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REPORT
Meeting Date: 2021-11-25
Regional Council

For Information

REPORT TITLE: **Overview and Update on the Status of Reserves**

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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.

<u>Operating Reserves</u>

- 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.

<u>Capital Reserves</u>

- 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 $3.6 billion by the end of 2041 (Tax: $2 billion, Utility Rate: $1.6 billion).
- Actions to address the shortfall in Tax and Utility Rate Supported Capital Reserves will be brought forward for consideration as part of the 2022 Budget.
- 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

<u>Specialty Reserves</u>

- Review of the Specialty Reserves indicates that the majority of Specialty Reserves are at appropriate levels given the current risk environment with the exception of the Housing-Contingency Liability Reserve and Workplace Safety & Insurance Board (WSIB) Reserve Pensions.
- Staff continue to assess the shortfall in the Housing-Contingency Liability Reserve, which will be addressed through the management of overall reserves.

- A detailed assessment of risk severity and its impact on the WSIB Reserve Pensions will be conducted and included in future reporting.

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 Reserves, Capital Reserves, Reserve Funds and Specialty Reserves.

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 or temporary 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, 2021.

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 10 per cent of the total budget for programs funded from Tax supported operating budget. Due to prudent financial decisions, Council has built a rate stabilization balance over the years to sustain operations. The reserve has provided Council with the flexibility to stabilize the impact of economic volatility on the Region's programs and, in more recent times, the impact of the COVID-19 pandemic.

As at August 31, 2021 the balance of the Tax Supported Rate Stabilization Reserve is at $172.3 million or 11.1 per cent of the 2021 Tax supported total operating budget. The balance is slightly above the range of five to 10 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. To help manage the pressure on the budget, on February 11, 2021 Council approved a $6.4 million draw from the Rate Stabilization Reserve to support various initiatives under Regionally Controlled programs in the 2021 Tax Supported Budget. If all planned draws were made, the reserve balance would decrease to 10.7 per cent of the 2021 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 $242 million at the end of August 2021.

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 maintained within the range of a minimum of five per cent and a maximum of 10 per cent of the total Utility Rate supported operating budget. As at August 31, 2021, the Utility Rate Supported Rate Stabilization Reserve has a balance of $49.7 million, which represents 8.2 per cent of the 2021 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.

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" was provided to Council in May 2021. 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. Appendix II, "Relationship between Capital Financing and Capital Plan" provides an overview of the relationship between the various sources of capital financing including Capital Reserves and the Capital Plan.

a) Asset Management

As detailed in the report titled, "Enterprise Asset Management Program Update" November 25, 2021, the Region owns and operates $34 billion in assets ($31.4 billion of Region owned and operated infrastructure and $2.6 billion Region owned and Peel Housing Corporation managed infrastructure). 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 Program 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 2022 Capital Budget and Forecast are required to maintain the Region's infrastructure at Council's level of service targets. The report also indicates that the Region'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. Appendix III illustrates the impact of the CCI on replacement costs.

The Region uses the Replacement Cost methodology to estimate future capital requirements. Due to the impact of inflation, the cost to repair and ultimately replace an asset is significantly different from its historical cost. For 2022, there may be significant pressure from inflation due to global supply chain issues. Staff has reflected significant impacts as part of the 2022 Capital Budget and will continue monitoring the inflation trend. If there are significant pressures over and above those reflected in the capital budget then staff will report back to Council with recommendations.

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, and put additional strain on the capital reserves which 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. These priorities include "Transform housing service delivery", "Expand community mobility" and "Build environmental resilience". Examples of work underway include the following: 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 from Capital Reserves

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.

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 2021, Tax Supported capital reserves have been enhanced by an additional amount of $786 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 $923 million in reserves by end of 2021.

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 Reserves

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 $5.7 billion is required over the next 20 years for Tax Supported Regionally Controlled services including state of good repair of Peel Living housing stock.

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 $2.0 billion by the end of year 2041. This figure has increased from the previous year as it now also reflects the projected capital reserve shortfall of Peel Living. To mitigate the gap, it is proposing that a one per cent infrastructure levy increase be included in the 2022 Budget and in each of the next eight years up to and including the 2030 Budget. Please refer to Appendix IV for details.

ii) Utility Rate Supported Capital Reserves

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 $6.8 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 $1.6

billion by the end of year 2041. In the 2021 Budget, it is proposing that the Council continue with the five per cent infrastructure levy increase and implement it each year for three more years until 2025. Please refer to Appendix IV for details. This estimate may change due to the review of the Utility Long Term Financial Plan.

iii) Infrastructure Funding

The Region continues to advocate for federal and provincial governments to provide infrastructure funding to stimulate Peel's economic recovery.

Successful advocacy has resulted in securing $22.7 million in infrastructure funding, through different streams of the Investing in Canadian Infrastructure Program (ICIP). In addition, the construction timelines attached to the ICIP, COVID-19 Infrastructure Resiliency Stream have been extended. Approved projects will now have until September 30, 2023 to begin and must be complete before December 31, 2023.

The Region also continues to receive infrastructure funding from the Canada Community Building Fund (formerly the Federal Gas Tax) and the provincial gas tax. After remitting part of its CCBF allocation to the lower tiers, this amounted to $14.5 million in CCBF funding and Provincial Gas Tax funding in the amount of $494,598, for 2021.

Going forward, the Region will assess and apply for external funding where appropriate including, but not limited to ,the following :

- The Clean Fuels Fund, through its Building New Domestic Production Capacity component.
- The National Trade Corridors Fund, targeting bottlenecks in trade corridors.
- The Disaster Mitigation and Adaptation Fund, through a new in-take supporting projects including the rehabilitation of storm water systems.
- The Active Transportation Fund (ATF), aimed at building new and expanded networks of pathways, bike lanes, trails and pedestrian bridges and planning studies.
- Investments of nearly $1.1 billion across Ontario, aimed at enhancing the province’s housing programs and supporting homeless populations in 2022-23.

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 and the “WSIB Reserve Pensions – R0880”. Please refer to Appendix V for details.

A most recent evaluation shows the Housing – Contingency Liability Reserve is expected to have a $607 million shortfall over the ten years from 2022 to 2031. 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, and is also funded as part of the one per cent infrastructure levy due to Region's mandate as Service Manager in ensuring a safe and adequate supply of Affordable Housing (also see Section 3.c.i – Tax Supported Capital Reserve Financing).

Current assessment shows WSIB Reserve Pensions reserve is insufficient to fully cover the potential unfunded liability estimated by Workplace Safety & Insurance Board. A detailed assessment of risk severity and its impact on the WSIB Reserve will be conducted and included in future reporting.

5. Risks and Pressures

Reserve, 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:

- Peel has received $72.5 million in the federal-provincial Safe Restart Agreements and the Provincial COVID-19- Recovery Fund to address any remaining service pressures not funded through program-specific funding. As the Region shifts its focus to recovery, there is some risk to the reserves that additional costs and pressures in 2022 may exceed Peel's residual balance of $14 million from these funds.
- The 2021 projected year end position assumes that the Province will fully fund the extraordinary costs driven by the Mass Vaccination Program. If the Province only partially funds the costs then there would be a significant negative impact on Peel's year end operating results and subsequently affect the Reserves.
- The 2022 Budget includes draws from the stabilization reserve to minimize yearly fluctuations to the taxpayer. Further changes in Provincial commitments may result in further pressures to the reserves.
- GO Transit liability: the potential GO Transit liability continues to grow, amounting to $242 million by August 2021.

Capital Reserve Risks:

- 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.
- A higher-than-expected inflation rate will impact future capital requirements.

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.

Overview and Update on the Status of Reserves

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 (e.g. 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 2022 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 $3.6 billion funding shortfall associated with the Region's long term capital financing requirements. The proposed 2022 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

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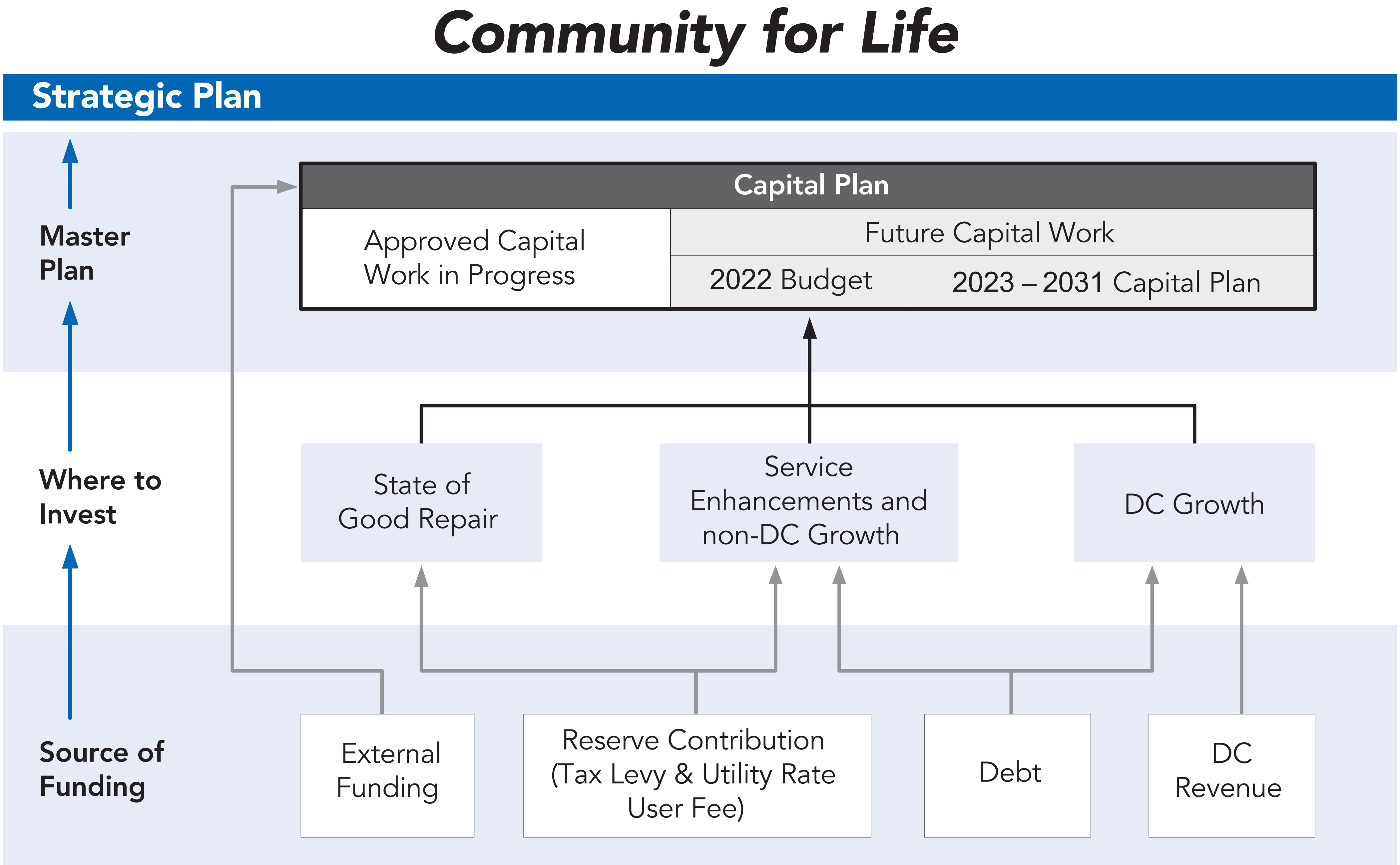
Appendix I
Overview and Update on the Status of Reserves

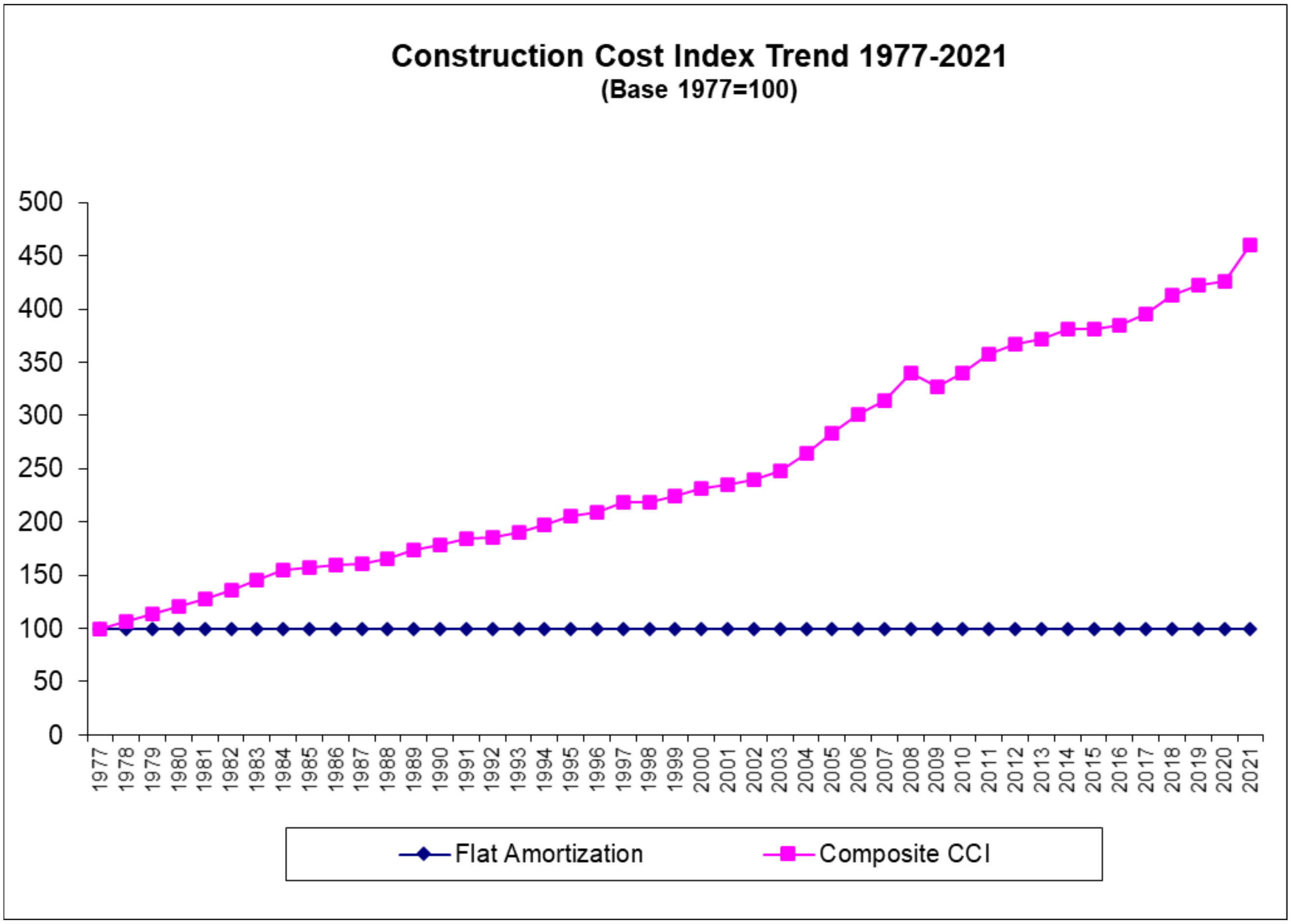
Rate Stabilization Reserves

	Balance as at August 31, 2021	Status of Reserves as at August 31, 2021
Tax	$172 million	11.1% of 2021 Tax Total Operating Budget *Slightly above the Reserve Management Policy required range
Utility Rate	$50 million	8.2% of 2021 Utility Rate Total Operating budget *In compliance with the Reserve Management Policy

*The Reserve Management Policy requires that the balance of the Tax and Utility Rate Supported Stabilization Reserves 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 operating budget.

Relationship between Capital Financing and Capital Plan



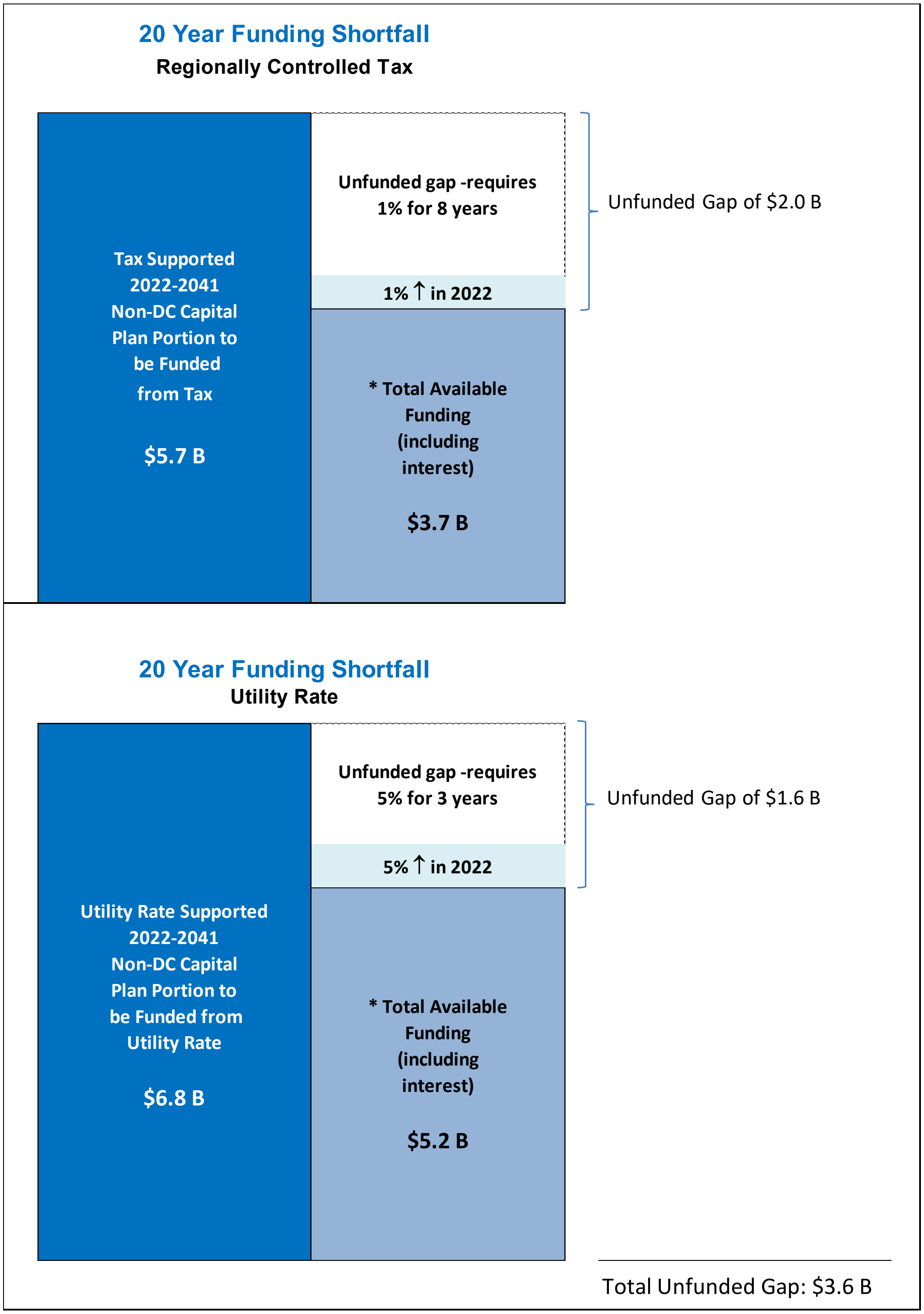


Source: US Department of the Interior, Bureau of Reclamation, Construction Cost Trends

The above chart illustrates the impact of Construction Cost Index (CCI) on an asset that was purchased in 1977 for $100 thousand. By July of year 2021, the cost to replace the same asset would be $460 thousand which is 4.6 times higher than the historical cost. The average annual increase over this period was 3.6%.

Appendix IV
Overview and Update on the Status of Reserves

Reserve Gap Analysis



* The available funding comprises of projected opening uncommitted reserve balance in 2022, regular annual contributions, annual estimated interest on reserve balances and council approved infrastructure tax levy and utility rate increases till 2021

Appendix V
Overview and Update on the Status of Reserves

Specialty Reserves

Reserve	Description	Intended Use	Cash Balance August 31, 2021 ($Millions)	Assessment
R0500	Insurance Stabilization Reserve	To fund any material variances that could adversely impact the Region relating to liability claims or accidental losses.	9.3	**Sufficient:** Currently deemed sufficient to reduce the impact of potential unexpected events. Detailed assessment of risk severity and its impact on reserve will be conducted and included in future reporting.
R0520	Administrative Service Only (ASO) Benefit Stabilization	To fund any material unexpected variances in self-insured Extended Health Care (EHC) and Group Life benefit plans	8.9	**Sufficient:** Currently deemed sufficient; there is limited impact on reserves due to provision of stop-loss in self-insured Extended Health Care (EHC) and Group plans.
R0880	WSIB Reserve Pensions	To fund the Region's future Workplace Safety & Insurance Board (WSIB) liability (self-insured) as determined by the actuaries.	14.8	**Insufficient:** Reserve balance insufficient to fund the current estimate of Workplace Safety & Insurance Board (WSIB) unfunded liability at about $21.6 million. Detailed assessment of risk severity and its impact on reserve will be conducted and included in future reporting.
R1140	Capital Long Term Waste Management Strategy - Energy From Waste Savings	To receive savings from interim landfill operation placed after expiry of third party incineration contract	92.0	**Sufficient:** Reserve amount will be supplemented by debt issuance to fund 75% 3Rs Target projects approved by Council.
R1919	Housing - Contingency Liability Reserve	To fund the potential gap in the state of good repair reserves faced by affordable housing service providers	78.1	**Insufficient :** An estimate of $607 million deficit (previous $370 million deficit in 2020) is expected by 2031 due to increase in Peel Housing Corporation (PHC) capital plan with no data provided by PHC for projecting repayments.
R1923	Housing-Advances to Providers	To track loans that the service provider obtains from Region (draw from R1919) that is under $500 thousand.	0.0*	**N/A**: Reserve is for tracking of loans issued from R1919; Notional use only, no incremental commitment is expected.
R1924	Housing-Loans to Providers Pre	To track loans that the service provider obtains from Region (draw from R1919) that is over $500 thousand.	0.0*	**N/A**: Reserve is for tracking of loans issued from R1919; Notional use only, no incremental commitment is expected.
R1925	Housing- Loan to Providers Post	This reserve is to track repayments which have begun from housing service providers.	0.0*	**N/A**: Reserve is for tracking of loans issued from R1923/24; Notional use only, no incremental commitment is expected.
R1261A	Human Services Revolving Capital Fund	To support community partner integration and system improvements activities in Human Services Department	0.7	**N/A:** Reserve is for tracking of loans issued from R1261A; Notional use only, no incremental commitment is expected.
R0221	Capital Finance Stabilization - Greenlands Securement	To provide annual funding of Greenlands capital project which involve securing greenlands by Peel's Conservation Partners	7.9	**Sufficient:** Spending projections are always aligned to reserve fund availability. Reserve balance is sufficient.

* Cash balance net of the loan that has been lent out