

2021 RESERVES REVIEW

RECOMMENDATION

1. That the Telus Field Reserve be closed with a Nil balance, as outlined in Attachment 1 of the December 6, 2021, Financial and Corporate Services report FCS00822.
2. That the Enterprise Portfolio Reserve be closed with the \$1.0 million balance to be transferred to the unappropriated Financial Stabilization Reserve, as outlined in Attachment 1 of the December 6, 2021, Financial and Corporate Services report FCS00822.
3. That a reserve be established for Commercial Revitalization, in order to consolidate the existing Development Incentive Reserve and the Storefront Improvement Reserve and related reserve balances, as outlined in Attachment 3 of the December 6, 2021, Financial and Corporate Services report FCS00822.
4. That City Policy C217E Reserve and Equity Accounts, as set out in Attachment 4 of the December 6, 2021, Financial and Corporate Services report FCS00822, be approved.
5. That City Policy C217D Reserve and Equity Accounts be repealed.
6. That City Policy C629 Financial Stabilization Reserve, as set out in Attachment 6 of the December 6, 2021, Financial and Corporate Services report FCS00822, be approved.

Executive Summary

- This report provides a summary of findings and recommendations as a result of the triennial review of the 2021 Reserves and Equity Accounts that are under the responsibility of the City Manager.
- Also included in the report is the triennial reassessment of the City's financial risk exposure for establishing the appropriate minimum and target balances for the Financial Stabilization Reserve (the unappropriated Financial Stabilization Reserve or FSR).
- Report recommendations include:
 - the establishment of new reserves
 - the closure of a reserve,
 - an update to an existing reserve policy,
 - creation of a new policy
 - a confirmation of the FSR minimum and target balances.

2021 RESERVES REVIEW

REPORT

As per the triennial review requirements in City Policy C217D Reserve and Equity Accounts, Administration completed a review on all the City's reserve funds. The policy provides general guidance on the creation, use and periodic review of all reserves and equity accounts and recommends target and minimum balances for the FSR. Reserve and equity accounts represent net accumulated surplus balances that have been restricted for specific requirements or made available for emergent financial needs.

Policy C217D requires the Chief Financial Officer to undertake a detailed review of reserve accounts and requirements every three years, and a detailed review of fund levels in equity accounts every five years at a minimum. The policy also requires the Chief Financial Officer to perform a full risk-based review of the FSR every three years.

Reserves

The City has a system of internal controls related to reserves, including policy, financial, and monitoring and review that support the appropriate use of reserve funds. The controls are applied through budget authorization, transaction approval and verification, and ongoing accounts review and reconciliation. Monitoring and review controls are related to periodic reviews such as performance reporting, annual budgeting process, the annual consolidated financial statements and the triennial reserves review. These reviews include:

- A review of budget and actual transfers to and from reserves,
- A review of significant variances from reserve budgets,
- A review of projections and forecasts for reserves, and
- Detailed discussions and documentation of the circumstances that result in reserves that fall below their minimum required balances.

In addition to general guidance in Policy C217D, certain reserve accounts are governed by more specific Council-approved policies that provide additional detail on the nature and purpose of the reserve such as procedures for budgetary or expenditure requirements and definitions specific to the reserve. For reserves that are narrower in scope and purpose, rather than a standalone policy, Administration's practice has been to document the details in the City Council report requesting approval of the reserve.

Regardless of the size or scope, Administration formally reviews the nature and purpose of all reserves every three years. Periodic reviews allow Administration to ensure prudent financial management and confirm the appropriateness of reserve balances and transactions. The review also ensures City reserves continue to support the financial goals and serve the highest priority needs of the City and its residents. Administration is able to review individual reserves at any time if required.

In 2021, the Office of the City Auditor undertook a review of the governance and management of reserves. The results of this review will be presented to Audit Committee on December 3, 2021, in report OCA00862 Reserve Funds Governance and Management Review.

2021 RESERVES REVIEW

The inclusion of a reserve register that is formally referenced within the reserve policy, and clarifying allowable use of reserve funds in this report are in response to the City Auditor's findings and recommendations.

Best Practice Review

To establish the City's reserve policies and procedures, Administration reviews the policies of other municipalities and the guidance provided by external organizations such as the Government Finance Officers Association (GFOA). The GFOA promotes excellence in local government financial management by identifying, developing, and advancing fiscal strategies, policies, and practices for North American municipalities. The City follows the best practice recommendations for reserve policy provided by GFOA.

A review of other municipalities demonstrated no significant change in practice since the last review in 2018. Other municipalities' reserves oversight ranges from no formal policy guidance to well established policies with minimum and target balances and robust governance in line with GFOA direction. Minimum and target balances for reserves in other municipalities varied based on risk assessments of those municipalities.

Based on external review, Administration determined that the City's reserve policies, guidelines and procedures are well aligned to best practice. The combination of Administration's review and the Reserve Audit informed this report.

Types of Reserves

The City's reserves are generally classified into the three categories:

- Specific purpose reserves are used to fund one-time or specific projects or initiatives.
- Regulatory/third party requirements reserves are used to allocate funds required to meet future obligations associated with third party agreements, legislation, and regulation.
- Stabilization reserves are used to minimize impacts on service delivery and the general tax-levy by accommodating fluctuations in program revenue and expenses for operations that are intended to be self-sustaining. These reserves are often used to stabilize volatile revenue streams or balance revenue and expenditure streams over the long term.

The type and purpose of each existing reserve account is summarized in Attachment 1. As at December 31, 2020, the City of Edmonton reserve funds totalled \$889.8 million. This total represents value of reserves under the control of City Administration included in the reserve review but excludes the reserves of the Edmonton Public Library, Explore Edmonton (previously Edmonton Economic Development Corporation), Fort Edmonton Management Company, and Non-Profit Housing Corporation as these reserves are administered by their respective boards and are not under the City Manager's authority.

Information on the activities of the significant reserves is provided in Attachment 2. For the purposes of this report, significant reserves are those that have: a year-end balance greater than \$10.0 million and/or a negative balance during the reporting period from January 1, 2018, to December 31, 2021, or any reserve with a required minimum balance by its respective reserve

2021 RESERVES REVIEW

policy. Including reserves with balances over a \$10.0 million threshold and negative balances provides coverage of over 92 percent of all reserve balances as at December 31, 2020.

Review of Reserves

In accordance with City Policy C217D Reserve and Equity Accounts, existing reserves were reviewed to ensure:

- Reserve policies and descriptions are updated to ensure they accurately reflect the purpose and function of the reserve as approved by City Council
- The reserve's purpose, funding, function and/or restrictions (minimum and target balances) are still relevant
- A summary review of transactions is completed and unusual transactions are flagged for further investigation

Existing reserves were reviewed in consultation with operational areas within City Administration. As a result of the internal review, Administration is recommending changes to existing reserves, the closure of reserves, the creation of new reserves and the development of specific reserve policies to formalize the scope, purpose and function of existing reserves.

Closure of Reserves

Telus Field Capital

The Telus Field Capital Reserve was established in 2004 as part of the license agreement between the City of Edmonton and the Northern League in Edmonton Incorporated (subsequently assumed by Katz Baseball Corporation) who operated out of the ballpark, which was named Telus Field at the time. The agreement stated that the license fees earned from the agreement be held in a separate account, resulting in the creation of the Telus Field Capital Reserve.

The funds in the reserve were intended to pay for structural repairs at Telus Field (now RE/MAX Field) for the term of the agreement.

In 2021, the remaining reserve funds of \$0.341 million were used to pay for drainage repairs at the facility, fulfilling the City's final contractual obligations. As a result, Administration is recommending that this reserve be closed through Recommendation 1 of this report. Lease revenues are no longer being held to cover capital costs associated with the Telus Field facility. Any future repairs will be managed through the City asset management process and facility maintenance budgets, with on-demand charges paid for by the lessee; regular lease revenues flow to general revenue.

Enterprise Portfolio

The Enterprise Portfolio Reserve was established to facilitate the implementation of City Policy C479 Fiscal Policy for the Enterprise Portfolio - Community Services to manage revenue fluctuations and to fund business development opportunities for all facilities managed by the Community and Recreation Facilities branch.

2021 RESERVES REVIEW

The Enterprise Portfolio plan never fully developed into an ongoing and sustainable operating model for Community and Recreation Facilities, as such the Policy and reserve have not been utilized as originally intended. On April 19, 2021, City Council approved Bylaw 19644 - General Repealing Bylaw 2021, which repealed City Policy C479 Fiscal Policy for the Enterprise Portfolio - Community Services. Accordingly, Administration is recommending that this reserve be closed through Recommendation 2 of this report and the existing balance of \$1.0 million be transferred to the Financial Stabilization Reserve.

Proposed Reserves

Consolidation of the Development Incentive Reserve and the Storefront Improvement Reserve into a new Commercial Revitalization Reserve (see Attachment 3)

The existing Storefront Improvement Program and the Development Incentive Program are the City's two financial reinvestment programs to support economic revitalization in Business Improvement Areas and two other Council identified target areas: Little Italy and Norwood Boulevard. The recently approved Corner Store Program is another development incentive focused on the revitalization of neighbourhood commercial areas in mature and established neighbourhoods. The Corner Store Program does not have an existing reserve specific to the program.

These programs have the same objective of supporting commercial revitalization across the City. They are strongly aligned, complement each other, and are administered in a coordinated way. As a result, Administration through Recommendation 3 of this report, requests that the existing Development Incentive and Storefront Improvement Reserves be consolidated into one main reserve - the Commercial Revitalization Reserve, that supports the Development Incentive, Storefront Improvement, and Corner Store Program. This consolidation will provide for improved transparency and reporting related to the City's comprehensive efforts to support commercial revitalization, and will allow the City to reduce the volume of small dollar program supported reserves. Individual program funds within the reserve will be monitored and tracked separately to ensure the proper funding is maintained and applied in accordance with separate program requirements.

The alternative to consolidation would be individual reserves supporting each of these programs, which does not allow for a consolidated financial view of the City's commercial revitalization efforts. Existing balances in the Development Incentive Reserve and the Storefront Improvement Reserve will be moved to the new Commercial Revitalization Reserve.

Amendment to Policy

Previously the City had a general reserve and equity account policy (City Policy C217D Reserve and Equity Accounts) that included high-level guidelines to be applied to all City reserves and equity accounts, and also included detailed guidance on the FSR.

For improved governance of reserves, Administration is recommending repealing City Policy C217D Reserve and Equity Accounts, through Recommendation 5 of this report, and replacing it with the updated City Policy C217E Reserve and Equity Accounts (included as Attachment 4), through

2021 RESERVES REVIEW

Recommendation 4 of this report. The amended policy will provide for increased clarity around governance, accountability, administration, monitoring and reporting of all City reserves and equity accounts, in addition to specific reserve policies that already exist. The amended policy will include a Reserve Register (see Attachment 5), which provides a listing of all active reserves, a description of the reserve and the allowable use of reserve funds, applicable policy or guidance documents and other important information. The creation of the Reserve Register as one document that captures all relevant information for each City reserve also supports the recommendations from the December 3, 2021, Office of the City Auditor in report OCA00862 Reserve Funds Governance and Management Review.

The detailed FSR policy guidance has been removed from the amended policy and included in a separate new policy specific to the FSR.

New Policy

C629 Financial Stabilization Reserve

Through Recommendation 6 of this report, Administration is requesting that a new, standalone FSR policy be created. The new proposed Financial Stabilization Reserve Policy C629 is included as Attachment 6. All changes needed for a new standalone policy are administrative in nature and do not change any principles related to authorization, oversight or balance requirements included in the previous City Policy C217D Reserve and Equity Accounts.

Financial Stabilization Reserve

The Financial Stabilization Reserve (FSR) was established in 1997 to provide flexibility in addressing financial risks associated with revenue instability and unforeseen costs on a transitional basis, such as snow removal costs, and to ensure the orderly provision of services to residents.

The City has unappropriated and appropriated FSR balances; the unappropriated balance exists to manage financial risks while the appropriated balances are designated for a specific use as approved by Council. The unappropriated balance in the FSR as at September 30, 2021, was \$119.2 million, with a projected year-end 2021 balance of \$113.0 million. The minimum and target balances as set in Policy C217D, and based on the 2020 audited financial statements, are \$110.4 million and \$183.2 million respectively, and are calculated as 5.0 per cent and 8.3 per cent of tax-supported operating expenses.

As part of an annual process, Administration reviewed the appropriated FSR items as of December 31, 2020, and \$1.5 million of items were identified as no longer needing FSR funding, out of a total balance of \$213.3 million. Upon approval of City Council, funds released from the appropriated balance of the FSR are automatically transferred to the unappropriated balance. The 2021 preliminary year-end financial results will be brought forward to City Council in the first quarter of 2022, including a detailed list of appropriated FSR items.

2021 RESERVES REVIEW

As mentioned, Policy C217D requires that a full risk based review of the unappropriated FSR be completed at a minimum every three years with revisions to the minimum and target balances if necessary. The last review was completed in 2018, with no changes recommended to the minimum and target balances. The results of the 2021 review are noted in the section below.

Unappropriated Financial Stabilization Reserve - 2021 Risk Based Review

As with any municipality, the City undertakes activities and provides services to its residents that have a level of inherent risk. Although the City strives to transfer or reduce many of those risks through insurance, contracts and robust strategic, capital and risk management plans, some risks cannot be fully mitigated. Where possible, emergent financial risks are managed through the City's budgeting practices. Where that is not possible, the unappropriated Financial Stabilization Reserve (FSR) is used to address immediate financial needs that may arise.

Since its creation, questions have arisen as to the right amount to set aside in the unappropriated FSR. Best practice guidance for setting minimum and target balances was taken from the Government Finance Officers Association (GFOA). The GFOA's Research and Consulting Centre worked with local governments to establish best practices in setting general stabilization reserve fund (i.e. FSR) balances using a risk-based methodology focused on the identification and measurement of a government's key financial risks. GFOA directs that minimum and target balances initially be based on a percentage of operating revenues and expenses to serve as a baseline only and then be adjusted in accordance with the financial risks inherent to each municipality. Any analysis of risks that could have a significant impact on a municipality and the financial reserves required to address uncertainty and financial loss should consider revenue source stability, expenditure volatility, a municipality's vulnerability to extreme events and public safety concerns, experience with capital projects, and the amount of debt and liabilities a municipality carries.

In undertaking the 2021 risk-based analysis for the unappropriated FSR, Administration identified the City's most significant areas of financial risk within the GFOA recommended categories. The pandemic's impact was new for 2021's assessment. Once the risks were identified, an assessment of the financial exposure was completed to quantify the potential financial impact to the City, using historical experience related to the risk where possible. The probability of individual risks was then assessed and the financial impacts were adjusted based on the assigned probability with consideration given to any mitigating factors. In establishing the required minimum and target balances, Administration considered the context of the City's long term exposure to financial risk. Attachment 7 provides the most current review of the risk assessment and methodology in applying probabilities along with a table summarizing each of the risks.

Based on the 2021 risk analysis, the adjusted range of financial exposure was determined to be between \$100.9 million and \$253.9 million, the range in 2018 was \$78.2 million to \$182.3 million. The pandemic, changes to climate risks and the risk to grant reductions were the primary drivers of the increased metrics. This range represents 4.6 to 11.5 per cent of the City's 2020 tax-supported operating expenditures, excluding non-cash items (e.g. amortization and loss on sale of tangible

2021 RESERVES REVIEW

capital assets). The range in 2018 was \$78.2 million to \$182.3 million, or 3.7 per cent and 8.6 per cent, as minimum and target percentages respectively.

In line with the GFOA recommendations, the intent of Administration's risk-based analysis was to validate the reasonableness of the existing minimum and target balances. While the results of the current risk-based analysis suggest a minimum of 4.6 per cent and a target of 11.5 per cent, there has not been a consistent long-term trend that would support adjusting the minimum or target. Administration therefore recommends that no changes be made to the minimum and target levels of 5.0 and 8.3 per cent of the City's 2020 tax-supported operating expenditures, excluding non-cash items (e.g. amortization and loss on sale of tangible capital assets), for the unappropriated FSR.

Attachment 8 provides a comparison of the unappropriated FSR balances in relation to its minimum and target balances over the past 10 years. Other than in 2015 and 2016, the FSR remained above its minimum balance but did not achieve the target balance over the decade presented. The projected year-end balance of the FSR, based on information as at September 30, 2021 is \$113.0 million, bringing it very close to the minimum balance. Administration continues to carefully monitor the FSR balance. As outlined in the proposed Financial Stabilization Reserve policy, in the event the balance falls below the minimum level, a strategy will be adopted to achieve the minimum level over a period not to exceed three years, starting with the subsequent year's operating budget. The strategy may include replenishing the FSR with any unplanned one-time revenues, previously committed one-time contingent funds or appropriated items that are no longer required for their original purpose. Other reserve and equity account balances will also be reassessed and where appropriate, amounts transferred to the FSR.

Deficit Reserves

In accordance with City Policy C217D Reserve and Equity Accounts and the proposed City Policy C217E Reserve and Equity Accounts, reserves expected to have deficit balances will only be established if future funding to offset the deficit balance has been identified at the time of creating the reserve. As of December 31, 2020, the City had five reserves that were in deficit balances and are expected to remain in a deficit position at the end of 2021, including CRL's, Brownfield Redevelopment and Interim Financing Reserves. Attachment 9 includes details on each of these deficit reserves, including a discussion on strategies for the reserves to return to a balanced position. A detailed schedule is also included in Attachment 10 for the Interim Financing Reserve.

Equity Accounts

Equity Accounts represent the accumulated earnings (accumulated surplus) within the City of Edmonton. As at December 31, 2020, equity account balances totaled \$978.8 million (summarized in Attachment 1), excluding equity balances for the City's controlled entities, specifically:

- EPCOR Utilities Inc.,
- Explore Edmonton and Innovate Edmonton (previously Edmonton Economic Development Corporation),
- Fort Edmonton Management Company,
- Non-Profit Housing Corporation,

2021 RESERVES REVIEW

- City of Edmonton Library Board, and
- the Edmonton Combative Sports Commission,

as these entities are administered by their respective Boards. See Attachment 11 for a discussion for each equity account.

GBA+

The proposed changes are expected to increase accessibility to reserve information for Administration and the general public and transparently demonstrate that reserves are being properly managed. This is consistent with the City of Edmonton's longstanding commitment to the principles of open government.

The reserve work detailed in this report is driven by various individual program policies and the completion of this work helps to support the GBA+ goals of those programs.

ATTACHMENTS

1. Summary of Reserve & Equity Accounts
2. Summary of Significant Reserve Accounts Activities
3. Proposed Reserves: Commercial Revitalization Reserve
4. C217E-Reserve and Equity Accounts Policy
5. Reserve Register
6. C629-Financial Stabilization Reserve Policy
7. Risk Analysis and Financial Risk Exposures - Risk Ratings
8. Financial Stabilization Reserve 2012-2021
9. Deficit Reserves
10. Interim Financing Reserve - Forecast
11. Equity Accounts