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REPORT
Meeting Date: 2024-11-21
Regional Council Budget

For Information

REPORT TITLE: **2024 Overview and Update on the Status of the Reserves**

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OBJECTIVE

To provide an annual 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 contributor to the Region's 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 Charges eligible growth.

<u>Operating Reserves</u>

- Tax Supported Stabilization Reserve is slightly below the range of five to ten per cent as per the Reserve Management Policy. Staff will continue to monitor the reserve throughout the year.
- Utility Rate Supported (Water and Wastewater services) Rate Stabilization Reserve is currently in compliance with the Reserve Management Policy and is sufficient to adequately maintain the Region's financial flexibility to mitigate service volatility.

<u>Capital Reserves</u>

- Analysis of both the Tax Supported and the Utility Rate Supported Capital Reserves shows that maintaining the reserve contribution at the current levels will result in a total shortfall of $8.7 billion by the end of 2044 (Tax: $4.4 billion, Utility Rate: $4.3 billion). The 2025 Budget proposes a one per cent infrastructure levy increase for tax supported capital, and a five per cent infrastructure levy increase for utility rate supported capital. To reduce the anticipated shortfall in the capital reserves over the 20-year horizon, Council's strategy of funding the Region's capital plan through Infrastructure levies has assisted in maintaining the financial sustainability and flexibility of the capital program. These proposals will be brought forward for consideration as part of the 2025 Budget discussion.
- Longer term solutions are required to address Peel's increased capital needs, which highlight the state of good repair of Peel's housing stock and increase the number of affordable housing units.

Specialty Reserves

- Overall, the Specialty Reserves are at appropriate levels, given the current risk environment, except for the Workplace Safety and Insurance Board (WSIB) Reserve.
- Since the WSIB Reserve Pensions is insufficient to fund the current estimated unfunded liability, a detailed risk assessment will be conducted and included in future reporting to gauge the severity and impact on this reserve.
- Staff continue to assess the Reserves on a regular basis.

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 very strong operating surpluses, exceptional liquidity, and sizable reserves resulting from a track record of conservative budgeting and prudent financial management. Along with moderate debt levels, the above noted factors act as positive attributes supporting the Region’s Triple A credit rating. Maintaining a high credit rating enables the Region to benefit from a low cost of capital supporting the Region and the local municipalities’ capital requirements and 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, whereby 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:

1) Operating Reserve (i.e. Rate Stabilization Reserve)
2) Capital Reserve
3) Reserve Funds and
4) Specialty Reserve Funds

2. Findings

The first of these categories, the Rate Stabilization Reserves, are defined in the Reserve Management Policy, as the reserves arising from the operations of Regional programs. The Region has two Rate Stabilization Reserves: a) Tax Supported Rate Stabilization Reserves’ and b) Utility Rate (Water and Wastewater services) Supported Rate Stabilization Reserves. Surpluses from Tax Supported programs and Utility Rate Supported programs are allocated to their respective, separate reserves. These reserves are used to minimize annual fluctuations in property tax and utility rates through funding 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 December 31, 2024.

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 recommended range. The recommended range is a minimum of five per cent and a maximum of 10 per cent of the total budget for programs funded from the Tax supported operating budget. Prudent financial decisions have enabled Council to build a solid rate stabilization balance over the years that has assisted Peel in sustaining operations. The reserve has provided Council with the flexibility and options to alleviate the impact of economic volatility on the Region's programs and, in the recent past, the impact of the COVID-19 pandemic.

By the end of 2024, the uncommitted balance of the Tax Supported Rate Stabilization Reserve is anticipated to be at $97.1 million or 4.7 per cent of the 2024 Tax supported total operating budget. The balance is slightly below the range of five to ten per cent as prescribed in the Reserve Management Policy. Staff will continue to monitor the reserve throughout the year.

To help manage the pressure on the budget, Council approved $29.6 million draws from the Tax Rate Stabilization Reserve during the 2024 budget process (Resolution Number RCB- 2023-137). The draws support various initiatives under Regionally Controlled programs in the 2024 Tax Supported Operating Budget. After all budgeted draws have occurred, the reserve balance would be 4.7 per cent of the 2024 Tax Rate Stabilization supported total operating budget.

If required, the Tax Supported Rate Stabilization Reserve may also be used to partially address the potential GO Transit liability which totals $247.9 million as at September 30, 2024.

b) Utility Rate Supported Rate Stabilization Reserve

The Reserve Management Policy similarly requires that the balance of the Utility Rate Supported Rate Stabilization Reserve be maintained within a recommended range. The recommended range is a minimum of five per cent and a maximum of ten per cent of the total Utility Rate supported operating budget.

The 2024 year-end forecast is anticipated to be at $47.1 million for the uncommitted balance of the Utility Rate Supported Rate Stabilization Reserve. The forecasted balance represents 6.7 per cent of the 2024 Utility Rate supported total operating budget.

The forecasted year-end position is in compliance with the Reserve Management Policy and provides financial flexibility to address volatility within the water and wastewater services.

To help manage the pressure on the budget, Council approved a $2.7 million draw from the Utility Rate Stabilization Reserve during the 2024 Budget process (Council Resolution Number RCB-2023-137). The draws support various initiatives under Regionally Controlled programs in the 2024 Utility Rate Supported Operating Budget to support Water and Wastewater initiatives. After all budgeted draws have occurred, the reserve balance would be at 6.7 per cent of the 2024 Utility Rate supported total operating budget.

3. Capital Financing

The Region's capital plans are financed through capital reserves, Development Charges (DC) 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.

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. For example, DC funding can only be used for eligible growth-related projects. A Council Report titled, "Growth Monitoring Program and Development Charge Performance – 2023 Overview and Progress Report" was brought forward to Council on July 11, 2024. The report highlighted "the changes brought about by Bill 23, including impacts on DC revenue collections and accelerated housing targets, which require more growth infrastructure in a shorter amount of time creating significant financial risks for the Region".

a) Determining the Cost of Future Capital Liability

i) Maintain Existing Service Level

During the last few years, several factors have impacted cost escalation, including the pandemic induced demand/supply imbalances in many markets, a 4-decade inflation, and high-interest rates. Inflationary pressures significantly impact 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 post-pandemic inflation, the cost to repair and ultimately replace an asset is now significantly different from its historical cost. The post-pandemic surge in prices caused the historic cost increase of many construction inputs. While prices have retreated from peak levels, combined with recent interest rate cuts, cost corrections are not immediately expected especially as Labour costs are not expected to decrease driven by cost of living and union agreements. Staff has incorporated significant price impacts as part of the 2025 Capital Budget and will continue to monitor 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 affordable housing required to address the waitlist and infrastructure to support housing); and other community changes due to population growth (e.g. need to increase road width for public transit, expand Paramedic Services to respond to call volume growth). These combined pressures have contributed to the increases in the 20-year Tax and Utility Rate Supported Capital Plans and placed additional strain on the capital reserves which are utilized to fund the increased requirements.

b) Funding Infrastructure from Capital Reserves

On September 24, 2020, Council approved its Capital Financing Strategy (Resolution 2020-738) to guide the use of the various financing sources available to fund capital projects. Funding for non-Development Charge eligible 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 2024, Tax Supported capital reserves have been enhanced by an additional amount of $1.2 billion 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 in an additional amount of $1.5 billion in reserves by end of 2024.

The benefit of the increased reserve contributions will continue to grow over time counterbalancing escalating costs and ensuring that Peel's assets are adequately maintained, and that the state of good repair of Peel's assets is sustainable.

i) Tax Supported Capital Reserves

To meet Peel's long-term capital requirements while maintaining financial stability, staff utilize 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 eligible growth requirements, it is estimated that approximately $9.3 billion is required over the next 20 years for Tax Supported Regionally Controlled services. This includes the state of good repair of Peel Living housing stock.

Existing reserve levels and contributions are deemed inadequate in addressing the Region's 20-year Tax Supported Capital requirements. Without an Infrastructure Levy, staff are projecting a shortfall of $4.4 billion by the end of year 2044. This figure has increased from the previous year as it now also includes the projected capital reserve shortfall for Peel Living. The latter is Peel's wholly owned municipal non-profit housing corporation.

To mitigate the gap, it is proposed that a one per cent infrastructure levy increase be included in the 2025 Budget and in each of the next nine years. However, even with this annual increase, a shortfall is anticipated in the tax capital reserves in the short and long term. Heightened inflation and the need to address critical needs in the community such as affordable housing has increased the risks to long term sustainability. Predicated on a reserve adequacy analysis, the infrastructure levy increase will be required for the foreseeable future. Refer to Appendix IV for further 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. Based on the evaluation of the state of good repair capital requirements, it is estimated that approximately $11.1 billion is required over the next 20 years for Utility Rate funded services including Water and Wastewater.

Current reserve levels and contributions are insufficient to address the Region's 20-year Utility Rate Supported Capital plan. Staff are projecting a shortfall of $4.3 billion by the end of year 2044.

To close the funding gap, the following infrastructure levy increases are proposed, 5.0 per cent increase for 2025, 6.0 per cent for the years, 2026-2028, 4.0 per cent for the years, 2029-2030 and 3.0 per cent Increase for each year thereafter to 2032. Refer to Appendix IV for further details.

iii) Government Infrastructure Funding

Whilst appreciating the federal and provincial funding that has been announced to date, the Region continues to advocate for additional fair, flexible, and reliable infrastructure funding. Advocacy efforts are on-going for the provision of infrastructure funding needed to address the housing crisis, build an integrated transit network, provide safe drinking water, and stimulate Peel's economic recovery.

The Region will continue to assess and apply for external funding where appropriate.

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 "Workplace Safety and Insurance Board (WSIB) Reserve Pensions" – R0880 and the "Housing-Contingency Liability Reserve" – R1919, refer to Appendix V for details.

Based on last year's assessment, the Workplace Safety and Insurance Board (WSIB) Reserve Pensions reserve is deficient in fully covering the unfunded liability. A detailed assessment of risk severity and its impact on the WSIB Reserve will be conducted and included in future reporting. However, Peel is not required to fully fund the WSIB liability.

In 2006, the "Housing-Contingency Liability Reserve" R1919 was established to facilitate in financing the state of good repair needs of Affordable Housing buildings in the Region. Currently Reserve R1919 finances the state of good repair needs of the external community housing providers. The reserve is used to provide loans and/or grants to service providers to aid in financing the shortfall between their respective state of good repair requirements and available capital reserves. The Region's mandate as Service Manager is ensuring a safe and adequate supply of Affordable Housing therefore the reserve is partly funded as part of the one per cent infrastructure levy. Staff will continue to monitor and assess the capital needs of the affordable housing stock, including ongoing advocacy for external funding opportunities.

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 Reserves:

- The 2024 Budget includes draws of $29.6 million from the Tax Stabilization Reserve to minimize yearly fluctuations to the taxpayer. The Budget also includes draws of $2.7 million from the Utility Rate Stabilization Reserve to minimize the fluctuations to the rate payer. Further changes in Provincial commitments may result in additional pressures to the reserves.
- GO Transit liability: the potential GO Transit liability continues to grow, amounting to $247.9 million as at September 30, 2024.

Capital Reserves:

- Service enhancements such as infrastructure requirements to achieve expanded transportation, Peel Regional Police facilities and additional affordable housing to address unmet needs.
- Unanticipated capital work such as emergency watermain repairs.
- Requirements for available matching funds to benefit from Federal and Provincial infrastructure funding.
- Heightened geopolitical and economic uncertainties have contributed to a generally higher-than-expected inflation environment that will impact future capital requirements.
- Continuing inflationary environment will impact future capital requirements.
- Financial impacts from new legislation.
- Without the additional tax infrastructure levy, increases from 2025 to 2034 tax capital reserves would experience shortfalls.

BILL 112 RISKS AND IMPLICATIONS

On June 8, 2023, the Province passed Bill 112, the *Hazel McCallion Act (Peel Dissolution), 2023*, which was initially intended to dissolve the Region of Peel and provided for a Transition Board to make recommendations to the province on how to implement the restructuring. On June 6, 2024, Bill 185 took effect, amending Bill 112 and reversing the decision to dissolve the Region of Peel. Bill 185 changed the name of the legislation to the *Hazel McCallion Act (Peel Restructuring), 2023* and recalibrated the Transition Board’s mandate to focus on making recommendations on land use planning; water and wastewater; storm water; highways; and waste management. Final details of the Transition Board’s recommendations, any associated provincial decision and impacts on Peel services are not known at this time and will be addressed in future reporting to Regional Council.

CONCLUSION

Council's current strategy of funding the Region's capital plan by utilizing the one per cent infrastructure levy for tax supported capital as well as infrastructure levy increases for utility rate supported capital has aided in maintaining financial sustainability and flexibility of the capital program. New legislation and amplified infrastructure needs, including affordable housing have increased pressure on Peel's reserves.

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 project that capital reserves for state of good repair, service enhancements and growth will not be sufficient to meet the combined $8.7 billion funding shortfall associated with the Region's long term capital financing requirements. For Council's consideration the proposed 2025 Budget will include a one per cent tax infrastructure levy and a five per cent utility rate infrastructure levy to address the inadequacy.

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 and Reserve Funds

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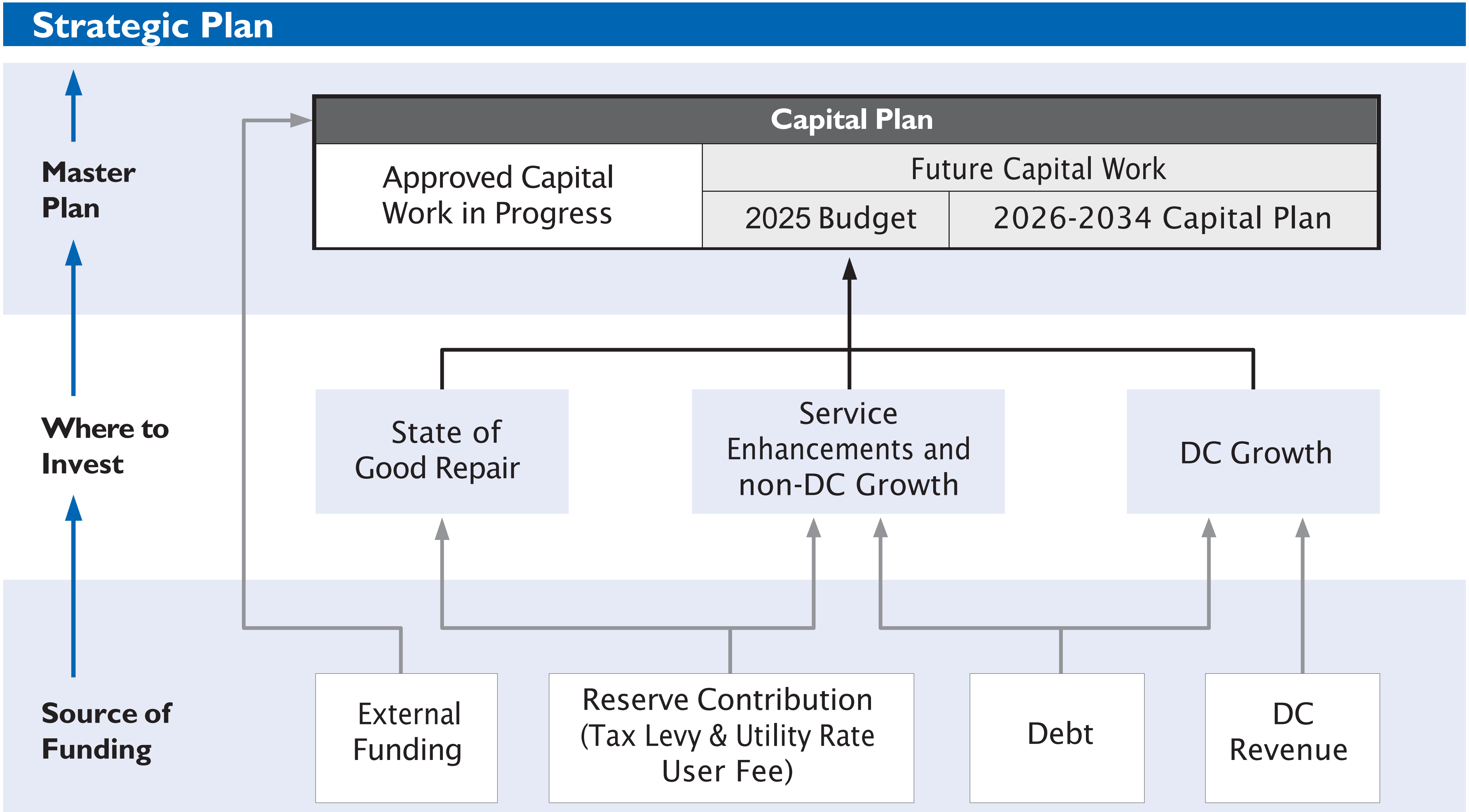
Rate Stabilization Reserves

	Projected Uncommitted Balance as at December 31, 2024	Projected Status of Reserves as at December 31, 2024	Reserve Management Policy Recommended Range: 5%-10%
Tax	$97.1 million	4.7% of 2024 Tax Total Operating Budget *Marginally below the Reserve Management Policy required range	
Utility Rate	$47.1 million	6.7% of 2024 Utility Rate Total Operating budget *In compliance with the Reserve Management Policy required range	

*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 from property taxation or utility rate collections.

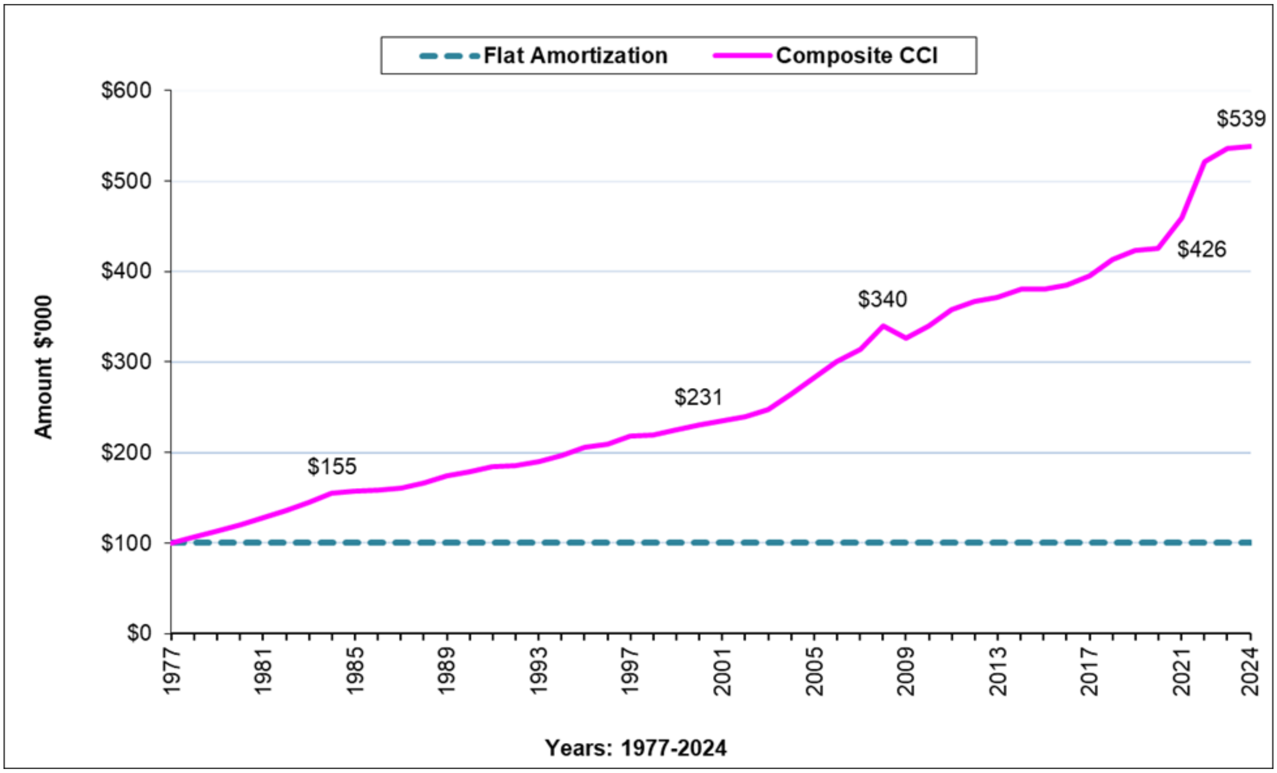
Relationship between Capital Financing and Capital Plan

Community for Life



Construction Cost Index Trend

The chart below illustrates the impact of Construction Cost Index (CCI) on an asset that was purchased in 1977 for $100,000. By July of year 2024, the cost to replace the same asset would be $539,000 which is approximately 5.4 times higher than the historical cost. The average annual increase over this period was 3.7%.



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

Reserve Gap Analysis

The available funding is comprised of projected opening uncommitted reserve balance in 2025, regular annual contributions, annual estimated interest on reserve balances and council approved infrastructure tax levy and utility rate increases till 2024.

Specialty Reserves and Reserve Funds

Reserve	Description	Intended Use	Balance September 30, 2024 ($Millions)
R0500	Insurance Stabilization Reserve	To fund any material variances that could adversely impact the Region relating to liability claims or accidental losses	10.2
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	9.7
R0880	WSIB Reserve Pensions	To fund the Region’s future Workplace Safety & Insurance Board (WSIB) liability (self- insured) as determined by the actuaries	15.9
R1159	Affordable Housing Incentives	Affordable rental incentives program to provide grants to developers to create more affordable rental units within their purpose-built projects	13.4
R1169	Development Charges (DC) Financial Incentive Reserve	To provide funding for grant-in-lieu of development charges for eligible developments	2.3
R1171	COVID-19 Recovery Reserve	To address work that has been backlogged due to COVID-19	30.2
R1261A	Human Services Revolving Capital Fund	To support community partner integration and system improvements activities in Human Services Department	0.7
R0221[1]	Capital Finance Stabilization - Greenlands Securement	To provide annual funding of Greenlands capital project which involve securing greenlands by Peel’s Conservation Partners R0221 is considered as a part of Capital Reserves, it is reported under the Tax Capital Section	2.9
R1140[1]	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 R1140 is considered as a part of Capital Reserves, it is reported under the Tax Capital Section	131.2
R1919[1]	Housing -Contingency Liability Reserve	To fund the potential gap in the state of good repair reserves faced by affordable housing service providers R1919 is considered as a part of Capital Reserves, it is reported under the Tax Capital Section	61.9
R1923[2]	Housing-Advances to Providers	To track loans that the service provider obtains from Region (draw from R1919) that is under $500 thousand	0.0
R1924[2]	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
R1925[2]	Housing- Loans to Providers (Post)	This reserve is to track repayments which have begun from housing service providers	0.0

Appendix V
2024 Overview and Update on the Status of the Reserves

Reserve	Description	Intended Use	Balance September 30, 2024 ($Millions)
R0025	Canada Community-Building Fund	A reserve fund established for the receipt of Canada Community-Building Funds under the Municipal Funding Agreement (MFA) for the transfer and use of the Canada Community-Building Fund with the Association of Municipalities (AMO). Fund is used for eligible capital expenditures	76.1
R0022	Provincial Gas Tax Funds	A reserve fund established for the receipt of Dedicated Gas Tax Funds for Public Transportation Program under the annual letter of agreement between the Region and the Province, with funds used for eligible public transportation expenditures	0.1
R0008	Heritage- Programming	To be used for the purpose of programing for Heritage, Arts and Culture	0.6
R0019	Heritage- PHCRC	To defray the capital cost of fixtures, furnishings, equipment and related installations for exhibitions, events, and other activities of Heritage, Arts and Culture	0.1
R0011	Transportation Demand Mgmnt	To establish a reserve fund for the maintenance of the dedicated Ontario Municipal Transportation Demand Management Grant associated with the development of the Interactive Web-based Active Transportation Map	0.0
R0018	Britannia Golf Course	To establish a reserve fund for the capital and stabilization requirements of a Britannia Golf Course Reserve use to receive deposit from the city of Mississauga and the money shall be used only for the purposes set out in Paragraph 6.4 of the agreement	0.3
R0030	Pub Sector Network Res Fund	To be used for eligible expenditures as directed by resolution of the PSN Steering Committee	1.0
R1168	Major Office Incentive Reserve	To seed funding for the Region’s Major Office Incentives Program	0.1
R2225	PRP-V-COM Mgmmt Res Fund	Reserve fund use for the management of costs related to the Vcom system as managed by the Vcom Group consisting of Police, regional services. PWs, mississauga fire services, brampton fire services and caledon fire.It is set up as reserve fund because a number of stakeholders in the VcomSystme not under the jurisdiction of regional Council	1.9

Notes:

1 Three capital speciality reserves are excluded, Based on the capital nature of these three reserves, they are included in the Tax- Supported Capital Reserve portfolio.

2 The three reserves are for notional use only, no incremental commitment is expected.