



# COMMITTEE OF THE WHOLE INFORMATION REPORT

To: Mayor and Council

Date: November 5, 2024

From: Ron Bowles, CAO

File No: File No.

Subject: **2025 Budget Primer Capital and Reserves**

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## INFORMATION SUMMARY

Reserves operate as the main savings vehicle for capital expenditures, improvements, and renewals strategy outlined in the 10-year capital plan. Consistently reviewing and bolstering reserves ensures that the City of West Kelowna can afford the projects in the plan as it progresses towards comprehensive life-cycle asset management.

## STRATEGIC AREA(S) OF FOCUS

The financial plan touches all areas of the strategic priorities set by Council each year. In particular Investing in infrastructure is the pillar focused on in the capital/reserves review.

**Invest in Infrastructure** – We will invest in building, improving and maintaining infrastructure to meet the needs of, and to provide a high quality of life for, current and future generations.

**Pursue Economic Growth and Prosperity** – We will work with stakeholders throughout the region to advocate for and support efforts aimed at helping West Kelowna businesses prosper. With a focus on the future, we will advance opportunities to expand our economy, increase employment, and develop the community in ways that contribute towards prosperity for all.

**Strengthen Our Community** – We will provide opportunities for the residents of West Kelowna to build connections, celebrate successes, embrace the community's strengths and diversity, address shared needs, and contribute to shaping the community's future.

**Foster Safety and Well-Being** – We will pursue through direct action, advocacy, and collaboration with local and regional service providers, investments in community health, needs-based housing, emergency preparedness, policing, and other services that foster safety and well-being in West Kelowna.

## BACKGROUND

Imbedded in the bylaws that created the City of West Kelowna's reserves are the guidelines for maintaining adequate balances to keep the funds healthy. The following is a list of the fund balance and deposit criteria as they were established. The bylaws and policy direction were approved by Council in March 2016. As per below the bulk of the capital reserves were meant to accumulate to a level that is, at a minimum able to fund the totality of projects identified to come from capital reserves over the next five years. West Kelowna has built capital reserves over time but never to this level as it would have required either more conservative usage or much higher additions to yearly transfers and ultimately higher tax increases over time. That being said the reality for some reserves is that they are just robust enough to cover the current year needs after factoring in previous year's approved capital projects (whether in-process or not yet started).

Other reserves were designed to accumulate towards an ultimate goal of funding a specific project by the time it came to fruition. An example of this is the Fire Hall #32 project which lists \$3.8M of funding from the Fire Hall reserve that has accumulated to \$1.047 million after two years. By 2026 it is expected that the reserve will have over \$2.5 million saved to contribute towards the approved project funding. A similar strategy was used for funding the City Hall project from 2021 to 2024. The reserve was not at an adequate level to fund the project at the onset but has grown to the required level by finalization. As well, in both cases the yearly transfer to reserve will be utilized as a debt payment once loans are converted from temporary to long-term.

Name of Reserve Fund	Deposit of Money	Fund Balance
<b>Future Expenditures Reserve Fund</b>	<ul style="list-style-type: none"> <li>a) Annual allocation from general operating budget as provided for in the financial plan</li> <li>b) Transfer of any development revenues over and above established base amounts</li> </ul>	The fund's credit balance will be kept at a minimum level of 1% of general operating fund revenues and a maximum of 2.5% of general operating revenues, either rounded to the nearest \$100,000.
<b>Policing Reserve Fund</b>	<ul style="list-style-type: none"> <li>a) Transfer of excess traffic fine sharing revenue not utilized within the annual policing operations</li> <li>b) Transfer of savings realized from policing operation budget</li> </ul>	The fund's credit balance will be kept at a minimum level of 10% of RCMP contract expenditures and a maximum of 20% of RCMP contract expenditures, either rounded to the nearest \$100,000.
<b>Capital Reserve Fund</b>	<ul style="list-style-type: none"> <li>a) Annual allocation from the general operational budget as provided for in the financial plan</li> </ul>	The fund's credit balance will be kept at a minimum level to adequately fund capital projects identified as capital funded for the next 5 years of the 10-year capital plan and a maximum level to

		adequately fund all capital projects identified as capital funded in the 10 Year Capital Plan.
<b>Sewer Capital Reserve Fund</b>	a) Annual allocation from the sewer operational budget as provided for in the financial plan	The fund's credit balance will be kept at a minimum level to adequately fund capital projects identified as sewer capital funded for the next 5 years of the 10 Year Capital Plan and a maximum level to adequately fund all capital projects identified as sewer capital funded in the 10 Year Capital Plan.
<b>Water Capital Reserve Fund</b>	a) Annual allocation from the water operational budget as provided for in the financial plan	The fund's credit balance will be kept at a minimum level to adequately fund capital projects identified as water capital funded for the next 5 years of the 10 Year Capital Plan and a maximum level to adequately fund all capital projects identified as water capital funded in the 10 Year Capital Plan.
<b>Equipment Replacement Reserve Fund</b>	a) Annual allocation from the general operational budget as provided for in the financial plan b) Allocation of all proceeds from the sale of municipal vehicles and equipment	The fund's credit balance will be kept at a minimum level to adequately fund the next 5 years of scheduled vehicle and equipment replacements and a maximum level to adequately fund all scheduled replacements in the 10 Year Financial Plan.
<b>Property Acquisition Reserve Fund</b>	a) Annual allocation from the general operational budget as provided for in the financial plan	The fund's credit balance will be kept at a maximum level to adequately fund property acquisitions identified in Master plans or Council priorities.

The Future Expenditures and Policing reserves are both examples of funds tied to either revenues or expenses. Future Expenditures according to the bylaw should be kept within 1% to 2.5% of total operating revenues. At the end of 2023 audited figures showed that the reserve was in that 2.5% range but after taking into account previous projects not yet funded by the reserve as well as approved 2024 projects and reserve additions, the balance to the end of the year is only expected to be \$404,746 or just over 0.5% of

revenues. The policing reserve on the other hand should be kept within 10 to 20% of RCMP contract expenses. This reserve, at the beginning of 2024 was just over \$1.2 million and is projected to be \$1.037 million by year end. With expenses budgeted at \$6.145 million the reserve should end up at about 17% of contracted expenditures.

Another major factor in allocating reserves comes about through master plan updates. Earlier this year the Parks Master Plan and the Trails Master Plan were updated, presented, taken through public consultation and endorsed by Council. These two plans contain a multitude of recommendations over ten years including park improvements, courts, signage, accessibility, land acquisitions among others. The City’s land acquisition reserve according to the bylaw requires that enough funds be maintained to adequately fund master plans but these two master plans alone account for tens of millions of spending over ten years. Building the reserve to this level would take a number of sizeable contributions each year over many years. And to note for reference, a 1% tax increase yields about \$450,000 and compounding that over 10 years results in just over \$5.5 million of savings, which is substantial but not enough to achieve levels needed for the master plans.

## FINANCIAL IMPLICATIONS

Selected key reserves and their relative balances appear in the chart below. Audited balances show a robust listing of reserves, but when we factor in commitments and costs not yet assigned to the reserve balances, we see a different full-costing result. Please note that, as referred to above, the Fire Hall #32 project is in process and as a result the reserve appears negative due to the full level of 2024 funding being applied to the project even though the funds will not be drawn until the end. Another negative appears in the Powers Creek reserve due to the number and value of current and previous projects funded from this reserve. This reserve is slowly recovering but there are many capital needs in this utility and scarce funds to meet those needs. On the bright side the borrowing for the Powers Creek water treatment plant ends in 2026 which should ultimately create room in the fee structure to add more funds to reserve.

	Audited balance Jan 2024	Pre 2024 projects in process	2024 Capital Projects funded	Debt Payments and adjustments	Reserve additions and interest earned	Expected Balance 2024
Capital Reserve	8,468,328	-7,616,810	-4,063,370	-588,944	5,341,605	1,540,809
Capital Reserve 1% Infrastructure	1,396,911	-1,226,386	-925,000		1,141,052	386,577
Equipment - General	3,115,714	-1,831,122	-1,065,120	-278,283	1,203,150	1,144,339
Future Expenditures	1,933,825	-1,231,994	-854,000	0	556,915	404,746
Reserve for Fire Hall	1,047,160	0	-3,800,000	0	500,000	-2,252,840
Rose Valley New	8,389,766	-1,597,612	-482,378	-99,904	2,547,628	8,757,500
Powers Creek New	1,445,942	-1,290,072	-1,221,936	0	912,578	-153,488
	25,797,646	-14,793,996	-12,411,804	-967,131	12,202,928	9,827,643

### A closer look at the main capital reserve:

Capital Reserve Opening Bal 2024	8,468,328	Audited figure year-end Dec 31,2023	
Projects in process pre 2024	-7,616,810	Approved projects in process 2021-2023	
Adjusted Capital Reserve Opening	851,518	Updated opening balance	
Approved Additions to Reserve 2024	5,341,605	Reserve addition did not change in 2024 as 2% increase was not approved	
Approved Capital Projects 2024	-4,063,370	2024 Capital budget authorization to spend	
Reserve transfer to operating	-588,944	The reserve funds a portion labour associated with capital	
<b>Balance projected to end of 2024</b>	<b>1,540,809</b>		

Taking a closer look at the main capital reserve we see a reasonably robust audited balance. This balance provides a snapshot in time ahead of carry forward allocations for projects which account for 90% of the balance. Adding in the approved additions to reserve, which remained unchanged for 2024 at just over \$5.341 million, then the approved 2024 capital projects at \$4.063 million and finally the transfer to operating of \$588,944 the projected balance for the end of 2024 comes in at just under \$1.541 million. This is a reasonable balance considering what it has funded to date but if we look further ahead the reserve could soon be overburdened.

### A three-year outlook:

<b>2025</b> Opening Balance	1,540,809		
2025 Reserve Addition plus 2% increase	6,310,941	Includes interest on reserve balance	
Reserve transfer to operating	-803,508	Labour funded from capital	
2025 Preliminary Projects	-5,811,750		
<b>Balance YE2025</b>	<b>1,236,492</b>	Reserve would finish the year close to where it started	
2026 Reserve Addition plus 2% Increase	7,320,583		
Reserve transfer to operating	-827,613		
2026 Preliminary Projects 10 Year Plan	-12,498,067	Projects were mitigated in 2024 and pushed later in the plan	
<b>Balance YE2026</b>	<b>-4,768,605</b>	Even with a 2% tax increase projects will have to be mitigated again	
2027 Reserve Addition plus 2% Increase	8,331,823		
Reserve transfer to operating	-860,718		
2027 Preliminary Projects 10 Year Plan	-10,554,140	Again projects were pushed later in plan to in order to fund 2024/2025	
<b>Balance YE2026</b>	<b>-7,851,639</b>		

A 2% hypothetical tax increase for capital reserves in 2025 equates to a \$6.31 million addition and appears to be adequate to fund the \$5.81 million in capital requests that have come forward from departments during this budget season. With a balance in 2025 of \$1.236 million the reserve would finish the year just short of its opening balance. Looking further into the plan we see the reserve becoming overwhelmed with capital

projects in 2026 and 2027. These two budget years and the balance of the 10-year plan still require significant review by management to make decisions on what could be delayed, scaled down or deleted.

Rationalizing affordability and completing mitigation to finalize the 10-year capital plan is still in process in order to keep reserves at a sustainable level. The question remains what is reasonable in light of the reserve bylaw's minimum guideline, the capital needs of the organization and the City's strategic priorities.

## **CONCLUSION**

Accounting for and planning reserve levels isn't complicated unto itself but tracking the projects that draw from each reserve can be intensive, especially when projects span multiple budget years or require place holders in the funding model because they haven't yet started. At this point there are reserves that are highly utilized but maintaining their balances and often this is done using innovative funding methods like equipment financing through the Municipal Finance Authority (MFA). Ultimately borrowing flattens the curve and spreads the cash flow into the future since financing requires the payments to be funded from reserve balances in order to not affect tax rates. Outside of this tool rationalization and prioritization of projects and their timelines is the best mitigation technique employed to date.

Discussion at the Council level may revisit priorities and immediate needs in light of limited funding for infrastructure at this early budget stage. Should 2025 be a year of capital restraint to allow reserves to replenish or should the budget be designed to increase additions to capital reserves as was the trend before 2024?

## **REVIEWED BY**

Trevor Seibel, Deputy CAO/Deputy Corporate Officer

## **APPROVED FOR THE AGENDA BY**

Ron Bowles, Chief Administrative Officer

PowerPoint: Yes  No