

Staff Report for Decision

DATE OF MEETING MARCH 18, 2020

AUTHORED BY LAURA MERCER, DIRECTOR, FINANCE

SUBJECT 2019 SURPLUS ALLOCATION

OVERVIEW

Purpose of Report

To provide the Finance and Audit Committee information regarding the allocation of the 2019 operating surplus.

Recommendation

That the Finance and Audit Committee recommend that Council approve the allocation of the 2019 operating surplus as follows:

1.	General Fund	
	a. Special Initiatives Reserve	\$ 2,013,000
	b. General Capital Reserve	2,955,073
	c. General Financial Stability Reserve	759,874
	d. Strategic Partnership Reserve	200,000

		\$ 5,927,947
		=====
2.	Sewer Fund	
	a. Sewer Reserve	\$ 581,616
		=====
3.	Water Fund	
	a. Water Distribution Reserve	\$ 1,069,989
		=====
	Total Surplus Allocation	\$ 7,579,552
		=====

BACKGROUND

The compilation of the 2019 draft financial statements is in progress and the audit by KPMG LLP started on 2020-MAR-09. In preparing the financial statements, staff needs to allocate the surplus prior to finalization of the audit.

Any remaining operating surplus funds are considered unallocated surplus and can be used to fund unexpected future liabilities.

In order to help stabilize future funding sources and minimize the impact on tax rates, a Reserve Policy was established in 2019. This policy provides guidance with respect to the development, maintenance and use of City Reserve Funds. The policy also institutes minimum and maximum balances, where appropriate, to ensure sufficient reserves are on hand at any given time. As outlined in the Policy, the first use of surplus funds is to bring the reserves up to the identified minimum balance.

The primary objectives of the reserve policy is to support financial resiliency by:

- Providing funds for operating emergencies
- Ensuring sustainable funding for infrastructure
- Ensuring stable and predictable property tax levies

DISCUSSION

The City of Nanaimo accounts for its budgets within three funds: general fund, sewer fund and water fund.

The unaudited financial results, including surplus for allocation, for the year ended 2019-DEC-31 are as follows for each of the funds:

General Fund

In the general fund the surplus was \$5,927,947 at 2019-DEC-31. This represents 4% of the budget.

The surplus is made up of the following major variances:

Type	Amount	Explanation
Wages and Benefits	\$2,066,000	Vacant positions throughout the City
Revenues:		
• Interest Income	1,116,100	Higher interest income due to rising interest rates
• Building Permits	560,400	Higher than anticipated revenues
• PRC Fees & Admissions	209,500	Higher than anticipated revenues
• Grants In Lieu	181,700	Higher than anticipated revenues
• Penalties & Interest on Taxes	114,300	Higher than anticipated revenues
Contracted Services	507,300	Expenditures were less than anticipated
Hardware, Software and Associated Licenses & Maintenance	286,700	Expenditures were less than anticipated
Janitorial Supplies	154,100	Expenditures were less than anticipated
Insurance	132,600	Expenditures were less than anticipated
Vancouver Island Conference Centre	(164,000)	Deficit due to 2017 & 2018 incentive fees paid in 2019
RCMP Contract	(232,000)	Contract settlement liability for the year was higher than anticipated

Staff propose the 2019 general fund surplus be allocated to reserves as follows:

Special Initiatives Reserve

\$2,013,000

The special initiatives reserve was established through the creation of the new Reserve Policy. The purpose of this reserve is to fund emerging issues that require short term funding and minimize impact on future property tax increases through contributions from prior year operating surplus. Funding for the following projects are being recommended:

VICC Audio Visual Upgrades

\$ 1,163,000

A review of the current audio visual (AV) system at the Vancouver Island Conference Center was undertaken in 2019. The review found that the AV equipment was failing as it uses outdated technology and a complete upgrade is needed. The estimated cost to replace existing equipment is \$1,163,000.

SARC Building Upgrades

\$ 750,000

With the organization restructuring that took place in 2019, changes to the SARC building need to be undertaken. This allocation will cover the necessary construction and furniture costs of this project. When the SARC building was built in 2012, the third floor was intended accommodate any growth in the future.

Sponsorship Project

\$ 100,000

Sponsorships provide an effective means of generating new revenue streams and alternative resources to support facilities, events and programs for all organizations. At the 2020-FEB-24 Council meeting, Council endorsed the Finance and Audit Committee recommendation to complete a feasibility study, develop a sponsorship strategic plan and policy. This allocation would cover the estimated cost of the project.

General Capital Reserve

\$ 2,955,073

This will increase the General Capital Reserve and provide Council with the maximum flexibility in the future. These funds could be used, in whole or part, for any future capital project that is a Council priority.

General Financial Stability Reserve

\$ 759,874

Like the Special Initiative reserve, this reserve was established through the creation of the new Reserve Policy in 2019. The purpose of this reserve is to mitigate risk arising from lower than expected revenues or sudden unplanned expenditures needed to maintain delivery of City services. Contributions to this reserve are from allocations of general operating surplus and/or a budget allocation. The minimum target balance for this reserve is calculated at 60 days of the prior year's budgeted general operating expenditures and the target is currently \$16,408,806. To meet this balance, \$759,874 will need to be allocated from surplus. Most of this change is due to funding the Post Employment Benefits liability that is budgeted for in 2020.

Post Employment Benefits - \$700,000

Per Public Sector Accounting Board (PSAB) requirements, the City must to account for the cost of post employment benefits in the financial statements. The City hires an actuarial consulting firm to value the present day cost of these benefits and we adjust the liability each year to their estimate. By putting money aside in a reserve each year this reduces the

reliance on current year surpluses to absorb the cost. The three (3) year average of liability adjustments is approximately \$700,000.

Strategic Partnership Reserve**\$ 200,000**

The Strategic Partnership Reserve was established in 2015 and provides funding for consultation with Snuneymuxw First Nation regarding joint projects.

Sewer Fund

The sewer fund recorded a surplus of \$581,616 at 2019-DEC-31. This represents 11% of the budget.

User fees relating to sewer use were higher than anticipated by \$ 279,000. An unspent sewer contingency of \$71,000 and \$128,000 from debt costs made up the majority of the remaining variance. The debt variance is due to a timing difference between when the budget anticipated borrowing and when we actually borrowed. The combination has enabled \$581,616 to be transferred to the sewer reserves for future projects.

Water Fund

The water fund recorded a surplus of \$1,069,989 at 2019-DEC-31. This represents 8% of the budget.

User fees and connection fees relating to water use were higher than anticipated by \$638,000. An unspent water contingency of \$115,000, and \$205,000 from position vacancies made up the majority of the remaining variance. The combination has enabled \$1,069,989 to be transferred to the water reserves for future projects.

Summary

If a municipality has a small surplus it means that tax rates were appropriately set to meet current year operations. However, it does not provide any excess monies to be transferred to reserves for the funding of future projects or cover any unexpected operating costs that may occur.

If low surplus values are sustained year after year, tax rates can potentially become more volatile as a larger percentage of funding for unexpected events and/or projects will need to come from current year taxes rather than reserves.

In 2019, the City of Nanaimo's accumulated surplus of all three (3) funds was \$7,393,853. By transferring these excess surplus funds to reserves this year it means that the need for future year tax increases are mitigated as these monies can be used to cover any unexpected operating costs, drops in revenue sources or fund future projects.

OPTIONS

1. That the Finance and Audit Committee recommend that Council approve the allocation of the 2019 operating surplus as follows:

1.	General Fund	
	a. Special Initiatives Reserve	\$ 2,013,000
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- The advantages of this option: Transferring excess surplus funds to reserves this year means that the need for future year tax increases are mitigated as these monies can be used to cover any unexpected operating costs, drops in revenue sources or fund future projects.
 - The disadvantages of this option:
 - Financial Implications: \$7,579,552 was reserved to fund general, sewer and water projects and operations in the future
2. That Council direct specific surplus funds to different and/or specific priorities. |

SUMMARY POINTS

- The General fund recorded an operating surplus of \$5,927,947 or 4% of approved budget in 2019.
- The Sewer Fund recorded an operating surplus of \$581,616 or 11% of approved budget in 2019.
- The Water Fund recorded an operating surplus of \$1,069,989 or 8% of approved budget in 2019.

- A Reserve Policy was established in 2019 and provides guidance with respect to the development, maintenance and use of City Reserve Funds to ensure appropriate funding levels are available at all.

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