



## COMMITTEE OF THE WHOLE REPORT

To: Paul Gipps, CAO

Date: October 19, 2021

From: Warren Everton, Director of Finance/CFO

Subject: **Reserve Funds Overview**

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### RECOMMENDATION

**THAT** Council approve a transfer from the Operating Surplus Reserve consisting of \$3.15 million to Capital Reserves, and \$250,000 to the Wildfire/Emergency Reserve for a total of 3.4 million; and

**THAT** Council amend the 2021 Financial Plan to change the funding of project C2021-55 “Self Contained Breathing Apparatus” from Fire Equipment Reserve to Equipment Financing through the Municipal Finance Authority.

### STRATEGIC AREA(S) OF FOCUS

Investment in Infrastructure and Economic Growth and Prosperity are the two areas of Strategic Priorities that financial planning touches. Maintaining, upgrading and replacing critical assets is an integral part these two focus areas and reserves are the building blocks of these priorities.

### BACKGROUND

To evaluate reserves it is essential we cover numerous aspects of reserve planning including:

- The reserve fund policy
- Maximum and minimum reserve balances as listed in the policy
- Reserve planning and link to the Capital Budget
- The ongoing Asset Management Plan (AMP)
- 2020 audited reserve ending balances vs projected balances including carry forwards
- Comparison of the City’s reserve balances to assets, revenues and debt levels
- Comparison of reserve balances to other medium size cities
- Comments on the overall health of critical reserves

These review items remain quite relevant when considering the age of the City relative to the age of the City’s infrastructure.

The City's reserve fund policy is contained within the Revenue Policy which uses an additional document (attached) listing minimum and maximum levels to be retained in any given year. Generally the minimum reserve balances equate to next 5 years of capital project spending in the ten year plan and the maximums equate to the full 10 years for a given budget year. These criteria have always been very ambitious and the City has rarely achieved these balances. The wording for reserves in the revenue policy is as follows.

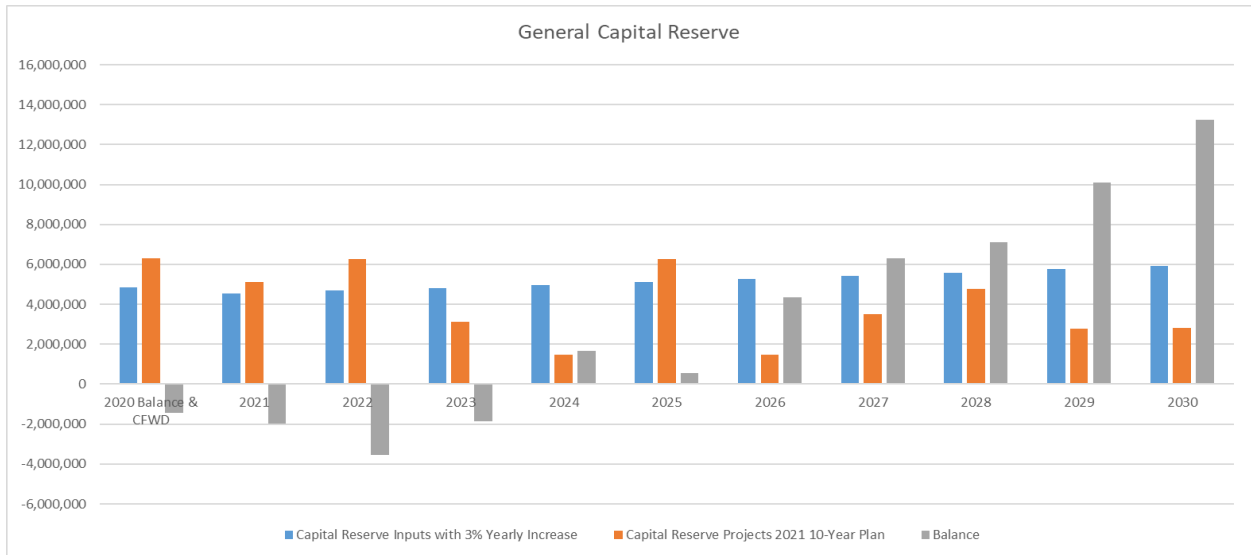
#### Reserve Funds

1. Provide sources of funds for future capital expenditures;
2. Provide a source of funding for areas of expenditure that fluctuate significantly from year to year (equipment replacement, special building maintenance, etc.);
3. Protect the District from uncontrollable or unexpected increases in expenditures or unforeseen reductions in revenues, or a combination of the two; and
4. Provide for working capital to ensure sufficient cash flow to meet the District's needs throughout the year.

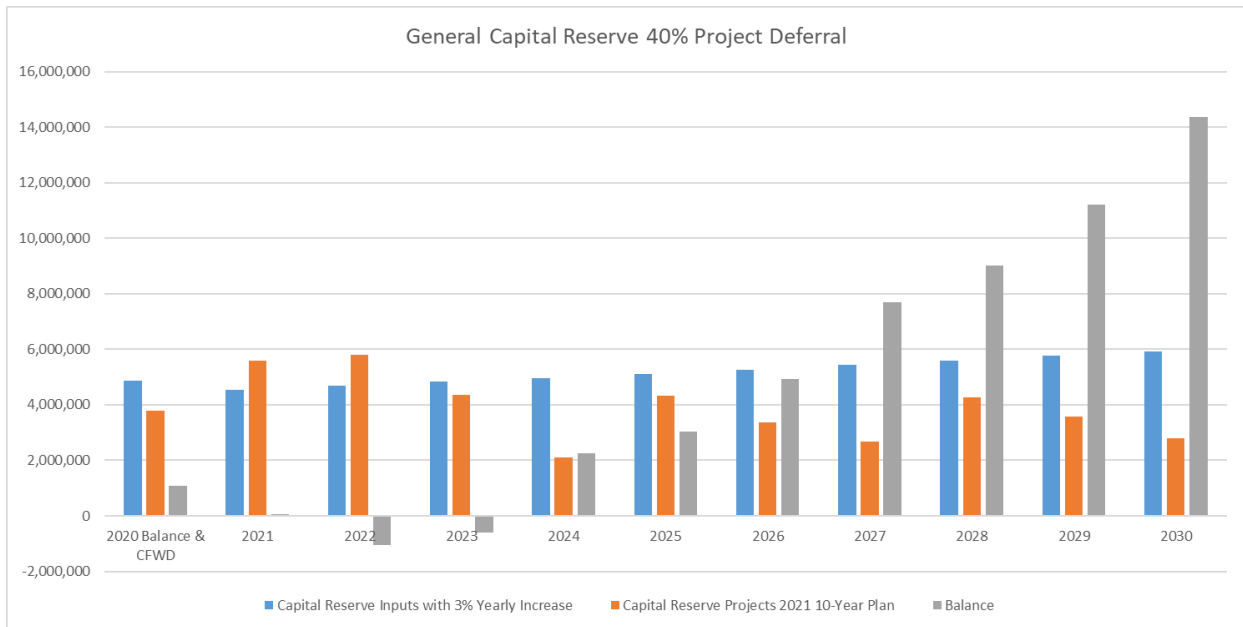
#### Classifications and Interest:

1. Reserve Funds (Statutory Reserves) which are authorized either by the Community Charter or by bylaw; and
2. General (Non-statutory) Reserves which are a combination of budgeted allocations such as equipment replacement reserves, or surplus funds such as the transfer of unspent amounts in our snow clearing budget to a reserve to assist with leveling out expenditures in those years when we get a harsh winter.
3. Interest will be allocated annually to all Statutory and Non-Statutory Reserve Funds at the investment portfolio average rate for the year less one-half percentage point.

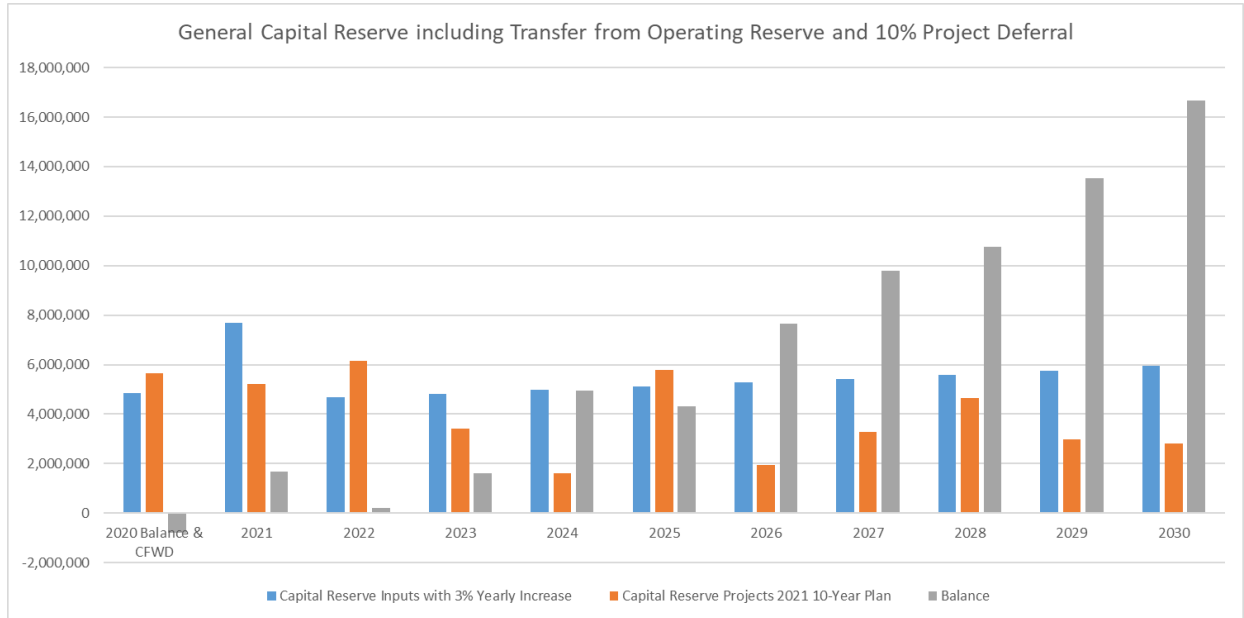
Linking reserves to capital spending is difficult since the actual cash outlay timing is always a moving target. When considering adequate balances it's important to look at cash flow and determine what carry forward projects will complete and what current projects may be carried forward or delayed. The following graph shows how the City's General Capital Reserve, as an example could drop into the negative for three years if all carried-forward projects were completed this year and all 2021 and future projects were completed on time.



Capital spending in the Financial Plan is very front loaded in part due to past plans being deferred to subsequent years. Deferring projects that deal with critical maintenance may leave assets at risk but when reserve balances are stretched this is often necessary. The AMP (Asset Management Plan), which is still in the development stage is key to identifying which assets should be prioritized over the next ten years. The following graph is a scenario where the General Capital Reserve might see a 40% deferral and/or carry-forward through the ten year plan. Though not ideal this reduces pressure on the reserve and is close to historical averages. Please note that reserve levels shown here have a modest 3% increase each year and begin to create sustainable balances by 2026.



Taking into account the proposed \$3.15 million transfer from Operating Surplus to Capital Reserve we would have a much different situation. The reserve could be enhanced enough to stay positive with minimal project deferrals into future years. This of course is contingent upon new requests for 2022 over and above what was projected in the 2021 Capital Budget.



The City's current and carry-forward projects appear in summary below with adjacent funding listed. The completion rate of 24% is low but is skewed by the Water Treatment Plant project.

Capital Projects Status					Funding Source				
Year	No. of Projects	Actual	Budget	% Complete	Reserve	DCC	Debt	Grants	Other
2021-Amendment	2	1,342,534	17,000,000	8%	6,572,574	-	10,427,426	-	-
2021	77	4,232,752	17,651,716	24%	12,047,064	4,162,500	750,000	144,000	129,000
2020	54	7,580,378	14,992,746	51%	9,167,241	4,185,700	1,938,894	-	120,063
2019	20	1,554,639	5,497,082	28%	3,315,814	657,500	1,004,818	-	518,950
2018	12	321,574	1,077,340	30%	1,047,540	-	-	-	29,800
2017	10	358,771	906,169	40%	739,169	67,000	100,000	-	-
2015	1	17,153	30,000	57%	30,000	-	-	-	-
2017 RV-WTP	1	15,171,512	71,998,091	21%	3,017,607	7,884,243	20,094,241	41,002,000	-
<b>Grand total</b>	<b>177</b>	<b>30,579,312</b>	<b>129,153,144</b>	<b>24%</b>	<b>35,937,009</b>	<b>16,956,943</b>	<b>34,315,379</b>	<b>41,146,000</b>	<b>797,813</b>

## FINANCIAL IMPLICATIONS

Many local governments similar in size to West Kelowna have long established and well-funded reserves due to the length of time they have been collecting them. West Kelowna, being a 14-year-old City has not had much time to build reserves and ultimately the process never ends. The following is a table that compares some statistics of similar sized cities for the 2020 financial statement-reporting period

2020	Vernon	Penticton	Campbell River	Mission	West Kelowna
<b>Comparative Financials</b>					
<b>Financial Assets</b>	<b>130,785,000</b>	<b>130,256,944</b>	<b>107,977,634</b>	<b>144,941,920</b>	<b>84,319,314</b>
<b>LT Debt</b>					
General	5,402,000	15,503,927	421,797	3,402,095	5,585,095
Water	0	6,728,355	6,248,729	0	4,985,314
Sewer	20,655,000	5,267,840	4,980,946	0	3,773,046
<b>Total Debt</b>	<b>26,057,000</b>	<b>27,500,122</b>	<b>11,651,472</b>	<b>3,402,095</b>	<b>14,343,455</b>
<b>Tangible Capital Asset Total</b>	<b>831,915,000</b>	<b>318,489,661</b>	<b>274,586,799</b>	<b>495,725,543</b>	<b>385,349,441</b>
<b>TCA Accumulated Amortization</b>	<b>227,968,000</b>	<b>255,525,312</b>	<b>210,992,109</b>	<b>175,163,538</b>	<b>250,235,644</b>
<b>Total Revenues</b>	<b>91,823,000</b>	<b>122,884,914</b>	<b>80,289,337</b>	<b>105,272,205</b>	<b>78,645,401</b>
<b>Savings</b>					
Annual Surplus	10,309,000	13,541,135	17,501,721	34,802,217	11,116,519
Reserve total	78,076,000	134,280,557	62,229,621	69,442,491	40,967,098
DCCs	15,663,000	19,057,314	12,720,575	21,044,179	19,425,058
<b>Total Savings</b>	<b>104,048,000</b>	<b>166,879,006</b>	<b>92,451,917</b>	<b>125,288,887</b>	<b>71,508,675</b>
<b>Analysis</b>					
Ratio of Savings to TCAs	12.5%	52.4%	33.7%	25.3%	18.6%
Remaining Useful Life TCAs	78.5%	55.5%	56.5%	73.9%	60.6%
Ratio of Savings to Revenue	113.3%	135.8%	115.1%	119.0%	90.9%

An important aspect of this analysis is the ratio of savings to TCA (Tangible Capital Assets). For the year-end 2020 CWK had the lowest total savings at \$72.5 million, but a reasonable ratio of savings to Tangible Capital Assets at 18%. Factoring in carry-forward projects and 2021 capital expenditures the figure drops to \$21.6 million with TCAs increasing proportionately.

The comparison also shows that West Kelowna has very low debt and is well positioned amongst its peers. This is ultimately expected to change with the City's priorities focused on infrastructure but should remain reasonable over in the next few years. Another factor affecting reserves is the City's Sewer Fund which borrowed \$9.3 million from other reserves in 2012 over twenty years with \$5.1 million still outstanding to be paid down and retired by 2032.

## CONCLUSION

Reserve health in general is a critical aspect of cash flow as projects run their course. The City's reserves are in reasonable condition but if depleted at the same pace as contributions they will struggle to accumulate adequately for future projects.

The General Capital Reserve spending/funding example is indicative of number of other reserves including the Powers Creek Reserve, Fire Equipment Reserve and the Sewer Reserve. These reserves are over committed at present and will need either increased funding for 2022 or projects may be deferred to later years. The Fire Equipment Reserve in particular requires that the 2021 SCBA project be shifted to equipment financing in order to allow the reserve to rebuild.

Fortunately there are funds on the operating side that can be utilized to shore up capital reserves. The Operating Surplus Reserve has accumulated to \$10.25 million and includes true surplus as well as a number of capital grants. Accounting standards require that the City recognize these grants as revenue in the year they are received regardless of when they are used. In the past we would record them as deferred revenue and then allocate against expenditures in the year or years in which they occurred. This allowed for better tracking compared to immediate recognition which can lead to grant assets flowing through to surplus at the end of the year. Accounting for this fact we have \$4.4 million of surplus to work with of which we are recommending a transfer of \$3.4 million leaving a \$1 million buffer to mitigate against a potential operating deficit in future years.

### Alternate Motion:

**THAT** Council approve the transfer of an amount other than the recommended \$3.15 million in Operating Reserve funds to the Capital Reserve and \$250,000 to the Wildfire/Emergency Reserve; and

**THAT** Council amend the 2021 Financial Plan to change the funding of project C2021-55 "Self Contained Breathing Apparatus" from Fire Equipment Reserve to the General Equipment Reserve.

### APPROVED FOR THE AGENDA BY

Paul Gipps, CAO

PowerPoint: Yes  No

### Attachments:

Consolidated Schedule of Accumulated Surplus as at Dec 31, 2020