Review of Sustainable Development Surplus, Current Planning Reserve Policy

Recommendation:
That Executive Committee recommend to City Council:

> That the Current Planning Reserve Policy C570, as outlined in Attachment 1 of the October 22, 2012, Financial Services and Utilities report 2012CA3024, be approved.

Report Summary

This report provides a summary of the proposed Current Planning Reserve Policy and recommends approval of the Policy. The report also provides analysis of the Current Planning surplus and the projected balance of the Current Planning Reserve.

Previous Council/Committee Action

At the October 22, 2012, Executive Committee meeting, the October 22, 2012, Financial Services and Utilities report 2012CA3024, was postponed to the November 19, 2012, Executive Committee meeting.

At the August 29, 2012, City Council meeting, the following motion was passed:

> That Administration provide reports to the appropriate Committee outlining the following information:
> 1. an analysis of Sustainable Development's surplus of $24.8 million with the appropriate supporting information

Report

The Current Planning Reserve (Reserve) was established in 2010, as part of the Current Planning Branch - Revised Business Model, Policy C557. It was implemented to stabilize revenue streams and allow for long-term planning and strategy, leading to improved service levels and productivity. It also enabled additional flexibility within the business model to implement key strategies at the most favorable time by having access to the reserve funds and maintaining service levels during all phases of the economic cycle.

Since inception, the Current Planning Reserve has been administered in compliance with the City's Reserve and Equity Accounts Policy C217B. In further advancing implementation of the Current Planning business model, Administration has developed the proposed Current Planning Reserve Policy as presented in Attachment 1, to formalize guidelines and introduce consistent framework for fiscal management of the Current Planning Reserve.

In development of the proposed policy, Administration has undertaken a comprehensive review including extensive research of current and best practices of other municipalities, historical and trend analysis, and development of a forecast model to assist with scenario and strategy development.

This review has been performed in alignment with the City's 2012 review of the City's reserves and equity balances in compliance with City Policy C217B. On October 31, 2012, Administration will present the 2012 Reserves Review.

Analysis of Current Planning Reserve Balance

As shown in Attachment 2, the reserve balance is projected to grow from $6.3 million in 2010 to $26.1 million by 2012 year end. The reserve balance growth is mainly the result of recent increases in service volumes (private and City developments), variances in the personnel budget and the gradual shift towards a full cost recovery model as part of the approved business model for 2013. The service commitments reflected in these variances are to be achieved in the near term. As a result, investments into system improvements, enhanced business processes, and staff capacity have been incorporated into the proposed 2013 budget.

Current Planning expenditures for 2012 are $33.7 million and are anticipated to reach $44.7 million in 2013 as Current Planning achieves full cost recovery as part of the approved business model. In 2013, Current Planning will reach full cost recovery status with an estimated allocation of $13.7 million (or 31% of the annual budget) for technical and corporate support services across the corporation. This enables the Branch to stabilize its service delivery model across multiple branches and departments leading to predictable service levels and productivity.

It is the branch strategy to manage the reserve balance by consistent review of fees, effective resource planning and monitoring achievement of service standards.

Use of Reserve Funds

Transfers to and from reserves will be approved by Council through the budget. The funds as proposed in the Policy are to be used to:

- Balance revenue shortfalls during economic downturns to maintain quality and service level requirements of planning services;
- Fund resource needs in a timely fashion during periods of increased service demand; and
- Fund operating and capital investments that increase productivity or support continuous improvement of service delivery.

Branch revenue is generated from the fees collected when an application is submitted. Application volumes are directly related to the level of development and construction activity, leading to significant volatility in Branch revenues. For example, in 2006 there were over 5,000 applications for house combo permits. By 2008, this had declined to just over 1,000 applications during the year. This represents an 80 per cent decline in annual submissions over a period of just two years; a trend that is mirrored by Branch revenue streams.

While Branch revenue follows this boom-and-bust pattern, the majority of expense is fixed and cannot be adjusted in the short-term. The short-term variations in revenue create mismatched revenue and expense streams during periods of economic expansion or contraction. This leads to challenges that make the Current Planning Reserve an essential component of the Current Planning business model.

During periods of economic decline, revenue may fall well below expense. While the practice has always been to bring the expense in line with the revenue, this may take several years. As well, a decline in revenue may not represent an equivalent decline in workloads since many types of applications can take up to several years to process completely. The Current Planning Reserve will mitigate the risk of the City needing to rely on the tax base to cover any deficit and that periods of low revenue do not have a negative impact on the entire organization.

During periods of economic expansion, revenue may exceed expense; however, workloads may also exceed the city's planning capacity. With a reserve in place, the Current Planning business model has sufficient flexibility to quickly secure additional temporary resources to address service volumes and to maintain service levels and productivity.

Capital spending and service improvement investments are required periodically to provide effective and consistent service levels. With a reserve in place, capital spending and service improvements can be funded when they will have the highest benefit to the entire organization and at a cost borne by the service users.

The challenges associated with providing quality services to the development industry that is so impacted by the economic cycle emphasize the need for financial planning and strategy to take on a longer term perspective. This is to be achieved through the implementation and appropriate use of the Current Planning Reserve.

Reserve Balance Target
Administration recommends the following:

- minimum balance of 30% of current budgeted Current Planning expenditures
- target balance of 75% of current budgeted Current Planning expenditures

Since the business model is still in early years, the proposed minimum and target balances are set as starting points and will be reviewed periodically. Any recommended change will be brought forward to Council for approval. The periodic review helps mitigate risk by ensuring reserve balances are neither too high, where cash is held unnecessarily, or too low, where funds are insufficient to meet future needs.

There are a number of factors that influence the decision when determining reserve levels. These include the size of operating budget, the risks of external events impacting both expenditure and revenue budgets, and the elasticity of revenue and expense. To assist with this decision, a forecast model was developed to predict revenue trends and expenditures that would reflect business strategies to be undertaken in a number of different scenarios, i.e. boom and bust.

Rationale for the Minimum Balance
The premise for the proposed minimum balance and target balance reserve is determined based on historic annual fluctuations of business unit activity levels and revenues, as well as the expenditure pattern and business

strategies that will be undertaken during different economic times.

Analysis of two major downturns in the 1990's and years 2007/2008 has shown reduction in development activity and related revenues of 20-30% in year one. The minimum 30% balance provides flexibility to resource service level requirements to meet service standards even when there is a decrease in revenue. It is important that the level of reserve is sufficient to retain trained staff and continue to meet service standards during a downturn in development activities. This allows time to develop strategies to adjust resources up or down to respond to the demand in subsequent years. The minimum balance eliminates the need to tap into tax levy in those situations.

Rationale for Reserve Target
Analysis of past Current Planning revenue and application volumes suggests that the impact of a large economic recession could last 3 to 4 years with 15-20% reduction of revenue in year 1, 30-35% in year 2, and 15-20% over years 3 and 4. Thus a reserve balance of minimum 75% of annual expenditure is required to cover costs during a recession as strategies for resource reduction are developed and implemented to minimize impact on service level standards.

The 75% recommended target is at the low end of the recommended target by best practices that suggests 9 to 18 months of annual expenditures. This target is supported by the financial modeling performed for a number of economic scenarios that were tested for as part of this review. The 75% target is a starting point and requires periodic review as noted previously.

As shown in Attachment 2, the forecast shows the reserve balance reaching just below 75% of Current Planning budgeted expenditures in 2012, but below this target in future years as the total operating budget will increase to reach full cost recovery.

Comparative Analysis
Administration has reviewed the practices of other cities including Ottawa, Calgary, Hamilton, Oakville, Mississauga and Regina. All have similar business models including reserves to address the economic volatility with a range of 9-18 months of operating expenses as recommended targets.

Policy

C557 – Current Planning Branch Revised Business Model
C217B – Reserve and Equity Accounts

Corporate Outcomes

This report supports the corporate goal of ensuring Edmonton's financial sustainability by contributing to the following corporate outcomes:

- The City has well managed and sustainable assets and services.
- The City has a resilient financial position.

Justification of Recommendation

The Current Planning Reserve Policy provides consistent direction and guidelines for sound fiscal management of the Current Planning Reserve and supports financial sustainability and delivery of consistent quality planning services.

Attachments

1. Proposed Current Planning Reserve Policy C570
2. Current Planning Trends & Forecast

Others Reviewing this Report

- R. G. Klassen, General Manager, Sustainable Development
- D. H. Edey, General Manager, Corporate Services