

<b>TO:</b>	<b>CHAIR AND MEMBERS STRATEGIC PRIORITIES AND POLICY COMMITTEE MEETING ON OCTOBER 15, 2018</b>
<b>FROM:</b>	<b>ANNA LISA BARBON MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER</b>
<b>SUBJECT:</b>	<b>SURPLUS/DEFICIT POLICY UPDATE</b>

<b>RECOMMENDATION</b>
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That, on the recommendation of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer, the attached proposed by-law (Appendix “B”) **BE INTRODUCED** at the Municipal Council meeting on October 16, 2018, to amend By-law CPOL.-46-242 being “Surplus/Deficit Policy”.

<b>PREVIOUS REPORTS PERTINENT TO THIS MATTER</b>
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Strategic Priorities and Policy Committee, meeting on December 7, 2015, Agenda Item 3, Surplus/Deficit Policy

<b>LINK TO THE 2015-2019 STRATEGIC PLAN</b>
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Council’s 2015-2019 Strategic Plan for the City of London identifies ‘Leading in Public Service’ as a strategic area of focus. The Surplus/Deficit Policy supports this strategic area of focus by contributing towards the strategic priority ‘Proactive Financial Management’. This strategic priority involves, among other things, ensuring that the City’s finances are well planned. The implementation of the Surplus/Deficit Policy signifies that the City is looking beyond a short term focus when planning its finances. The Surplus/Deficit Policy provides consistent direction for Municipal Council and Civic Administration regarding the annual treatment of surplus and deficit in a manner that is consistent with long-term financial sustainability.

<b>BACKGROUND</b>
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The purpose of this report is to seek Municipal Council approval for amendments to the current Surplus/Deficit Policy (“the policy”). The proposed amendments are:

1. The policy scope (previously section 2.0) has been expanded to include the Water Rate Supported Budget (the “Water Budget”) and the Wastewater & Treatment Rate Supported Budget (the “Wastewater Budget”);
2. The policy principles (previously section 3.0) have been revised to include the following:
  - a. Language regarding the treatment of surplus or deficit positions within the Water Budget and the Wastewater Budget;
  - b. Update to the Operating Budget Contingency Reserve (OBCR) target to link to the Council approved Reserve and Reserve Fund Policy implemented in July 2018.
3. The reporting requirements (previously section 4.0) have been revised to accommodate the changes to the frequency Civic Administration provides Municipal Council monitoring reports;

4. New section added stating the minimum timeframe for review of the Surplus/Deficit Policy;
5. Removal of “Transition to New Surplus/Deficit Policy” (previously section 5.0); and
6. The policy has been updated for reformatting into the new Council Policy template.

The proposed Surplus/Deficit Policy is attached as Appendix “C”. The current Surplus/Deficit Policy is attached as Appendix “D” for reference.

#### **Definition of a Surplus or Deficit**

A surplus arises in the operating budget when there is an excess of revenues over expenditures. Year-end surpluses generally arise from two circumstances – higher than budgeted revenues (including one-time only revenues), and/or lower than budgeted expenditures.

A deficit arises in the operating budget when there is an excess of expenditures over revenues. Year-end deficits generally arise from two circumstances – lower than budgeted revenues, and/or higher than budgeted expenditures (including one-time only expenditures).

#### **The *Municipal Act, 2001* Disposition of Surplus/Deficit**

The *Municipal Act, 2001* requires municipalities to bring the prior year’s surplus forward into the next year as a revenue for the operating budget; conversely the *Municipal Act, 2001* also requires municipalities to bring the prior year’s deficit forward into the next year as an expenditure for the operating budget.

Either method would result in fluctuations from year to year. Once a surplus has been carried forward into a future year, it must be maintained because the reduction or elimination of the revenue creates a pressure in the following year’s operating budget (i.e. if a surplus of \$1 million was realized and carried forward, the following year would have to see the same surplus realized).

Where municipalities have had surpluses or deficits, there is a need to maintain consistency from one budget year to the next to avoid significant budget pressures or unsustainable revenue increases. The Surplus/Deficit Policy provides parameters to support the yearly balancing of the operating budget to mitigate future year impacts of carryover surplus or deficit.

#### **What is the Difference between One-Time and On-Going Impacts?**

One-time means that we can only expect to see the expenditure or the revenue in a given year and it should not be built into our base operating budget. If one-time expenditures are built into the base operating budget, surpluses would arise from expenditures that would not materialize. The opposite is true of revenues. If one-time revenues are built into the base operating budget, deficits would arise from revenues that would not materialize.

On-going impacts are those that can be reasonably expected each year. In order to properly fund on-going costs each year, ongoing revenues must be raised. Slight adjustments may be required over time, but generally the expenditure or revenue will remain stable from year to year (except for changes resulting from significant inflation, volume or regulatory requirements).

#### **Inclusion of Water Budget and Wastewater Budget in the Proposed Policy**

The proposed Surplus/Deficit Policy has been expanded to include the Water Budget and Wastewater Budget. Appendix “A” provides a summary diagram of the proposed Surplus/Deficit Policy. The treatment of surplus/deficit for the Water Budget and Wastewater Budget is based on the same set of principles that have been used to guide the treatment of Property Tax Supported Budget surplus/deficit.

The principles of the proposed Surplus/Deficit Policy are:

1. All surpluses and deficits be treated as one-time in nature;
2. The year-end operating surplus for the Property Tax Supported Budget, Water Rate Supported Budget, and Wastewater & Treatment Rate Supported Budget will only be allocated within the operations and reserves and reserve funds of each respective Budget; and
3. The year-end operating deficit for the Property Tax Supported Budget, Water Rate Supported Budget, and Wastewater & Treatment Rate Supported Budget will only be funded within the operations and reserves and reserve funds of each respective Budget.

With the guidance of these principles, the allocation of surplus/deficit for the Water Budget and the Wastewater Budget are proposed as follows:

In A Year of Surplus

- a) The City Treasurer, or designate be authorized to contribute an amount to the applicable Water/Wastewater Budget Contingency Reserve not to exceed the reserve target balance established through the Reserve and Reserve Fund Policy, subject to the contribution being confirmed by the Municipal Council.

*Comment: The Water/Wastewater Budget Contingency Reserves cover contingencies to mitigate unforeseen events or one-time anticipated revenue losses and expenses in order to stabilize the Water/Wastewater rates and contribute the necessary working funds required for operating expenditures incurred prior to the collection of rates. In a year of surplus, on a one-time basis, a contribution to the Water/Wastewater Budget Contingency Reserve should receive priority consideration if it is determined the balance of the reserve is not adequate.*

- b) Remaining surplus to be reported in the Operating Budget Year-End Monitoring Report with the surplus contributed to the applicable Water/Wastewater Budget Contingency Reserve to balance year-end operations. The remaining surplus allocations shall be drawn down from the applicable Water/Wastewater Budget Contingency Reserve and allocated in accordance with the following proportions:
  - i. 50% of any operating surplus shall be applied to reduce Water/Wastewater authorized but unissued debt, it being noted that debt reduction will reduce future year's debt servicing costs. If the operating surplus allocation exceeds the authorized debt amount, the authorized debt shall be reduced to nil with the remaining surplus added to the allocation specified in b ii).

*Comment: On an annual basis, Municipal Council approves a capital budget with corresponding financing such as debt. Often due to the nature of capital works, the issuance of debt is not required until the work is close to complete, two to three years after budget approval. As a result of this timing difference, Municipal Council can reduce the amount of authorized, but unissued debt through the allocation of year-end surplus to debt substitution.*

- ii. 50% of any operating surplus shall be contributed to the Waterworks Reserve Fund (Water) or Sewage Works Reserve Fund (Wastewater) to mitigate growth in the infrastructure gap.

*Comment: The Waterworks Reserve Fund and Sewage Works Reserve Fund support capital asset renewal and replacement for the City's Water and Wastewater infrastructure. As per the 2013 State of Infrastructure Report, the City of London had a total asset replacement value of \$6.8 billion for Water and Wastewater infrastructure. At that time, the infrastructure gap for Water and Wastewater was projected to grow to \$61 million in 10 years if the City maintained the current spending plans.*

*In 2017, the City hired external expertise to analyze the replacement values of Water and Wastewater linear assets. The resultant replacement values have significantly increased from the 2013 estimate due to the improved accuracy of unit cost assumptions and increases in construction and labour costs. Reserve Fund levels have increased over the last five years, however, current balances are not sufficient to fund all capital asset renewal and replacement projects needed in the next ten years.*

*Contributing Water and Wastewater surplus to these Reserve Funds can help the City manage the infrastructure gap, mitigating deterioration in City owned assets and limiting the burden on current and future rate payers.*

In a Year of Deficit

- c) The City Treasurer, or designate be authorized to drawdown from the Water/Wastewater Budget Contingency Reserve to balance year-end operations.

### **Update to the OBCR target to link to the Council Approved Reserve and Reserve Fund Policy**

In a year of surplus, the current Surplus/Deficit Policy for the Property Tax Supported Budget authorizes the City Treasurer, or designate to contribute an amount to the OBCR not to exceed the reserve target balance of 1.5% to 2.0% of the property tax gross expenditure budget, subject to the contribution to the OBCR being confirmed by the Municipal Council.

As per the Reserve and Reserve Fund Policy approved by Municipal Council in July 2018, the City Treasurer or designate has the responsibility for setting reserve and reserve fund targets, it being noted targets will be periodically reported to Council through reserve and reserve fund reports. By linking the Surplus/Deficit Policy to the targets established through the Reserve and Reserve Fund Policy, the Surplus/Deficit Policy will not require amendments when changes to the targets are made.

### **Reporting Frequency Amendment Summary**

As a result of moving to multi-year budgeting, Civic Administration has amended the frequency of monitoring reports to two per annum versus the three per annum that was in place before multi-year budgeting was implemented.

Proposed Policy

The City Treasurer, or designate shall provide the following reports related to year-end projected or actual surplus or deficit positions:

- i. Operating Budget Mid-Year Monitoring Report (January 1<sup>st</sup> to June 30<sup>th</sup>)
- ii. Operating Budget Year-End Monitoring Report (January 1<sup>st</sup> to December 31<sup>th</sup>)

Current Policy

The Managing Director, Corporate Services & City Treasurer, Chief Financial Officer or designate shall strive to provide the following reports related to year-end projected surplus or deficit positions within 45 days of the close of the reporting period:

- i. Second Quarter Operating Budget Status Report to be submitted at the discretion of the City Treasurer (January 1<sup>st</sup> to June 30<sup>th</sup>)
- ii. Third Quarter Operating Budget Status Report (January 1<sup>st</sup> to September 30<sup>th</sup>)
- iii. Fourth Quarter Operating Budget Status Report (January 1<sup>st</sup> to December 31<sup>st</sup>)

Civic Administration is recommending the revision as existing budget development and monitoring practices allow for the ongoing monitoring of the current year budget between June 30<sup>th</sup> and December 31<sup>st</sup> without formally reporting projections as of September 30<sup>th</sup> to Municipal Council. Furthermore, consistent with present administrative practices, should a material matter regarding the current year budget arise, Civic Administration will bring forward a report to Municipal Council. The adoption of the revised reporting frequency maintains strong Municipal Council and Civic Administration oversight of

annual budgets while ensuring that each annual budget update in the multi-year budget cycle receives due consideration.

**Removal of “Transition to New Surplus/Deficit Policy” Section**

The current Surplus/Deficit Policy includes language on phasing out the \$850 thousand annual draw from the OBCR by the year 2021. The plan continues to be to phase out the draw by 2021, however this section has been removed from the proposed policy as it does not specifically apply to the treatment of surplus/deficit.

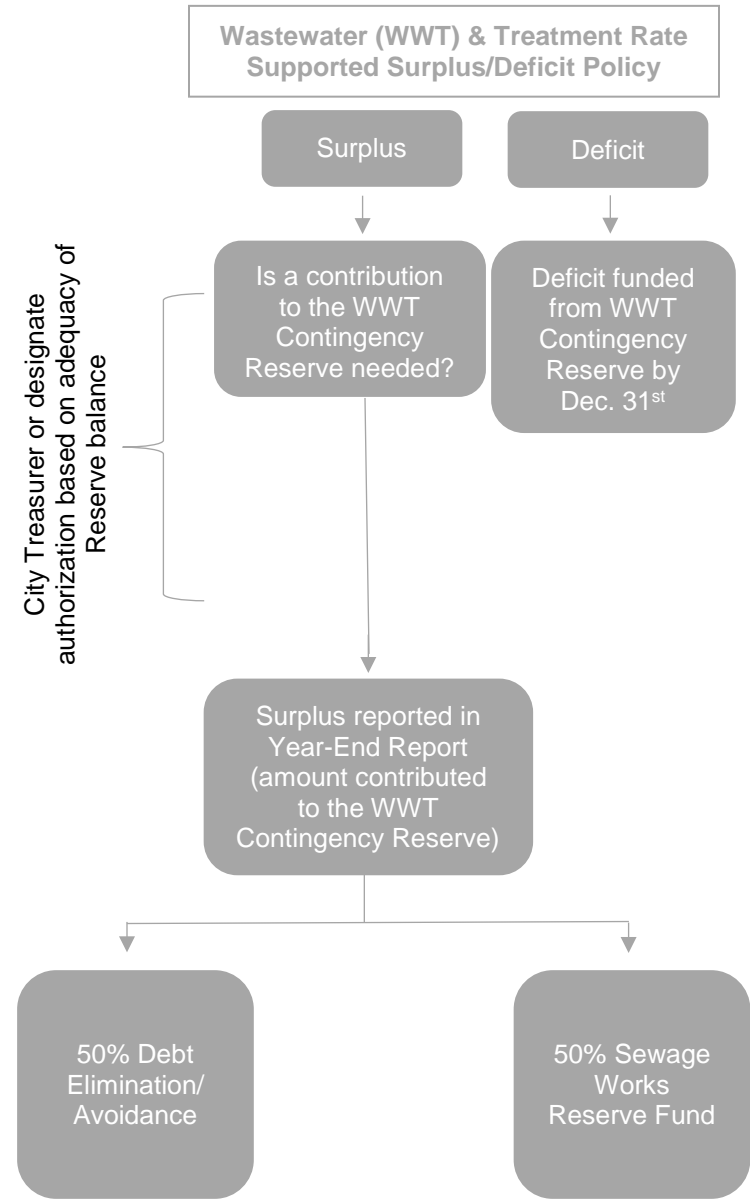
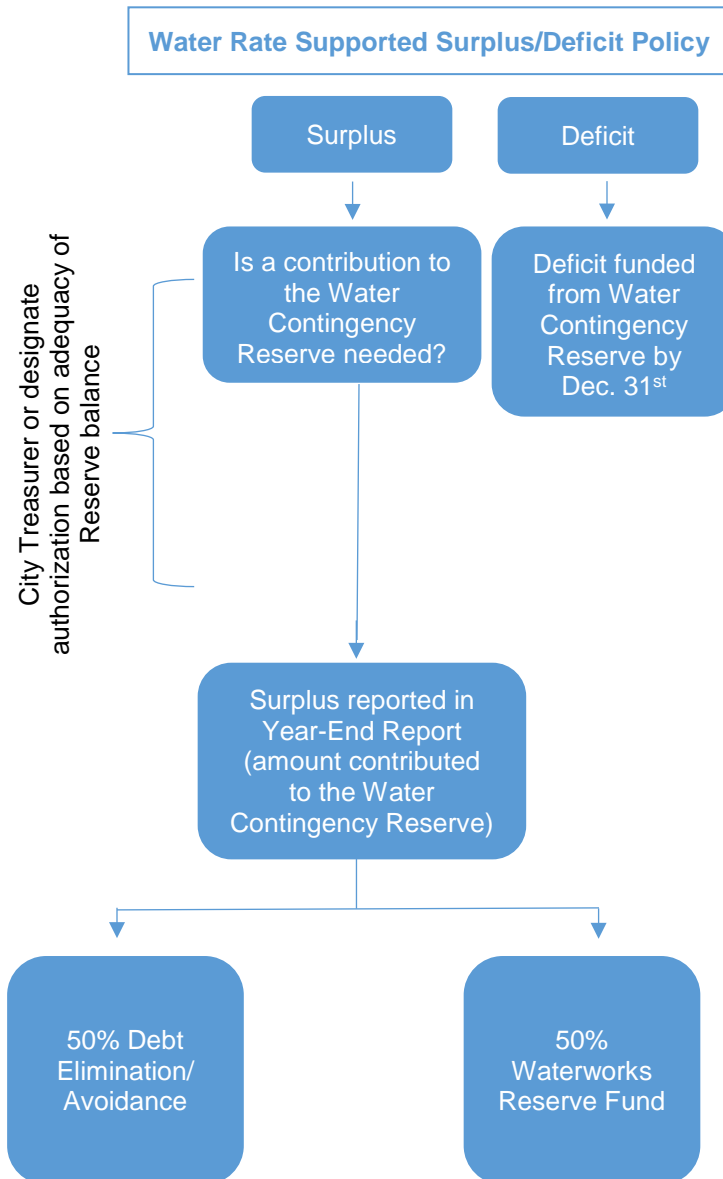
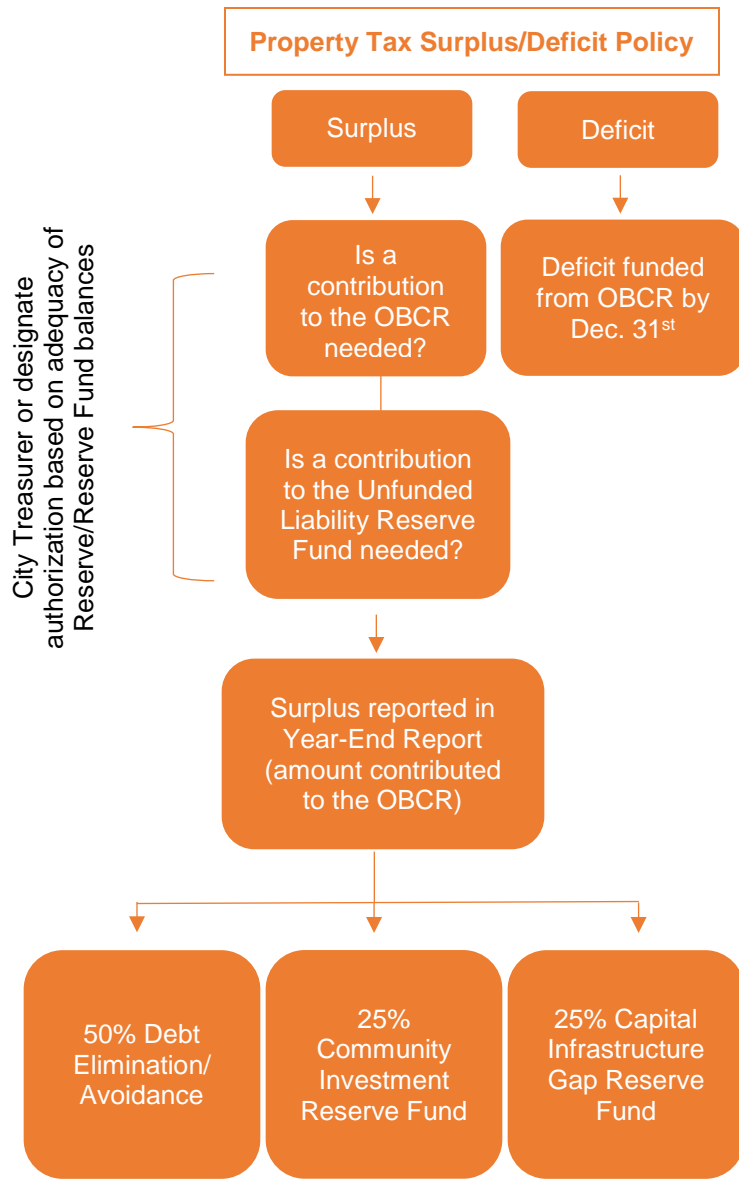
**Conclusion**

The Surplus/Deficit Policy provides consistent direction for Municipal Council and Civic Administration regarding the annual treatment of surplus and deficit in a manner that is consistent with long-term financial sustainability.

<b>PREPARED BY:</b>	<b>REVIEWED BY:</b>
<b>RICK LAMON, CPA, CMA MANAGER, ACCOUNTING AND REPORTING</b>	<b>MARTIN GALCZYNSKI, CPA, CA MANAGER, FINANCIAL PLANNING &amp; POLICY</b>
<b>RECOMMENDED BY:</b>	
<b>ANNA LISA BARBON, CPA, CGA MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER</b>	

- Attachments: Appendix “A” – Proposed Surplus/Deficit Policy Diagram  
 Appendix “B” – By-Law  
 Appendix “C” – Proposed Surplus/Deficit Policy  
 Appendix “D” – Current Surplus/Deficit Policy

Appendix "A"



## Appendix “B”

Bill No.  
2018

By-law No. CPOL.-

A By-law to amend By-law No. CPOL.-46-242  
being “Surplus/Deficit Policy”.

WHEREAS section 5(3) of the *Municipal Act, 2001*, S.O. 2001, C.25, as amended, provides that a municipal power shall be exercised by by-law;

AND WHEREAS section 9 of the *Municipal Act, 2001*, S.O. 2001, C.25, as amended, provides a municipality with the capacity, rights, powers and privileges of a natural person for the purpose of exercising its authority;

AND WHEREAS the Council of The Corporation of the City of London wishes to amend By-law No. CPOL.46-242 being “Surplus/Deficit Policy” by deleting Appendix “C(35)” in its entirety and replace it with a new Council Policy entitled “Surplus/Deficit Policy”;

NOW THEREFORE the Municipal Council of The Corporation of the City of London enacts as follows:

1. By-law No. CPOL.-46-242 being “Surplus/Deficit Policy” is hereby amended by deleting Appendix “C(35)” in its entirety and replacing it with the “Surplus/Deficit Policy” attached as Appendix “C”.
2. This by-law shall come into force and effect on the date it is passed.

PASSED in Open Council on October 16, 2018.

Matt Brown  
Mayor

Catharine Saunders  
City Clerk

First Reading – October 16, 2018  
Second Reading – October 16, 2018  
Third Reading – October 16, 2018

## Appendix “C”

**Policy Name:** Surplus/Deficit Policy

**Legislative History:** Enacted June 13, 2017 (By-law No. CPOL.-46-242)

**Last Review Date:** October 15, 2018

**Service Area Lead:** Manager III, Financial Planning and Policy

### 1. Policy Statement

The purpose of this policy is to establish a priority framework for the allocation of any operating surpluses and funding for any operating deficits.

### 2. Definitions

2.1 **Authorized Debt:** Council approved debt financing as a source of funding for capital projects.

2.2 **City Treasurer:** The individual appointed by the municipality as treasurer.

2.3 **Deficit:** In the operating budget, when there is an excess of expenditures over revenues.

2.4 **Multi-Year Budget:** Approval of a four year operating and capital budget.

2.5 **Operating Budget:** A budget that funds day to day operations. Some of the expenses could include personnel, utilities, and reserve fund contributions.

2.6 **Property Tax Supported Budget:** A budget that includes property taxes as a primary source of revenue used to fund City programs and services.

2.7 **Reserve:** An appropriation from net revenue and/or cost savings at the discretion of Council, after the provision for all known expenditures. It has no reference to any specific asset and does not require the physical segregation of money or assets as in the case of a reserve fund. Municipal Councils may set up reserves for any purpose for which they have the authority to spend money.

2.8 **Reserve Fund:** Funds that have been set aside either by a by-law of the municipality or by a requirement of senior government statute or agreement to meet a future event. Municipal Councils may set up reserve funds for any purpose for which they have the authority to spend money.

2.9 **Reserve Fund Policy:** A policy governing the management and administration of reserve and reserve funds, establishing guiding principles, primary objectives, key management and administrative responsibilities, and standards of care for reserves and reserve funds managed by the City.

2.10 **Surplus:** In the operating budget, when there is an excess of revenues over expenditures.

2.11 **Wastewater & Treatment Rate Supported Budget:** A budget to fund services exclusively related to the collection and treatment of wastewater and stormwater through rates charged to users of the system.

2.12 **Water Rate Supported Budget:** A budget to fund services exclusively related to the distribution of potable water through rates charged to users of the system.



### **3. Applicability**

This policy applies to the annual operating budgets for the Property Tax Supported Budget, Water Rate Supported Budget, and Wastewater & Treatment Rate Supported Budget, unless otherwise stated.

### **4. The Policy**

#### **4.1. Principles**

4.1.1. All surpluses and deficits be treated as one-time in nature.

4.1.2. The year-end operating surplus for the Property Tax Supported Budget, Water Rate Supported Budget, and Wastewater & Treatment Rate Supported Budget will only be allocated within the operations and reserves and reserve funds of each respective Budget.

4.1.3. The year-end operating deficit for the Property Tax Supported Budget, Water Rate Supported Budget, and Wastewater & Treatment Rate Supported Budget will only be funded within the operations and reserves and reserve funds of each respective Budget.

#### Property Tax Supported Budget – In a Year of Surplus

- a) The City Treasurer, or designate be authorized to contribute an amount to the Operating Budget Contingency Reserve (OBCR) not to exceed the reserve target balance established through the Reserve and Reserve Fund Policy, subject to the contribution to the OBCR being confirmed by the Municipal Council.
- b) The City Treasurer, or designate be authorized to contribute an amount to the Unfunded Liability Reserve Fund not to exceed:
  - i) The Reserve Fund target balance established through the Reserve and Reserve Fund Policy; and
  - ii) Operational savings realized from personnel and contingency budgets at year-end.
- c) Remaining surplus to be reported in the Operating Budget Year-End Monitoring Report with the surplus contributed to the OBCR to balance year-end operations. The remaining surplus allocations shall be drawn down from the OBCR and allocated in accordance with the following proportions:
  - i) 50% of any operating surplus shall be applied to reduce authorized but unissued debt, it being noted that debt reduction will reduce future year's debt servicing costs.
  - ii) 25% of any operating surplus shall be contributed to the Community Investment Reserve Fund to be allocated at the discretion of Municipal Council.
  - iii) 25% of any operating surplus shall be contributed to the Capital Infrastructure Gap Reserve Fund to mitigate growth in the infrastructure gap.

#### Property Tax Supported Budget – In a Year of Deficit

- d) The City Treasurer, or designate be authorized to drawdown from the OBCR to balance year-end operations.

#### Wastewater & Treatment Rate Supported Budget – In a Year of Surplus

- e) The City Treasurer, or designate be authorized to contribute an amount to the Wastewater Budget Contingency Reserve not to exceed the reserve target balance established through the Reserve and Reserve Fund Policy, subject to the contribution to the Wastewater Budget Contingency Reserve being confirmed by the Municipal Council.
- f) Remaining surplus to be reported in the Operating Budget Year-End Monitoring Report with the surplus contributed to the Wastewater Budget Contingency Reserve to balance year-end operations. The remaining surplus allocations shall be drawn down from the Wastewater Budget Contingency Reserve and allocated in accordance with the following proportions:
  - i) 50% of any operating surplus shall be applied to reduce Wastewater & Treatment authorized but unissued debt, it being noted that debt reduction will reduce future year's debt servicing costs. If the operating surplus allocation exceeds the authorized debt amount, the authorized debt shall be reduced to nil with the remaining surplus added to the allocation specified in f) ii).
  - ii) 50% of any operating surplus shall be contributed to the Sewage Works Reserve Fund to mitigate growth in the infrastructure gap.

#### Wastewater & Treatment Rate Supported Budget – In a Year of Deficit

- g) The City Treasurer, or designate be authorized to drawdown from the Wastewater Budget Contingency Reserve to balance year-end operations.

#### Water Rate Supported Budget – In a Year of Surplus

- h) The City Treasurer, or designate be authorized to contribute an amount to the Water Budget Contingency Reserve not to exceed the reserve target balance established through the Reserve and Reserve Fund Policy, subject to the contribution to the Water Budget Contingency Reserve being confirmed by the Municipal Council.
- i) Remaining surplus to be reported in the Operating Budget Year-End Monitoring Report with the surplus contributed to the Water Budget Contingency Reserve to balance year-end operations. The remaining surplus allocations shall be drawn down from the Water Budget Contingency Reserve and allocated in accordance with the following proportions:
  - i) 50% of any operating surplus shall be applied to reduce Water authorized but unissued debt, it being noted that debt reduction will reduce future year's debt servicing costs. If the operating surplus allocation exceeds the authorized debt amount, the authorized debt shall be reduced to nil with the remaining surplus added to the allocation specified in i) ii).
  - ii) 50% of any operating surplus shall be contributed to the Waterworks Reserve Fund to mitigate growth in the infrastructure gap.

## Water Rate Supported Budget – In a Year of Deficit

- j) The City Treasurer, or designate be authorized to drawdown from the Water Budget Contingency Reserve to balance year-end operations.

### **4.2. Reporting**

The City Treasurer, or designate shall provide the following reports related to year-end projected or actual surplus or deficit positions:

- i) Operating Budget Mid-Year Monitoring Report (January 1<sup>st</sup> to June 30<sup>th</sup>)
- ii) Operating Budget Year-End Monitoring Report (January 1<sup>st</sup> to December 31<sup>th</sup>)

### **4.3. Policy Review**

The Surplus/Deficit Policy shall be reviewed at a minimum every four years, after each multi-year budget period, by the City Treasurer, or designate and be updated as deemed appropriate or required.

## Appendix “D”

### Original Surplus/Deficit Policy:

#### 1.0 POLICY STATEMENT AND PURPOSE

The purpose of this policy is to establish a priority framework for the allocation of any operating surpluses and funding for any operating deficits.

#### 2.0 SCOPE

This policy applies to the annual operating property tax supported budget.

#### 3.0 PRINCIPLES

With the overarching principle that all surpluses and deficits be treated as one-time in nature, the one-time allocation and funding principles of the Surplus/Deficit Policy are as follows:

##### In A Year Of Surplus

- a) The Managing Director, Corporate Services & City Treasurer, Chief Financial Officer or designate be authorized to contribute an amount to the Operating Budget Contingency Reserve (OBCR) not to exceed the reserve target balance of 1.5% - 2.0% of the property tax gross expenditure budget, subject to the contribution to the OBCR being confirmed by the Municipal Council.
- b) The Managing Director, Corporate Services & City Treasurer, Chief Financial Officer or designate be authorized to contribute an amount to the Unfunded Liability Reserve not to exceed any operational savings realized from personnel and contingency budgets at year-end.
- c) Remaining surplus to be reported in the 4<sup>th</sup> Quarter Operating Budget Status Report with the surplus contributed to the OBCR to balance year-end operations. The remaining surplus allocations shall be drawn down from the OBCR and allocated in accordance with the following proportions:
  - i. 50% of any operating surplus shall be applied to reduce authorized but unissued debt, it being noted that debt reduction will reduce future year's debt servicing costs.
  - ii. 25% of any operating surplus shall be contributed to the Community Investment Reserve Fund to be allocated at the discretion of Municipal Council.
  - iii. 25% of any operating surplus shall be contributed to the Capital Infrastructure Gap Reserve Fund to mitigate growth in the infrastructure gap.

##### In A Year Of Deficit

- d) The Managing Director, Corporate Services & City Treasurer, Chief Financial Officer or designate be authorized to drawdown from the OBCR to balance year-end operations.

#### 4.0 REPORTING

- e) The Managing Director, Corporate Services & City Treasurer, Chief Financial Officer or designate shall strive to provide the following reports related to year-end projected surplus or deficit positions within 45 days of the close of the reporting period:

- i. Second Quarter Operating Budget Status Report to be submitted at the discretion of the City Treasurer (January 1<sup>st</sup> to June 30<sup>th</sup>)
- ii. Third Quarter Operating Budget Status Report (January 1<sup>st</sup> to September 30<sup>th</sup>)
- iii. Fourth Quarter Operating Budget Status Report (January 1<sup>st</sup> to December 31<sup>th</sup>)

## **5.0 Transition To New Surplus/Deficit Policy**

As part of the existing Surplus/Deficit Policy (passed by Municipal Council on December 3, 2007), an annual draw of \$850 thousand from the OBCR was established. This annual draw is recognized as revenue each year, reducing the property tax levy requirement.

To mitigate budget pressures within the implementation of the City's first multi-year budget (2016-2019), the plan is to phase out the \$850 thousand draw from the OBCR by the year 2021. This approach provides needed continuity to the City's existing budget framework, while ensuring the elimination of this draw occurs in a reasonable period.