ITEM 10
MANAGER'S REPORT NO. 46
COUNCIL MEETING 1985 07 02

Re: CORPORATE PLANNING
RESERVE POLICY AND CAPITAL FINANCING POLICY

MUNICIPAL MANAGER'S RECOMMENDATION:

1. *THAT the recommendation of the Director Finance be adopted.*

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1985 June 24
File: M4-10

TO: MUNICIPAL MANAGER

FROM: DIRECTOR FINANCE

RE: CORPORATE PLANNING
RESERVE POLICY AND CAPITAL FINANCING POLICY

RECOMMENDATIONS

1. THAT the principles and concepts defined in the Reserves policy and the Capital Financing policy be approved in principle subject to annual review as part of the budget process.

REPORT

SUMMARY

The purpose of this report is to formally present to Council the Reserves Policy and the Capital Financing Policy which were developed as part of the Corporate Planning Process. The contents of the reports were discussed extensively at two separate informal meetings between Council and the Management Committee held earlier this year.

BACKGROUND

As part of the Corporate planning process, it was considered beneficial that a policy statement be developed to define the use of the municipality's existing reserves. In conjunction therewith, it was also decided that a policy should be developed which examines the merits of various alternatives of financing Burnaby's capital and development program. These two policies were developed and distributed to Council on 1985 February 18, and discussed at an informal meeting with the Management Committee on 1985 March 05. The policy reports were also the subject of a Council-Management Committee meeting on Corporate Planning held 1985 April 02.

Reserve Policy and Capital Financing Policy

The executive summaries contained in the reports are attached. Some minor revisions to the report itself have been made following the meetings with Council but no changes have been made to the Summary. The changes will be highlighted when an updated version of the reports will next be distributed to Council as part of the 1986 Provisional budget process.

In brief, the reserve policy discusses the purpose, funding, control and legality of the various reserve accounts that the municipality maintains. The Capital Financing Policy reviews financing alternatives that are available, as well as trends and projections for debt and reserves.

Included in the reports are a number of recommendations. Some of the recommendations can only be achieved over a period of time, others require further study, and others may need periodic amendment because of changes in legislation or economic circumstances.

In general terms the concepts or broad principles which flow from the reports are summarized as follows:

- That borrowing for general, water or sewer capital purposes, whether internal or external be limited to the extent that repayments of principal and interest on borrowings should not exceed 20% of the total operating budget for general, water and sewer purposes.

- That sufficient funds should be maintained in reserve to finance all of the works defined in the five year capital program, which are intended to be financed out of existing capital reserves.

  During the informal meetings with Council there was discussion regarding the need to develop guidelines or measures regarding the total dollar value of the annual capital budget. For example, the total value might be expressed as a percentage of the annual operating budget. These guidelines have not yet been prepared, but will be given consideration when the 1986 Capital program is developed, with the intent to include such guidelines in future policy updates.

- That a study be done which examines the need to establish reserves for the eventual replacement of the existing municipal infrastructure.

  This study has already been added to our corporate planning task list, as reported to Council on 1985 May 13.

- That the municipality's working capital be set at a level sufficient to eliminate the need to borrow for operating purposes, and that this level be attained through an orderly accumulation of operating funds over a number of years.

  During the informal meetings with Council, there was discussion regarding the need to develop guidelines for this matter. For example, the extent of working capital might be related to the size of the budget. These guidelines have not yet been prepared, but will be included in future policy updates.

- That the Reserve and Capital Financing Policies be updated and reviewed annually as part of the budget process to ensure that the funding recommendations contained in the Operating and Capital budgets are consistent with corporate objectives flowing from these policies.

Conclusion

The Reserve and Capital Financing policies are seen as live documents, beneficial to both Management and Council. The policies will be updated annually and form an integral part of the annual budget process. Changes to the policy statements will be made as needed to reflect changing circumstances.

It is recommended that the principles and concepts defined in the Reserves Policy and the Capital Financing Policy be approved in principle subject to annual review as part of the budget process.

Howard Karras
DIRECTOR FINANCE

BURNABY

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RESERVES POLICY

EXECUTIVE SUMMARY

RESERVES POLICY

Executive Summary

Purpose and Definition of Reserves

The purpose of this policy is to define the policy for the use of the Corporation's 40 or more reserves having a combined total value of about $80 million at the end of 1983, and to recommend a working capital level that should be maintained for the municipality. The development of this policy was approved by Council on 1982 July 26. Having a policy for the use of reserves is considered beneficial to both management and Council for reasons outlined in the report.

A monetary reserve is money or its equivalent set aside or kept available to meet future liabilities. Reserves can be appropriated by statute, regulation, trust indenture, or at the discretion of management or Council. For this policy, reserves include monetary surplus funds which are necessary for working capital, and trust funds. The accumulation and use of reserves is for a variety of intentions:

- working capital
- self-insurance purposes
- works in progress and future development and capital programs
- required by statute, regulation or trust indenture
- performance of contracted obligations
- meeting development charge obligations

Reserves can also be listed and classified by the sequence or category that conforms to the principles prescribed by Statistics Canada as modified by the Province of B.C. This is the format adopted for Burnaby's Annual Financial Reports and used throughout this policy, as outlined below:

- General revenue fund reserves
- Capital fund reserves
- Waterworks utility reserves
- Sanitary sewer system reserves
- Statutory reserves

How the Policy was Developed

Before individual reserves were analysed, a set of standard categories was developed to give consistency to the analysis and its outcome. It was considered appropriate to analyse each reserve in each of the following areas:

- purpose
- funding
- fund trend
- appropriate fund level
- control
- legality

This format and the analysis contained in Schedule 3 in the main report forms the basis for all subsequent Schedules and report discussions and recommendations.

Purpose

In most cases, the purpose or use of each reserve is quite specific, but in some cases the reserve could be used for a variety of purposes, as long as it conformed to the legality of the pertinent sections of the Municipal Act. The purpose of each reserve is summarized in Exhibit A in this summary and Schedule 1 in the report.

Funding

Reserves may be funded from many sources, including:

- funds from sale of municipal land
- general revenue contributions
- grants, private or governmental
- investment income
- borrowing, with or without ratepayers' approval
- development cost charges
- sale of services
- other reserves, e.g. tax sale reserve

The degree of control of funding is critical when it comes to controlling the level of the reserves. Where funding can be controlled, it is through the capital or operating budget and Council approval and, where applicable, through by-laws adopted by Council.

Appropriate Fund Levels

The appropriate level of reserves can be maintained only if both the funding sources and spending rates are controllable. Where spending can be controlled, it is by similar mechanisms as for funding controls. Exhibit A in this summary and Schedule 1 in the report summarize all of the individual funds' appropriate funding levels. Exhibit B in this summary summarizes the reserves that are controllable and their respective appropriate fund levels.

The funding level deemed to be appropriate fluctuates as circumstances and needs change. Annually, therefore, in conjunction with the budget process, the reserve fund levels will be reviewed to make a determination regarding the adequacy of those levels.

Legality

The legality of each reserve is summarized in Exhibit A in this summary and in Schedule 1 in the report.

Working Capital

Working capital is defined as capital actively turned over in or available for use in the course of business activity. It can also be defined as the excess of current assets over current liabilities, or all capital of a business except that invested in capital assets.

The source of funds for the total working capital needs is as follows:

- operating funds
- non-statutory reserves where assets have not specifically been set aside
- designated capital funds provided by general revenue fund
- designated capital and operating funds of waterworks and sanitary sewer systems
- internal borrowing from local improvement fund
- external borrowing

In Burnaby, like other municipalities, the major revenue, property taxes, is collected once a year, whereas the expenditures occur about evenly throughout the year. Therefore the requirement for working capital at any one time varies according to the time of year with respect to collection of property taxes. It has been Burnaby's practice to borrow externally its additional working capital requirements just prior to collection of taxes and invest short term its cash in excess of expenditure requirements just after collection of taxes. In 1983 and 1982, this borrowing requirement peaked at about $17 million in June of each year, at an interest cost of about $247,000 in 1983 and $585,000 in 1982.

The following table summarizes the reserves that comprised the working capital for actual levels for the end of 1983 and the appropriate fund levels.

Reserve	1983 Actual Level $000	Appropriate Fund Level $000
Operating funds - existing	2,706	2,700
- additional required to eliminate short term borrowing	-	17,000
Long term disability	207	178
Snow removal	513	490
Self-insurance (vehicle and fire)	145	250
Life insurance	1,000	1,000
Designated capital funds	6,530	6,000
Designated sewer capital funds	173	50
Designated water capital funds	1,891	200
Sewer operating funds	1,587	1,000
Water operating funds	1,585	1,000
Rounding amount	-	132
	16,337	30,000

The operating fund requires an additional $17 million to eliminate short term borrowing pending collection of property taxes, thereby resulting in an appropriate fund level of $30 million for total working capital for 1983. If the additional $17 million of funds were in place, it would increase investment income and eliminate borrowing costs for a net increase in municipal revenues of about $1.5 million annually. This additional revenue could be used either to decrease the tax levy or to finance new or increased services.

Working capital demands vary according to the size of the total operating budget, and the timing of cash receipts and payments, rather than being fixed at 1983 levels. Therefore it is appropriate to have a working capital level sufficient to eliminate the need to borrow for operating purposes. Currently within the Greater Vancouver Regional District, some communities have achieved the position of not having to borrow for operating purposes.

The appropriate level for total working capital at the end of 1983 is $30 million, whereas it was only $16.3 million at the end of 1983. "Making-up" the $13.7 million shortfall in a short period would put an extraordinary burden on taxpayers. Therefore the additional requirements should be funded over a number of years through a planned program of operating fund accumulations, or a more frequent billing of taxes be introduced when suitable legislation is enacted.

Assets Having no Replacement Reserves

Only a portion of the Corporation's total assets have replacement reserves established to replace the assets as they wear out, e.g. vehicles. Currently there is no provision for replacement of the waterworks and sanitary sewer systems at the end of their useful lives, at about the end of this century. Also, there is no provision for replacement of other municipal infrastructure, or buildings, and computer equipment. A decision to create replacement reserves for these or any other assets would necessitate a policy revision and appropriate reserve levels to be established.

Until such new reserves are established, there is the option of using existing reserves such as the Capital Works Financing Fund, Tax Sale, or Corporate Lands set aside for general or specific capital purposes as a source of funding for replacement of existing assets as well as new assets.

Recommendations

In the development of a policy for the use of reserves, a standard format was developed to analyse each reserve that resulted in a meaningful conclusion for the use for each reserve, and where controllable, on the appropriate funding level for each reserve. These results are summarized in Exhibits A and B. It is recommended that the purpose and fund levels described therein become the Corporation's policy on reserves, and that the policy for the use of reserves be reviewed annually in conjunction with the budget process.

It is recommended that the Corporation's working capital level be set at a level sufficient to eliminate the need to borrow for operating purposes and that this level be attained through an orderly accumulation of operating funds over a number of years unless existing legislation is amended to implement more frequent tax billing.

It is also recommended that additional replacement reserves be considered for certain key Corporation assets, such as computers, that currently do not have replacement reserves.

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THE CORPORATION OF THE DISTRICT OF BURNABY

CAPITAL FINANCING POLICY

Finance Department
1984 December

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EXECUTIVE SUMMARY

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CAPITAL FINANCING POLICY

EXECUTIVE SUMMARY

Purpose of and Approach Used in this Study

The development of this policy examines the merits of various alternatives of financing of Burnaby's capital and development program. The analysis includes the Corporation's past and future expenditure programs, the portion financed out of general revenue or existing reserves, various financing alternatives, and debt trends. The policy also examines advantages/disadvantages of borrowing and costs of borrowing with and without interest cost considerations. The foregoing analysis leads to the recommendations which appear at the end of both the Executive Summary and the Report.

Financing Alternatives

There are several ways in which the Corporation's capital and development programs can be funded:

- From general revenue
- Usage of or transfers from internal reserves that are non-repayable
- Borrowing from internal reserves with repayment terms
- Borrowing from external sources, short term or long term
- Grants from governments and others, or donations
- Development cost charges
- Joint participation with developers, governments or others
- Leasing or renting
- Developer financed services

Net Debt and Borrowing Limit Trend

An analysis of the Corporation's funding sources over the past six years indicates that funding from the general revenue sources accounted for a range of 14.4% to 38.1% of the total funding sources, and that there was no clear pattern as to the use of general revenues vs. borrowing or other funding mechanisms. General revenue fund contributions for capital programs and to reserves accounted for as much as 13.4% of the operating budget in the past, although the trend in recent years is downward. Therefore general revenue funds should continue to be used to fund a significant portion of the capital program in the future, as they were in the past.

At the end of 1983, the Corporation's external and internal outstanding debt, including utilities, of $49.8 million was only 28.9% of the allowable gross borrowing limit, and 21.2% of the limit if only external debt were considered. Internal debt repayments have no legal status in that Council can change the current repayment policy and make this debt forgiveable.

The debt load in the 1983 operating budget of $10.1 million, including utilities, accounted for about 12.45% of the Corporation's total operating budget. The debt payments as a percentage of operating expenditures have been declining since 1980. It is considered that borrowing could be increased gradually at minimal disruption to the existing level of service until the debt load of principal and interest repayment approached 20% of the operating budget.

Factors that Influence Decision to Borrow

The following factors would influence the municipality's decision to borrow:

- amount and timing of funding capital and development requirements in the future, including replacement of major works such as sewer and water lines
- amount of borrowing capacity available
- ability to meet municipal regulations and ratepayers approval, if necessary
- ability to repay from tax base
- life of asset (i.e. long term borrowing not recommended for short life assets)
- external market lending conditions
- outlook for inflation, economic conditions
- amount of safety margin required for future with respect to taxpayers' obligation and municipality's financial condition.
- availability of low cost funds from senior governments

In addition, there are considerations of Council policies and political implications, and the linkage with the current reserve policies. The funding for each major capital or development program would have to be evaluated in light of the above factors before a decision can be made whether to borrow or not.

Is Borrowing Necessary?

Borrowing would not be necessary if the municipality could finance its capital programs either through prior "build-up" of reserves to accommodate peak capital requirements or through taxation, or a combination of both.

If the municipality had a significant level of uncommitted reserves available and had a program pending that required a significant amount of funding, then it would have a choice of using general revenue funds, its reserves, or borrowing externally, or a combination of each.

If the municipality had no reserves and could not raise taxation significantly over a short period to accommodate a large capital program, it could either borrow externally or defer expenditures until later, during which time it could accumulate reserves.

In a growing or redeveloping municipality where municipal services such as roads, sewers, watermains, buildings, land assembly, etc., have to be provided, the capital requirements can be significant, and borrowing may be necessary to provide these services. Such services have a long life and will benefit the current and future taxpayers, so the cost of such services should be distributed fairly among all recipient taxpayers. Borrowing is a mechanism by which costs can be disbursed over a long time period so that taxpayer load can be more evenly apportioned.

Borrowing may also be advantageous if the interest rate is low and fixed for the life of the loan and inflationary expectations are high, or if grants or other financial assistance are readily available with the loan.

However, the municipality should have the ability and sufficient tax base to repay debt obligations and be able to maintain other essential services to the taxpayer at the same time.

Cost of Pay-as-you-go vs. Borrowing

If a capital program is financed through borrowing rather than a cash basis (pay-as-you-go) from general revenues and/or non-repayable reserves, the total cost of the funding is always greater through borrowing, if the time-value (Note 1) of money is not considered. However, if time-value of the funds under both alternatives is considered, then the cost becomes similar for both alternatives, depending on the interest cost of the loan and the interest rate temporarily idle funds can earn. The higher the investment interest rate compared to the loan interest rate, the more advantageous is the borrowing alternative.

This concept is valid whether the funds are borrowed externally or from the Corporation's own reserves. However, external loan interest rates are normally higher than investment rates, and therefore borrowing, if required, would be more advantageous from internal reserves as the interest differential advantage would accrue to the municipality rather than to the outside lenders. In other words, there is a financial advantage in being one's own banker.

Note 1 The equivalent present day value of money to be spent in the future when interest earnings are taken into consideration.

Linkage of Current Reserves With Future Capital Program

Perhaps one of the most important factors in the decision of whether to borrow or not is to examine the future capital program in the five year capital budget in relation to current reserves and general operating revenues that are available to finance it.

Schedules 1 and 5 in the separate policy on reserves indicated that the Capital Works Financing Fund was available to finance capital programs, and the Tax Sale and Corporate Lands reserves were available to finance land assembly and development programs.

Schedule 6 in this policy shows the effect of the projected capital program in the 1984-1988 Capital Budget on the Capital Works Financing Fund (CAWFF). The projected borrowings from the reserve include funding classified as unknown at this time, as it is likely that the required funding will come from this reserve, unless other funding arrangements are made at a later date. Repayments on any new borrowings will depend on the timing and amounts projected, and any changes in the borrowing projections will affect these repayments.

It is emphasized that these capital projections are re-estimated annually with each five year budget and may change considerably in scope, amount and timing. Furthermore, there may also be changes in priority and capital spending requirements before the next capital budget, so any major changes must be considered for their effect on the reserve, or funds in other reserves such as Tax Sale and Corporate Lands will have to be used.

Currently, the funding and repayment projections indicate that the CAWFF reserve will be depleted before the end of 1985. Therefore, either the capital program will have to be modified, additional funds will have to be provided from general revenues to the extent possible, or the required funding will have to be borrowed from external sources.

Schedule 7 in this policy shows the effect of the projected land assembly and development program on the combined total of the Tax Sale and Corporate Lands reserves.

Unlike the outlook for CAWFF, the outlook for the combined Tax Sale and Corporate Lands reserves is for growth from $20 million at the end of 1983 to over $41 million by the end of 1988.

With the projected increase in growth of these reserves, consideration should be given to the financing of some capital programs from these reserves rather than from CAWFF, which is projected to have insufficient capacity for capital funding by 1985.

Linkage of Current Reserves with Future Capital Program (cont'd)

As with the CAWFF projections, the actual transactions and projections of demands and revenue for the combined Tax Sale and Corporate Lands reserves should be updated annually, in conjunction with the preparation of the five year capital budget.

It is considered prudent to maintain sufficient reserves, including projected repayments and contributions, in CAWFF, Tax Sale, and Corporate Lands, if possible, to finance 100% the Corporation's five year capital program, which is designated to be financed from this funding source.

Assets Having No Replacement Reserves

Currently, Burnaby has no replacement reserves for its computer equipment, waterworks and sanitary sewer facilities, engineered structures and buildings. Consideration should be given to the establishment of reserves for such assets, following the adoption of this and the reserve policy.

The need for the establishment of such reserves will be examined as a separate issue following the adoption of this and the reserve policies.

Recommendations

On the basis of this study, the following recommendations are being made:

1) Financing from general revenue is preferable to borrowing as long as the cost of borrowing exceeds the interest rate at which temporarily idle funds can be invested. General revenue funds should continue to be used for some capital funding, as they were in the past.

2) If borrowing is necessary, and sufficient reserves are on hand, it is preferable to borrow internally as compared to external sources, provided that external borrowing costs exceed investment interest rates.

3) Consideration should be given to limiting borrowings when repayments begin to reach 20% of the operating budget.

4) Sufficient funds should be maintained in the CAWFF, Tax Sale and Corporate Lands reserves to finance 100% of the five year capital program, which designates these reserves as the funding source.

5) The projections for the CAWFF reserve, and the Tax Sale and Corporate Lands reserves should be updated annually in conjunction with the preparation of the five year capital budget.

6) The need to establish replacement reserves for assets that currently have no such reserves should be examined as a separate issue following the adoption of this and the reserve policies.