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REPORT
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Regional Council

For Information

REPORT TITLE:	**Overview and Update on the Status of Reserves**
FROM:	Stephen Van Ofwegen, 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

- The Region of Peel's (Region) Long Term Financial Planning Strategy, Financial Management By-law and Reserve Management Policy establish the present framework for managing reserves.
- 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 Growth.
- Tax Supported and Utility Rate (Water and Wastewater services) Supported Stabilization Reserves are currently sufficient to adequately maintain the Region's financial flexibility to mitigate service volatility.
- Analysis of the Tax Supported Capital Reserve and the Utility Rate Supported Capital Reserve shows that maintaining the reserve contribution at the current levels will result in a total shortfall of $2.4 billion by the end of 2040 (Tax: $1.3 billion, Utility Rate: $1.1 billion).
- Actions to address the shortfall in Tax and Utility Rate Supported Capital Reserves will be brought forward for consideration as part of the 2021 Budget.
- Review of the Specialty Reserves indicates that 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 sustainability of the Housing-Contingency Liability Reserve and will provide an update to Council in 2021 on the overall state of good repair needs and sustainability of the housing Capital/Infrastructure Loan program.
- Staff continue to assess the sustainability of the Housing-Contingency Liability Reserve, and will provide an update to Council in 2021 on the overall state of good repair needs of the housing providers and the housing loan program.
- Council's strategy of funding 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 the financial sustainability and flexibility of the capital program.

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 positive attributes helping it to achieve a Triple A (AAA) credit rating. Maintaining a high credit rating ensures the Region's 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 like investments, where the overall pooled risk is lower than the separate individual risks. Pooling similar reserves into a portfolio enables Council to easily deploy the funds to areas of greatest need. The policy classifies reserves into four major categories: 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 rates 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 August 31, 2020.

a) Tax Supported Rate Stabilization Reserve

The Reserve Management Policy requires that 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 for programs 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 economic volatility on the Region's programs.

As at August 31, 2020 the balance of the Tax Supported Rate Stabilization Reserve is at $145 million or 9.6 per cent of the 2020 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 adequate to provide financial flexibility to address one-time pressures and volatility within the Tax Supported operating budget. On October 22, 2020, through the report titled, "Update on the Development of the 2021 Budget", Council approved the use of $16.7 million to replace the remaining debt financing for the

Senior's Health and Wellness Village, reducing the balance of the reserve to $128.7 million or 8.5 per cent of the 2020 Tax supported total operating budget. The Tax Supported Rate Stabilization Reserve will also be used if need be to partially address the potential GO Transit liability which totals $236 million at the end of August 2020.

b) Utility Rate Supported Rate Stabilization Reserve

The Reserve Management Policy also requires that 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 operating budget. As at August 31, 2020, the Utility Rate Supported Rate Stabilization Reserve has a balance of $45.1 million, which represents 8.1 per cent of the 2020 Utility Rate supported total operating budget, which is in compliance with the Reserve Management Policy and provides financial flexibility to address volatility within the water and wastewater services.

3. Capital Financing

The Region's capital plans are financed through capital reserves, Development Charge 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 finance the state of good repair requirements of the existing assets and other capital work not eligible for Development Charge funding.

The capital financing sources used are largely dependent on the type of capital project. For example, Development Charge funding can only be used for eligible growth-related projects. A separate report titled "Peel's Growth Management Program and Development Charge Performance – 2019 Overview and Progress Report" was provided to Council in April 2020. That report detailed the status of development charge revenues, growth related capital expenditure, associated risks and mitigation measures and the adequacy of Development Charge Reserves. The Region updated and approved its Development Charge By-law on December 10, 2020.

a) Asset Management

As detailed in the companion report titled, "Enterprise Asset Management" December 10, 2020, the Region owns and operates $32.1 billion in assets ($29.6 billion of Regional infrastructure and $2.5 billion of infrastructure in the Peel Housing Corporation). 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. 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 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 to identify priority initiatives. The report concludes that the levels of investments that will be proposed in the 2021 Capital Budget and Forecast are 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" in accordance with Council's targets.

b) Determining the Cost of Future Capital Liability

i) Maintain Existing Service Level

Inflation is one of the variables that significantly impacts the cost of maintaining or repairing assets such as buildings, roads and watermains. 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 CCI on replacement costs).

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

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 Rate Supported Capital Plans, which put strain on the capital reserves that are used to fund the increased requirements.

iii) Term of Council Priorities

The Term of Council priorities for the term of 2018-2022 were approved by Council on June 13, 2019. The Term of Council priorities include seven priorities including "Transform housing service delivery", "Expand community mobility" and "Build environmental resilience". Examples of work underway include Peel Housing Master Plan, Sustainable Transportation Strategy, Long Range Transportation Master Plan, Accessible Transportation Master Plan, Inflow & Infiltration Strategy and Asset Management Plan. The 20-year Tax and Utility Rate Supported Capital Plans reflect the capital requirements driven by the Term of Council priorities. These additional capital requirements have increased pressures on the capital reserves which are the major funding sources.

c) Funding

On September 24, 2020, Council approved its Capital Financing Strategy to guide the use of the various financing sources available to fund capital projects. Funding for non-Development Charge capital projects is generally provided from reserves that can be broken down into two major categories: Tax Supported and Utility Rate Supported capital reserves.

Overview and Update on the Status of Reserves

In the fall of 2007, Council adopted a strategy to increase reserves based on a one per cent tax rate each year for capital financing purposes to achieve long term financial sustainability. By 2020, Tax Supported capital reserves have been enhanced by an additional amount of $670.8 million since the implementation of this strategy 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 a range of three to seven per cent have been implemented in annual budgets to strengthen Utility Rate Supported capital reserves resulting into an additional amount of $760.2 million in reserves by end of 2020.

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

To meet the Region of Peel's long-term capital requirements while maintaining financial stability, staff use a 20-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-Development Charge growth requirements, it is estimated that approximately $4.8 billion is required over the next 20 years for Tax Supported Regionally Controlled services.

Current reserve levels and contributions are not adequate to address the Region's 20-year Tax Supported Capital requirements. Staff are projecting a shortfall of $1.3 billion by the end of year 2040 (see Appendix IV for details). To mitigate the gap, it is proposing that a one per cent infrastructure levy increase be included in the 2021 Budget and in each of the next five years up to and including the 2026 Budget.

ii) Utility Rate Supported Capital Financing

Similar to Tax Supported services, staff use a 20-year capital forecast to assess the capital reserve adequacy for Utility Rate Supported services. It is estimated, based on the evaluation of the state of good repair capital requirements, that approximately $5.9 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 $1.1 billion by the end of year 2040 (see Appendix IV for details). In the 2020 budget, staff had forecast that a 5 per cent infrastructure levy would be needed for two more years. In the 2021 Budget, it is proposing that the Council continue with the 5 per cent infrastructure levy increase and implement it each year for two more years until 2023. This estimate may change as the overall financial sustainability of the utility rate program is being reviewed.

Overview and Update on the Status of Reserves

iii) Infrastructure Funding

There has been an increased focus on infrastructure funding from the Federal government in municipal infrastructure areas. The Federal Government launched the Investing in Canadian Infrastructure Program (ICIP) in 2016, as its main infrastructure investment program. Since then, Peel has received or been approved for $105,933.875 in infrastructure funding, through the program.

During the first in-take for ICIP Phase II, Peel has had one Public Transit stream project receive final approval ($5,312,758 between 2020 and 2029) and is waiting on another ($1,121,949 between 2020 and 2029). The Region is also waiting on final approval for one project under the ICIP Community Culture and Recreation stream, submitted by PAMA ($590,306.50). The Region of Peel is currently awaiting the second in-take processes for both the Public Transit and Green Streams.

At the start of the COVID-19 pandemic, the Region included a call for expedited infrastructure funding as part of its recommended short-term advocacy measures to the federal and provincial government, to address the immediate financial impacts of COVID-19 and to stimulate economic recovery. This messaging was in alignment with our municipal partner organizations.

The Province recently announced its own ICIP COVID-19 Resiliency Infrastructure Stream including $250 million for municipalities' critical local infrastructure needs (this funding is a 10 per cent carve out from the province's existing federal ICIP allocation and does not represent new funding). Eligible streams include:

- Community, recreation, health and education renovations;
- COVID-19 response infrastructure;
- Active transportation; and
- Disaster mitigation, adaptation, or remediation.

The Ministry of Infrastructure allocated $18.7 million to Peel with Council approving submission of five capital envelopes totalling $18.7 million through the December 10, 2020 report titled "COVID-19 Infrastructure Resiliency Fund".

In addition to the above-mentioned ICIP funding, the federal government recently allocated $30,394,076 to the Region, through the Major Cities Stream of its Rapid Housing Initiative (RHI). The Region will have to submit an investment plan, demonstrating alignment with RHI criteria, as well as how it will achieve results. As stated in its allocation letter, the Region will be encouraged to take a community benefits approach and push for projects targeting the needs of women and those most vulnerable.

The Region continues to advocate for additional fair, flexible, and reliable infrastructure funding, while appreciating the federal and provincial funding that has been announced so far.

The proposed 2021 Ten Year Capital Plan reflects the utilization of infrastructure funding. Future infrastructure funding may be significant and would mitigate 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 all specialty reserves are at appropriate levels given the current risk environment except for the "Housing-Contingency Liability Reserve" – R1919.

In 2006, the "Housing-Contingency Liability Reserve" R1919 was established to help finance the state of good repair needs of the Affordable Housing buildings in the Region. The housing stock of approximately 20,000 units/homes, is owned and managed by Peel Living as well as external housing providers. The reserve is used to provide loans and/or grants to service providers to help finance the shortfall between their respective state of good repair requirements and available capital reserves. As these loans are to be re-paid over time, the Housing-Contingency Liability reserve will be partially replenished and available for new loan requests.

On October 24, 2019, an update on the status of the Capital/ Infrastructure Loans program was provided to Council. At the time of the report, $39.6 million had been loaned to housing providers including Peel Living to finance the state of good repair of the buildings. Given the increasing capital requirements from providers, staff will bring a report to Council in 2021 on the overall needs and sustainability of the Capital/ Infrastructure Loan program.

5. Risks and Pressures

Reserves, reserve funds and specialty reserves ensure the capital plan is sustainable and provide flexibility to mitigate volatility in tax and utility rates. The 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. The risks and pressures include the following:

Rate Stabilization Risks:

- The Province has provided Phase 1 Safe Restart funding to address the overall 2020 operating deficit driven by COVID-19 related costs and pressures and has more recently announced an additional $20.58 million in Phase 2 Safe Restart funding. As Peel has entered a second wave of COVID-19, there is some risk that the additional costs and pressures may exceed the allocated Safe Restart Funding.
- GO Transit liability: the potential GO Transit liability continues to grow, amounting to $236 million by August 2020.

Capital Reserve Risks:

- Bill 197, *COVID-19 Economic Recovery Act 2020* (Bill 197); was positive compared to the changes first proposed through *Bill 108, More Homes, More Choice Act, 2019* (Bill 108). However, there remain some financial implications and risks to the Region. The Development Charge revenue loss would require the Region to take on additional debt or increase property taxes and utility rates to continue with its capital infrastructure investment plan for growth. This would impact the Region's financial sustainability and flexibility over the long term.

- Impact of COVID-19 on Development Charge collections could have adverse financial implications and poses risks to the Region.
- Service enhancements such as infrastructure requirements to achieve increased waste diversion and additional affordable housing to address unmet needs.
- Unanticipated capital work such as emergency watermain repairs.
- The need to have available balances to match Federal & Provincial infrastructure funding.

All of the above risks and pressures require the Region to maintain reserve balances as prescribed in the Region's Reserve Management Policy. This sustains the Region's capital plan and provides flexibility in mitigating the volatility of tax and utility rates.

In addition to maintaining reserve balances to mitigate risk, staff continue to assess and monitor any fiscal pressures on reserves and reserve funds by carrying out the following strategies:

- Ensure service levels are maintained.
- Review service operations and capital infrastructure requirements to meet the changing needs of the community.
- Improve processes to identify efficiencies and to prioritize resource allocations.
- Utilize external funding whenever possible (examples include Infrastructure Funding, Federal and Provincial Gas Tax funding).
- Explore opportunities to increase revenue (an example includes the following):
  - By identifying changes in the development of land use planning; staff have completed a review and the user fee updates have been included in the 2021 Budget submission.

CONCLUSION

Council's current strategy of funding 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 has helped to maintain its financial sustainability and flexibility of the capital program.

As indicated in the Long Term Financial Planning Strategy, the 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 reserves for state of good repair, service enhancements and growth will not be sufficient to meet the combined $3.1 billion funding shortfall associated with the Region's long term capital financing requirements. The proposed 2021 Budget will include capital infrastructure levies to address this insufficiency, for Council consideration.

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.

Reviewed and/or approved in workflow by:

Department Commissioner and Division Director.