lum@Peelregion.ca.
Rate Stabilization Reserves

<table>
<thead>
<tr>
<th></th>
<th>Balance as at October 31, 2018</th>
<th>Status of Reserves as at October, 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax</strong></td>
<td>$128 million</td>
<td>9.1 % of 2018 Tax Total Operating Budget</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In compliance with the Reserve Management Policy</td>
</tr>
<tr>
<td><strong>Utility Rate</strong></td>
<td>$38 million</td>
<td>7.4% of 2017 Utility Rate Total Operating budget</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In compliance with the Reserve Management Policy</td>
</tr>
</tbody>
</table>
Relationship between Capital Financing and Capital Plan

**Community for Life**

### Strategic Plan

- **Master Plan**
  - Where to Invest
  - Source of Funding

- **Capital Plan**
  - Approved Capital Work in Progress
  - Future Capital Work
    - 2019 Budget
    - 2020–2028 Capital Plan

### Where to Invest

- State of Good Repair
- Service Enhancements and non-DC Growth
- DC Growth

### Source of Funding

- External Funding
- Reserve Contribution (Tax Levy & Utility Rate User Fee)
- Debt
- DC Revenue
The above chart illustrates the impact of Construction Cost Index (CCI) on an asset that was purchased in 1977 for $100 thousand. By July of year 2018, the cost to replace the same asset would be $413 thousand which is 4.1 times higher than the historical cost. The average annual increase over this period was 3.5%.
APPENDIX IV
OVERVIEW AND UPDATE ON THE STATUS OF RESERVES

Reserve Gap Analysis

**20 Year Funding Shortfall**
Regionally Controlled Tax

- Tax Supported 2019-2038
  - Non-DC Capital Plan Portion to be Funded from Tax
  - $5.0 B

- Unfunded gap - requires 1% for 6 years
  - 1% ↑ in 2019

- Total Available Funding (including interest)
  - $3.4 B

Unfunded Gap of $1.6 B

**20 Year Funding Shortfall**
Utility Rate

- Utility Supported 2019-2038
  - Non-DC Capital Plan Portion to be Funded from Utility Rate
  - $5.7 B

- Unfunded gap - requires 5% for 3 years
  - 5% ↑ in 2019

- Total Available Funding (including interest)
  - $4.1 B

Unfunded Gap of $1.6 B

Total Unfunded Gap: $3.2 B

* The available funding comprises of projected opening uncommitted reserve balance in 2019, regular annual contributions, annual estimated interest on reserve balances and council approved infrastructure tax levy and utility rate increases till 2018
<table>
<thead>
<tr>
<th>Reserve</th>
<th>Description</th>
<th>Intended Use</th>
<th>Cash Balance October 31, 2018 ($Millions)</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0500</td>
<td>Insurance Stabilization Reserve</td>
<td>To fund any material variances that could adversely impact the Region relating to liability claims or accidental losses.</td>
<td>8.5</td>
<td>Sufficient: Currently held sufficient to reduce the impact of potential unexpected events. Detailed assessment of risk severity and its impact on reserve will be conducted and included in future reporting.</td>
</tr>
<tr>
<td>R0520</td>
<td>ASO Benefit Stabilization</td>
<td>To fund any material unexpected variances in self-insured Extended Health Care (EHC) and Group Life benefit plans</td>
<td>8.1</td>
<td>Sufficient: Currently held sufficient; there is limited impact on reserves due to provision of stop-loss in self- insured EHC and Group plans.</td>
</tr>
<tr>
<td>R0880</td>
<td>WSIB Reserve Pensions</td>
<td>To fund the Region’s future WSIB liability (self-insured) as determined by the actuaries.</td>
<td>13.5</td>
<td>Sufficient: Reserve balance sufficient to fund current estimate of WSIB unfunded liability at about $9.5 million.</td>
</tr>
<tr>
<td>R1140</td>
<td>Capital Long Term Waste Management Strategy - Energy From Waste Savings</td>
<td>To receive savings from interim landfill operation placed after expiry of third party incineration contract</td>
<td>58.0</td>
<td>Sufficient: The full amount of the reserve will be used to fund 75% 3Rs Target projects approved by Council.</td>
</tr>
<tr>
<td>R1919</td>
<td>Housing - Contingency Liability Reserve</td>
<td>To fund the potential gap in the state of good repair reserves faced by affordable housing service providers</td>
<td>79.0</td>
<td>In-Sufficient: An initial estimate of $417 million deficit is expected by 2028.</td>
</tr>
<tr>
<td>R1923</td>
<td>Housing-Advances to Providers</td>
<td>To track loans that the service provider obtains from Region (draw from R1919) that is under $500 thousand.</td>
<td>0.0*</td>
<td>N/A: Reserve is for tracking of loans issued from R1919; Notional use only, no incremental commitment is expected.</td>
</tr>
<tr>
<td>R1924</td>
<td>Housing-Loans to Providers Pre</td>
<td>To track loans that the service provider obtains from Region (draw from R1919) that is over $500 thousand.</td>
<td>0.0*</td>
<td>N/A: Reserve is for tracking of loans issued from R1919; Notional use only, no incremental commitment is expected.</td>
</tr>
<tr>
<td>R1925</td>
<td>Housing-Loan to Providers Post</td>
<td>This reserve is to track repayments which have begun from housing service providers.</td>
<td>0.0*</td>
<td>N/A: Reserve is for tracking of loans issued from R1923/24; Notional use only, no incremental commitment is expected.</td>
</tr>
<tr>
<td>R1261A</td>
<td>Human Services Revolving Capital Fund</td>
<td>To support community partner integration and system improvements activities in Human Services Department</td>
<td>0.6</td>
<td>N/A: Reserve is for tracking of loans issued from R1261A; Notional use only, no incremental commitment is expected.</td>
</tr>
<tr>
<td>R0221</td>
<td>Capital Finance Stabilization - Greenlands Securement</td>
<td>To provide annual funding of Greenlands capital project which involve securing greenlands by Peel’s Conservation Partners</td>
<td>7.3</td>
<td>Sufficient: Currently held sufficient based on recent spending patterns</td>
</tr>
</tbody>
</table>

* Cash balance net of the loan that has been lent out