

DATE OF MEETING NOVEMBER 18, 2020

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**SUBJECT RESERVE POLICY UPDATE**

## **OVERVIEW**

### **Purpose of Report**

To revise the minimum and define the maximum reserve balances for the three (3) Financial Stability Reserves.

### **Recommendation**

That the Finance and Audit Committee recommends that Council revise the minimum and set a maximum balance for the three (3) financial stability reserves, to be reviewed every five (5) years, as follows:

#### Minimum Balances:

1. \$15,000,000 for the General Financial Stability Reserve
2. \$500,000 for the Sewer Financial Stability Reserve
3. \$1,700,000 for the Water Financial Stability Reserve

#### Maximum Balances:

60 days of prior year's budgeted general operating expenditures for all three (3) financial stability reserves.

## **BACKGROUND**

On 2019-MAR-11 at a Special Committee of the Whole meeting Staff presented the Draft Reserve Policy to Council for consideration. The purpose of the Policy is to:

- I. Establish responsible governance for the development, maintenance and use of the City's Reserves;
- II. Establish governance roles and responsibilities that ensure appropriate establishment and management of Reserves;
- III. Define principles and objectives for Reserves management that are appropriate for the City's financial position, and are reasonable, logical and necessary for delivery of sustainable, affordable services; and,
- IV. Ensure the City's Reserves management is compliant with the statutory and legal requirements of the Local Government Act and the Community.

At the 2019-JUL-22 Regular Council meeting, Council endorsed the summary of recommendations included in the “City of Nanaimo Reserves Review Report” that was presented at the 2019-JUL-17 Finance and Audit Committee meeting. A copy of this report is included in Attachment A. A Reserves Framework was established and included the following categories:

**1. Financial Stability Reserves:**

Mitigate specific risks or provide funding for future costs

**2. Equipment Reserves:**

Provide funding for equipment replacement

**3. Infrastructure Reserves**

Primary funding source for infrastructure renewal

**4. Parking Reserves**

Provide funding for renewal or upgrades to parking infrastructure/amenities or parking studies.

**5. Property Reserves**

For the purchase and sale of land.

**6. Strategic Reserves**

Provide funding for strategic initiatives and investment identified by Council.

**7. Other Reserves**

Either fulfil a specific administrative function, comply with a bequest or are for short-term purposes.

Section 7.2 of the Reserves Policy speaks to the subject of establishing target minimum and maximum reserve balances, where appropriate, to ensure that specific reserves are stable to fulfill their purpose but do not grow beyond their intended purpose.

The Government Finance Officers Association (GFOA) recommends a target balance in ‘working capital’ between 45 and 90 days of expenditure budgets. ‘Working capital’ for local governments can be equated to unrestricted operating reserve balances in the General Operating Fund, the Sewer Operating Fund and the Water Operating Fund.

If a reserve was reduced below its target minimum balance, the budget review process would both clearly disclose if/when a reserve balance fell below the minimum target and the strategy to restore the reserve’s balance to its minimum target.

Currently, only minimum balances are identified in the Reserves Policy.

## **DISCUSSION**

On 2020-MAR-17, the Province of BC declared a Provincial Health Emergency due to the COVID-19 Pandemic and it is still ongoing to this day. The Pandemic has caused financial hardships for many citizens and governments across Canada and the world as a whole.

Like all the municipalities in Canada, the City of Nanaimo has been adversely affected by the COVID-19 Pandemic. The organization has experienced loss of revenues from Casino, parking fees and Parks, Recreation and Culture (PRC) closures to name a few. To compensate for these losses, Staff have worked to reduce expenditures where possible. As the Pandemic continues with no fixed end date, it is a challenge to maintain level of service while keeping property taxes to a palatable level.

The Financial Stability Reserves were created for an event just like this. Staff have been working on how best to use these reserves without causing large property tax and user fee increases in futures years of the financial plan.

One scenario was to look at establishing a maximum balance in each of the financial stability reserves for five (5) years. At the end of the five (5) years, a review would be undertaken to determine if the balances are still sufficient or if changes are needed.

The current balance in each reserve is:

<b>Reserve</b>	<b>Current Balance</b>	<b>Minimum Balance Calculation</b>
<b>General Financial Stability Reserve</b>	\$16,408,806	60 days of prior year's budgeted general operating expenditures
<b>Sewer Financial Stability Reserve</b>	\$471,249	45 days of prior year's budgeted sewer operating expenditures
<b>Water Financial Stability Reserve</b>	\$1,701,055	60 days of prior year's budgeted water operating expenditures

The recommended minimum and maximum balance for each reserve are:

<b>Reserve</b>	<b>Minimum Balance</b>	<b>Maximum Balance Calculation</b>
<b>General Financial Stability Reserve</b>	\$15,000,000	60 days of prior year's budgeted general operating expenditures
<b>Sewer Financial Stability Reserve</b>	\$500,000	60 days of prior year's budgeted sewer operating expenditures
<b>Water Financial Stability Reserve</b>	\$1,700,000	60 days of prior year's budgeted water operating expenditures

As part of the Reserves Policy, reserves that are drawn down below their minimum balances must have a repayment schedule built into the next financial Plan. By adjusting the minimum balance and creating a maximum balance in the Financial Stability reserves, it will allow flexibility in dealing with the long-term COVID-19 effects without creating an automatic repayment trigger until the balance drops below the minimum.

The current Draft 2021-2025 Financial Plan assumes that operations, other than Casino revenues and investment income, are back to normal levels in 2022. As there are many unknowns with COVID-19 and no defined end date, having this funding available will help mitigate assumption risks.

The minimum balances would still maintain the reserves within the range that is considered best practices.

## **OPTIONS**

1. That the Finance and Audit Committee recommends that Council revise the minimum and set a maximum balance for the three (3) financial stability reserves, to be reviewed every five (5) years, as follows:

### Minimum Balances:

1. \$15,000,000 for the General Financial Stability Reserve
2. \$500,000 for the Sewer Financial Stability Reserve
3. \$1,700,000 for the Water Financial Stability Reserve

### Maximum Balances:

60 days of prior year's budgeted general operating expenditures for all three (3) financial stability reserves.

- **The advantages of this option:** Will allow the flexibility to smooth property tax and user fee increases that could result from the COVID-19 Pandemic in future years.
- **The disadvantages of this option:** The amounts in the reserves will not increase with the increase in the operating budget over the next five (5) years.
- **Financial Implications:** For 2021, no allocation, other than the \$700,000 for post-employment benefits, from the 2020 budget variance will be transferred to the General Financial Stability reserve. Setting a minimum and maximum balance for these reserves will allow the City to use funds without triggering an automatic payback, while still maintaining an adequate amount in each reserve.

2. That the Finance and Audit Committee recommends that Council deny revising the minimum reserve balances and imposing maximum balances for the General, Sewer and Water Financial Stability Reserves.

- **The advantages of this option:** No change to the Policy will be needed and the best practices established in 2019 will remain unchanged.
- **The disadvantages of this option:** Any use of these reserves will affect future years of the Financial Plan as a repayment plan will need to be established for any amount taken from the reserves.
- **Financial Implications:** The first \$1,055,770 of the 2020 budget variance will need to be allocated, in addition to the \$700,000 for the post-employment benefits, to the

General Financial Stability Reserve. This would bring the reserve to the minimum balance or alternatively if the budget variance is insufficient a repayment plan will need to be incorporated into the 2021-2025 Financial Plan. Currently the Draft 2021-2025 Financial Plan uses \$1.4 million from the General Financial Stability Reserve to reduce taxes in 2021 with no repayment budgeted. Without the recommended changes, a repayment plan would need to be implemented in future years of the plan.

3. That the Finance and Audit Committee provides alternative recommendations to Council.

#### **SUMMARY POINTS**

- Council adopted the Reserves Policy on 2019-JUL-22.
- Three (3) Financial Stability Reserves, one for each fund, were created to mitigate specific risks or provide funding for future costs.
- Minimum balances have been established for each reserve and an allocation of prior year surpluses are used to maintain these balances.
- Staff are recommending the revision of minimum balances and the establishment of a maximum balance in each of the three (3) Financial Stability Reserves, with a review to be performed every five (5) years to determine if the values are still appropriate.
- Setting a minimum and maximum balance for these reserves will leave room to use the funds without triggering an automatic payback, while still maintaining an adequate amount in each reserve.

#### **ATTACHMENTS:**

- Attachment A: City of Nanaimo Reserves Review Report 2019-JUL-17
- Attachment B: Reserve Policy

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